



May 27, 2022

VIA ELECTRONIC DELIVERY

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

RE: Proposed Rule: Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer, Release No. 34-94524, File No. S7-12-22 (Mar. 28, 2022)

Dear Ms. Countryman:

Virtu Financial, Inc.¹ (“Virtu”) respectfully submits this letter in response to the above-referenced rule proposal issued by the Securities and Exchange Commission (the “SEC” or “Commission”) on March 28, 2022 (the “Proposal”).² Among other items, the Proposal calls for the adoption of two new rules – Rule 3a5-4 and Rule 3a44-2 – under the Securities Exchange Act of 1934 that would expand the definitions of “dealer” and “government securities dealer” requiring registration with the Commission and imposing enhanced regulatory obligations. The new rules would establish broad new qualitative and quantitative tests to determine whether a firm meets the expanded definitions under the Proposal.

Virtu has long been a vocal proponent of smart, data-driven regulation that supports the goals of enhancing transparency, fostering robust competition among market participants, and ensuring the high quality of the retail investor experience. While we are supportive of the Commission’s interest in ensuring that there are appropriate guardrails around the activities of market participants that play a significant role in trading and providing liquidity in the marketplace, we worry that the Proposal suffers from similar defects as several other recent SEC proposals that have been hastily advanced without the deliberate and thoughtful consideration of the impact, benefits, and costs that is required under the law – and without appreciation for the interrelated

¹ Virtu is a leading financial firm that leverages cutting edge technology to deliver liquidity to the global markets and innovative, transparent trading solutions to its clients. Virtu operates as a market maker across numerous exchanges in the U.S. and is a member of all U.S. registered stock exchanges. Virtu’s market structure expertise, broad diversification, and execution technology enables it to provide competitive bids and offers in over 25,000 securities, at over 235 venues, in 36 countries worldwide. Virtu broadly supports innovation and enhancements to transparency and fairness that increase liquidity and promote competition to the benefit of all marketplace participants.

² U.S. Securities and Exchange Commission, Proposed Rule, *Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer*, Release No. 34-94524, File No. S7-12-22 (Mar. 28, 2022), available at <https://www.sec.gov/rules/proposed/2022/34-94524.pdf>.

and cumulative implications presented by the many overlapping rule proposals recently advanced by the Commission.

The term “dealer” is defined in Section 3(a)(5)(A) of the ‘34 Act in substance as one who is engaged in the business of buying and selling securities for its own account as part of a regular business. Dealers were distinguished from traders, who may also buy and sell securities for their own account but did not do so as part of a regular business. The conclusion that one is a “dealer” may be drawn from the attendant facts and circumstances. The Proposal seeks to focus solely on three narrow qualitative circumstances, the presence of any of which would lead to a person being deemed a dealer, and in the case of government securities a strict quantitative threshold. While we support an even playing field so that competitors engaged in like activity be subject to the same regulatory scheme, we believe the Proposal does not achieve that end. Like several of the Commission’s recent proposals, it utilizes ambiguous definitions that are likely to have unintended consequences and sweep in market participants who may be buying and selling securities for their own account and who may on a given day provide liquidity to the market, but who do not intend to act as dealers, i.e., providing liquidity on a regular and continuous basis as part of a regular business.

The Proposal fails to identify a market failure that needs to be addressed. The Commission’s articulated rationale for the enhanced regulatory requirements contemplated by the Proposal is that, in light of recent advances in technology and the recent proliferation of market participants that provide liquidity electronically, “identification and registration of these market participants as dealers, including those that are not currently regulated as dealers, would provide regulators with a more comprehensive view of the markets through regulatory oversight and would enhance market stability and investor protection.”³ This purported justification ignores the fact that the electronic provision of liquidity has been part of our marketplace ecosystem for decades, and that there is already a very comprehensive regulatory reporting framework embedded in our securities law and SEC rules that facilitate the Commission’s access to vast amounts of data and information that enable it to exercise oversight of our markets and protect investors. Exhibit A is the Consolidated Audit Trail (“CAT”), which has dramatically enhanced the nature and scope of information about equity and options trading that is required to be reported to the Commission and that enables the SEC to identify which market participants are involved in a transaction. Since 2017, broker-dealers have been required to report information about trading in Treasury securities to FINRA’s TRACE system. And there are similar requirements for reporting municipal securities transactions to the MSRB’s EMMA database. Further, as noted in the Proposal, proprietary trading firms that are not registered with the Commission are still subject to the anti-manipulation and anti-fraud provisions under Securities Act Section 17(a) and to Exchange Act Section 10(b). And an unregistered market participant does not access a market directly – only through registered brokers. As such, an unregistered market participant must comply with the controls and surveillance programs of their executing broker, and all corresponding activity on an exchange is subject to regulatory oversight.

³ Proposal at p. 4.

The Proposal fails to articulate why the existing reporting regime is insufficient for the Commission to exercise oversight of the markets and protect investors. Instead, like a number of other proposals recently issued by the Commission – *see, e.g.*, short position and short activity reporting by institutional investment managers, proposed amendments to Form PF, reporting of securities loans – the Proposal seeks enhanced reporting of “nice to have” rather than “need to have” information, and a broad expansion in the nature and scope of market participants that are required to register with the Commission (and in so doing take on the added costs and burdens associated with registration). Yet again, in issuing the Proposal the Commission has failed to demonstrate that changing requirements warrant an updated rule, and that there is sound policy basis underlying such changes.

The Proposal fails to demonstrate a benefit that the proposed changes would confer on investors or the marketplace. In addition to its obligation to identify the need for a proposed regulatory action (*i.e.*, a market failure that needs to be addressed), the Commission also is obligated to identify a benefit that its proposed changes would confer on investors and the marketplace. The Proposal fails to present a persuasive argument that any such benefit would flow from the proposed changes.

The only purported benefit advanced by the Commission is that the “Proposed Rules would support the stability and transparency of U.S. Treasury and other securities markets by closing the regulatory gap that currently exists and ensuring consistent regulatory oversight of persons engaging in the type of activities described in the Proposed Rules. Specifically, the rules would result in increasing the share of liquidity provision undertaken by persons who are subject to dealer rules related to financial risk-taking, reporting, deceptive practices, and examinations.”⁴ However, the Proposal is devoid of explanation for why the SEC’s existing authority and tools are inadequate to police the markets and protect investors in the face of this supposed “regulatory gap”. Just as Commissioner Peirce observed in her dissenting statement, we question whether the Proposal articulates “a sufficiently clear rationale—other than leveling the regulatory playing field—for requiring active traders who do not have any customers to register? What benefit would come from requiring active liquidity providers to register as dealers?”⁵ The Proposal’s attempt to paint a narrative that its contemplated sweeping changes to our market structure would somehow benefit investors and the marketplace is unsupported and unpersuasive. As far as we can tell, the only benefit identified in the proposal is a benefit to the Commission itself – *i.e.*, to expand its jurisdictional reach– not a benefit to investors or the markets.

The Proposal fails to adequately assess the potentially disruptive impact the new rules could have on the marketplace. In particular, we have serious concerns about the potentially harmful impact the Proposal could have on liquidity in the marketplace, including that many currently active liquidity providers might change or limit their trading activity if they are required to register with the Commission. As Commissioner Peirce aptly posited in her dissenting statement

⁴ Proposal at p. 125.

⁵ SEC Commissioner Hester Peirce, *Statement on Proposal to Further Define “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer* (Mar. 28, 2022), available at <https://www.sec.gov/news/statement/peirce-statement-proposal-further-define-dealer-032822>.

when the Proposal was issued: “What will the proposal’s effect be on liquidity in different markets? The market generally benefits when there are more, rather than fewer, liquidity providers. A more varied set of liquidity providers also benefits market resilience; when one type of liquidity provider is unwilling to step in, another may be able to fill the gap.”⁶

Like other proposals the Commission has recently advanced, the Proposal is based on a deficient analysis of the potential impact the new registration requirements could have on market structure, and in particular on liquidity. It is not apparent from the Proposal that the Commission collected or studied data to determine what the impact of the new rules would be, nor that it considered how the Proposal would interact with other recent Commission proposals. For example, as Commissioner Peirce also noted in her statement, the Proposal would “capture dealing activity wherever it occurs, including on Communication Protocol Systems, which were the subject of a proposal the Commission approved in January of this year. What issues might this raise?”⁷

At a time when the Commission is considering issuing final rules that both individually and collectively could severely alter the existing market structure, we are very concerned that the Commission appears to have abdicated its duty to consider the potential disruption the Proposal could introduce to the marketplace and the attendant harms that could be experienced by investors, including retail investors.

The Proposal fails to take into account challenges that would be presented to firms in implementing the new requirements. For example, the Proposal contemplates that certain active traders captured by the broadly expanded definitions would be considered dealers but would not be eligible for the bona fide market making exceptions under Regulation SHO. It seems illogical to us that the Commission would seek to sweep a broader swath of the marketplace into the regulatory framework for dealers – by essentially subjecting them to the same rules that govern market makers – but is not willing to extend to them the same regulatory benefits that are available to market makers which are designed to increase liquidity. The Proposal also glosses over thorny challenges that would be associated with the requirement for covered market participants to become broker-dealers – such as compliance with the market access rule and the potential that covered firms could be “trading centers” subject to heightened obligations under Regulation NMS – and fails to clearly articulate whether such firms would be required to become members of FINRA. Moreover, firms that would be swept in by the newly expanded definitions in the Proposal would incur significant new costs and be required to implement burdensome new technology systems to comply with new CAT reporting obligations that would result.

If the Commission is inclined to proceed with this Proposal and the adoption of two new rules – Rule 3a5-4 and Rule 3a44-2 it is imperative that impacted market participants be afforded sufficient time to pivot to the new rule set while enabling them to continue functioning.

⁶ *Id.*

⁷ *Id.*

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Virtu appreciates the opportunity to comment on the Proposal. While we support the Commission's interests in enhancing transparency, promoting competition, and protecting investors, regrettably the Commission has once again missed the mark in this Proposal and instead has chosen an overreaching path that could force dozens, if not hundreds, of firms to register with the Commission and assume burdensome regulatory reporting requirements concerning information that the SEC already has access to or can easily access in other ways. Instead of utilizing the long-established Concept Release process or other forms of industry engagement to learn about the industry, the Proposal represents yet another attempt by the Commission to expand its jurisdictional reach over wide swaths of the marketplace without justifying a need to do so. This "regulatory gerrymandering" is not the role that Congress envisioned for the SEC when it promulgated the securities laws, and present serious risk of disrupting our existing, well-functioning market structure and harming investors in the process.

Respectfully submitted,



Thomas M. Merritt
Deputy General Counsel

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Allison H. Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Markets