May 27, 2022

By Email

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 205499–1090
rule-comments@sec.gov

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:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the release by the U.S. Securities and Exchange Commission (the "SEC" or "Commission") proposing new rules ("Proposing Release") to further define the phrase "as a part of a regular business" as used in the statutory definitions of "dealer" and "government securities dealer" under Sections 3(a)(5) and 3(a)(44), respectively, of the Securities Exchange Act of 1934 ("Exchange Act").[2]

This letter supplements our overall comments on the Proposing Release, which we have submitted under separate cover. In this letter, we focus on certain issues of particular relevance to our members that are bank holding companies or foreign banking organizations. Specifically, this letter addresses: (a) significant issues raised by Commission's proposal to require aggregation of securities trading activity across commonly controlled affiliates for purposes of determining "dealer" and "government securities dealer" status, which the Commission either should replace with a more

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] See Exchange Act Release No. 94524 (March 28, 2022), 87 FR 23054 (April 18, 2022).

targeted anti-evasion prohibition or otherwise limit in scope; and (b) necessary clarifications with respect to: (i) asset-liability, liquidity, and collateral management activities; (ii) activities ancillary to exempt dealer activities; and (iii) inter-affiliate transactions.

We do not think that any of the issues identified in this letter are consequences that the Commission intends, especially considering the Proposing Release focuses primarily on certain principal trading firms and other market constituencies other than bank holding companies or their subsidiaries. Accordingly, we hope that the Commission can address these issues before adopting any final rules.

Overview of the Proposed Rules

The Proposing Release sets forth proposed Rule 3a5-4, which would establish three qualitative, activity-based standards for when a person that is engaged in buying and selling securities for its own account is engaged in such activity "as a part of a regular business" such that the person must register as a dealer with the Commission. Similarly, proposed Rule 3a44-2 (together with proposed Rule 3a5-4, the "Proposed Rules") would establish the same three qualitative, activity-based standards, as well as a separate quantitative standard, for when a person that is engaged in buying and selling government securities for its own account is engaged in such activity "as a part of a regular business" such that the person must register as a government securities dealer with the Commission.

The Proposed Rules would define a person's "own account" for these purposes to include, in addition to an account held in the name (or for the benefit of) of the person, an account held in the name of (or for the benefit of) a person over whom the person exercises control or with whom that person is under common control (the "Aggregation Rule"). The Aggregation Rule would be subject to limited exceptions for an account in the name of: (a) a registered broker, dealer, government securities dealer, or investment company; (b) certain clients of a registered investment adviser; and (c) another person under common control with the person solely because both persons are clients of the same registered investment adviser, unless those accounts constitute a parallel account structure.

Discussion

I. Comments on the Aggregation Rule

Subject to the limited exceptions summarized above, the Aggregation Rule would require a person to aggregate its activities with those of all of its commonly controlled affiliates in order to determine which of those entities must register as a dealer or government securities dealer. The Proposing Release states that the Commission proposed this requirement to avoid incentivizing market participants to change their corporate structures for purposes of avoiding registration.[3]

A. The Commission Should Replace the Aggregation Rule with an Anti-Evasion Prohibition

The Aggregation Rule would apply far more broadly than is necessary to achieve its anti-evasion objective. In particular, it would require aggregation of trading activity across entities regardless of whether there is coordination of such trading activity by those entities or a common control person. As a result, it would lead to the unsupportable and presumably unintended result that every unregistered subsidiary of a common parent company would need to register as a dealer if, in the aggregate, those subsidiaries trigger a qualitative or quantitative standard, even if none of the individual subsidiaries is itself engaged in any dealing activity. For example, one of the Proposed Rule's qualitative standards would apply when a person routinely engages in roughly comparable purchases and sales of the same or substantially similar securities in a day. Because of the Aggregation Rule, this standard would appear to require registration if two commonly controlled entities, each acting independently, purchased a security (*e.g.*, as an investment asset) and sold that security (*e.g.*, as a short sale to establish a hedge). But this trading activity would exhibit none of the hallmarks of dealing activity and, if it has the effect of providing liquidity to other market participants (which it may not), that would only be coincidental.

The Aggregation Rule also would impose very substantial burdens on companies, such as bank holding companies and foreign banking organizations, engaged in securities trading across a wide range of different legal entities, lines of business, and geographic locations. Importantly, unlike other rule contexts in which aggregation is required, such as the large trader reporting example cited in the Proposing Release, here a company would: (a) need to consider entities over which it has corporate control without regard to whether it exercises investment discretion over those entities' securities trading; (b) need to address all types of corporate equity or debt securities, U.S. government securities, and foreign government securities, not just listed equities;[4] and (c) need to evaluate qualitative standards in addition to a quantitative one.

Not only would companies incur very substantial costs to implement policies, procedures, systems, and controls to address the above considerations, but counterintuitively they would need to coordinate trading across otherwise independent entities to as to avoid inadvertently triggering registration. For example, companies would need to prevent independent entities and business units from both buying and selling the same or substantially securities in the same day.

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[3] Proposing Release, 87 FR at 23074.

[4] In a separate letter on the Proposed Rules, we have expressed concerns regarding the scope of securities covered by the Proposed Rules. We do not reiterate those here.

In addition, the Aggregation Rule would undermine statutory and regulatory limits on the scope of dealer and government securities dealer registration. For example, consider a bank holding company whose U.S. bank is permissibly engaged in securities trading activities excepted or exempted by the Gramm-Leach-Bliley Act or related rules from the Exchange Act's "dealer" definition (such as dealing in identified banking products or engaging in conduit securities lending). The Aggregation Rule would appear to require the bank holding company, by virtue of its control over the bank, to register as a broker-dealer, unless the bank so registered. This result would impermissibly conflict with the Gramm-Leach-Bliley Act because it would result in activity that Act excludes from the "dealer" definition nonetheless triggering dealer registration, either for the bank or its holding company. Or as another example, consider a bank holding company that owns a foreign broker-dealer subsidiary engaged in trading activity wholly outside the United States and/or in compliance with the exemption in Exchange Act Rule 15a-6. Here again, the Proposed Rule would appear to require the bank holding company, by virtue of its control over the foreign broker-dealer, to register as a broker-dealer, unless the foreign subsidiary so registered. This result would impermissibly conflict with the limit on the Commission's territorial jurisdiction set forth in Section 30 of the Exchange Act and/or effectively repeal the availability of Rule 15a-6 in such circumstance. We do not believe any of these results was or should have been intended by the Commission, given the Proposing Release's statement that otherwise available and applicable statutory or regulatory exemptions or exceptions would continue to apply.[5]

Beyond these presumably unintended legal conflicts, the Aggregation Rule suffers from other serious legal deficiencies. There is no indication in the Exchange Act that the dealer or government securities dealer definitions or registration requirements may apply other than on a person-by-person basis; in contrast, where the Exchange Act applies on the basis of a "control" test, it does so explicitly, such as in connection with its various "associated person" definitions[6] or in the context of applying margin requirements to foreign persons controlled by United States persons.[7] In addition, the Commission's economic analysis explicitly fails to account for the Aggregation Rule when assessing the number of entities the Proposed Rules would subject to registration,[8] and its brief, one-paragraph assessment of the costs to a firm of evaluating whether it satisfies any of the Proposed Rules' standards makes no mention of the Aggregation Rule.[9] Thus, the

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[5] Proposing Release, 87 FR at 23056.

[6] See, e.g., Section 3(a)(18) of the Exchange Act (definition of "person associated with a broker or dealer").

[7] See Section 7(f) of the Exchange Act.

[8] Proposing Release, 87 FR at 23080, n. 219 ("The analysis does not aggregate affiliated firms, but counts them separately, even though they may be controlled by a common corporate parent").

[9] See id. at 23090.

Proposing Release fails to satisfy the Commission's obligation to assess the costs and benefits of the Aggregation Rule.

We also submit that the risks of evasion are already addressed, in the context of bank holding companies and foreign banking organizations, by application of the federal banking laws. The Bank Holding Company Act and Federal Reserve regulations thereunder already prescribe, through various ownership and activity limitations, the extent to which, and the circumstances under which, subsidiaries of a bank holding company or foreign banking organization can engage in securities dealing or other securities trading activities. In addition, all purchases or sales conducted for the trading account of a bank holding company, foreign banking organization, or its subsidiary must satisfy the trading prohibitions and exemptions set forth by the Volcker Rule. The Federal Reserve further exercises consolidated supervision over bank holding companies and foreign banking organizations.

In light of these problems, instead of the Aggregation Rule, the Commission should adopt a targeted anti-evasion standard prohibiting a person from willfully evading dealer or government securities dealer status (under the existing definition and guidance) through coordinated trading activity across commonly controlled entities over which the person exercises investment discretion.

B. If the Commission Retains the Aggregation Rule, It Should Exclude Subsidiaries of Bank Holding Companies or Foreign Banking Organizations

As noted above, the Aggregation Rule has an anti-evasion objective. Given that the various measures described above comprehensively constrain the ability for a bank holding company or foreign banking organization to structure or restructure its subsidiaries so as to evade registration, if the Commission adopts the Aggregation Rule in any form, such rule should not require a bank holding company or foreign banking organization to aggregate the activities of its subsidiaries or those subsidiaries to aggregate their activities with each other.

C. If the Commission Retains the Aggregation Rule, It Should Expand the Exclusions from the Rule

If the Commission retains the Aggregation Rule, then it should expand the rule's exclusions in order to address the various problems described in Part I.A above. In particular, the Commission should:

- Not require aggregation by a person with an entity it controls if it does not exercise day-to-day investment discretion over that entity;
- Not require aggregation by a person with another person under common control with that person unless the same person exercises day-to-day investment discretion over both persons;

- Exclude from the Aggregation Rule any foreign broker or dealer or foreign government securities broker or dealer engaged in the purchase or sale of securities outside of the jurisdiction of the United States or in reliance on Exchange Act Rule 15a-6 or its government securities dealer analogue, 17 C.F.R. 401.7; and
- Exclude from the Aggregation Rule any bank acting pursuant to an exception or exemption from the definition of "dealer" in Exchange Act Section 3(a)(5)(C) or the rules thereunder.

II. The Commission Should Clarify the Treatment of Asset-Liability, Liquidity and Collateral Management Activities

Banking organizations regularly purchase and sell securities as part of their asset-liability and liquidity management activities. For example, in order to manage its interest rate or foreign exchange risk, a banking organization might purchase securities whose coupons help offset interest rates that the organization must pay on deposits or other liabilities; due to frequent turnover of its liabilities, the organization may need to actively purchase and sell securities to achieve its objectives in this area. Banking organizations also are required, under various liquidity-related regulations (such as liquidity coverage ratio rules), to maintain buffers of highly liquid assets, usually securities, to address potential liquidity outflows; they also regularly purchase securities as longer term investments, as part of the organization's target allocation of capital, and booked as available-for-sale or held-to-maturity assets. Further, banking organizations often post and receive securities or cash as collateral for other transactions, such as derivatives and securities financing transactions, and they in turn must purchase securities (either to post as collateral or as investments of cash collateral) or sell them (to generate cash from collateral received or as part of default management).

Certain aspects of the Proposed Rules, particularly the qualitative standard for roughly comparable purchases and sales of securities in a day and the quantitative standard for more than $25 billion in government securities trading in four out of the last six calendar months, could inadvertently capture this activity. For example, a banking organization that purchases and sells the same securities in a day (*e.g.,* to roll a Treasury position from off-the-run Treasuries to on-the-run Treasuries) as part of the investment of its cash could trigger that qualitative standard. And particularly for larger banking organizations, their ordinary purchases for asset-liability, liquidity, and collateral management activities within a month could inadvertently trigger the quantitative standard, even without sales (or *de minimis* sales) on the other side.

Treating these activities as "dealer" activities would not only lead to an inappropriate expansion of dealer registration requirements, it would also create problems under the Volcker Rule. The definition of "trading account" under the Volcker Rule includes all purchases and sales of financial instruments by a banking entity either (a) licensed or registered, or required to be licensed or registered, to engage in the business of a dealer, in connection with activities for which such license or registration is required or (b) engaged in the business of a dealer outside the United States.[10] Due to the substantial breadth of the Proposed Rules, any bank holding company, foreign banking organization, or subsidiary thereof (*i.e.*, banking entities under the Volcker Rule) that falls within the expanded "dealer" definition due to the Proposed Rules will have the relevant activity captured by the definition of "trading account," including long-term investment activity and asset-liability management activity that has been traditionally excluded from the definition of trading account due to its longer-term, non-trading nature. The Volcker Rule generally does not contain any exclusion for long-term investment activity when the activity is within the "trading account," therefore potentially prohibiting these previously excluded activities. In our view, changes to the nature and scope of the Volcker Rule's requirements should not be made solely by the Commission, without the simultaneous rulemakings by the other four Volcker Rule agencies.

To address these issues, the Commission should exclude asset-liability, liquidity, or collateral management activities, when conducted by a bank holding company, foreign banking organization, or its subsidiary, from the scope of the Proposed Rules, subject to requirements under the pre-existing definitions of "dealer" and "government securities dealer" under current rules. This exclusion would be consistent with exclusions the Commission has recognized for similar activities in other contexts, such as the liquidity management exclusion from the Volcker Rule[11] or positions held in the banking book for market risk capital purposes and thus, under existing law, considered non-trading assets under the Volcker Rule.

III. The Commission Should Clarify the Treatment of Activities Ancillary to Exempt Dealer Activities

Under the Gramm-Leach-Bliley Act and rules thereunder, a bank is excluded or exempt from the definition of "dealer" when it engages in certain securities activities: buying and selling certain permissible securities (such as exempted securities);[12] engaging in certain investment, trustee, and fiduciary transactions;[13] engaging in certain asset-backed transactions; [14] buying and selling identified banking products (including swap agreements),[15] engaging in a limited number of riskless principal transactions;[16]

[10] See 17 C.F.R. § 255.3(b)(1)(iii).

[11] See 17 C.F.R. § 255.3(d)(3).

[12] Section 3(a)(5)(C)(i) of the Exchange Act.

[13] Section 3(a)(5)(C)(ii) of the Exchange Act.

[14] Section 3(a)(5)(C)(iii) of the Exchange Act.

[15] Section 3(a)(5)(C)(iv) of the Exchange Act.

[16] Exchange Act Rule 3a5-1.

effecting certain transactions in securities issued pursuant to Regulation S;[17] and engaging in certain securities lending transactions as a conduit lender.[18]

In addition, Section 3(a)(5) of the Exchange Act excludes security-based swaps with eligible contract participants from the "dealer" definition. We note that this exclusion applies not only to banks but to other persons as well and is frequently relied on by registered nonbank security-based swap dealers.

As part of these activities, a bank or nonbank security-based swap dealer may engage in other ancillary securities activities. For example, a bank acting as a dealer in an over-the-counter equity option, which is a type of "swap agreement" as defined in Section 206 of the Gramm-Leach-Bliley Act and hence an identified banking product,[19] frequently will also purchase or sell the underlying equity security or a mirror listed derivative as a hedge to its exposure. Similarly, a security-based swap dealer frequently will purchase or sell underlying securities as hedges. A bank engaged in such physical hedging transactions of its customer-driven derivatives is already subject to regulation by the banking authorities, which impose substantive limitations on hedging activity that mitigate any concerns that such activity is covert dealing.[20] Furthermore, there is no indication that the Commission intended, through the Proposed Rules, to supersede its prior guidance about bank dealing activity,[21] which contemplated hedging by banks.

Also, the Treasury Department has exempted certain activities by financial institutions from government securities dealer registration, most notably government securities dealer activities limited to repurchase and reverse repurchase activities.[22] A bank engaged in repurchase or reverse repurchase transactions in government securities in reliance on this exemption might buy or sell government securities to generate or deploy cash associated with those transactions.

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[17] Exchange Act Rule 3a5-2.

[18] Exchange Act Rule 3a5-3.

[19] Section 206(b) defines a "swap agreement" to mean any individually negotiated contract, agreement, warrant, note or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets, but does not include any other type of identified banking product.

[20] See, e.g., 12 C.F.R. § 7.1030.

[21] See Definition of Terms in and Specific Exemption for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, SEC Release No. 34-46745 (Oct. 30, 2002), 67 Fed. Reg. 67,496, (Nov. 5, 2002).

[22] See 17 C.F.R. §401.4.

We are concerned that the Proposed Rules could be read broadly in a manner that inadvertently captured the activity described above.[23] In so doing, they would inadvertently and inappropriately undermine these exceptions from the "dealer" definition. Accordingly, the Commission should exclude from the scope of the Proposed Rules any purchases or sales of securities intended to hedge or mitigate the risks arising from, or otherwise as part of collateral management or other activities ancillary to, activity excluded or exempt from the "dealer" definition or exempt from government securities dealer registration.

IV. The Commission Should Clarify the Treatment of Inter-Affiliate Transactions

Banking institutions frequently engage in inter-affiliate transactions to centrally manage risks or cash throughout their organization. For example, rather than having multiple entities transact with third parties, an organization might centralize such transactions through one or more market-facing entities (frequently a registered dealer) and then transfer resulting positions to an affiliate. Inter-affiliate transactions may also be used to allocate capital or other funding within a consolidated group or to hedge certain customer deposit accounts. To the extent a U.S. bank is involved, frequently these inter-affiliate transactions are subject to extensive requirements under the Federal Reserve's Regulation W.

The Commission has previously recognized, in the context of security-based swaps, that inter-affiliate transactions do not involve the interaction with unaffiliated persons to which dealer regulation is intended to apply.[24] For the same reason, the Commission should exclude inter-affiliate transactions from the Proposed Rules. We note that such exclusion would be consistent with the language of the Proposed Rules, which focuses on transactions that have "the effect of providing liquidity to *other* market participants" (emphasis added).

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[23] For example, the Proposing Release describes "[b]uying an OTC call option on a stock and selling a listed option on the same stock with the same strike and security" as an example of roughly comparable purchases and sales of the same or substantially similar securities in a day. Proposing Release, 87 FR at 23067.

[24] See Exchange Act Release No. 66868 (April 27, 2012), 77 FR 30596, 30625 (May 23, 2012).

SIFMA appreciates the opportunity to respond to the Proposing Release and also your consideration of our comments as set forth above. SIFMA would welcome the opportunity to meet with the Commission Staff to discuss our recommendations and any other aspects of the Proposed Rules. If you have any questions or require additional information, please do not hesitate to contact us by calling Rob Toomey at [redacted] or Joe Corcoran at [redacted]

Sincerely,

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Cc: The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Allison Herren Lee, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
Mr. Haoxiang Zhu, Director, Division of Trading and Markets