

# Crypto Council for Innovation

April 18, 2022

## By Electronic Submission and Email

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street N.E.  
Washington, D.C. 205499-1090

**Re: File No. S7-02-22; Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange”; Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities**

Dear Ms. Countryman:

The Crypto Council for Innovation (“CCI”) appreciates the opportunity to comment on the Securities and Exchange Commission (“SEC” or “Commission”) proposal to amend Rule 3b-16 under the Securities Exchange Act of 1934 (“Exchange Act”) regarding the definition of “exchange” and what “shall be considered to constitute, maintain, or provide ‘a marketplace or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange’ as those terms are used” in the statutory definition of “exchange” under Exchange Act Section 3(a)(1).<sup>1</sup> The proposal, if approved, would in part require that “communication protocol systems” register as exchanges or, as a substitute, register as broker-dealers and become alternative trading systems (“ATSS”) by filing Form ATS with the SEC.

CCI is an alliance of crypto industry leaders with a mission to communicate the opportunities presented by crypto and demonstrate its transformational promise. CCI members span the crypto ecosystem and include some of the leading global companies and investors operating in the industry. CCI members share the goal of encouraging the responsible global regulation of crypto to unlock economic potential, improve lives, foster financial inclusion, protect national security, and disrupt illicit activity. Achieving these goals requires informed, evidence-based policy decisions realized through collaborative engagement.

Given our mission, the feedback in this letter focuses on the potential effects of the proposed changes on the crypto markets, their participants, and the innovative technology underpinning this space. As President Biden noted recently in the Executive Order on Ensuring Responsible Development of Digital Assets, “we must reinforce United States leadership in the global financial system and in technological and economic competitiveness, including through the responsible development of payment innovations and digital assets.”<sup>2</sup> We encourage the SEC to

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<sup>1</sup> See Exchange Act Release No. 94062 (Jan. 26, 2022), 87 FR 15496 (Mar. 18, 2022).

<sup>2</sup> See Executive Order on Ensuring Responsible Development of Digital Assets (Mar. 9, 2022), available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>.

carefully consider the potential effects of the proposed changes on the crypto ecosystem in order to mitigate unintended consequences that would impede U.S. leadership and global competitiveness. We are concerned that the proposed amendment does not support this goal. Our view is based on several factors, including:

1. Our reading of the analysis accompanying the proposal indicates that the scope is limited to traditional, centralized securities financial products, services, technology, and participants. Unfortunately, however, the language of the regulatory text itself is broad and open-ended. Under the broadest interpretation, it is possible that the proposal could sweep certain portions of the crypto and decentralized finance (“defi”) markets within the scope of regulations designed for traditional financial markets without providing any discussion of this fundamental shift. Lack of regulatory certainty is already a significant challenge for the industry. The mismatch between regulatory text and analysis in this proposal risks exacerbating the existing opacity surrounding the applicability of U.S. federal securities laws to crypto and defi.
2. The proposal, as written, fails to satisfy the obligations to which the agency is subject under the Administrative Procedures Act (“APA”), the Exchange Act (including in the economic analysis section of the proposal (“EA”)), and the Paperwork Reduction Act of 1995 (“PRA”), as it lacks a clear and definitive statement by the Commission with respect to its application, specifically to traditional, centralized securities financial products, services, technology, and participants.

**If the Commission adopts the proposed amendments, CCI requests the following guidance and additional steps from the agency.** Without these, the proposal would not satisfy the agency’s tripartite mission of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation.

1. The Commission should clarify that the proposal covers only the technologies and products described within the release. Absent such clarification, the ambiguity and breadth of the proposed regulatory text could have a chilling effect on investor confidence, innovation, and capital formation in the crypto and defi space in the United States.
2. The Commission should evaluate and address the risk that the proposal may further handicap or alienate the United States in an area that the Executive Branch of our federal government recently described as critically important to “United States leadership in the global financial system and in technological and economic competitiveness.”<sup>3</sup>
3. The Commission should propose a definition for “communication protocol system.” The very reasons that make it difficult for the SEC to pinpoint a definition underscore the importance of providing one. Taking such a step is critically important to properly frame the scope of Rule 3b-16 and avoid confusion.

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<sup>3</sup> *Id.*

4. On the other hand, if the scope does cover crypto and defi protocols (whether intentionally or unintentionally), the Commission should withdraw the existing proposal and repropose it to meet its statutory requirements under the APA, the Exchange Act, and the PRA, as we discuss in greater detail below. This would enable the Commission to give the public (including critical industry stakeholders) fair and adequate notice of the likely outcome of the rulemaking and the necessary opportunity to provide meaningful comment.

We welcome the opportunity to engage with the Commission and other regulators and their staffs to hone regulation and solutions together in line with these requests.

### **The Proposal On Its Face Does Not Apply to Crypto**

On its face, the proposal does not apply to crypto or defi projects or protocols, even those that the SEC would consider to be (or relate to) “digital asset securities” or investment contracts. There are no references to crypto or defi in the 654-page release. Instead, nearly all of the background references and discussion in the proposal relate to the fixed income markets, related history, and discussion of assets such as corporate bonds and government-issued paper that are commonly understood to be securities. The Commission establishes this scope in the introduction of the proposal, for example by referring to the agency’s rulemaking process of “taking into consideration comment letters submitted in response to the 2020 Proposal and the Concept Release”<sup>4</sup> and by noting that “[t]he proposed amendments to Exchange Act Rule 3b-16(a) would include Communication Protocol Systems that make available for trading any type of security, including, among others, government securities, corporate bonds, municipal securities, NMS stocks, equity securities that are not NMS stocks, private restricted securities, repurchase agreements and reverse repurchase agreements, foreign sovereign debt, and options.”<sup>5</sup> There is no mention of digital asset securities or investment contracts.

Given the magnitude of the potential effects on the blockchain industry, an objective reader would not expect a proposal intended to cover crypto and defi to be silent regarding its application to those asset types and technologies. Despite this, many in the crypto community are left wondering whether the proposed scope of Rule 3b-16 applies to them, given the lack of a definition for the new term communication protocol system. If interpreted to include crypto and defi, this proposal could have significant, destabilizing effects on a \$3 trillion industry, without analysis by the SEC of the nature or extent of these effects. The novel, innovative, and distinct characteristics of the technology used within the crypto and defi ecosystem merit intentional and narrow consideration. Even a technology neutral proposal, in order to be complete, would need to discuss the full contemplated scope, breadth, and applicability of Rule 3b-16.

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<sup>4</sup> See Exchange Act Release No. 90019 (September 28, 2020), 85 FR 87106 (Dec. 31, 2020).

<sup>5</sup> See Exchange Act Release No. 94062 at 15498.

But the proposal is not technology neutral—it specifically addresses certain systems and processes (e.g., RFQ systems, stream axes, and condition order systems). Given the various specific asset types and systems the proposal does discuss, and the distinct absence of any discussion related to crypto, defi, digital asset securities, or investment contracts, the logical reading of the proposal is that the Commission does not intend for amended Rule 3b-16 to cover these asset types and technology.

The words of the proposal itself, however, state that the SEC will take “an expansive view of what would constitute ‘communication protocols’ under...Rule 3b-16(a).”<sup>6</sup> Unfortunately, the SEC did not define the new term communication protocol system. Instead, the proposal includes various examples and descriptions, none of which is dispositive of status, of features, or parameters that could be indicative of systems that could be communication protocol systems, despite each ultimate determination being based on a “facts and circumstances” analysis.<sup>7</sup> Simply providing examples injects a high level of ambiguity and uncertainty and leaves the industry uncertain of how to react, if at all.

Accordingly, the SEC must consider, and publicly and transparently address, the possible consequences that the proposed rule could have if applied beyond the traditional securities financial products and technology on which it focuses. This should include specifically the cost of any chilling effect on the growing crypto and blockchain industry.

### **The Potential Impact on Crypto and DeFi Necessitate Thoughtful and Distinct Economic and PRA Analyses**

Several key required elements of SEC rulemaking include analyses of the costs, benefits, effect on competition, and other economic considerations implicated by the changes the agency is considering. **The proposal fails to satisfy these obligations for any asset types and technologies beyond those specifically mentioned in the release.”**<sup>8</sup>

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<sup>6</sup> See *id.* at 15507.

<sup>7</sup> These include, for example, setting minimum criteria for what messages must contain; setting time periods under which buyers and sellers must respond to messages; restricting the number of persons to which a message can be sent; limiting the types of securities about which buyers and sellers can communicate; setting minimums on the size of the trading interest to be negotiated; or organizing the presentation of trading interest, whether firm or non-firm, to participants. See *id.* at 15507.

<sup>8</sup> When a federal agency promulgates legislative rules, or new or amended rules made pursuant to congressionally delegated authority, in order to ensure public participation in the rulemaking process, the APA requires agencies to provide the public with adequate notice of a proposed rule followed by a meaningful opportunity to comment on the rule’s content. See 5 U.S.C. § 553. Exchange Act Section 3(f) requires the Commission, when it is engaged in rulemaking pursuant to the Exchange Act (like this one) and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. See 15 U.S.C. 78c(f). See also Exchange Act Release No. 94062 at 15593. In addition, Exchange Act Section 23(a)(2) requires the Commission, when making rules pursuant to the Exchange Act, to consider, among other matters, the impact that any such rule would have on competition and not to adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. See 15 U.S.C. 78w(a)(2). See also Exchange Act Release No. 94062 at 15593. Proposals like this one are also subject to “collection of information” requirements

If the scope of the proposal does cover crypto and defi (whether intentionally or unintentionally), the Commission must withdraw the existing proposal and repropose it in order to satisfy the minimum thresholds for compliance with the Commission’s obligations under the APA and PRA, and to conduct a properly scoped EA. A reproposal is required in these circumstances to ensure that the Commission gives the public and industry stakeholders fair notice of the likely outcome of the rulemaking and the necessary opportunity to provide meaningful comment, as required by statute.<sup>9</sup>

Neither the EA nor the PRA analyses meet the SEC’s legislatively-imposed requirement of adequately accounting for the proposal’s likely costs and other burdens and effects if the Commission ultimately takes the view that the proposal applies to crypto and defi, given that such broad application is not contemplated in any part of the proposal, including the EA or the PRA. We include several examples that support this view:

1. The PRA analysis in the proposal estimates the total number of communication protocol systems to be 22.<sup>10</sup> This number is not sufficient to account for crypto and defi protocols and related technology.
2. Crypto and defi products, services, and technology exhibit features that are unlike those in traditional financial markets. A specific analysis of those differences (and likely implications) is necessary to meet the standard required by the APA that the public have adequate notice of a proposed rule and a meaningful opportunity to provide comment.<sup>11</sup> The EA contains ample analysis of systems that trade government securities, agency securities, corporate debt, municipal securities, equities, options, repurchases, and asset

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under the PRA. *See* 44 U.S.C. 3501 et seq. *See also* Exchange Act Release No. 94062 at 15582. The Commission is also subject to the Small Business Regulatory Enforcement Fairness Act of 1996 and the Regulatory Flexibility Act. The Commission must, among other PRA requirements, justify the documents required in its existing and proposed rules.

<sup>9</sup> Generally speaking, the SEC Division of Economic and Risk Analysis (“DERA”) is responsible for the EA and aspects of the PRA sections of SEC rule proposals. To borrow from a 2012 internal memo from the SEC Office of the General Counsel and DERA (known then as “RSFI”), “[the] Commission has long recognized that a rule’s potential benefits and costs should be considered in making a reasoned determination that adopting a rule is in the public interest.” *See* Memorandum to Staff of the Rulewriting Divisions and Offices from: RSFI and OGC (Mar. 16, 2012) available at [https://www.sec.gov/divisions/riskfin/rsfi\\_guidance\\_econ\\_analy\\_secrulemaking.pdf](https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf). The internal memo also emphasizes that “[h]igh-quality economic analysis is an essential part of SEC rulemaking. It ensures that decisions to propose and adopt rules are informed by the best available information about a rule’s likely economic consequences, and allows the Commission to meaningfully compare the proposed action with reasonable alternatives, including the alternative of not adopting a rule.” The same internal memo notes that the United States Court of Appeals, District of Columbia Circuit (“D.C. Circuit”) “has viewed these provisions, together with the requirement under the [APA] that Commission rulemaking be conducted ‘in accordance with law,’ as imposing on the Commission a ‘statutory obligation to determine as best it can the economic implications of the rule.’” *Id.* (citing *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005)). The memo also states that “the court has [similarly] found certain Commission rules arbitrary and capricious based on its conclusion that the Commission failed adequately to evaluate a rule’s economic impact. *Id.* (citing *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (finding that the Commission had failed “adequately to assess the economic effects of a new rule”)).

<sup>10</sup> *See* Exchange Act Release No. 94062 at 15586.

<sup>11</sup> *See* 5 U.S.C. § 553.

backed securities, but it is devoid of any discussion or analysis of the application of the proposal to crypto and defi. For example, the proposal makes no mention of DAOs (decentralized autonomous organizations) or digital smart contracts developed by a party that has no further involvement in the operation of the software code underlying the DAO or smart contract. These are features unique to the crypto industry, materially different from traditional finance, and merit distinct consideration and analysis – the absence of which would indicate action of an arbitrary and capricious nature. For all of the types of securities the proposal does mention, the proposal contains neither a reference to digital asset securities, which is a term the SEC itself coined, nor investment contracts, the framework under which the SEC has analyzed these assets previously. We can only conclude that this omission was intentional because the SEC does not intend for the proposal to apply to these asset types.

3. The SEC estimates the burden required to comply with Rule 301(b)(1) and register as a broker-dealer to consist of a total time requirement of 2.75 hours to file Form BD. While this might be accurate solely in relation to filing Form BD, it fails to account for the lion’s share of the time and effort it takes to become a registered broker-dealer in the first instance—namely, the FINRA process. A stated goal of the PRA is to “minimize the paperwork burden for...persons resulting from the collection of information by or for the Federal government.”<sup>12</sup> If the PRA analysis does not discuss the full burden of complying with the proposed rule, it fails to comply with 44 U.S.C. § 3507(a)(1)(D)(ii)(V), which requires that a rule proposal contain “an estimate of the burden that shall result from the collection of information.” While the process of becoming a FINRA member is not technically a collection of information by the federal government, it is necessarily a prerequisite to becoming a broker-dealer and thus becoming an ATS. Accordingly, this burden is directly related to a collection of information “for” the federal government, necessary to comply with the proposed rule and is required to be estimated pursuant to the statute. A broker-dealer new member application (“NMA”) with FINRA generally requires dozens of hours of preparation time just to get to the point of filing the NMA with FINRA. Then, the review and comment period with FINRA, which can span six months or longer, requires dozens of additional hours to satisfy FINRA that the applicant has met FINRA’s 12 “standards” for admission as a member.<sup>13</sup> The PRA is silent on the total burden to become a FINRA member, instead taking an extraordinarily narrow view by focusing solely on the time and cost outlays for Form BD. While the EA does note the initial and ongoing financial cost, it does not provide any analysis of the duration of time associated with becoming a FINRA member. Accordingly, the SEC’s burden estimates in

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<sup>12</sup> 44 U.S.C. § 3501(a)(1).

<sup>13</sup> FINRA Rule 1017(i)(3) is generally understood to require FINRA to approve or deny an NMA within 180 days. Often, however, FINRA does not act within the 180<sup>th</sup> day. This can, of course, be a result of delays caused by the applicant. However, often this is result of FINRA itself not completing the NMA review on time. Applicants have the option of filing a written request with the FINRA Board requesting that the FINRA Board direct FINRA’s membership department to issue a decision. In reality, however, applicants realize this is a zero sum approach. So instead, FINRA often “encourages” (really, instructs/requires) the applicant to request an extension with FINRA, even if FINRA itself is the cause of the delay.

the PRA are incomplete as they do not account for the time and cost necessary to register a broker-dealer with FINRA. While this issue is not specific to the crypto industry, the process has been significantly more complex, time consuming, and costly for FINRA applicants if the applicant's business model or services relate even in small ways to crypto, blockchain, or digital assets. We understand from speaking with various FINRA applicants with crypto- or blockchain-related business plans that they hit roadblocks with FINRA during the 2018-2021 timeframe and, ultimately, seeing no actual path forward, withdrew their applications. Given this history, additional time may be needed for the industry to work with FINRA to pave a way forward for crypto-related applications after the new changes are finalized.

4. The Commission proposes allowing communication protocol systems that are not registered as broker-dealers at the time the proposed rule would be effective, if adopted, to provisionally operate pursuant to the Rule 3a1-1(a)(2) exemption while their broker-dealer registrations are pending until the earlier of (1) the date the ATS registers as a broker-dealer and becomes a member of a national securities association or (2) the date 210 calendar days after the effective date of the final rule. The Commission notes that the 210 calendar day period is designed to provide time for a communication protocol system to submit its broker-dealer registration application and for FINRA to conduct its NMA for a new member. The SEC designed the proposed transition period to provide a communication protocol system that is not a registered broker-dealer adequate time to comply with the necessary broker-dealer registration requirements under Regulation ATS without disrupting its market or its participants. Unfortunately, the implementation schedule of 210 days from adoption of a final rule is not only inconsistent with realistic timelines today, but it is an impractical timeline if a flood of new broker-dealer and ATS applicants try to register at essentially the same time as a result of being deemed communication protocol systems. This is especially true, as we noted above, for any applicants that engage with crypto, blockchain, or defi.
5. A compliance date any earlier than one calendar year from approval risks setting participants up for a de facto violation (or forcing them to cease operations in the United States) given the impracticability of complying any earlier, predominantly as a result of exogenous factors. As noted above, the NMA process can, and often does take longer than 210 days, even despite FINRA's self-imposed 180-day deadline. And the time period makes no allowance for the time needed to prepare the NMA (or the multitude of compliance and supervisory systems and processes requirement to operate a broker-dealer and ATS in a compliant manner). We are reminded of the 2019 implementation schedule of Form ATS-N for "NMS ATSs" for which 120-day extensions were required for SEC staff review on top of the initial 120-day review period the staff was initially allocated. Not all of those filings spanned 240 days. But given history, resource constraints at the SEC (and FINRA), the novelty of what it would take for the SEC and FINRA to review filings for potentially hundreds of communication protocol systems that would in any way relate to crypto or defi, and the lengthier review times that appear to apply to crypto or defi applicants for FINRA membership, we believe the compliance

period is inadequate, and again conclude that this is because the proposal does not apply to, and therefore does not contemplate application to, the crypto and blockchain industry.

6. The proposal addresses communication protocol systems that seek to operate as ATSs and that are already operating when the proposed rule, if adopted, becomes effective. To avoid disruption of the services of the ATS, the Commission proposed requiring communication protocol systems (other than those that are “Covered ATSs”) to file an initial operation report on Form ATS no later than 30 calendar days after the effective date of any final rule. This timeline fails to account for the time and complexity involved in satisfying this requirement, which again would be especially true for a first-time applicant from the crypto or defi community.

There has been increasing recognition of the value of crypto to the United States, evidenced by the recent White House Executive Order on digital assets, which encourages the development of the industry. The global financial and technological competitive positioning of the United States is a key theme of the Executive Order. In rulemakings like this one, the SEC would be advised to consider, among other matters, the impact the proposal would have on competition and not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

### **Working Together Toward Next Steps**

CCI and its members stand ready and willing to work with the SEC (and lawmakers and other regulatory bodies) to accomplish what is necessary to ensure that the most transformative innovations of this generation and the next are anchored in the United States.

We welcome the opportunity to engage with the Commission and other regulators and their staffs to hone regulation and solutions together. New or enhanced regulation of crypto and defi in the United States, even when involving digital asset securities or investment contracts, must come about through an evolutionary approach, as the Executive Order recognizes. Such an approach must be fair and transparent, and must acknowledge and reflect the fundamental differences between traditional finance, on the one hand, and crypto and defi, on the other.

We look forward to collaborative and constructive engagement to move closer toward a clear and effective regulatory environment for crypto—one that not only protects investors and furthers the remainder of the SEC’s mission, but that also preserves the competitive edge of the United States as the leading innovator of financial technologies that will drive the world through the 21<sup>st</sup> century.

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Ms. Vanessa Countryman, Secretary  
U.S. Securities and Exchange Commission  
April 18, 2022  
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Respectfully submitted,

/s/ Sheila Warren

Sheila Warren

Chief Executive Officer  
Crypto Council for Innovation

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The Hon. Allison Herren Lee, Commissioner  
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