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SEC Adopts New Rules That Will Require More Market Participants to Register as Dealers

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Introduction

On February 6, 2024, by a vote of 3-2 along party lines, the Securities and Exchange Commission (the SEC or the Commission) adopted Rules 3a5-4 and 3a44-2 under the Securities Exchange Act of 1934 (the Exchange Act), which will significantly expand the definitions of "dealer" and "government securities dealer" to cover additional market participants engaged in liquidity-providing activities, what the staff refers to as "pro forma" market makers.[1] The Exchange Act defines "dealer" as "any person engaged in the business of buying and selling securities … for such person's own account through a broker or otherwise," subject to certain exceptions.[2] Under the so-called trader exception, the term "dealer" does not include a person that "buys or sells securities … for such person's own account, either individually or in a fiduciary capacity, *but not as a part of a regular business*."[3] The Exchange Act similarly requires a person to register as a government securities dealer only if the person buys and sells government securities for its own account "*as a part of a regular business.*"[4]

The final rules add new definitions of "as a part of a regular business," which will capture entities that engage in a regular pattern of buying and selling securities or government securities that has the effect of providing liquidity to other market participants. Specifically, market participants could meet these new definitions and be required to register with the SEC if they have or control assets of $50 million or more and either (1) regularly express trading interest at or near the best available

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[1] Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer in Connection with Certain Liquidity Providers, Exchange Act Release No. 34-99477 (Feb. 6, 2024), available at https://www.sec.gov/files/rules/final/2024/34-99477.pdf (Adopting Release).

[2] 15 U.S.C. § 78c(a)(5)(A).

[3] 15 U.S.C. § 78c(a)(5)(B) (emphasis added).

[4] 15 U.S.C. § 78c(a)(44) (emphasis added).

prices on both sides of the market for the same security in a manner that is accessible to others or (2) earn revenue primarily based on bid/offer spreads or payments for providing liquidity.[5] These entities could include principal trading firms (PTFs), investment advisers, private funds, firms that provide liquidity in the crypto asset securities market and other market participants that meet the standards set forth in the new rules. Crucially, there is no requirement under the final rules that an entity has or holds itself out to customers.[6] There also is no requirement that a person "continuously" express trading interest or "simultaneously" express trading interest on both sides of the market in order to be a "dealer."

In response to comments, the Commission made some notable changes to the proposed rules, including the elimination of the proposed "quantitative standard" for government securities dealers and the proposed qualitative factor that would have captured persons that "routinely" make roughly comparable purchases and sales of the same or substantially similar securities in a day. We described the proposed rules in detail in a 2022 client alert.[7] In explaining the need for the new rules, the Commission expressed concern that there are participants in securities markets that "play an increasingly significant liquidity providing role" and are not registered and regulated as dealers.[8] In particular, the Commission noted that PTFs "account for about half of the daily volume in the interdealer market" for US Treasury securities.[9] In a statement made at the SEC's open meeting, Chairman Gary Gensler stressed the importance of regulatory rules that "benefit market integrity, resiliency, transparency, and more."[10]

Commissioners Hester Peirce and Mark Uyeda dissented. Commissioner Peirce argued that "[o]nce liquidity provision—not in the form of a service provided to market participants but as an effect of one's trading activity—turns a person into a dealer, the dealer-trader distinction becomes unintelligible."[11] The rules, moreover, "penalize … liquidity provision, which means there will be less of it."[12] Dealer registration is also likely to "cause firms to consolidate so that they can spread the

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[5] Adopting Release at 243–47. There are exceptions for registered investment companies, central banks, sovereign entities and international financial institutions.

[6] *Id*. at 23.

[7] *SEC Proposed New Rules Defining "Dealer" Status: Proposal Seeks to Clarify When Unregistered Firms Engaged in Market-Making and Liquidity-Providing Activities May Need to Register as Dealers* (Apr. 6, 2022), https://www.wilmerhale.com/insights/client-alerts/20220406-sec-proposes-new-rules-defining-dealer-status#:~:text=Download-,SEC%20Proposes%20New%20Rules%20Defining%20%E2%80%9CDealer%E2%80%9D%20Status%3A%20Proposal%20Seeks,April%206%2C%202022.

[8] Adopting Release at 3–4.

[9] *Id.* 9–10.

[10] Gary Gensler, *Statement on Final Rules Regarding the Further Definition of a Dealer-Trader* (Feb. 6, 2024), https://www.sec.gov/news/statement/gensler-statement-dealer-trader-020624.

[11] Hester Peirce, *Dealer, No Dealer?: Statement on Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer in Connection with Certain Liquidity Providers* (Feb. 6, 2024), https://www.sec.gov/news/statement/peirce-statement-dealer-trader-020624 (Peirce Statement).

[12] *Id.*

fixed costs of the dealer regulatory regime over more activity."[13] Commissioner Uyeda warned that the "lack of any limiting principle" in the final rules "creates the potential for arbitrary and capricious government action."[14]

Significantly, a person may be a dealer even if the person does not satisfy the standards adopted under these new rules, and persons who do not meet the standards adopted under the new rules are not entitled to a presumption that they fall outside of the Exchange Act's definition of "dealer."[15] The staff in the Division of Trading and Markets is reviewing its guidance on the dealer definition, including no-action letters, to determine which prior guidance may need to be withdrawn in connection with the adoption of these new rules.[16]

In this alert, we discuss new Rules 3a5-4 and 3a44-2. We begin with an explanation of the important provisions of the rules. We then offer some observations and key takeaways for market participants and potential registrants, including PTFs, investment advisers, private funds, firms that implement quantitative and statistical arbitrage trading strategies, firms that provide liquidity in the crypto asset securities market, and other market participants that meet the new liquidity-providing or revenue test.

Key Elements of the Final Rules

A. The Qualitative Standard

Under final Rules 3a5-4 and 3a44-2 and subject to limited exclusions, a person will be viewed as buying and selling securities or government securities for its own account "as a part of a regular business" if that person "engages in a regular pattern of buying and selling securities [or government securities] that has the effect of providing liquidity to other market participants by:

i. Regularly expressing trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants; or
ii. 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 interest."[17]

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[13] *Id.*

[14] Mark Uyeda, *Statement on Further Definition of "As a Part of a Regular Business" in the Definition of Dealer* (Feb. 6, 2024), https://www.sec.gov/news/statement/uyeda-statement-dealer-trader-020624 (Uyeda Statement).

[15] Adopting Release at 92–93.

[16] *Id.* at 8 n.14.

[17] *Id.* at 243–47.

i. The “regularly expressing trading interest” factor

Market participants will need to conduct a highly detailed factual analysis of their activity as a whole to assess whether they meet the “regularly expressing trading interest” factor. We discuss the key elements of this factor in more detail below.

Regularly – The Adopting Release emphasizes that the term “regularly” does not mean continuously, although no precise definition was provided.[18] Instead, the Adopting Release explains that the requirement distinguishes “persons whose regularity of expression of trading interest demonstrates that they are acting as dealers” from “persons engaging in isolated or sporadic expressions of trading interest.”[19] Importantly, whether a person’s activity is “regular” will require an analysis of intraday activity as well as activity over time[20] and will also depend on “the liquidity and depth of the relevant market for the security.”[21] For the most liquid markets, “regular” would mean “more frequent periods of expressing trading interest on both sides of the market both intraday and across days given the efficiency in which securities can be bought and sold and the market’s ability to absorb orders without significantly impacting the price of the security.”[22] For less liquid securities, the term “regular” would “account for the possibility of more interruptions or wider spreads for the best available prices.”[23]

Trading Interest – The term “trading interest” means (i) an “order” as the term is defined in Rule 3b-16(c) or (ii) “any non-firm indication of a willingness to buy or sell a security that identifies the security and at least one of the following: quantity, direction (buy or sell), or price.”[24] The Adopting Release explains that the definition “accounts for the varied mechanisms that permit market participants to make markets,” including streaming quotes, requests for quotes and order books.[25] Requests for quotes on a security, without including prices, on both sides of the market would generally not satisfy this qualitative factor because, absent more, that trading interest would not be “at or near the best available price.”[26]

Both Sides of the Market – The Commission instructs market participants “to assess the totality of their trading activity to determine if they are expressing trading interests on both sides of the market

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[18] *Id*. at 36 (emphasis added). Notably, the term “regularly” in the final rules replaces the term “routinely.” *Id.* at 35. As the Commission notes, unlike “routine,” “regular” is in the statutory definition of “dealer” in the Exchange Act. *Id.*

[19] *Id.* at 35.

[20] *Id.*

[21] *Id.* at 36.

[22] *Id*. at 37.

[23] *Id.*

[24] *Id.* at 41.

[25] *Id.*

[26] *Id.* at 42.

for the same security sufficiently close in time to have the effect of providing liquidity in the same security to other market participants."[27] The Adopting Release notes that a market participant can meet this test even if it does not simultaneously express trading interest on both sides of the market.[28]

Accessible to Other Market Participants – This reflects "the plain meaning that a person expresses trading interests to more than one market participant."[29]

ii. The "primary revenue" factor

As explained in both the proposing release and the Adopting Release, "one fundamental characteristic typical of market makers and liquidity providers—and one that has historically been viewed as dealer activity—is trading in a manner designed to profit from bid-ask spreads or liquidity incentives rather than with a view toward appreciation in value."[30] This qualitative factor is intended to capture this economic feature of dealer activity.

Earn Revenue – Like the proposed rules, the final rules require only that a participant "earn revenue" from the bid-ask spread or liquidity incentives. There is no requirement that the participant profit from its dealer activity.[31]

Primarily – The Commission reiterates that if a person derives the majority of its revenue from the bid-ask spread and liquidity incentives, it is likely in a regular business of buying and selling securities or government securities for its own account.[32] Conversely, "it is unlikely that a person who regularly earns more revenue from an appreciation in the value of its inventory of securities than from capturing bid-ask spreads or incentive payments for liquidity provision, would be considered to earn revenue 'primarily' from capturing bid-ask spreads or trading incentives."[33]

Trading Venue –The definition of "trading venue" is not limited to exchanges and alternative trading systems or OTC market makers, but rather is intended to be broader than the definition of "market center" in Regulation NMS. According to the Adopting Release, the term "is intended to accommodate the variety of venues in which market participants today engage in liquidity-providing dealer activity."[34] The Commission further notes that "the use of this term is intended to capture venues as they evolve, wherever that activity occurs, whether on a national securities exchange, an

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[27] *Id.* at 47.

[28] *Id.* at 46.

[29] *Id.* at 49.

[30] *Id.* at 51.

[31] *Id.* at 56.

[32] *Id.* at 57.

[33] *Id.* at 57–58.

[34] *Id.* at 56.

ATS, any other broker- or dealer-operated platform for executing trading interest internally by trading as principal or crossing orders as agent, or any other platform performing a similar function … The particular venue matters less than the fact that a market participant provides liquidity on it."[35] For crypto asset securities, it is the same test. The Adopting Release states that "[w]hether a particular structure or activity in the crypto asset securities market, including the so-called DeFi market, involves a trading venue is a facts and circumstances determination."[36]

B. The Definition of "Own Account" and the Anti-Evasion Provision

The final rules define "own account" to mean any account held in the name of the potential dealer or held for the benefit of the potential dealer.[37] Unlike the proposed rules, the final rules do not define "own account" to also include accounts held in the name of a person over whom that person exercises control or with whom that person is under common control (the proposed aggregation provision).[38] Under the adopted definition, the expression of trading interest by investment advisers on behalf of their clients would not be activity captured by the rules, unless the investment adviser itself is the account holder or the account is held for the benefit of the investment adviser.[39]

To deter the establishment of multiple legal entities or accounts to evade registration, the final rules include an anti-evasion provision that prohibits persons from evading the registration requirements by (i) engaging in activities indirectly that would satisfy the qualitative standard or (ii) disaggregating accounts.[40] The first prong of the anti-evasion provision is intended to prevent persons from using another person or entity to indirectly engage in activity that would meet the qualitative standard.[41] The second prong is modeled on Rule 13h-1(c)(2), which prevents persons from disaggregating accounts to avoid the requirements of the Large Trader Rule.[42] It is "intended to address market participants who disaggregate their existing business *for the purpose of* evading the final rules, but not limit the ordinary course business activities of persons who have no such intent or purpose."[43] The Adopting Release lists potential considerations in determining whether a person is evading the dealer registration requirements in violation of the anti-evasion provision.[44]

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[35] *Id*. at 56–57.

[36] *Id*. at 57 n.188.

[37] *Id.* at 88.

[38] *Id.* at 64.

[39] *Id*. at 42

[40] *Id*.

[41] *Id.* at 90.

[42] *Id*. at 90.

[43] *Id.* at 91 (emphasis added).

[44] *Id*. at 92.

C. Exclusions

The final rules exclude three categories of persons: (i) persons that have or control assets of less than $50 million; (ii) registered investment companies; and (iii) central banks, sovereign entities and international financial institutions.

i. Persons that have or control assets of less than $50 million

Persons that have or control assets of less than $50 million are excluded from the final rules. Note, however, that the $50 million exclusion is specific to the final rules. As the Commission explains, "[o]utside of the context of these rules, the question of whether any person, including a person that has or controls less than $50 million in total assets, is acting as a dealer will remain a facts and circumstances determination."[45]

ii. Registered investment companies

As described in the Adopting Release, investment companies registered under the Investment Company Act of 1940 (Investment Company Act) are excluded from the application of Rules 3a5-4 and 3a44-2.[46] In contrast, the Commission declined to include an express exclusion for private funds or registered investment advisers, instead modifying the definition of "own account" as described above to remove the aggregation standard and thereby avoid capturing advisers trading on behalf of their clients.

iii. Central banks, sovereign entities and international financial institutions (i.e., "official sector exclusions")

The purpose of the official sector exclusions is "to permit central banks, sovereign entities, and international financial institutions to continue to pursue important policy goals, and to be consistent with principles of international comity and the privileges and immunities granted to foreign central banks, foreign sovereigns and sovereign entities, and certain international financial institutions under U.S. federal law."[47] The definition of "sovereign entity" includes "a central government (including the U.S. Government), or an agency, department, or ministry of a central government." In the February 6 open meeting, Commissioner Uyeda raised the question of whether the final rules would apply to state governments.[48]

D. The "No Presumption" Provision

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[45] *Id*. at 64.

[46] *Id.*

[47] *Id.* at 73.

[48] Specifically, he asked whether the state of Texas is a sovereign entity. A member of the staff read the definition aloud and responded: "If the state of Texas falls into that definition, then I am going to answer yes—but I am no expert on sovereign entities." Securities and Exchange Commission, 2024-02-06-Open-Meeting (Feb. 8, 2024), available at https://www.youtube.com/watch?v=zHzNDvDbIzg.

The final rules are not the exclusive means of establishing that a person is a dealer or government securities dealer, and they do not displace or modify existing court precedent and Commission interpretations of Sections 3(a)(5) and 3(a)(44) of the Exchange Act.[49] Thus, persons who do not meet the qualitative standard are not entitled to a presumption that they fall outside of Sections 3(a)(5) or 3(a)(44).[50] Rather, the analysis of whether a person meets the definition of dealer will continue to depend on all relevant facts and circumstances. For example, the Commission's 2002 release on specific exemptions from the definition of dealer states, "A person generally may satisfy the definition, and therefore, be acting as a dealer in the securities markets by conducting various activities: (1) underwriting; (2) acting as a market maker or specialist on an organized exchange or trading system; (3) acting as a de facto market maker whereby market professionals or the public look to the firm for liquidity; or (4) buying and selling directly to securities customers together with conducting any of an assortment of professional market activities such as providing investment advice, extending credit and lending securities in connection with transactions in securities, and carrying a securities account."[51] As noted above, the staff in the Division of Trading and Markets is reviewing its guidance on the dealer definition, including no-action letters, to determine whether and which prior guidance may need to be withdrawn in connection with the adoption of these new rules.[52]

Deadlines for Compliance

The Commission adopted a compliance date of one year from the effective date of the final rules.[53] The effective date will be 60 days after the date of publication in the *Federal Register*.[54] The release stresses that "the one-year compliance period only applies to market participants who are engaging in activities covered by the final rules prior to the compliance date, and does not apply to persons whose activities otherwise satisfy the definition of dealer under applicable Commission interpretations and court precedent."[55] SEC staff mentioned in the SEC's February 6 open meeting that the Financial Industry Regulatory Authority (FINRA) had committed to expedite the process for persons applying for membership in connection with the dealer registration requirement. The

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[49] Adopting Release at 93.

[50] *Id.* at 92–93.

[51] Definitions of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, 67 Fed. Reg. 67496, 67499 (Nov. 5, 2002).

[52] Adopting Release at 8 n.14.

[53] *Id.* at 94.

[54] *Id.* at 1.

[55] *Id.* at 94.

Adopting Release also mentions "FINRA's expressed commitment" and references FINRA's comment letter on the proposed rules.[56]

Key Takeaways for Market Participants

A. Increased Compliance Costs for Firms Required to Register as Broker-Dealers and Potential Loss of Liquidity if Certain Market Participants Do Not Register but Instead Modify or Cease Trading Activity That Would Otherwise Trigger Registration

Market participants will need to assess whether their trading activity across different strategies (and funds in the case of a master fund structure) could cause them to be engaged in dealer activity, either because they are "regularly expressing trading interest" on both sides of the market at or near best available prices that is accessible to other market participants, or because they primarily earn revenue by capturing bid-ask spreads or through liquidity-provider rebates. This issue is particularly acute for firms that use quantitative and statistical arbitrage strategies (or similar strategies, particularly those that are latency-sensitive) because these strategies often have short holding periods and may result in significant rebates.

If these market participants are required to register as dealers, they will have to comply with new requirements such as the net capital rule. Some commenters noted that rather than registering, certain firms that meet the qualitative standard may choose to modify or cease their trading activity, which could in turn significantly and negatively affect liquidity.[57] Commissioner Uyeda explained that these additional requirements would increase regulatory costs for PTFs and private funds "who make money by buying low and selling high in the Treasury market" and these increased costs will "lead them to supply less liquidity and some firms may exit."[58]

Using TRACE data for US Treasury securities across six months in 2022, the Commission estimated that between 13 and 22 entities classified as PTFs and up to four entities classified as hedge funds would meet the primary revenue factor.[59]

B. Unique Challenges for Investment Advisers and Private Funds

The Commission did not exempt private funds or investment advisers from the rules because the Commission is concerned that exempting these entities could result in regulatory arbitrage. For example, the Commission expressed concern that certain PTFs engaged in market-making activity potentially would restructure themselves as private funds to circumvent the rules.[60]

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[56] *Id*. at 95.

[57] *Id.* at 66.

[58] Uyeda Statement.

[59] Adopting Release at 117. The Commission did not estimate the number of non-broker-dealers that appear to meet the expressing trading interest factor or the primary revenue factor for non-US government securities.

[60] *Id*. at 10, 68.

Each private fund and investment adviser must be evaluated independently. With respect to private funds, there are particular challenges in evaluating those that have multiple portfolio management or trading strategies, such as multi-strategy hedge funds or multi-manager subadvised funds. This is because the application of the "regularly expressing trading interest" factor is particularly challenging for funds that have decentralized investment decision-making and trade order processing.

With respect to investment advisers, the Commission did not exclude any investment advisers, regardless of registration status. Accordingly, all registered investment advisers, exempt reporting advisers, state-registered investment advisers and foreign advisers are potentially within the scope of the rule. The Commission did, however, clarify that an adviser's client accounts, including the private funds managed by the investment adviser, generally would not be attributed to the adviser absent evasive activity.[61] Nevertheless, the Commission left open a number of issues with respect to investment advisers, including whether an adviser's ownership in a private fund it manages could cause the private fund's activity to be attributed to the adviser by virtue of being part of the adviser's "own account."

As many commenters noted, applying the dealer regulatory framework to investment advisers and private funds, as well as to other advisory clients, will result in significant legal changes and practical difficulties.[62] Notably, once registered as a dealer, the adviser or the private fund would no longer be a "customer" under applicable rules (e.g., restrictions on markups, obligations to provide fair prices and prohibitions on trading ahead). Additionally, the net capital rule is an example of practical challenges cited by commenters as being wholly inconsistent with an adviser's management of a private fund in that it could restrict the fund's investment strategy and trading program, as well as investors' liquidity rights. To the extent a private fund may have to comply with net capital requirements, a fund may need to amend the liquidity attributes of the fund to ensure the fund can comply with its net capital requirements.

Lastly, advisers to private funds must consider the new rules in the context of the tangled web of new rulemaking applicable to private funds and their advisers. Commissioner Uyeda raised the issue that "[t]he Commission has [also] not considered the aggregate effects of the various rules proposed and/or adopted for private funds since the proposing release."[63] As Commissioner Uyeda indicated, the Commission has adopted several new rules in the past year that are directly

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[61] *Id.* at 91 (noting that the Commission "would generally consider management by a registered investment adviser of separately owned client accounts that follow substantially the same investment objectives and strategies to be ordinary course business activities, and so would not impute the trading in the clients' accounts to the adviser's 'own account,' absent intent to evade the dealer registration requirements").

[62] *Id*. at 67. The Commission separately discussed governmental plans, including public pensions. The Commission does not believe such plans will be captured following the removal of the quantitative standard. *See id*. at 82.

[63] Uyeda Statement.

applicable to private funds and their advisers, including additional reporting rules, which were adopted just two days after Rules 3a5-4 and 3a44-2.[64]

C. Application to Crypto Asset Securities

The Commission confirmed that the final rules would apply to persons engaged in crypto asset securities transactions, declining to make a distinction among different types of securities and rejecting crypto industry members' requests to carve out from the rules or to tailor the rules to crypto asset securities.[65] Mirroring earlier claims made by the Commission that "[m]any of the entities operating [crypto asset] trading systems … [may be subject to the requirement] to register as an exchange … [or] a broker-dealer,"[66] the Commission stated that "certain persons engaging in crypto asset securities transactions may be operating as dealers" and that "crypto asset platforms transacting in crypto assets for their own account may already be dealers under current law."[67] In particular, the Commission specified that persons engaged in crypto asset securities transactions, including in the decentralized finance (DeFi) markets, such as "persons using so-called 'automated market makers,'" could be subject to dealer registration.[68]

Because the final rules do not carve out crypto market participants, participants must assess whether their activities require registration as a dealer—a facts and circumstances determination—and, if necessary, register with the SEC in advance of the one-year compliance date. The final rules, however, leave several questions unanswered regarding how they would apply to crypto market participants. Expressing harsh criticism of the final rules, Commissioner Peirce asserted that "the rule reflects little thought regarding its practical application in the crypto markets."[69] As noted in the Adopting Release, commenters expressed their concern that they do not understand which crypto assets are offered and sold as "securities"[70] —a necessary condition for application of the federal securities laws and the dealer registration requirement, and a dispute that is currently playing out in multiple federal courts.[71] There also remain open questions regarding who will need

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[64] *See, e.g.,* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Investment Advisers Act Release No. 6383 (Aug. 23, 2023), https://www.sec.gov/files/rules/final/2023/ia-6383.pdf; Form PF; Event Reporting for Large Hedge Fund Advisers and Private Equity Fund Advisers; Requirements for Large Private Equity Fund Adviser Reporting, Investment Advisers Act Release No. 6297 (May 3, 2023), https://www.sec.gov/files/rules/final/2023/ia-6297.pdf; Form PF; Reporting Requirements for All Filers and Large Hedge Fund Advisers, Advisers Act Release No. 6546 (Feb. 8, 2024), https://www.sec.gov/files/rules/final/2024/ia-6546.pdf.

[65] Adopting Release at 44, 210–12.

[66] Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange," 88 Fed. Reg. 29448, 29465 (May 5, 2023) (Exchange Reopening Release).

[67] Adopting Release at 80.

[68] *Id*. at 43–44, 122.

[69] Peirce Statement.

[70] Adopting Release at 77.

[71] See Dave Michaels, "Big Battles Loom in SEC's War on Crypto," WALL ST. J. (Dec. 28, 2023), https://www.wsj.com/finance/regulation/big-battles-loom-in-secs-war-on-crypto-aeff0d78.

to register as a dealer and how certain activities referenced in the final rules implicate dealer registration. For example, as Commissioner Peirce recognized, an automated market maker is a software protocol; she questioned, in that circumstance, "who will have to register? In light of the difficulties that other would-be crypto registrants have encountered with the SEC and FINRA, will those persons even be able to register?"[72] Crypto industry members have expressed similar concerns, which were also expressed during the comment periods for the proposed amendments to the definition of "exchange." Crypto industry members sought to understand who would need to register with respect to the operation or implementation of a DeFi trading protocol—which, like an automated market maker, is software—how a software protocol could be registered with the SEC, and whether there is a viable path for crypto firms to register with the SEC.[73]

Because the final rules do not apply to persons that have or control assets of less than $50 million,[74] certain market participants may be excluded from the registration requirement based solely on the criteria of the final rules. The Adopting Release explains that the SEC is focused on market participants that perform critical market functions, such as liquidity provision, that historically have been performed by dealers, and that "smaller market participants are unlikely to engage in the significant liquidity provision that is the focus of the final rules."[75] Thus, retail market participants—even those explicitly trading in crypto asset securities—that have or control less than $50 million in assets would not have to register as dealers solely by virtue of the new rules. However, the SEC clarified that this exclusion is limited in scope because it "does not modify existing applicable court precedent and Commission interpretations" regarding the definition of dealer.[76] Therefore, in light of the open questions about the status of crypto assets and the application of the dealer definition and final rules to crypto asset securities, crypto market participants should carefully review their activities and closely follow the pending federal court actions addressing when a crypto asset satisfies the definition of "security" (and any other SEC guidance on this topic) to determine whether registration is required.

Conclusion

The final rules are likely to require many new entities to register as dealers with the Commission for the first time and become members of FINRA. Private funds, proprietary trading firms, participants

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[72] Peirce Statement.

[73] *See* Exchange Reopening Release, at 29456; *see also* Hearing Before the Committee on Agriculture, US House of Representatives, *The Future of Digital Assets: Providing Clarity for Digital Asset Spot Markets* (June 6, 2023), https://www.govinfo.gov/content/pkg/CHRG-118hhrg53287/pdf/CHRG-118hhrg53287.pdf (congressional testimony relating to how certain crypto trading platforms had attempted to come in and register at the Commission's urging, without success).

[74] *See* Rule 3a5-4(a)(2)(i).

[75] Adopting Release at 10, 63.

[76] *Id.* at 43 n.132.

in the crypto asset securities market and others should carefully consider whether their trading activities trigger the dealer registration requirement.

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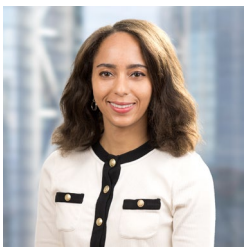

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