June 8, 2022

Vanessa A. Countryman,
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Further Definition of "As a Part of a Regular Business" in the Definition of "Dealer" and "Government Securities Dealer" (File No. S7-12-22)

Dear Ms. Countryman:

Morgan, Lewis & Bockius LLP ("Morgan Lewis") appreciates the opportunity, on behalf of one of our proprietary trading firm ("PTF") clients ("we," "ours," or "us"),\(^1\) to comment on the above-referenced U.S. Securities and Exchange Commission (the "Commission" or "SEC") release\(^2\) under which the SEC proposes new rules that would further define the phrase "as a part of a regular business" as used in the statutory definitions of "dealer" and "government securities dealer" under Sections 3(a)(5) and 3(a)(44), respectively, of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). If adopted in its current form, the Proposal will significantly broaden the number of market participants that will have to register as "dealers" and "government securities dealers" with the SEC and become members of self-regulatory organizations, without regard to the established dealer-trader distinction, the costs to market participants and the likely damage to the market for U.S. Treasury obligations.\(^3\) As discussed below, we do not support the Proposal in any form and strongly urge the Commission to withdraw it.

\(^1\) For ease of reference, the use of "we," "us," and "ours" in this comment letter reflects the views of our PTF client and not necessarily the view of Morgan Lewis, its partners, associates or other staff, or the views of its other clients. While this comment letter focuses on the Treasury markets, the concerns raised in it are applicable to other markets as well, including the equity market, the debt market, and the nascent digital asset market.


\(^3\) As other commenters have noted, we strongly urge the Commission to extend the comment period for this Proposal. We believe that the Proposal’s complexity and broad reach merits a comment period of longer than 30 days. See, e.g., Administrative Procedure Act: Legislative History, S. Doc. No. 248, at 259 (1946) (suggesting that longer comment periods are merited in matters "of great
As an initial matter, we note that (1) the historical reasons for requiring dealer registration are not present for firms like PTFs that have no customers; and (2) there are existing mechanisms in place that satisfy the vague policy reasons provided in the Proposal for requiring PTFs to register as government securities dealers. With respect to investor protections, as the SEC is well aware, the dealer registration and oversight provisions are primarily intended to protect the investing public on two fronts: (i) ensuring that the persons that offer and sell securities to the investing public do not engage in unscrupulous sales practices; and (ii) ensuring that customers’ assets are protected and that customers are made whole if a dealer fails. These concerns are not applicable to PTFs.

With respect to the policy objectives discussed in the Proposal, the SEC makes vague references to market transparency, market event reconstruction, market disruptions, and trade reporting. To the extent the SEC is seeking to increase market transparency to understand, detect, and reconstruct market events, the Proposal makes bare mention of the existing frameworks already in place that can be, and have already been, leveraged to achieve these goals. Indeed, under the current and soon-to-be-implemented changes to the trade-reporting and compliance engine (“TRACE”) reporting framework, the SEC will have all the information that it purports it needs under this Proposal.

A troubling aspect of the Proposal is the inference that requiring PTFs to register as government securities dealers will somehow result in these new registrants having market-maintenance obligations during periods of market volatility. That is just not the case. While Primary Dealers in government securities may have certain market obligations, registered government securities dealers that are not Primary Dealers do not. More specifically, Primary Dealers have certain market maintenance, capital requirements, and liquidity obligations for which they receive certain benefits, such as direct trading with the Federal Reserve System, reputational enhancements, and access to Federal Reserve lending facilities. These benefits are not conferred to entities solely registered as government securities dealers that, unlike Primary Dealers, have no specific obligations to participate in the government securities market.

We believe that the lack of benefits for those government securities dealers that are not Primary Dealers, coupled with the initial and ongoing costs of registration (which we believe that the SEC has underestimated), will result in PTFs significantly reducing their government securities activities, or exiting this business altogether. This will have a chilling effect on the market for government securities, with a corresponding decrease in market liquidity, an increase in bid/offer spreads to the detriment of the market and the investing public, and an increase in government borrowing costs.

importance, or those where the public submission of facts will be either useful to the agency or a protection to the public, [and] should naturally be accorded more elaborate public procedures.”. Should the Commission extend the comment period, we may supplement this comment letter with additional information.

4 For example, Primary Dealers are the trading counterparties of the New York Fed, are expected to make markets for the New York Fed, if broker-dealers, must generally maintain net capital of at least $50 million (if a bank, at least $1 billion in Tier 1 capital), maintain markets, clear through certain U.S. clearing organizations, and have business continuity plans that are routinely tested to ensure the continued operation of the Treasury markets during times of stress. https://www.newyorkfed.org/markets/primarydealers. These responsibilities are not going to apply to entities solely by registering as government securities dealers.
Such a result is not consistent with the Commission’s broad investor-protection and public-interest mandate. In fact, it is antithetical to such mandate.

As discussed in greater detail below, we oppose the Proposal for the following reasons:

- We do not believe the Proposal identifies a problem that needs to be solved;
- The SEC has exceeded its authority with the Proposal, and it does not meaningfully advance investor protections or the public interest;
- The quantitative standards that the Commission is proposing are inconsistent with congressional intent;
- The SEC fails to focus on the nature of the activity;
- The SEC fails to explain why existing rules are insufficient in advancing the articulated goals in the Proposal;
- The qualitative standards do not provide meaningful guidance regarding the circumstances that would cause a person to be deemed a dealer or government securities dealer and risk being arbitrarily and capriciously applied;
- The Commission’s expansive definition of “own account” and “control” and the concept of aggregation will capture unintended participants, including entities that do not undertake any trading activity; and
- The Commission fails to adequately consider the costs of the Proposal against the purported benefits, particularly the significant increase in costs related to regulatory capital and increased margin for holding futures in a broker dealer, which will serve as a disincentive to market participants to engage in trading activity.

1. Background

A. Dealer-Trader Distinction

Section 3(a)(44) of the Exchange Act defines a “government dealer” as “any person engaged in the business of buying and selling government securities . . . for such person’s own account through a broker or otherwise.” Among other exemptions and exclusions,5 Section 3(a)(44)(A) excludes from the definition of a government securities dealer “any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.” As a result, whether a person is engaged in the regular business of providing dealer

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5 Under Section 3(a)(5)(C) of the Exchange Act, additional exceptions from the “dealer” definition are available to banks (as that term is defined in Section 3(a)(6)) that engage in certain enumerated activities. These exceptions are further codified as Exchange Act Rules 3a5-1, 3a5-2, 3a5-3. 17 C.F.R. §§ 240.3a5-1, 3a5-2, 3a5-3.
services is the primary factor for assessing whether a person is a “government securities dealer” and must register as such, versus a trader who does not engage in dealer services.

This distinction between dealers and traders has existed since at least the early 1950s and has been embraced by the SEC and its staff over the years. The distinction has always been based on the nature of the activities of the market participant. In 2002, the SEC proposed rules to grant banks exceptions and exemptions from the definitions of “broker” and “dealer” as part of the SEC’s implementation of the Gramm-Leach-Bliley Act of 1999. In that proposal, the SEC identified activities that historically have been associated with dealers and would cause someone to be regularly engaged in the business of dealing, such as:

- acting as an underwriter in the distribution of new issues;
- acting as a market-maker or specialist on an organized exchange or trading system;
- acting as a *de facto* market-maker whereby market professionals or the public look to the person for liquidity;
- buying and selling securities directly to customers with an assortment of professional market activities such as providing investment advice, extending credit, lending securities in connection with transactions and carrying a customer’s securities account;
- normally having regular clientele;
- holding themselves out as willing to buy and sell securities at a regular place of business;
- participating in the distribution of new issues; and

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6 See Louis Loss, *Securities Regulation* 722 (1st ed. 1951) (discussing dealer-trader distinction). In this connection, the dealer-trader distinction may have been used or developed as an analytical concept within the SEC before the publication of Loss’s treatise, given that Loss held various positions at the SEC during its formative years.


transacting a substantial portion of their business with investors.\textsuperscript{9}

In contrast, the SEC identified different activities attributable to traders such as: (i) not handling other people’s money or securities; (ii) not making a market in securities; and (iii) not furnishing dealer-type services, such as providing investment advice, extending credit or lending securities.\textsuperscript{10}

The SEC upheld the use of the dealer-trader distinction in connection with the definition of a “security-based swap dealer” in 2012.\textsuperscript{11} Courts have also regularly opined on what it means to be regularly engaged in the business of buying and selling securities, focusing on activities such as soliciting investors, handling investor money and securities, providing advice, and buying securities from and selling securities directly to customers.\textsuperscript{12} What is clear, and which the SEC appears to willfully disregard in the Proposal, is that the nature of the trading activity has always mattered.

B. Proposed Rule 3a44-2

Proposed Rule 3a44-2 would further define the term “government securities dealer” to identify certain activities that would constitute a “regular business,” thus requiring registration. The Proposed Rules set forth the following three qualitative standards designed to more specifically identify

\textsuperscript{9} See id. In addition to the factors listed in the 2002 Proposal, with respect to dealer status in the context of the Government Securities Act of 1986 (“GSA”), the SEC staff also identified similar indicia for assessing whether a person was acting as a government securities dealer. See, e.g., United Savings Association of Texas, SEC Staff No-Action Letter (Apr. 2, 1987).


\textsuperscript{11} See SBS Release, supra note 7. Senior SEC officials have also reaffirmed the dealer-trader distinction over the years. In 1994, Arthur Levitt, then chair of the SEC, provided this testimony before Congress: “Hedge funds typically claim an exclusion from registration as securities dealers under Section 15(a) of the [Exchange Act] (15 U.S.C. § 78o(a)) based on the ‘trader’ exception to the definition of ‘dealer.’ In general, a trader is an entity that trades securities solely for its own investment account and does not carry on a public securities business. On the other hand, a dealer buys and sells securities as part of a regular business, deals directly with public investors, engages in market intermediary activities, and may provide other services to investors.” Testimony of Arthur Levitt, Chairman, SEC, Concerning Hedge Fund Activities in the U.S. Financial Markets, Before the House Committee on Banking, Finance and Urban Affairs (Apr. 13, 1994). In 1998, Richard Lindsey, then director of what is now known as the Division of Trading and Markets, echoed Chairman Levitt’s testimony, noting in written testimony that “hedge funds also rely on the trader exception from broker-dealer registration.” Testimony of Richard R. Lindsey, Dir., Div. of Mkt. Regul., SEC, Concerning Hedge Fund Activities in the U.S. Financial Markets, Before the House Committee on Banking and Financial Services (Oct. 1, 1998).

\textsuperscript{12} In re Scripsamerica, Inc., No. 16-11991 (JTD), 2021 WL 5745698, at *4 (Bankr. D. Del. Nov. 29, 2021); see also In re Immune Pharms. Inc., No. 19-13273 (VFP), 2021 WL 5989337, at *4 (Bankr. D.N.J. Dec. 8, 2021) (“A person who buys and sells securities for his own account in the capacity of a trader or individual investor is generally not considered to be engaged in the business of buying and selling securities and consequently, would not be deemed a dealer.”).
activities of certain market participants who, in the Commission’s view, assume dealer and government securities dealer roles:

1. Routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day ("Comparable Purchases Standard");

2. Routinely expressing trading interests that are at or near the best available prices on both sides of the market and are communicated and represented in a way that makes them accessible to other market participants ("Trading Interest Standard"); or

3. Earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interests.

In addition, Proposed Rule 3a44-2 would include a quantitative standard applicable to government securities dealers, regardless of whether any of the qualitative standards are met. Under this standard, a person would be deemed a government securities dealer if, in each of four out of the last six calendar months, that person engaged in buying and selling more than $25 billion of trading volume in government securities.

C. Additional Concepts under the Proposal

The Proposal would expand the definition of a person’s "own account" to include any account that is:

- held in the name of a person;

- held in the name of a person over whom that person exercises control or with whom that person is under common control, subject to certain exclusions; and

- held for the benefit of those persons above.

The concept of control would cross-reference the meaning of control in Exchange Act Rule 13h-1. Under this concept of control, certain firms will have to aggregate trading activities and assets to determine whether, collectively and individually, a firm or the entities under a firm’s control come within the meaning of a dealer or government securities dealer.

2. Concerns with the Proposal

A. No “Solution” Necessary

While we support thoughtful efforts to increase investor protections, market transparency and market stability, we do not believe that the Proposal advances any of those efforts. There are no investor protection concerns that have been articulated in the Proposal. There is no market transparency or reporting gap that the SEC has identified in the Proposal that additional registration would solve. There are no market disruptions that the SEC has identified in the Proposal that would
have been prevented if PTFs were registered. Put succinctly, the SEC has simply not articulated the problem that it is trying to solve with the Proposal.

B. The Commission Has Exceeded Its Statutory Authority

We believe that the broad manner in which the Commission is proposing to change the definitions of “as a part of a regular business” and “dealer” is inconsistent with congressional intent and a plain reading of the statute. More specifically, by requiring firms with absolutely no customers to register as dealers, the SEC is exceeding its statutory authority. As the Commission is aware, the main impetus for requiring dealer registration is customer protection. This is in large part why Congress required the SEC to study whether the functions of dealers should be segregated from the functions of brokers.\(^{13}\) The study that followed that directive\(^{14}\) specifically describes dealers in the following manner:

The characteristic activities of a dealer in securities are similar to those of a dealer or jobber in merchandise. The dealer sells securities to his customer which he has purchased or intends to purchase elsewhere or buys securities from his customer with a view to disposing them elsewhere.\(^ {15}\)

That study further provides that:

Where the broker and dealer functions are combined in a single person, his own interests may conflict with the interests of those to whom he owes a fiduciary duty. This conflict may react to the disadvantage of his brokerage customers in a variety of ways. A broker who trades for his own account or is financially interested in the distribution or accumulation of securities, may furnish his customers with investment advice inspired less by any consideration of their needs than by the exigencies of his own position. The securities, equities and credit balances of his customers may be endangered by the risks which he incurs in making excessive commitments for his own account. A complicating factor in these situations is that the average investor too frequently is unaware of the distinction between the broker and dealer relationships and hence takes no account of the possibility that the advice and service proffered by a broker may be affected with a powerful, independent interest at variance with his fiduciary obligation. As a method of safeguarding the ambassador from dangers of this type, complete segregation of the broker and dealer functions has been proposed.\(^ {16}\)

What is clear, as reflected by the above, is that the rationale for requiring brokers and dealers to register with the Commission is the protection of investors from unscrupulous sales practices and

\(^{13}\) Exchange Act Section 11(e) (1934).


\(^{15}\) Id. at XIV.

\(^{16}\) Id. at XV.
from financial distress at the hands of broker-dealers that have custody of their assets. These concerns are simply not present with PTFs. A PTF does not have any customers and does not maintain custody of any investor funds or securities. As a result, we do not believe that the Commission has a statutory basis for requiring that PTFs register as dealers.

Although Section 3(b) of the Exchange Act gives the SEC some authority to define terms used in the Exchange Act, that authority has its limits and must be used in a manner consistent with the Exchange Act and congressional intent. Neither is present in the Proposal. We note that the SEC’s use of Exchange Act Section 3(b) has been successfully challenged when the SEC attempted to go beyond its congressional mandate in an attempt to bring banks within its jurisdiction.\(^{17}\) We believe that the SEC has similarly gone beyond its statutory authority and congressional intent in seeking to require that PTFs register as government securities dealers.

C. **Volume Threshold Is Flawed**

Distinguishing between a dealer and a trader has always relied on the nature of the activity and, as a result, a volume threshold alone cannot be adopted for only one class of dealers as such a result contradicts congressional intent. As noted by the SEC:

> The legislative history relating to the enactment of the Government Securities Act of 1986 provides that the term government securities dealer “would utilize key concepts from the current definitions of . . . ‘dealer’ and ‘municipal securities dealer.’”\(^{18}\)

Despite a clear congressional intent that the terms dealer, municipal securities dealer and government securities dealer have a consistent meaning and application, the SEC seeks to impose a volume threshold only in the context of government securities dealers. This is clearly inconsistent with congressional intent based on the very language above that the SEC cites. In addition, such an application is inconsistent with the SEC’s long recognized view that volume alone is not a determinative factor for assessing dealer status. For example, in a release adopting rules regarding the registration of municipal securities dealers, the SEC stated:

> While the determination of when a bank is a municipal securities dealer might be premised on, among other matters, the number of transactions engaged in by the bank in a non-fiduciary capacity or the rate of turnover of the bank’s inventory of municipal securities, the Commission does not now have sufficient data or experience with bank municipal securities dealers to ascertain whether such tests are appropriate. In any event, it would appear that the nature of a bank’s activities,

\(^{17}\) See, e.g., Am. Bankers Ass’n v. SEC, 804 F.2d 739 (D.C. Cir. 1986).

rather than the volume of transactions or similar criteria, are of greater relevance in determining when a bank is a municipal securities dealer.\textsuperscript{19}

D. The SEC Should Focus on the Nature of the Activity

As discussed above, the nature of the trading activity has been the basis on which the courts, the Commission, and its staff have previously assessed whether a person was engaged in the regular business of buying and selling securities, or whether such a person is a trader. However, the SEC is proposing a rule for government securities dealers that only focuses on the volume of trading activity without taking into account that PTFs engage in bona fide activities that bear no relation to the dealing activities that the Commission and staff have long identified. For example, the Proposal has no provision or exception addressing circumstances under which market participants use government securities to hedge activities in other markets such as those for futures, swaps, agency securities, mortgages and others. A market participant undertaking hedging activities that support activities in entirely different markets and instruments cannot be viewed as regularly engaging in dealing activities. The SEC recognized this when it adopted the rules associated with securities-based swap dealers, specifically stating that “entities that use securities-based swaps to hedge business risks, absent other activities, likely would not be dealers.”\textsuperscript{20} Historically, when assessing whether a person was a government securities dealer, the SEC and its staff have focused on the nature of the activity, including for example:

- issuing or originating securities that would qualify as securities under the GSA;
- participating in a selling group or underwriting government securities;
- purchasing or selling government securities as principal from or to customers;
- carrying a dealer inventory;
- advertising or otherwise holding oneself out as a government securities dealer, such as holding oneself out as being willing to buy and sell particular government securities on a continuous basis;
- rendering investment advice to customers;

\textsuperscript{19} Adoption of Rule 15ba2-1, Related Form Msd, Rule 15ba2-2 and Temporary Rule 15ba2-3(T) Relating to the Registration of Municipal Securities Dealers Under Section 15b(A) of the Securities Exchange Act of 1934; Adoption of Temporary Rule 15a-1(T) Relating to the Registration of Municipal Securities Brokers and Dealers Under Section 15 of the Act; and Delegation of Authority to the Staff of the Commission, Exchange Act Release No. 11,742 (Oct. 15, 1975) (emphasis added). We note that the definition of a municipal securities dealer and that of a government securities dealer are substantially the same.

\textsuperscript{20} SBS Release, 77 Fed. Reg. at 30,599.
extending or arranging for the extension of credit to others in connection with government securities; and

running a book or repurchase and reverse repurchase agreements on government securities.\textsuperscript{21}

PTFs do not engage in the activities identified above. Rather, they engage in the activities that have traditionally been associated with traders. Focusing on trading volume alone rather than the nature of the activity effectively creates a strict liability regime. That is not what Congress intended when it adopted the dealer registration frameworks.

E. Availability of Other Means

As noted above, the Commission does not meaningfully articulate any specific investor-protection concerns that necessitate that PTFs register. Rather, the Commission cites to broad public-policy interests and vaguely points to concepts of market stability, increased insight into trading activities, and a concept of fairness by which the Commission seeks to level the playing field between regulated and unregulated entities. There is no real connection between the furtherance of these goals and the registration of PTFs as dealers.

The Commission also fails to articulate why other existing rules with respect to market surveillance and market stability are not sufficient to advance the goals that it seems to be articulating. There are a number of transaction-reporting regimes and requirements already in existence that would address the policy objectives that the SEC purports to advance. In 2017, for example, concerted efforts were made to increase reporting of government securities transactions to TRACE. On July 10 of that year, FINRA required that its broker-dealer member firms begin reporting transactions in U.S. Treasury securities to TRACE.\textsuperscript{22} As reflected in RN 16-39, FINRA amended the TRACE rules to include all securities issued by the Treasury Department with the exception of savings bonds within the TRACE reporting framework. The elements required to be reported under that framework include:

1. CUSIP number or, if a CUSIP number is not available at the time of execution, a similar numeric identifier or a FINRA symbol;
2. The size (volume) of the transaction, as required by FINRA Rule 6730(d)(2);
3. Price of the transaction (or the elements necessary to calculate price, which are contract amount and accrued interest) as required by Rule 6730(d)(1);
4. A symbol indicating whether the transaction is a buy or a sell;
5. Date of trade execution (for “as/of” trades only);
6. Contra-party’s identifier (MPID, customer, or a non-member affiliate, as applicable);

\textsuperscript{21} See, e.g., United Savings Association of Texas, SEC Staff No-Action Letter (Apr. 2, 1987).

7. Capacity — principal or agent (with riskless principal reported as principal);
8. Time of execution;
9. Reporting side executing broker as "give-up" (if any);
10. Contra side introducing broker in case of "give-up" trade;
11. The commission (total dollar amount);
12. Date of settlement;
13. If the member is reporting a transaction that occurred on an ATS pursuant to Rule 6732, the ATS’s separate MPID obtained in compliance with Rule 6720(c); and
14. Such trade modifiers as required by either the TRACE rules or the TRACE users guide.

These reporting requirements will be expanded on September 1, 2022, when banks will be required to report transactions to TRACE.23

As previously mentioned, PTFs typically access the Treasury markets through broker-dealers, banks, and trading platforms that are operated by broker-dealers and banks. Because the TRACE reporting elements require, among other things, the contra-party’s identifier, the information that the SEC seeks from PTFs is already available to it or will be when the additional reporting referenced above begins on September 1.

Regarding risk-mitigation measures, the Commission also fails to sufficiently address the requirements of Rule 15c3-5, the so-called Market Access Rule. That rule generally requires broker-dealers with market access or that provide market access to their customers to "appropriately control the risks associated with market access so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system."24 The goals of that rule are to "reduce the risks faced by broker-dealers, as well as the markets and the financial system as a whole, as a result of various market-access arrangements, by requiring effective financial and regulatory risk-management controls reasonably designed to limit financial exposure and ensure compliance with applicable regulatory requirements to be implemented on a market-wide basis."25 As mentioned above, PTFs access the government securities markets through broker-dealers, banks, and platforms operated by banks and broker-dealers, meaning that risk reducing measures are already in place.


F. Qualitative Standards Are Vague and Will Be Arbitrarily Applied

We believe that the qualitative standards outlined in the Proposal are incredibly vague and will ultimately lead to arbitrary application across market participants. In discussing the Comparable Purchases Standard and the Trading Interest Standard, the SEC references the concept of “routinely” in terms of engaging in activities “more frequently than occasionally, but not necessarily continuously.” This conceptual framework is extremely imprecise and will result in an arbitrary and potentially capricious application. Ultimately, market participants will be at the whim of SEC examination or enforcement staff members exercising discretion on the meaning of “routinely.” Indeed, it is entirely plausible that enforcement and examination staff will take completely opposite views, leaving market participants in a state of chaos, not knowing when a regulator’s views will change. Indeed, the lack of a solid foundation by which to assess routine activity will effectively result in on-demand rulemaking by the SEC and its staff in a manner that runs contrary to the Administrative Procedures Act (“APA”).

Further, although the SEC relies on the adopting release defining terms associated with security-based swap dealing activities to develop the “routinely” standard, that approach is flawed and should not serve as a starting point. The concept of “routinely” was developed in the SBS Release because the SEC recognized that “many types of swaps are not entered into on a continuous basis, and it is not necessary that a person enter into swaps at the request of counterparties on a continuous basis in order for the person to be a market maker in swaps and, therefore, a swap dealer.” That simply is not true when it comes to the government securities market, which is the most liquid and continuously traded in the world. In addition, the SBS Release framed the concept of “routinely” in the context of the nature of dealing activity, and not simply the trading itself, specifically highlighting certain types of activities that if engaged in on a routine basis could bring a person within the definition of a security-based swap dealer. We thus find it disingenuous for the Commission to borrow a concept that is unique to the security-based swaps market and apply it to an entirely different market.

These same issues are present in the “roughly comparable” and “substantially similar” concepts outlined in the Intraday Standard. For instance, market participants and their affiliates may use various types of trading strategies that focus on particular approaches and operate independently of one another. Where one market participant may focus on long positions in a particular instrument, an affiliate may seek to focus on short positions in a related instrument. When these activities are coupled with the aggregation provisions discussed below, two different but affiliated entities employing different strategies in a similar instrument may inadvertently trigger a dealer registration obligation based entirely on whether a particular SEC staff member takes the view that the vague concepts in the qualitative standards apply even though one affiliated entity may have no idea of the other’s activities.

G. Definition of “Own Account” Is Too Broad

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27 Id. at 23,066 n.132 (citing SBS Release at 30,609).
The definition of “own account,” with its cross-reference to the definition of “control” in the large trader reporting rule, is not an appropriate benchmark for determining dealer status. The framework that the Commission is proposing would capture entities that undertake no customer-facing activities that are the basis for requiring brokers and dealers to register under the Exchange Act. As illustrated in Example One in the Proposal, a holding company with control over subsidiaries that meet the proposed definition of a dealer could itself be required to register solely because of its control over its subsidiaries even though it does not engage in any trading activity whatsoever. How can an entity that does not engage in trading activities be required to register?

This issue is also of concern where a U.S.-based holding company has foreign subsidiaries whose activities would be included under the aggregation provisions of the “own account” definition, even though those activities have no U.S. nexus. The Proposal notes that foreign entities coming within the meaning of a dealer under the Proposal would not be required to register in the United States if they avail themselves of Rule 15a-6 under the Exchange Act. That said, unlike U.S.-registered broker-dealers, government securities dealers, and investment companies, the trading activities and volume of these foreign subsidiaries would have to be aggregated by the U.S. holding company. Accordingly, we believe that the Commission should exclude from the aggregation provisions activities by persons that are otherwise exempt from dealer registration, and not limit the exclusion to registered broker-dealers, government securities dealers, and investment companies.

In addition, the Proposal does not address circumstances under which market participants use government securities to hedge activities in other markets such as those for futures, swaps, agency securities, mortgages and others. Any hedging activities that support activities in entirely different markets and instruments should be excluded from any of the aggregation provisions.

In assessing whether a person has to register as a government securities dealer, we believe that Congress intended the Commission to focus on activity on an entity-by-entity basis rather than on an aggregated basis. This approach was best articulated by the Commission when it adopted Rule 15a-6 and stated that:

[T]he Commission uses an entity approach with respect to registered broker-dealers. Under this approach, if a foreign broker-dealer physically operates a branch in the United States, and thus becomes subject to U.S. registration requirements, the registration requirements and the regulatory system governing U.S. broker-dealers would apply to the entire foreign broker-dealer entity. If the foreign broker-dealer establishes an affiliate in the United States, however, only the affiliate must be registered as a broker-dealer, the foreign broker-dealer parent would not be required to register.²⁹

We believe that the Commission should use the same approach here.

H. Issues under the Administrative Procedures Act; Cost-Benefit Analysis

As the Commission knows, Section 553 of the APA outlines notice-and-comment rulemaking procedures and is intended to provide the public with a meaningful opportunity to comment on proposed rules. The 30-day comment period that the Commission provides is simply not enough time for market participants to provide meaningful input into a Commission action that will have a far-reaching impact. Section 553 of the APA also requires that an agency “provide sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully.” As mentioned above, the SEC fails to provide a sufficient rationale for requiring PTFs to register as dealers and provides little in the way of factual details regarding the operations of PTFs to adequately make the case for requiring registration. Moreover, the vague qualitative standards that the SEC proposes do not give PTFs a sufficient basis for assessing whether they would be subject to the Proposal. This is not consistent with the APA.

In addition, we believe that the Proposal does not satisfy the requirements of Section 3(f) of the Exchange Act. That section provides that:

> Whenever pursuant to this chapter the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

As mentioned above, the SEC has not articulated why the Proposal is consistent with the public interest, let alone how investors will be protected. Nor has the Commission adequately considered how the Proposal will promote efficiency, competition, or capital formation. Rather, we believe that the Proposal will result in reduced competition and hampered capital formation. The SEC estimates that it will cost firms $600,000 to register as dealers with $265,000 in annual costs thereafter. The Commission does not, however, consider the costs associated with trading (not dealing) in a registered dealer entity, which includes a significant lock up of trading capital and increased margin for related activities such as futures trading. These changes alone represent a multiple in the costs associated with activities such as hedging, basis trading, and spread trades. We believe these costs serve as a major deterrent to participating in the markets altogether and, given the broad nature of the Proposal and who it will force under this regime, it will likely have a disruptive outcome, rather than preventing one. For example, a capitalized broker-dealer will effectively have to lock-up its capital for significant periods of time, even if its government securities activities are simply incidental to trading in futures and options on futures (i.e., hedging). As a practical matter, for example, the margin requirement imposed by the Chicago Mercantile Exchange for trading futures and options on futures contracts is likely to increase by as much 150%. This is unsustainable for some firms and will likely result in a reduction in trading activity that will have a cascading effect: as firms decrease trading size or even exit the business completely, spreads will widen, and the overall US Treasury market will suffer as a consequence.

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3. Conclusion

For the reasons outlined above, we strongly urge the Commission to withdraw the Proposal and go back to the drawing table before it adopts rules that run the real risk of downgrading the U.S. Treasury market as the most liquid and deep in the world. We are happy to answer any questions the Commission or staff may have at

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Sincerely,

Ignacio Sandoval