Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York | Brussels | London

December 19, 2023

Via Electronic Mail: rule-comments@sec.gov

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Notice of Proposed Rulemaking on 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:

Managed Funds Association ("**MFA**")[1] submits these comments to the Securities and Exchange Commission ("**Commission**" or "**SEC**") on the proposed rulemaking to further define the terms "dealer" and "government securities dealer," as defined in Sections 3(a)(5) and 3(a)(44), respectively, of the Securities Exchange Act of 1934 ("**Exchange Act**").[2] These comments supplement our previous comment letters on the Proposal.[3]

[1] MFA, based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 170 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly $2.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

[2] Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, 87 Fed. Reg. 23054 (Apr. 18, 2022) ("**Proposal**"), available at: https://www.govinfo.gov/content/pkg/FR-2022-04-18/pdf/2022-06960.pdf.

[3] *See* Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (May 27, 2022), available at: https://www.sec.gov/comments/s7-12-22/s71222-20129911-296085.pdf ("**May Comment Letter**"); Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (Dec. 5, 2022), available at: https://www.sec.gov/comments/s7-12-22/s71222-20152323-320251.pdf; Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (Dec. 5, 2022), available at: https://www.sec.gov/comments/s7-12-22/s71222-20152322-320250.pdf; Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (Apr. 6, 2023),

For reasons set forth in our previous comment letters, we believe the proposed quantitative and qualitative tests for determining who is a dealer or government securities dealer ("**Proposed Rules**") are vague, significantly overbroad, and, in the case of the quantitative test in particular, unprecedented.[4] In this letter, we want to address two additional issues with the Proposal.

First, given the significant and pervasive flaws with the Proposed Rules, in order to proceed with this rulemaking, the Commission would be required to make material changes from what was proposed. Based on its recent practice in adopting other rules,[5] we are concerned that the Commission may finalize these changes without providing market participants with an opportunity to comment on the revisions. We believe this is a mistake because it will likely:

(i) Result in a final rule that is not appropriately tailored; and

(ii) Violate the "logical outgrowth" doctrine under the Administrative Procedure Act ("**APA**").

Second, the Proposal asserts that satisfying the tests set forth in the Proposed Rules is not necessary for a person to be considered a dealer but that, depending on the facts and circumstances, it is possible for a person to be a dealer for other reasons. We are very concerned that the Commission has not foreclosed bringing enforcement actions against market participants for being an unregistered dealer based on even more ambiguous, open-ended, and unprecedented theories of who a dealer is that the Commission appears to have articulated in recent endorsement actions.

We address each of these points below.

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available at: https://www.managedfunds.org/wp-content/uploads/2023/04/MFA-Supplemental-Comment-Letter-on-Dealer-Proposal-As-submitted-4.6.23.pdf.

[4] *See* May Comment Letter.

[5] *See, e.g.*, Commissioner Hestor Peirce, "Air Dancers and Flies: Statement on Adoption of the Latest Round of Money Market Fund Reforms" (July 12, 2023), available at: https://www.sec.gov/news/statement/peirce-statement-air-dancers-flies-adoption-latest-money-market-fund-reforms (noting that commenters "spoke broadly about different approaches that could be taken . . . but did not provide the particularized feedback that we need to guide the design of liquidity fees, which were one of fifteen rejected alternatives sketched out in the proposing release"); and Commissioner Mark T Uyeda, "Statement on Reporting of Securities Loans" (Oct. 13, 2023), available at: https://www.sec.gov/news/statement/uyeda-statement-securities-lending-101323 (noting that, with respect to the securities loan reporting final rule "the public has not had the opportunity to comment on this very different regime than the one that was proposed and, for that reason, one could argue that this final rule is arbitrary and capricious" and further noting that "[a] re-proposal with an appropriate economic analysis and a proper comment period might have gone a long way to address my concerns.").

I. It is critical that the Commission provide interested parties with an opportunity to provide comment on any significant changes to the dealer definitions, particularly if the changes involve introducing new thresholds/metrics or making other changes that may have unexpected interactions with each other.

Commenters provided clear evidence that the Proposed Rules are overly broad and inconsistent with the Exchange Act definition of a "dealer." Therefore, before proceeding with a final rule, we believe the Commission would be required to make significant changes, including eliminating the proposed quantitative threshold and significantly narrowing the proposed qualitative thresholds. In that case, the Commission should solicit public comment on any significant changes to the test to ensure that the public had a reasonable opportunity to comment before finalizing the rule. Failing to do so will likely result in a final rule that is not appropriately tailored.

A. The Commission should solicit public comment on any changes to Prong 1.

As an example of these concerns, consider Prong 1 of the proposed qualitative tests, which provides that a person is a dealer for purposes of sections 3(a)(5) and 3(a)(44) of the Exchange Act[6] if the person engages in a routine pattern of buying and selling securities that has the effect of providing liquidity to other market participants by:

> Routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day.[7]

Putting aside the lack of statutory authority to redefine "dealer" in this way, the Proposal provides that the term "routinely" in Prong 1 means "more frequent than occasional but not necessarily continuous."[8] The Proposed Rule is so overly broad that seemingly a single sale and purchase of a security in the course of a day would result in a person meeting the definition of "dealer" under the Proposal. Moreover, the Proposal provides that "roughly comparable" would "generally capture purchases and sales similar enough, in terms of dollar volume, number of shares, or risk profile, to permit liquidity providers to maintain **near market-neutral positions** by netting one transaction against another transaction" (emphasis added).[9] In the economic analysis, the Proposal assumes that a daily buy-sell imbalance between two identical or

[6] The term "dealer" is defined in section 3(a)(5) of the Exchange Act as "any person engaged in the business of buying and selling securities … for such person's own account through a broker or otherwise," but excludes any 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." The term "government securities dealer" is similarly defined in section 3(a)(44) of the Exchange except that it is limited to the buying and selling of government securities, as defined in section 3(a)(42) of the Exchange Act. In this letter, we use the term "dealer" to refer to both the term "dealer," as defined in section 3(a)(5), and the term "government securities dealer," as defined in section 3(a)(44), unless otherwise indicated.

[7] Proposed Rule § 240.3a5–4(a)(1).

[8] Proposal at 23066.

[9] *Id.*

substantially similar securities, in terms of dollar volume, below 10 percent or, alternatively, 20 percent may be indicative of purchases and sales that are "roughly comparable."[10]

Prong 1 is unclear, overly broad, and will cause confusion for market participants. To begin with, the relatively wide buy-sell imbalance figures used in the Proposal's economic analysis do not come close to fitting the "near market-neutral" standard set forth in the Proposal (for that, closer to 1% or 5% would be more appropriate). But even if this aspect of the rule were revised to more accurately reflect what "near market-neutral" means (a term that does not appear in the Exchange Act), the test would still be overly broad as it would capture entities that are not engaged in dealing activity but are merely investors.

Consider a fund that buys and sells thousands of securities a day. It is statistically probable that the firm will be near market-neutral (within whatever range the Commission adopts) on any given day with respect to a certain number of the securities it trades. Does engaging in near market-neutral trading over the course of a day with respect to one security or a few securities bought and sold by a firm make the firm a dealer, especially when this may be a small fraction of the securities the firm buys and sells on a given day? This is not indicative of dealing activity as traditionally understood by the Commission or anyone else. The firm is not dealing simply by virtue of being market-neutral on any given day with respect to a small fraction of the securities it has traded.

A similar problem occurs in the case of a multi-strategy firm that has multiple portfolio managers who trade independently of one another. The firm may inadvertently have market neutral trading (within whatever range the Commission adopts) in a given day with respect to one or more securities. However, the activities of independent multiple portfolio managers who buy and sell securities without any coordination should not make such a firm a dealer merely because when considered together the firm happens to have market-neutral positions in a given day with respect to one or more securities. Engaging in market neutral trading over the course of a day does not mean a person is a dealer.

If the Commission proceeds with Prong 1 in the final rule with a "roughly comparable" test, ***which we strongly oppose and which the Exchange Act does not support***, at a minimum, the Commission should provide an exception from application of Prong 1 in any final rule for persons whose intra-day market neutral trading in specific securities represents a small fraction of their overall trading activity or is the product of uncoordinated trading activity of independent portfolio managers.

B. The Commission must seek public comment on any significant changes to Prong 1 (or change to any of the other Proposed Rules).

The APA requires the Commission, when engaged in rulemaking, to give the public notice of the substance of a new rule to provide a meaningful opportunity to comment on the Commission's plans. The final rule must be a "logical outgrowth" of the proposed rule to satisfy the notice requirement. According to the D.C. Circuit, "Where the change between proposed and final rule is important, the question for the court is whether the final rule is a 'logical outgrowth'

[10] *Id.* at n.136.

of the rulemaking proceeding."[11] The "logical outgrowth" test typically is "applied to consider whether a new round of notice and comment would provide the first opportunity for interested parties to offer comments that could persuade the agency to modify its rule."[12] Under the logical outgrowth doctrine, "[t]he object, in short, is one of fair notice."[13]

The Commission's recent trend of proposing extreme rules with numerous questions, only to revise the rule text significantly in the final rule, is antithetical to the principles set forth in the APA to provide fair notice regarding rulemakings.[14] Commenters cannot anticipate what alternatives the Commission is seriously considering, given the number of questions the Commission asks in its proposals and the potential interaction among the alternatives they represent. The Commission's recent approach to rulemaking does not meet the "fair notice" requires articulated by the courts and deprives market participants of a meaningful opportunity to comment on the Commission's rulemaking.

Failing to solicit public comment on significant, material changes to the proposed rule, not only will be a violation of the "logical outgrowth" doctrine, but it will likely result in a final rule that is not appropriately tailored. Soliciting public comment is essential if the Commission hopes to adopt a rule that is narrowly tailored to address its specific policy concerns, without sweeping in investors not engaged in dealing activity.

II. If the Commission narrows the Proposed Rules, it should not simultaneously support broader theories of the definition of "dealer" in the enforcement context.

In the Proposal, the Commission asserts that meeting the tests set forth in the Proposed Rules is not necessary for a person to be considered a dealer. Depending on the facts and circumstances, the Commission says it is possible for a person to be a dealer for other reasons. For example, the Proposal states:

> Further, a person not meeting the standards in the Proposed Rules may still be a dealer under otherwise applicable dealer precedent. Whether or not a person is a "dealer" is based on the facts and circumstances, where various factors are "neither exclusive, nor function as a checklist," and meeting any one factor may be sufficient to establish dealer status.[15]

It would be arbitrary and capricious for the Commission to finalize a Proposal intended to define a term, but then not define it and continue to pursue enforcement actions based on broader

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[11] *United Steelworkers of Am., Etc. v. Marshall* (D.C. Cir. 1980) at 1221 (citing *South Terminal Corp. v. EPA*, 504 F.2d 646, 659 (1st Cir. 1974)).

[12] *Nat'l Exch. Carrier Ass'n, Inc. v. FCC* (D.C. Cir. 2001) at 4 (citing *Arizona Public Service Co. v. EPA*, 211 F.3d 1280, 1299 (2000)).

[13] *Long Island Care at Home, Ltd. v. Coke* 551 U.S. 158 (2007).

[14] *See supra* note 5.

[15] Proposal at 23059 n.51 (quoting, among other cases, *SEC v. Almagarby*, 479 F. Supp. 3d 1266, 1272–73 (S.D. Fla. 2020)).

statutory interpretations of who a dealer is that are fundamentally inconsistent with, and effectively override, the final rule. In other words, the Commission should not seek, through litigation, to pursue an interpretation of the term "dealer" that exceeds both the bounds of the Proposal and the traditional understanding of who a dealer is based on longstanding market practice and existing Commission guidance. Essentially, the Commission would be adopting one definition of dealer through the rulemaking process while seeking to advance a much broader and conflicting interpretation of dealer through the judicial process that effectively renders the rulemaking process moot.

In several recent enforcement actions, the Commission has argued novel and expansive theories regarding the meaning of the Exchange Act term "dealer". We are concerned that the Commission is taking the position that the definition of "dealer" is so broad it would encompass virtually every financial firm in the world, including mutual funds, private funds, and pensions.

Most recently, in a letter to the Court of Appeals for the Eleventh Circuit, Commission staff pointed the court to two recent decisions that it says support the Commission's interpretation of the term "dealer." The Commission staff describes the holding in the first case in the following way:

> First, in *SEC v. Morningview Fin. LLC*, No. 22 Civ. 8142, 2023 WL 7326125 (S.D.N.Y. Nov. 7, 2023) (Exhibit A), the district court held that under the "plain language of the Exchange Act" and "previous SEC guidance regarding the Act," an individual or entity acts as a dealer if that "person or entity (1) bought and sold securities, (2) as principal rather than as agent for another, (3) as part of a profit-seeking enterprise, and (4) on more than a few isolated occasions." Id. at *13.[16]

It appears from this letter that the Commission staff is advocating for a sweeping four-factor test for who is a dealer that would appear to capture every financial firm in the world.

There are multiple problems with this four-factor test. First, it is so broad that any entity that buys and sells securities as a part of a business would be dealer. Under this interpretation, this would mean that every investment company—whether registered or unregistered—would be a dealer. This would make the Investment Company Act of 1940 superfluous as every investment company would already be required to register as broker-dealer with the Commission. Second, if the Commission can rely on this broad four-factor test in bringing enforcement actions against parties for alleged unregistered dealer activity, then there is no point in the Commission adopting a rule that would further define the term dealer. This four-factor test is so broad that it would sweep in far more persons as dealers than even the Proposed Rules do.

Accordingly, even if the Proposal is adopted in some form, it is critical that the Commission define "dealer" properly, in accordance with the statute, and disavow the absurd

[16] *See* Letter from Dominick V. Freda, Assistant General Counsel, David D. Lisitza, Senior Appellate Counsel, and Archith Ramkumar, Appellate Counsel, SEC, to David J. Smith, Clerk of Court, U.S. Court of Appeals for the Eleventh Circuit (Dec. 5, 2023).

legal theories of the term "dealer" that are fundamentally inconsistent with, and effectively override, the final rule.

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We appreciate the opportunity to provide our comments to the Commission regarding the Proposed Rules, and we would be pleased to meet with the Commission and its staff to discuss our comments. If the staff has questions or comments, please do not hesitate to call Matthew Daigler, Vice President & Senior Counsel, or the undersigned, at (202) 730-2600, with any questions regarding this letter.

Very truly yours,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Global Regulatory Affairs

cc: The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
The Hon. Mark T. Uyeda, Commissioner
The Hon. Jaime Lizárraga, Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Markets