DIGITAL ASSETS & BLOCKCHAIN TECHNOLOGY

U.S. Court Vacates SEC Dealer Rule

On November 21, 2024, a federal court vacated a controversial SEC rule that expanded the definition of securities “dealer” in a way that could encompass participants in DeFi protocols, finding that the agency had overstepped its legal authority.

What is the Dealer Rule?

- In February 2024, the SEC adopted the “dealer rule,” which broadly expanded the definition of “dealer” under the Exchange Act.
- The Exchange Act excludes from the definition of “dealer” 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 “dealer rule” narrowed this exception by providing that a person that buys and sells securities “for its own account” is engaged in that activity “as a part of a regular business” if such person engages in a regular pattern of buying and selling securities that has the effect of providing liquidity to other market participants in certain ways.
- In effect, the “dealer rule” defined those persons taking on significant liquidity-providing roles as a “dealer,” subjecting them to an array of regulatory requirements.
- The “dealer rule” did not exempt the digital assets industry or offer explanation on how the rule would apply in the Web3 context.

Why the Court Vacated the Dealer Rule

- Inspired by outcry from the digital asset sector, private fund and digital asset trade associations filed two lawsuits against the SEC in the U.S. District Court for the Northern District of Texas.
- On November 22, 2024, the Court granted summary judgement, finding that the “dealer rule” impermissibly exceeded the SEC’s statutory authority.
- In reaching its decision, the Court analyzed the historical context and meaning of “dealer,” and concluded that the “dealer rule” broadly and impermissibly expanded the Exchange Act because it removed the critical distinction between “trader” and “dealer,” as those concepts have been understood for a century.

Implications for the Digital Asset Space

- The issuance of the “dealer rule” led to serious concerns that it could encompass traders and other participants in DeFi protocols, despite the fact that these markets are innovated to operate without the need for dealer intermediation.
- Particularly because the SEC currently considers many digital assets to be sold as “investment contracts” (placing them within the definition of “securities”), the “dealer rule” presented potentially widespread implications in the digital assets sector.
- This led to significant worry that many individuals and businesses participating in DeFi protocols would be required to register with the SEC, become members of a self-regulatory organization, and comply with federal securities laws and regulatory obligations.

Implications for the Digital Asset Space (CONT'D)

- In another string of significant victories for the digital assets industry, the Court's determination to vacate the "dealer rule" allows DeFi participants that currently rely on the "trader" exemption to continue to do so.
- On the same day the "dealer rule" was vacated, SEC Chair, Gary Gensler–whose tenure was marked by controversial enforcement activity toward the digital asset sector–announced that he would step down in January 2025.

Next Steps – Potential Appeal

- The SEC has an opportunity to appeal the ruling to the U.S. Court of Appeals for the Fifth Circuit in an attempt to reinstate all or part of the "dealer rule."
- The SEC's determination regarding whether it will appeal the decision may be driven, at least in part, by expectations regarding the future composition of SEC leadership following the November elections.
- There is general optimism in the digital assets sector regarding the trajectory of the SEC, but the ultimate fate of the "dealer rule" is not entirely clear.