

June 7, 2022

Ms. Vanessa A. Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 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:

We appreciate the opportunity to provide comments to the Securities and Exchange Commission (the “Commission”) on the proposal to “further define” the statutory term “dealer” (the “Proposal”).<sup>1</sup>

Citadel is a leading investor in the world’s financial markets, managing in excess of \$50 billion in investment capital on behalf of a diverse array of investors, including pensions (local, corporate, and union), endowments, healthcare providers, foundations, and insurance companies. Founded in 1990, our flagship fund has delivered a 19.3% annualized return since inception, returns that help our investors fund innovative research, support leading academic institutions, and secure the retirement futures of their beneficiaries. Citadel has been a longstanding proponent of policy measures designed to modernize the regulatory framework for the U.S. Treasury market, including implementing public post-trade transparency, increasing central clearing, and registering multilateral trading venues.<sup>2</sup>

Citadel participates in financial markets as a *customer*, regulated by the Commission as an investment adviser under the Investment Advisers Act of 1940 (the “Advisers Act”). As a *customer*, Citadel regularly transacts with Commission-registered *dealers* who fulfill the important role of providing liquidity to the diverse array of customers active in U.S. financial markets.

However, without statutory authority and with the real risk of severe damage to our financial markets, the Commission now proposes to require many customers to register as dealers by dramatically rewriting the definition of the term “dealer,” particularly for the U.S. Treasury market, where an arbitrary bright-line trading volume threshold would counterintuitively reclassify investors as dealers. Under this proposed rule, investors in the U.S. Treasury market, such as Citadel, would be required to separately register as dealers themselves solely based on the volume of their trades, notwithstanding the fact that these customers do not engage in any actual dealing activities as defined in the Securities Exchange Act of 1934 (the “Exchange Act”), longstanding

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<sup>1</sup> 87 Fed. Reg. 23054 (Apr. 18, 2022), available at: <https://www.govinfo.gov/content/pkg/FR-2022-04-18/pdf/2022-06960.pdf>.

<sup>2</sup> See, e.g., Citadel Response to the U.S. Department of the Treasury RFI (April 2016), available at: <https://www.regulations.gov/document?D=TREAS-DO-2015-0013-0045>. For the avoidance of doubt, Citadel Securities is a separate leading global market maker that engages in dealing activities in U.S. Treasuries through a registered broker-dealer and FINRA member.

Commission interpretations, and federal case law. The Commission has also proposed separate new qualitative criteria that likewise may reclassify many investors as dealers given the overexpansive and ambiguous nature of these criteria.

The Commission has failed to articulate any rational basis for requiring private funds and their advisers to register not only as investment advisers but *also* as dealers. In practice, it is unworkable to subject those who invest in the Treasury market as customers to an extremely burdensome regulatory framework designed specifically for dealer firms that facilitate customer trading, meaning that the most likely course of action for these customers would be to reduce the volume of their investment, trading, and hedging activities below the proposed threshold, or to materially withdraw from the market.

The Commission's Proposal would thus have profound negative effects for U.S. Treasury market liquidity, resiliency, and efficiency, and threatens to damage U.S. financial markets and the U.S. economy. This Proposal is especially dangerous now, as the U.S. Treasury market has dramatically increased in size over the last 15 years as the U.S. national debt has soared. Since 2007, the U.S. Treasury market has grown from \$4.5 trillion to more than \$23 trillion today, and is expected to reach \$40 trillion by 2032.<sup>3</sup> In addition, the Federal Reserve has announced plans to meaningfully reduce its portfolio of nearly \$9 trillion of Treasury securities, meaning that there will be an even greater supply of securities that market participants will need to absorb.<sup>4</sup> These market dynamics, against a backdrop of significant geopolitical and macro-economic uncertainty, clearly demonstrate the ill-conceived nature of a proposal that would significantly curtail investor participation in this critically important market.

This Proposal would directly imperil the functioning of the U.S. Treasury market by compelling some of the largest customers by holdings to reduce their investment, trading, and hedging activities. This would make the market more fragile, prone to volatility, and even further dependent on purchases by foreign official institutions. These negative impacts on market quality and liquidity will extend beyond the secondary cash Treasury market to the primary auctions and related asset classes, such as Treasury futures, interest rate swaps, and Treasury repos, and ultimately spill over into the market for mortgage-backed securities and corporate debt. The cumulative effects cannot be overstated – increasing the funding costs of the U.S. government to the detriment of U.S. taxpayers, harming U.S. capital markets and the U.S. economy, and needlessly damaging the central role that Treasuries play as investment and hedging instruments in the U.S. and global economies.

We urge the Commission to maintain consistency with the Exchange Act, as well as its accompanying interpretative history, by removing the proposed quantitative threshold and by

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<sup>3</sup> US Treasury Securities Statistics, SIFMA, available at: <https://www.sifma.org/resources/research/us-treasury-securities-statistics/>; Budget and Economic Data, at Table I-1, CBO, available at <https://www.cbo.gov/data/budget-economic-data>.

<sup>4</sup> See Katherine Greifeld, *The Weekly Fix: Financial Conditions are Easing. Maybe that's Ok*, Bloomberg (June 3, 2022), available at <https://www.bloomberg.com/news/newsletters/2022-06-03/the-weekly-fix-financial-conditions-are-easing-maybe-that-s-ok>; Plans for Reducing the Size of the Federal Reserve's Balance Sheet, Board of Governors of the Federal Reserve System (May 4, 2022), available at: <https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504b.htm>.

ensuring the proposed qualitative criteria are modified to avoid designating customers as dealers (including by focusing on continuous two-sided price streaming activities in a given instrument by firms designated as a liquidity provider and by applying the qualitative criteria to independent trading strategies instead of aggregating across one or more legal entities under common control).

## **I. The Commission Lacks A Rational Basis For Requiring Private Funds To Also Register As Dealers.**

The Commission and other policymakers have long suggested that many proprietary trading firms (“PTFs”) active in the U.S. Treasury market should be registered as dealers.<sup>5</sup> Therefore, it is of little surprise that the Proposal focuses heavily on PTFs and the policy rationale for seeking their registration.<sup>6</sup> However, the Commission also acknowledges that the Proposal, in particular the quantitative threshold for the U.S. Treasury market, is expansive and “some private funds may be affected.”<sup>7</sup> The Commission does not articulate a rational basis for why, or how, private fund investors who are customers of dealers should also register as dealers.

### ***A. The Commission Does Not Articulate a Compelling Policy Rationale For Registering Private Funds As Dealers.***

The Commission is unable to articulate a compelling policy rationale for registering private funds as dealers. The Proposal does not cite prior statements by the Commission or other policymakers in support of this notion, or academic research demonstrating that private funds are engaging in dealing activities. Nor does the Commission point to any adverse effects specifically resulting from private fund customers not being registered as dealers. The Commission is also unable to identify any particular trading activities carried out by private funds that appear to resemble dealing activity as historically defined by the Commission.<sup>8</sup>

The Proposal contains some general discussion of recent U.S. Treasury market volatility during March 2020 in an effort to establish that registering additional market participants should be expected to increase overall market resiliency. However, market volatility is not related to why

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<sup>5</sup> See, e.g., Chair Mary Jo White, “Taking Stock of Treasury Market Regulation” (Oct. 20, 2015), available at: <https://www.sec.gov/news/speech/taking-stock-of-treasury-market-regulation.html>; Chair Gary Gensler, “Prepared Remarks at U.S. Treasury Market Conference,” (Nov. 17, 2021), available at: <https://www.sec.gov/news/speech/gensler-us-treasury-market-conference-20211117>; and “Conference Summary: The Evolving Structure of the U.S. Treasury Market” (Oct. 20-21, 2015) at page 5, available at: <https://www.newyorkfed.org/medialibrary/media/newsevents/events/markets/2015/Conference-Summary.pdf>.

<sup>6</sup> See, e.g., Proposal at 23054, FN 2 (“[Principal trading firms] dominate activity on the electronic [interdealer broker] platforms (61 [percent].)”), 23055, FN 8 (“For purposes of this release, when discussing the U.S. Treasury market, we will be primarily focused on trading activities occurring in the interdealer market.”); and 23072 (“PTFs have displaced the role of traditional dealers in the interdealer U.S. Treasury market.”).

<sup>7</sup> Proposal at 23088.

<sup>8</sup> In particular, the Commission was unable to identify any private funds engaging in dealing activities based on the data reviewed. See Proposal at 23087 and the discussion in Section II.C below.

Congress required dealers to register with the Commission.<sup>9</sup> Moreover, the Commission omits to note research suggesting that “hedge funds had a minimal role in the dislocation of the US Treasuries market” and that other types of institutions, including mutual funds and foreign official accounts, carried out far more selling activity.<sup>10</sup> As a result, this recent market event does not help to explain why the Commission decided to arbitrarily require certain private funds to register as dealers, while providing exemptions to mutual funds and foreign official accounts (as a result of jurisdictional limitations).

The disparate treatment of private funds and mutual funds (i.e. registered investment companies (“RICs”)) further highlights the lack of justification for requiring private funds to register as dealers. The Commission asserts that “in light of the regulatory structure that governs registered investment companies,” it is not appropriate to require RICs to register as dealers and therefore a blanket exemption is warranted.<sup>11</sup> However, the Investment Company Act and the Exchange Act are very different regulatory regimes; the fact that the Commission is compelled to argue that they are interchangeable in order to justify an exemption clearly shows that the Proposal is overbroad and rests on a misleading interpretation of the statute, as detailed in Section II below.<sup>12</sup>

Moreover, the Commission’s logic for exempting RICs equally applies to private funds. Private funds and their advisers are already subject to a comprehensive regulatory framework, including regular reporting of investment and trading strategies, exposures, and liquidity, recordkeeping obligations, and examinations. These requirements provide the Commission with broad oversight over private fund activities, meaning that any purported incremental benefits of applying a second regulatory regime to private funds are extremely small and cannot possibly justify the enormous associated costs, as detailed in Section I.B immediately below.<sup>13</sup>

Without more explanation from the Commission, it is difficult to ascertain the motivations for requiring certain private funds to register as dealers, but there are certainly more reasonable alternatives that the Commission failed to consider. For example, if the Commission believes it is appropriate to supplement the regulatory requirements applicable to private funds, it can do so

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<sup>9</sup> See, e.g., *Roth v. SEC*, 22 F.3d 1108, 1109 (D.C. Cir. 1994) (dealer registration is designed to ensure that “securities are only sold by a salesman who understands and appreciates both the nature of the securities he sells and his responsibilities to the investor to whom he sells”).

<sup>10</sup> IOSCO Investment Funds Statistics Report (Jan. 2022), available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD693.pdf>. See also Treasury Market Structure & Recent Stresses: Presentation Before CFTC Global Markets Advisory Committee,” MFA (Oct. 25, 2021), available at: <https://www.cftc.gov/PressRoom/Events/opaeventgmac102521>.

<sup>11</sup> Proposal at 23057.

<sup>12</sup> See, e.g., *Util. Air Regulatory Grp. v. EPA*, 573 U.S. at 328; *Chamber of Commerce v. Dep’t of Labor*, 885 F.3d at 382-83.

<sup>13</sup> Indeed, the Commission acknowledges the immateriality of the benefits of applying the dealer regulatory regime to private funds, concluding that the benefits “might be very small, since the regulatory regime that applies to registered private fund advisers already contains similar provisions to the rules that apply to dealers.” Proposal at 23088.

through targeted amendments to Adviser Act regulations,<sup>14</sup> and in fact, the Commission only recently proposed an extensive batch of new regulatory requirements for private funds.<sup>15</sup> At a minimum, any supplementary regulatory requirements applicable to private funds should cover all private funds (rather than the subset that may exceed the arbitrary quantitative threshold in this proposal) in order to maintain a level competitive playing field.

***B. The Commission Did Not Adequately Assess The Economic Consequences Of The Proposal on Private Funds.***

The Commission's assessment of the economic consequences of the Proposal is clearly inadequate. First, the Commission fails to acknowledge that subjecting customers of dealers to a regulatory framework designed specifically for dealers would inevitably lead to unworkable conflicts. For example, customers, such as Citadel, benefit from important regulatory protections under Commission rules and regulations when transacting with registered broker-dealers. These include customer protection rules relating to collateral segregation and control,<sup>16</sup> the suite of sales practice rules (including suitability, best execution, and the prohibition on trading ahead of customer orders),<sup>17</sup> and protections in the event of a counterparty default.<sup>18</sup> However, if required to register as a dealer, it appears a private fund would be excluded from the definition of "customer" commonly used in Commission and FINRA rules and regulations, and therefore these protections would no longer apply.<sup>19</sup> Requiring private funds to forego standard customer protections in order to continue their current trading activities in the U.S. Treasury market is an untenable outcome for both private fund advisers, as fiduciaries, and for the underlying investors.

In addition, requiring private funds to register as a dealer would appear to deprive them of access to the U.S. IPO market, harming issuers, investors, and overall market liquidity and capital formation. FINRA Rule 5130 generally prohibits a broker-dealer from selling U.S. initial public offerings to any account in which a "restricted person" has a beneficial interest. FINRA members and other broker-dealers are considered to be restricted persons under this rule, meaning that a private fund registered as a dealer would become subject to these restrictions. This would have enormous negative consequences for U.S. financial markets and private fund investors, all of which the Commission completely neglects to consider.

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<sup>14</sup> The Commission appears to suggest private funds should be subject to trade reporting requirements, but we note that these transactions are already being reported since private funds trade with registered broker-dealers. For example, there is broad acknowledgment that the key remaining gap in the reporting of U.S. Treasury transactions relates to transactions executed by banks, not private funds ("Remarks at U.S. Treasury Market Conference," Elad Roisman (Sept. 29, 2020), available at: <https://www.sec.gov/news/speech/roisman-us-treasury-conference-2020-09-29>). If the Commission believes customer identities should be disclosed on those transaction reports, then a targeted rule amendment is more appropriate, similar to how CAT data will be reported as of July 2022. See Proposal at 23082, FN 228.

<sup>15</sup> 87 Fed. Reg. 16886 (Mar. 24, 2022), <https://www.govinfo.gov/content/pkg/FR-2022-03-24/pdf/2022-03212.pdf>.

<sup>16</sup> §240.15c3-3.

<sup>17</sup> FINRA Rules 2111, 5310, and 5320.

<sup>18</sup> 15 U.S.C. 78aaa-111.

<sup>19</sup> See, e.g., the definition of "customer" in §240.15c1-1 and §240.15c3-3.

Second, the Commission's cost estimates are far too low. The Commission asserts "compliance costs of approximately \$600,000 initially and \$265,000 annually thereafter to register as a broker-dealer with the Commission, become a member of an SRO, and comply with the associated dealer regulations."<sup>20</sup> This assessment is inadequate and inaccurate.<sup>21</sup>

For example, the Commission makes no effort to assess the costs for private funds of complying with dealer net capital rules. SEC regulations require registered broker-dealers to maintain net capital at specific levels in order "to protect [their] customers' funds."<sup>22</sup> Putting aside the absurdity of applying these rules to private funds, which do not hold customer securities, the net capital rules would impose substantial costs. Private fund investment strategies tend to be more directional than those of actual dealers, and we therefore expect this Proposal would result in billions of dollars in net capital requirements, limit private funds' investment strategies, and further reduce the amount of investment capital available to invest in U.S. Treasuries. In addition, before the Commission can apply a capital rule designed for dealers to other types of market participants, it would need to address critical questions regarding qualifying capital sources for private funds, any impact on investor withdrawal rights (strict limitations on withdrawing capital from a registered broker-dealer may impose new withdrawal "gates" on private fund investors in practice), and acceptable internal risk models for non-government securities.<sup>23</sup>

In addition, the assertion that these estimates cover the full panoply of dealer regulations is false. Later in the Proposal, the Commission acknowledges that the costs associated with complying with just a *single* dealer requirement – CAT reporting – may be up to "\$8,218,000 for implementation costs and \$5,405,000 for ongoing annual costs."<sup>24</sup> Separate reporting infrastructure would need to be established for other asset classes, including corporate bonds and U.S. Treasuries, and entirely new regulatory reporting, monitoring, and surveillance systems would need to be implemented. Additional requirements include establishing market access controls required of a dealer, becoming a member of the Securities Investor Protection Corporation (even though a private fund does not have any customer accounts), and becoming a member of FINRA and complying with the entire FINRA rulebook. All of these requirements would result in significant upfront and ongoing costs for private funds that far exceed the Commission's overall estimate.

In turn, the Commission is unable to identify material benefits associated with requiring dealer registration for private funds that participate in financial markets as customers. Several of the purported benefits noted by the Commission appear inaccurate. For example, public post-trade transparency should not be expected to increase if private funds register as dealers, as private fund

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<sup>20</sup> Proposal at 23089.

<sup>21</sup> Further, in cases where an investment advisor manages several funds that must be aggregated for purposes of either the quantitative or qualitative criteria, it is unclear whether each fund must separately register as a broker-dealer and incur the associated costs.

<sup>22</sup> SEC, Study of Unsafe and Unsound Practices of Brokers and Dealers 8 (1971).

<sup>23</sup> Relatedly, the Commission states "it is unclear how registered investment companies would comply with net capital requirements, or how they would define net capital." Proposal at 23094.

<sup>24</sup> Proposal at 23090.



transactions are already reported by their registered broker-dealer counterparties.<sup>25</sup> As a result, the Commission is correct in concluding that the benefits of dealer registration for private funds “might be very small, since the regulatory regime that applies to registered private fund advisers already contains similar provisions to the rules that apply to dealers.”<sup>26</sup> When combined with the significant costs detailed above, it is clear the Commission lacks a rational basis for requiring private funds to register as dealers.

## **II. The Proposed Quantitative Threshold Is Unsupported By Law And Should Be Removed.**

The Proposal would require any entity that trades more than \$25 billion in U.S. Treasuries in four of the last six calendar months to register as a dealer, regardless of any other regulatory status they may have, except in the case of registered investment companies. As acknowledged by the Commission, this proposed quantitative threshold is expected to capture not only PTFs, but also certain private funds and other investors who are customers of dealers in the U.S. Treasury market. By attempting to reclassify customers as dealers, the Commission would exceed its statutory authority and act arbitrarily.

### ***A. The Commission Did Not Adequately Assess The Economic Consequences Of The Proposal on the U.S. Treasury Market.***

The U.S. Treasury market is the deepest and most liquid government securities market in the world, and plays a fundamental role in both the U.S. and global economies. The liquidity, resiliency, and efficiency of the U.S. Treasury market support the efficient funding of the U.S. government at the lowest cost to the U.S. taxpayer and the widespread use of Treasuries as an investment and hedging instrument.

The Commission did not adequately consider the impact of the Proposal on this critically important market. The U.S. Treasury market has dramatically increased in size over the last 15 years, with total amount outstanding increasing from \$4.5 trillion in 2007 to more than \$23 trillion today, and expected to reach \$40 trillion by 2032.<sup>27</sup> In addition, the Federal Reserve has announced plans to meaningfully reduce its portfolio of nearly \$9 trillion of Treasury securities, meaning that there will be an even greater supply of securities that market participants will need to absorb.<sup>28</sup>

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<sup>25</sup> While customer identities may not be disclosed on certain transaction reports made by registered broker-dealers, the post-trade transparency information published to the market *never* includes counterparty identities, meaning that equivalent information is published for transactions entered into by private funds and broker-dealers. *Cf.* Proposal at 23083 (“markets have more post-trade transparency with regards to registered dealers than with regards to private funds.”).

<sup>26</sup> Proposal at 23088.

<sup>27</sup> US Treasury Securities Statistics, SIFMA, available at: <https://www.sifma.org/resources/research/us-treasury-securities-statistics/>; Budget and Economic Data, at Table 1-1, CBO, available at <https://www.cbo.gov/data/budget-economic-data>.

<sup>28</sup> See Katherine Greifeld, The Weekly Fix: Financial Conditions are Easing. Maybe that’s Ok, Bloomberg (June 3, 2022), available at <https://www.bloomberg.com/news/newsletters/2022-06-03/the-weekly-fix-financial-conditions->

This Proposal would directly imperil the functioning of the U.S. Treasury market by compelling some of the largest customers by holdings to reduce their investment, trading, and hedging activities. This would make the market more fragile, prone to volatility, and even further dependent on purchases by foreign official institutions. In particular, in light of the frictions and costs associated with subjecting customers to a regulatory framework designed specifically for dealers, the most likely course of action for these customers would be to reduce trading activity below any proposed quantitative threshold, or to materially withdraw from the market. This would include customers captured by the proposed quantitative threshold for trading activities as basic as holding cash reserves in short-term Treasury securities. It is exceedingly difficult to square this regulatory proposal with the official sector’s focus on ensuring resilient liquidity in the U.S. Treasury market<sup>29</sup> and reducing the cost to U.S. taxpayers of our national debt.

Compelling some of the largest investing customers in the U.S. Treasury market to reduce their investment, trading, and hedging activity would negatively impact price discovery, market efficiency, and overall liquidity. These negative impacts on market quality and liquidity would extend beyond the secondary cash Treasury market to the Treasury futures market, the interest rate swaps market, and the Treasury repo market, and ultimately spill over into the market for mortgage-backed securities and corporate debt. In addition, constraining secondary-market cash trading could also impact the participation of customers in Treasury auctions, which is significant given that in 2021, investment funds accounted for 47.8% of auction allotments for marketable Treasury coupon securities.<sup>30</sup> Instead of conducting a serious analysis of these considerations, the Commission simply concluded that the Proposal’s effect on efficiency, competition, and capital formation was “uncertain.”<sup>31</sup> That non-determination alone is sufficient reason to return to the drawing board and conduct a proper analysis.

***B. The Proposed Quantitative Threshold Is Inconsistent With The Exchange Act, Commission Interpretations, and Federal Case Law.***

The Commission has proposed a transformative legal rule by offering a new interpretation of a long-extant statute. Under the Proposal, any entity that trades more than a certain dollar-threshold of U.S. Treasuries is a securities “dealer” required to register with the Commission. The Commission’s attempt to graft a quantitative, volume-based test onto the statutory definition of “dealer” is unlawful.

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[are-easing-maybe-that-s-ok](#); Plans for Reducing the Size of the Federal Reserve’s Balance Sheet, Board of Governors of the Federal Reserve System (May 4, 2022), available at:

<https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504b.htm>

<sup>29</sup> “Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report,” Inter-Agency Working Group for Treasury Market Surveillance (Nov. 8, 2021) at page 22, available at:

<https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf>.

<sup>30</sup> Based on data available at: <https://home.treasury.gov/data/investor-class-auction-allotments>.

<sup>31</sup> Proposal at 23091 (“The net effect on market efficiency is uncertain.”), *id.* (“The net effect that the Proposed Rules may have on competition is uncertain.”), *id.* at 23092 (“The likely effect on aggregate market participation is uncertain.”).



The Commission starts with an inaccurate premise. The Commission asserts, without citation, that the “statutory definition of ‘dealer’ ... [was] drawn broadly by Congress in 1934 to encompass a wide range of activities involving the securities markets and their participants.”<sup>32</sup> That is incorrect. The “words of a statute must be read in their context and with a view to their place in the overall statutory scheme.”<sup>33</sup> Here, Congress defined two pre-existing, interrelated business functions—broker and dealer—in parallel language, in back-to-back sentences that have remained materially unchanged for ninety years. A broker is any person engaged in the business of effecting securities transactions “for the account of others,” while a dealer is any person engaged in the business of “buying and selling securities” for “his own account.”<sup>34</sup> Read in the proper context, these related definitions refer to “generally similar” things<sup>35</sup> and reach a far narrower set of activities than the Commission asserts.

At the time Congress passed the Exchange Act, the related concepts of trading for the “account of others,” as a broker, or for one’s “own account,” as a dealer, had longstanding, well-understood meanings.<sup>36</sup> Then, as now, a broker would execute a customer’s securities transactions “for the customer,” as an agent, whereas a dealer would buy or sell securities “from his customer[]” or “to his customer,” as a principal.<sup>37</sup> In ordinary parlance, the distinction between brokers and dealers was expressed in terms of whose “account” facilitated the customer’s trade. A broker would be said to trade “for the account of the customer,” while a dealer would be said to effectuate the customer’s order by taking the opposite side in his (i.e., the dealer’s) “own account.”<sup>38</sup> The “own account” versus “others account” language was thus commonly used to distinguish the two methods of effectuating a customer’s securities order.<sup>39</sup> When Congress employed this language in the Exchange Act, it is presumed to have adopted the commonly understood meaning. That meaning was entirely unrelated to the volume of transactions.

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<sup>32</sup> Proposal at 23057.

<sup>33</sup> *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 320 (2014).

<sup>34</sup> Securities Exchange Act, ch. 404, § 3(a)(4), (5), 48 Stat. 881, 883 (codified at 15 U.S.C. § 78c(a)(4)(A), (a)(5)(A)).

<sup>35</sup> *Bullock v. BankChampaign, N.A.*, 569 U.S. 267, 274 (2013).

<sup>36</sup> *See Wisc. Central Ltd. v. United States*, 138 S. Ct. 2067, 2070 (2018) (“[O]ur job is to interpret the words consistent with their ‘ordinary meaning ... at the time Congress enacted the statute.’”).

<sup>37</sup> C.H. Meyer, *Law of Stock Brokers and Stock Exchanges* § 43-a, at 32, 34 (Supp. 1933).

<sup>38</sup> SEC, *Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker*, at XIV (1936).

<sup>39</sup> *See, e.g.*, Exchange Act Release No. 211, 1935 SEC LEXIS 179, at \*5 (May 6, 1935) (explaining that a “broker or dealer must disclose to his customer .. whether he is acting as a dealer for his own account, . . . or as a broker”); SEC Report, *supra* note \_\_, at XIV (“The characteristic activities of a dealer ... [are that he] sells securities to his customer ... or buys securities from his customer.... In any such transaction he acts for his own account....”); Meyer, *supra* note \_\_, at 33 ([T]he broker does not himself sell to or buy from the customer, but acts as the customer’s representative in making a purchase from or a sale to a third party. However, there is nothing in the law which prevents a person from engaging in the business of buying and selling securities for his own account as principal. Such a person is a security dealer as distinguished from a broker. His rights and duties have been before the courts for adjudication repeatedly. He sells to his customers ... securities which he has purchased for his own account elsewhere, or buys from his customers securities for his own account with a view of disposing of them elsewhere....”).

Other statutory arguments further undercut the Commission’s proposed quantitative test. In the Exchange Act, Congress excluded from the “dealer” definition any firm that buys or sells securities “but not as part of a regular business.”<sup>40</sup> The Commission asserts that the phrase “regular business” is undefined,<sup>41</sup> but that does not mean that the text lacks independent meaning; once again, the Commission fails to evaluate the statutory language in its historical and statutory context in order to ascertain that meaning. At the time Congress enacted the Exchange Act, the word “dealer” already appeared in federal law.<sup>42</sup> And federal regulations already excluded from that term’s reach any person that bought or sold securities “not in the course of an established business.”<sup>43</sup> It is a fundamental canon of statutory construction that when Congress borrows language from a pre-existing body of law, Congress is presumed to have adopted “the cluster of ideas” that were attached to the borrowed phrase.<sup>44</sup> Here, there is no question that the pre-existing cluster of ideas turned on a firm’s function—not the volume of transactions.<sup>45</sup> It is hard to see why Congress would have incorporated in the Exchange Act language from a body of law that eschewed a volume-based test if it wanted to empower the Commission to adopt a volume-based test.

The Commission’s proposed volume-based test is particularly untenable in light of the conjunctive “and”—“buying *and* selling securities.” As the Commission has long recognized, this language plainly requires a dealer to both buy and sell securities, and connotes a degree of offsetting activity,<sup>46</sup> which necessarily requires a certain parity and temporal proximity between the buys and sells.<sup>47</sup> Trading on one side of the market is not enough to make one a dealer.<sup>48</sup> Yet, here, the Commission’s proposed quantitative rule would sweep in any firm with a “trading volume” above a certain threshold, even if that volume occurs almost entirely on the buy or sell side.<sup>49</sup> Thus, if a firm bought \$25 billion of Treasuries in four out of the past six months, it would be required to register as a dealer even if it only entered into a single transaction to sell securities during the same month. This volume-based approach cannot be squared with the statutory text (or the Commission’s prior understanding of that text).

Nor can the Commission’s approach be squared with the broader statutory structure. The existing regulatory scheme for dealers is entirely premised on the nature of the activities performed

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<sup>40</sup> 15 U.S.C. § 78c(a)(5)(B).

<sup>41</sup> Proposal at 23058.

<sup>42</sup> Revenue Act of 1928, ch. 852, § 118, 45 Stat. 791, 826.

<sup>43</sup> *Donander Co. v. Comm’r*, 29 B.T.A. 312, 313 (1933).

<sup>44</sup> *Air Wisc. Airlines Corp. v. Hoeper*, 571 U.S. 237, 248 (2014).

<sup>45</sup> See, e.g., *Sec. Allied Corp. v. Comm’r*, B.T.A.M. (P-H) ¶ 34,47 (1934) (holding that an “investment trust” was not a dealer, even though its activities consisted entirely of “buying and selling securities”).

<sup>46</sup> See, e.g., *Further Definition of “Swap Dealer,”* 77 Fed. Reg. 30596, 30607 n.174 (May 23, 2012).

<sup>47</sup> See, e.g., *Lake Building Prods., Inc. v. Sec’y of Labor*, 958 F.3d 501, 505 (6th Cir. 2020) (nothing that the conjunctive “and” requires a “certain temporal proximity”).

<sup>48</sup> See, e.g., *OTC Derivatives Dealers*, 63 Fed. Reg. 59362, 59370 n.61 (noting that a dealer quotes “a market in or publish[es] quotes for securities (other than quotes on one side of the market[])”).

<sup>49</sup> Proposal at 23092.

by dealers—not on the volume of their activity. A dealer, for example, must register with the Securities Investor Protection Corporation to insure the securities and cash that the dealer holds on behalf of its customers.<sup>50</sup> This, and other aspects of the regulatory scheme specifically designed to ensure a dealer protects its customers, have no connection with the volume of trading activity.<sup>51</sup>

Other aspects of the Proposal undermine the Commission’s proposed volume-based test. The Commission first develops an intricate, multi-factor analysis for determining what a “dealer” is via qualitative criteria. For example, under this analysis, a dealer makes “roughly comparable purchases and sales of the same or substantially similar securities in a day.”<sup>52</sup> But the Commission then asserts that, regardless of this test, a firm is a dealer *anyway* if it simply trades a lot. It makes no sense to say that a dealer is both any firm that performs one of a few extremely specific functions based on qualitative criteria *and* any firm that happens to buy or sell a great deal of Treasuries, no matter the nature of the activity.

The novelty of the Commission’s volume-based approach is further evidence against it. For decades, the Commission has correctly recognized that a firm that trades “solely” for its own investment purposes is not a dealer, even if it trades with “frequency.”<sup>53</sup> Instead, in assessing dealer status, the Commission has consistently looked to the nature of a firm’s activity. As the Commission has repeatedly stated, a dealer furnishes “the services which are usually provided by dealers, such as quoting the market in one or more securities, rendering incidental investment advice, or extending or arranging for the extension of credit in connection with securities transactions.”<sup>54</sup> In fact, the Proposal acknowledges that “[i]n addition to frequency of activity, *the nature of the trading activity is a factor in determining whether a person is a dealer.*”<sup>55</sup> The Commission even admits that a “rule that relies solely on quantitative factors” is not a “reliable” way to distinguish dealers.<sup>56</sup> But the Commission then proposes such a rule anyway by laying out a “bright-line test under which persons engaging in certain levels of activity in the U.S. Treasury market would be defined” as dealers, “regardless of whether they meet any of the qualitative standards.”<sup>57</sup> When the Commission “claims to discover in a long-extant statute” a new meaning

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<sup>50</sup> See 15 U.S.C. § 78aaa *et seq.*

<sup>51</sup> A registered dealer must take a variety of other steps to protect its customers. For instance, a dealer must provide certain “notice[s] to its customers,” 15 U.S.C. § 78o(e), meet “financial responsibility” standards for the “custody and use of customers’ securities,” *id.* § 78o(c)(3)(A), and associate with a self-regulatory organization (i.e., FINRA), *id.* § 78o(b)(1), which requires training on handling customer accounts and orders, see *Series 7 – General Securities Representative Exam*, FINRA, <https://www.finra.org/registration-exams-ce/qualification-exams/series7> (last visited May 21, 2022). These requirements do not make any sense for private fund advisers like Citadel.

<sup>52</sup> Proposal at 23105.

<sup>53</sup> *Adoption of Rule 15Ba2-1*, 1975 WL 163406, at \*3 (Oct. 15, 1975); see also *Guide to Broker-Dealer Registration*, <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html> (“Individuals who buy and sell securities for themselves generally are considered traders and not dealers.”).

<sup>54</sup> Burton Sec., 1977 WL 10680, at \*1 (SEC No-Action Letter Dec. 5, 1977).

<sup>55</sup> Proposal at 23058 (emphasis added).

<sup>56</sup> *Id.* at 23094.

<sup>57</sup> Proposal at 23071.

that brings about a “transformative expansion” in the Commission’s authority, courts “greet its announcement with a measure of skepticism.”<sup>58</sup>

That skepticism is especially warranted here, where no knowledgeable observer, including every previous Commission, ever saw the meaning that the Commission now identifies in the Exchange Act. In 1940, for example, Congress adopted the Investment Company Act because, as was widely understood at the time, “the great majority of investment companies have never come within the purview of” the Exchange Act.<sup>59</sup> That is, no one at the time read the Exchange Act to mean that investment companies could be dealers if they simply traded enough volume. That today’s Commission must explicitly exempt from its proposed quantitative threshold a class of firms (registered investment companies)<sup>60</sup> that no one at the time of the Act’s adoption thought could have been dealers under the Exchange Act is clear proof that the Commission’s volume-based test sweeps too broadly.<sup>61</sup>

A separate proposal put forward by the Commission in 2004 relating to hedge funds is further reason to be skeptical of the current proposal. In 2004, as now, the Commission was concerned about the growing “trading volume” of hedge funds,<sup>62</sup> and thus sought to bring about “more comprehensive regulation of hedge funds” by forcing them to register with the Commission (as investment advisers).<sup>63</sup> But, tellingly, the Commission did not attempt to regulate hedge funds as dealers. Instead, the Commission attempted to ground its regulatory authority in a strained reinterpretation of the word “client” that the D.C. Circuit ultimately vacated. And while Commissioners at the time discussed alternative ways of regulating hedge funds, including a proposal by the Chairman of the Federal Reserve to regulate hedge funds “through oversight of those broker-dealers ... that clear, settle, and finance trades for hedge funds,”<sup>64</sup> no one at the time hinted (or imagined) that hedge funds may themselves have been broker-dealers. Today’s Commission does not explain how it sees in the Exchange Act what everyone else has supposedly missed for decades. “When an agency claims to discover in a long-extant statute an unheralded power to regulate ‘a significant portion of the American economy,’” the courts “typically greets its announcement with a measure of skepticism.”<sup>65</sup>

The Commission’s proposed volume-based rule is thus a significant departure from the historical understanding of what a “dealer” is and a long line of the Commission’s own interpretations. The Commission fails to establish that the market participants captured by the

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<sup>58</sup> *Util. Air Regulatory Grp.*, 573 U.S. at 324.

<sup>59</sup> H.R. Rep. No. 76-2639, at 10 (1940).

<sup>60</sup> Proposal at 23106.

<sup>61</sup> See *Util. Air Regulatory Grp.*, 573 U.S. at 328 (finding that the need to “tailor” a new rule “should have alerted [the agency] it had taken a wrong interpretive turn”); *Chamber of Commerce v. Dep’t of Labor*, 885 F.3d 360, 382-83 (5th Cir. 2018) (recognizing that when exemptions are needed to narrow a rule’s overbreadth, the rule itself may be invalid).

<sup>62</sup> *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, 69 Fed. Reg. 72054, 72056 (Dec. 10, 2004).

<sup>63</sup> *SEC v. Goldstein*, 451 F.3d 873, 882 (D.C. Cir. 2006).

<sup>64</sup> *Id.* at 72091 n.17,

<sup>65</sup> *Util. Air Regulatory Grp.*, 573 U.S. at 324.

proposed quantitative threshold satisfy any of the criteria that the Commission has ever associated with the dealer definition.<sup>66</sup> Moreover, the Commission does not explain how it is consistent with the Exchange Act to apply a quantitative threshold in only the U.S. Treasury market. Congress has provided one dealer definition. So, if trading a large volume of securities were sufficient to make an entity a dealer in the Treasury market, it would be sufficient to make that entity a dealer in any other securities market. Yet the Commission appears to have concluded that adopting a volume-based threshold is unwarranted in other securities market. This should have “alerted” the Commission that it “had taken a wrong interpretive turn” in proposing a volume-based threshold at all.<sup>67</sup>

We urge the Commission to maintain consistency with text, structure and history of the Exchange Act, as well as its accompanying agency interpretative history, by removing the proposed quantitative threshold for the U.S. Treasury market.

### ***C. The Proposed Quantitative Threshold Is Calibrated In An Arbitrary Manner.***

The Commission acknowledges that “at present we do not have a reliable quantitative framework for defining liquidity provision.”<sup>68</sup> This is exemplified as the Commission attempts to analyze TRACE data in the U.S. Treasury market, with incorrect assumptions and methodological flaws impairing its ability to accurately set a quantitative threshold or estimate the number of firms that would be captured by such a threshold.

In the Proposal, the Commission analyzes TRACE data from July 2021 and focuses on transactions entered into by non-FINRA member firms (i.e. firms not currently registered as dealers). Counterparty identities are included in only 42% of the total trading volume executed by non-FINRA members. These transactions are executed on registered alternative trading systems (“ATSS”), where counterparty identities are required to be disclosed by regulation. Since the remaining 58% of non-FINRA member trading volume is anonymous, the Commission discards this data from its analysis, and focuses on quantifying the total trading volume of individual firms that can be identified in the data.<sup>69</sup>

However, for purposes of setting the quantitative threshold and estimating the number of firms captured by such threshold, the Commission assumes that “all non-FINRA member market participants are equally represented in both the anonymous and identified subsets of TRACE,” which would mean that the 42% of data provides the Commission with a view into the trading activity of all non-FINRA member firms. This assumption is grossly inaccurate.

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<sup>66</sup> See Proposal at 23056.

<sup>67</sup> *Util. Air Regulatory Grp.*, 573 U.S. at 328.

<sup>68</sup> Proposal at 23094.

<sup>69</sup> See Proposal at 23081.

As the Commission is aware, there are currently 17 registered ATs active in the U.S. Treasury market.<sup>70</sup> These registered ATs generally cater to the *dealer-to-dealer* segment of the U.S. Treasury market, where PTFs are active participants. However, customers generally transact in the *dealer-to-customer* segment of the U.S. Treasury market either bilaterally or on trading venues that are not registered as ATs.<sup>71</sup> This means that the data analyzed by the Commission provides little to no view into the Treasury trading activity of customers. As a result, the Commission is unable to appropriately calibrate a quantitative threshold or accurately estimate the number of customers that would be captured.<sup>72</sup>

More generally, the Commission does not establish that a single snapshot of data from July 2021 provides a representative sample of trading activity in the U.S. Treasury market for purposes of setting a quantitative threshold. Data shows that July 2021 was one of the lowest volume months over the last 28 months,<sup>73</sup> and quantitative tightening by the Federal Reserve means that, moving forward, there will be an even greater supply of securities that market participants will need to absorb. The Commission also neglects to consider whether the proposed quantitative threshold is reasonable compared to the average *daily* trading volume of approximately \$675 billion (in 2022) and the total amount outstanding of more than \$23 trillion (which is expected to reach \$40 trillion by 2032). All of these considerations suggest that the Commission failed to conduct a thorough and accurate analysis of available data.

### **III. The Commission Should Modify The Qualitative Criteria To Ensure Private Funds Are Not Required To Register As Dealers.**

As detailed above, there are significant negative consequences associated with requiring private funds to register as dealers. In order to avoid inadvertently capturing private funds participating in financial markets as customers, we recommend that the Commission also make certain targeted changes to the proposed qualitative criteria.

First, the proposed criteria relating to “routinely expressing trading interests that are at or near the best available prices on both sides of the market and that are communicated and represented in a way that makes them accessible to other market participants” should be further clarified. As proposed, this criteria does not appear limited to a given instrument, meaning that a customer would appear to be prohibited from expressing trading interest on one side of the market in one instrument and on the other side of the market in a related instrument. In addition, it is unclear over what period of time this criteria would be evaluated, which could prohibit a customer from

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<sup>70</sup> 87 Fed. Reg. 15496 (Mar. 18, 2022) at 15585, available at: <https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-01975.pdf>. See also <https://www.sec.gov/foia/docs/atlist.htm>.

<sup>71</sup> See, e.g., “Principal Trading Firm Activity in Treasury Cash Markets,” FEDS Notes (Aug. 4, 2020), available at: <https://www.federalreserve.gov/econres/notes/feds-notes/principal-trading-firm-activity-in-treasury-cash-markets-20200804.htm> (finding the buy-side only accounts for 4% of trading volume on dealer-to-dealer platforms).

<sup>72</sup> We also note that, when analyzing the 42% of non-FINRA member trading volume, the Commission considered “each counterparty to be responsible for half of the volume.” However, since a given counterparty would have to count 100% of the transaction volume towards any quantitative threshold, this approach may also underestimate the number of impacted firms. Proposal at 23081, FN 222.

<sup>73</sup> US Treasury Securities Statistics, SIFMA, available at <https://www.sifma.org/resources/research/us-treasury-securities-statistics/>.



routinely using a central limit order book (“CLOB”) trading protocol in any securities market regulated by the Commission. A CLOB enables customers to both post resting orders and trade against available liquidity, in contrast to other trading protocols, such as request-for-quote, which confine customers to a price-taking role. Therefore, market participants using a CLOB routinely express trading interests on both sides of the market in various instruments over the course of a trading day.<sup>74</sup> In other contexts, the Commission has recognized the value that central limit order books can provide to overall market liquidity and competition, and has encouraged adoption by customers.<sup>75</sup> In light of the above, the Commission should remove this specific qualitative criteria, or, at a minimum, exclusively focus on continuous two-sided price streaming activities in a given instrument by firms designated as a liquidity provider by a trading venue.

Second, the Commission should not aggregate trading activities across independent entities, portfolio managers, or trading strategies when assessing whether the proposed qualitative criteria are met, particularly if there are information barriers in place. The Proposal’s approach of applying the qualitative criteria at an entity level, and across entities “under common control,” constitutes a significant overreach that risks inadvertently capturing customer firms as dealers and should be removed. Therefore, the Commission should amend the Proposal’s definition of “own account” to apply the qualitative criteria to independent trading strategies instead of aggregating across one or more legal entities under common control.

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To conclude, requiring *customers* to register as *dealers* is unsupported by law, unworkable in practice, and would force significant pools of investment capital to curtail their investment, trading, and hedging activities in ways that would have profound negative effects for U.S. Treasury market liquidity, resiliency, and efficiency.

As detailed above, imposing this proposal is especially dangerous now, as the U.S. Treasury market continues to dramatically increase in size and the Federal Reserve begins to meaningfully reduce its portfolio of Treasury securities, meaning that there will be an even greater supply of securities that market participants will need to absorb. This Proposal would directly imperil the functioning of the U.S. Treasury market by compelling some of the largest customers by holdings to reduce their investment, trading, and hedging activities. The cumulative effects cannot be overstated – increasing the funding costs of the U.S. government to the detriment of U.S. taxpayers, harming U.S. capital markets and the U.S. economy, and needlessly damaging the central role that Treasuries play as investment and hedging instruments in the U.S. and global economies.

This Proposal unnecessarily jeopardizes the efficiency and resiliency of the U.S. Treasury market. The U.S. has the deepest, most liquid capital markets in the world, fostering groundbreaking companies, technology, and innovation that have been vital ingredients to our economic strength. The U.S. Treasury market is the linchpin of not just our capital markets, but

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<sup>74</sup> As a further example, in the U.S. Treasury market, in the context of a establishing a “curve” or “butterfly” position, market participants may have resting bids and offers in an order book at the same time for U.S. Treasury securities with varying maturities.

<sup>75</sup> See 87 Fed. Reg. 28872 (May 11, 2022) at 28879, available at: <https://www.govinfo.gov/content/pkg/FR-2022-05-11/pdf/2022-07850.pdf> (requiring all SBSEFs to offer an order book).

the entire U.S. economy, as it enables the government to fund itself, and provide critical services to American citizens. The Treasury market serves as the most credible and relied-upon benchmark in the world, contributing to price discovery and the efficient allocation of capital across virtually every other asset class. For example, Treasury yields are strongly correlated with mortgage rates, and this Proposal risks further increasing interest rates, fueling yet more inflation at a time when American families already face soaring housing costs.

We urge the Commission to maintain consistency with the Exchange Act, as well as its accompanying interpretative history, by removing the proposed quantitative threshold and by ensuring the proposed qualitative criteria are modified to avoid designating customers as dealers.

We appreciate the opportunity to comment on this Proposal. Please feel free to contact the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy