

## Client Alert- Recent Securities and Exchange Commission Proposals Would Subject Unregulated Traders and Systems to Broker-Dealer Registration

This year the Securities and Exchange Commission (the “SEC”) has proposed new rules and rule amendments that, if adopted as proposed, would require (i) certain traders providing liquidity in a marketplace to register as dealers, and (ii) communication protocol systems that bring together buyers and sellers of securities (“CPSs”), to register as broker-dealers and comply with SEC Regulation ATS for alternative trading systems. The new requirements would subject to an extensive broker-dealer regulatory regime under the Securities Exchange Act of 1934 (the “Exchange Act”) many persons, businesses and algorithmic systems. Requirements could include registration with the SEC and FINRA and one or more state regulatory authorities, compliance with a vast array of financial, compliance, recordkeeping and reporting obligations, as well as periodic examination by regulatory authorities. The SEC proposals are intended to protect investors and even the playing field for registered and unregistered entities.

In January, the SEC proposed amendments to the definition of “Exchange” in the Exchange Act to encompass systems that provide communication protocols and non-firm trading interests to bring together buyers and sellers of securities.<sup>i</sup> In the SEC’s view CPSs perform the same market-place functions of bringing together buyers and sellers as registered exchanges and alternative trading systems (“ATSs”), which are required to register with the SEC.<sup>ii</sup> Examples of CPSs discussed in the ATS Release include “Request for Quote” systems and systems that electronically display continuous firm or non-firm trading interest, or “stream axes,” in a security or type of security to participants on the system.<sup>iii</sup> However, according to the ATS Release, because such systems are not now within the definition of “exchange” in the Exchange Act, the investors using CPSs do not receive the investor protection, transparency, and oversight benefits that they would have on regulated exchanges. In addition, the ATS Release would even the playing field between CPSs and exchanges. However, the inclusion of CPSs in the definition of “exchange” in the ATS Release and the resulting requirement that CPSs register as broker-dealers and comply with Regulation ATS are seen by some as having a potentially chilling effect on technological innovation, particularly in the blockchain industry, because broker-dealers are subject to extensive regulation.

On March 28, 2022, the SEC proposed two new rules to further define the phrase “as a part of a regular business” as such terms are used in the definitions of “dealer” and “government securities dealer” under Sections 3(a)(5) and 3(a)(44), respectively, of the Exchange Act.<sup>iv</sup> The Exchange Act defines a “dealer” (in relevant part) as “any person engaged in the business of buying and selling securities ... for such person’s own account through a broker or otherwise. There are exceptions to this definition, including, importantly, an exception for a person not *engaged in the business* of dealing. This exception provides as follows:

“The term “dealer” does not include a person that buys or sells securities (not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants) for such person’s own account, either individually or in a fiduciary capacity, but not as a part of a regular business.”<sup>v</sup>

The exclusionary language above is often described as a carve out for ordinary persons that trade securities for their own account, i.e., the so-called “dealer-trader” distinction.<sup>vi</sup> Generally, the SEC has interpreted this exclusionary language not to apply to market-makers who provide liquidity to markets.<sup>vii</sup>

The SEC is now proposing to further define “as part of a regular business” to focus on activities rather than status or labels and is proposing standards to identify market participants that are providing liquidity in securities markets. Any person that meets the activity-based standards identified in the Dealer Release would be considered a dealer or government securities dealer and be required to register, absent an otherwise available exemption or exception. According to the Dealer Release, the SEC is expecting that principal trading firms, proprietary trading firms and certain investment advisers and private funds, among others, may be required to register as dealers because of their role providing liquidity to markets. The application of the proposed rules would be to liquidity providers in any market, including decentralized exchanges and markets in digital assets that are considered securities. Investment companies registered with the SEC under the Investment Company Act of 1940 and a person that has or controls total assets of less than \$50 million are excluded from the application of the proposed rule.

The comment period on the ATS Release ends April 18, 2022. The comment period on the Dealer Release ends 30 days after its publication in the Federal Register or May 27 (which is 60 days after issuance), (whichever is later).

FisherBroyles attorneys are knowledgeable on SEC, FINRA and broker-dealer matters and are able to advise and assist you with interpretative and regulatory matters, as well as responding to regulatory inquiries and enforcement matters.

**For additional information, please contact any of the following: Robert Boresta at [robert.boresta@fisherbroyles.com](mailto:robert.boresta@fisherbroyles.com), Michael Pierson at [michael.pierson@fisherbroyles.com](mailto:michael.pierson@fisherbroyles.com), or your regular FisherBroyles contact for assistance.**

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<sup>i</sup> Exchange Act Release No. 34-94062; Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities; 87 FR 15496 (the "ATS Release"). The ATS Release also provided for the registration of certain traders of government securities as a broker-dealer and Alternative Trading System ("ATS").

<sup>ii</sup> Section I, Introduction, the ATS Release.

<sup>iii</sup> Section II.B.2, the ATS Release.

<sup>iv</sup> Exchange Act Release No. 34-94524; Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer; March 28, 2022 (the "Dealer Release")

<sup>v</sup> Section 3(a)(5), Exchange Act.

<sup>vi</sup> Section II.A., the Dealer Release.

<sup>vii</sup> Id., note 51.