



SEC finalizes new rules to further define “dealer” and “government securities dealer”

On February 6, 2024, the Securities and Exchange Commission (SEC) finalized new rules 3a5-4 and 3a44-2 under the Securities Exchange Act to further define the phrase “as part of regular business” in the definition of broker-dealer.¹

What’s in the new rules

- The new rules define “as part of regular business” as engaging in a regular pattern of buying and selling securities (or government securities) that the effect of providing market liquidity to other participants by:
 - (i) regularly expressing interest at or near the best price on both sides of the market
 - (ii) earning revenue primarily by capturing bid-ask spreads or capturing incentives offered on trading venues to liquidity-supplying trading interest
- **Exclusions are made for:**
 - Entities controlling less than \$50 million in assets
 - Investment companies registered with the SEC
 - Sovereign banks, international entities or foreign financial institutions
- **Impacted entities are required to register with the SEC and FINRA as dealers**

Who is impacted

- The SEC estimates that a **maximum 43 entities are impacted** by the new rules.
- Further analysis by the SEC suggests that approximately **22 proprietary trading firms and four hedge funds** could be impacted by the rule.
- Firms that are impacted will **need to register with the SEC as well as the Financial Industry Regulatory Authority (FINRA)** and be subject to compliance with their existing rules.
- Effected firms have approximately **one year to comply** with the new rules.
- While not the SEC’s primary targets, firms’ market-making in crypto asset securities could be impacted by the new rules.

Next steps for impacted firms ²

- **Identify the current or future entity that would register and perform a pro forma capital computation:** The net capital rule will require significant permanent funding to support the positions that are deemed to be market-making. Some non-market-making positions that act as hedges may reduce capital charges, while others may increase them dramatically. Firms should perform pro forma capital calculations to determine how to structure and capitalize the entity they choose to register and what positions should be put in that entity.
- **Conduct gap assessments for technology systems, compliance programs and supporting control environment:** Among other things, systems will need to support monthly FOCUS and financial reporting, daily capital compliance, trade execution, trade reporting, and registration (and supervision) of employees. Firms will also need to assess the current and future state of their compliance programs and internal controls.
- **Register the new dealer and its principals with the SEC and FINRA:** In addition to filing relevant forms, the new dealer would have to obtain a new member agreement with FINRA and register certain employees with it. Those persons may be required to take examinations as a prerequisite to being registered.
- **Engage with an external independent auditor:** Dealers are required to file annual financial statements that are audited by and external independent auditor in accordance with Public Company Accounting Oversight Board (PCAOB) auditing standards. Firms are also required to file an “Exemption Report” with the SEC that is reviewed by the independent auditor.

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¹ SEC, “Further definition of ‘As part of Regular Business’ in the definition of dealer and government securities dealer in connection with certain liquidity providers”, February 2024.

² Deloitte, “SEC proposed changes to definition of dealer and government securities dealer”, October 2022.