

## US Rates Watch

## SEC dealer definition - rates impact

**Broadening the definition of dealer**

The SEC voted 3-2 on Tuesday to expand the definition of security dealers in the Securities Exchange Act to include a broader group of financial firms that trade securities in dealer-like roles. The initial proposal would have included firms that in four of last six months “engaged in buying and selling” of UST trading >\$25b. This likely would have scoped in a large amount of UST relative value hedge funds and risked swap spread tightening / UST cheapening.

The final rule was materially softened to focus more specifically on principal-trading firms (PTFs) that use high-frequency trading strategies. Chair Gensler stated PTFs can represent ~60% of volume on inter-dealer broker platforms in UST markets but have not been subject to dealer registration. The rule expanded the definition of buying and selling securities as part of a regular business to include “earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interest”. The change represents another ambitious SEC UST proposal that has been dialed back.

**What it means to be a dealer**

Paraphrasing SEC Commissioner Crenshaw’s supporting statement at the vote: the regulatory regime for registered dealers includes reporting and disclosure requirements, the Net Capital Rule, and operational integrity rules. These requirements provide visibility into trading activity and can help regulators monitor market risks. Registered dealers are also subject to the SEC’s authority to conduct examinations and impose sanctions, and are subject to the authority of relevant self-regulatory organizations.

**Market relevance: a liquidity impact**

The final rule becomes binding in one year, and we would expect newly covered firms to begin preparing for dealer registration relatively soon. The high frequency trading firms mainly provide 2-way markets in on-the-run Treasuries for the larger dealer community. Increasing costs to run these firms could reduce their size and/or widen markets they make. This could result in moderately lower overall liquidity in the Treasury markets.

To the extent that these firms reduce their total footprint in trading markets, it could also potentially reduce the negative impact that comes from their sudden reduction in participation when markets become very volatile. The SEC clearing rules are separate from this dealer designation but do intersect. The SEC clearing rule requires FICC clearing members to clear cash UST trades with dealers. As a result, this will expand the scope of these cleared cash Treasury trades to firms newly designated as dealers.

Outside of liquidity impact, we expect limited impact on UST spreads or basis since UST RV HFs are largely out of scope. SEC rule scope reduction should limit any UST cheapening.

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UST = US Treasury

RV = relative value

HF = hedge fund

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