



April 14, 2022

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

**RE: Proposed Amendments to Exchange Act Rule 3b-16  
(Release No. 34-94062; File Number S7-02-22)**

Dear Ms. Countryman:

The Digital Asset Regulatory & Legal Alliance<sup>1</sup> (“DARLA”), Global Blockchain Convergence<sup>2</sup> (“GBC”), and Global Digital Asset & Cryptocurrency Association<sup>3</sup> (“Global DCA”) greatly appreciate this opportunity to provide comments on the amendments proposed by the U.S. Securities and Exchange Commission (the “Commission”) to Exchange Act Rule 3b-16 regarding the definition of “Exchange”; Regulation ATS for Alternative Trading Systems (“ATSS”) that trade U.S. Government Securities, NMS Stocks, and other Securities; and Regulation SCI for ATSS that trade U.S. Treasury Securities and Agency Securities (the “Proposal”).

DARLA is an industry group, founded in 2018, and consists of executives, chief legal officers, chief compliance officers, and senior legal and compliance professionals from financial institutions and blockchain technology companies that are actively involved in shaping the legal and regulatory landscape in the United States as applied to blockchain and digital assets.

DARLA has more than 170 members, acting in their individual capacities.<sup>4</sup> This letter provides the views of DARLA and does not necessarily reflect the opinion of any individual member.

GBC is an informal global organization whose primary mission is to create organic opportunities for collaboration and self-organizing communities of professionals from diverse segments of the global blockchain ecosystem, dedicated to advocating, writing about, and generating proposed approaches to business, market, and policy frameworks that facilitate the adoption of blockchain

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<sup>1</sup> More information about the Digital Asset Regulatory & Legal Alliance is available at the following website: [www.darla.io](http://www.darla.io).

<sup>2</sup> More information about Global Blockchain Convergence is available at the following website: [www.globalbc.io](http://www.globalbc.io).

<sup>3</sup> More information about Global Digital Asset & Cryptocurrency Association is available at the following website: [www.global-dca.org](http://www.global-dca.org)

<sup>4</sup> DARLA thanks the following members, among others, for their contributions to this letter: Kristin Boggiano (President and Co-Founder, CrossTower), Lee A. Schneider (General Counsel, Ava Labs; Co-Founder, GBC), Cathy Yoon (Chief Legal Officer, MPCH; Co-Founder, GBC), Annemarie Tierney (Founder and Principal, Liquid Advisors), Salman Banaei (Global Co-Head of Public Policy, Chainalysis, Inc.), Brandon Ferrick (General Counsel, Injective Labs), Ruby Sekhon (Chief Legal Officer, Polychain Capital), Joyce Lai (Founder, New Territories LLC), Georgia Quinn (General Counsel, Anchorage), David Brill (Head Commercial Counsel, Voyager), Vanessa Savino (Deputy General Counsel, tZERO), Alan Konevsky (Executive Vice President, tZERO), and Bill Hughes (Senior Counsel and Director of Global Regulatory Matters, ConsenSys Software Inc).

and complementary technologies and that advance entrepreneurship and inclusion. Our membership includes nearly 200 professionals, many with extensive backgrounds in legal, compliance, and operations. Members volunteer time and resources in working groups, monthly meetings, and projects to help further initiatives and education. This comment letter represents one of those collaborations and does not purport to speak for all members of GBC.

Global DCA is a global self-regulatory association for the digital asset & cryptocurrency industry. It was established to guide the evolution of digital assets, cryptocurrencies, and the underlying blockchain technology within a regulatory framework designed to build public trust, foster market integrity and maximize economic opportunity for all participants.

Global DCA's 70 member entities represent spot and derivative exchanges, proprietary trading firms, traders, investors, asset managers, brokerage firms, custodians, decentralized technology organizations, banks, legal firms, audit firms, insurance professionals, academics, consultants, and media.

## **Introduction**

We appreciate and support the Commission's objectives to adapt its regulatory framework to reflect new technologies and manners of trading in the securities markets. While much of the discussion in the 650-page Proposal focuses on government securities trading, we are focused particularly on the portion of the Proposal that seeks to expand the definition of "exchange" under both Commission rules and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This portion of the Proposal would bring within the meaning of "exchange" many new platforms that are not currently contemplated under either Rule 3b-16 or the Exchange Act. Such an *ultra vires* action by the Commission would be contrary to the Exchange Act, contrary to the Administrative Procedure Act, and contrary to the Commission's prior precedents because it proposes regulation on a multitude of platforms that simply do not engage in the activities of an exchange as contemplated when Congress adopted the Exchange Act.

Within the Exchange Act, "exchange" is defined to mean "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place 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 that term is generally understood, and includes the market place and the market facilities maintained by such exchange."<sup>5</sup>

In 1998, the Commission adopted Rule 3b-16 to clarify terms used in the statutory definition of "exchange" under the Exchange Act. Under Rule 3b-16, an exchange is any organization, association, or group of persons that: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade.<sup>6</sup>

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<sup>5</sup> Section 3(a)(1) of the Exchange Act.

<sup>6</sup> 17 CFR 240.3b-16(a).

The Commission's Proposal to expand Rule 3b-16 to include Communication Protocol Systems<sup>7</sup> ("CPSs") as exchanges exceeds the Commission's authority granted by the Exchange Act and will cause harm to participants in the capital markets while providing limited benefits for the investing public. Furthermore, the Commission has not articulated the harm it is attempting to remedy with such proposed expansion. We sincerely hope that the Commission will engage in proper conversations with the participants and platforms they propose to affect and with Congress to seek an amendment of the Exchange Act, which we believe would be required if the Commission intends to move forward with this portion of the Proposal.

## **What Is an Exchange?**

The Proposal's attempt to amend the definition of exchange does not spend any time contemplating the history behind the Exchange Act definition of exchange, nor does it provide much rationale for why CPSs would meet that definition. Below, we address the core features of an exchange, none of which is present in a CPS, and then discuss various negative consequences from requiring CPSs to register as an exchange.

## **Essential Features of an Exchange**

The Exchange Act limits the regulation of exchanges to venues that perform "the functions commonly performed by a stock exchange as that term is generally understood."<sup>8</sup> While the size, location, and interface of exchanges has varied significantly since the Exchange Act's inception in 1934, exchanges have been generally understood to have certain essential features that differentiate them from broker-dealers and unregulated technology companies. If implemented, the Proposal would regulate many more market participants as exchanges which do not have some or any of these essential features of a securities exchange.

The four core features of an exchange are (i) continuous and predictable liquidity, (ii) pricing of the securities traded on the exchange, (iii) effecting transactions and earning compensation, and (iv) listing and membership requirements and trading floors. We address each in turn below. We note that all of these elements require a central authority responsible for administering, coordinating and maintaining them. As the Commission has noted throughout its history, over-the-counter markets and bulletin boards are not exchanges because, among other reasons, they lack this central authority.<sup>9</sup>

### **1. Continuous and Predictable Liquidity**

Exchanges are generally understood to feature continuous and predictable liquidity. As the Commission has previously stated, "[t]he sole purpose of a modern [exchange] is to provide the public with an efficient and dependable mechanism through which securities can be bought and sold. This means, ideally, that every buyer and seller should be able to find his opposite number

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<sup>7</sup> Communication Protocol System is defined in the Proposal as systems that use various technologies and connectivity and generally offer the use of non-firm trading interest and establish protocols to prompt and guide buyers and sellers to communicate, negotiate, and agree to the terms of the trade without relying solely on the use of orders.

<sup>8</sup> Section 3(a)(1) of the Exchange Act.

<sup>9</sup> See Real Goods Trading Corporation, SEC No Act. LEXIS 566 (June 24, 1996); PerfectData Corporation, SEC No-Act. LEXIS 700 (Aug. 5, 1996); and Flamemaster Corporation, SEC No-Act. LEXIS 972 (Oct. 29, 1996).

quickly, and at a price reasonably close to the last sale.”<sup>10</sup> The Commission’s comments align with the features of exchanges that are commonly used today. Registered National Securities Exchanges (“RNSEs”), such as the New York Stock Exchange and the Nasdaq Stock Market, allow buyers and sellers to quickly and easily find and execute trades with counterparties. This functionality creates continuous and predictable liquidity for securities market participants.

The Proposal, if implemented, would include platforms that do not offer continuous and predictable liquidity, but instead involve users merely expressing non-firm “trading interest” (defined as any expression of interest in trading a security that involves the security’s name and either the price, quantity or direction) or simply communicating some potential desire to trade. Continuous and predictable liquidity requires the ability for users to be able to see and match with orders of a counterparty that contain, at a minimum, a security’s name, price, initial quantity, and direction. A user of a trading platform that only involves “trading interest” (*e.g.*, a simple communications platform or other forum where users can express only one or two of those elements such as “SPY, BUY”) could go hours, weeks, or months before finding a counterparty willing to trade with them. This situation would not be possible at any RNSE or even at any broker-dealer that has registered an ATS under the exemption from registration as a national securities exchange created by Regulation ATS. Instead, the hallmark of continuous and predictable liquidity for an exchange allows users to submit an order and that is matched with a counterparty in a predictable and efficient manner. A CPS simply cannot meet this requirement.

## 2. Securities Pricing

The Exchange Act describes exchanges as displaying “the prices of securities.”<sup>11</sup> At the time the Exchange Act was adopted, pricing was an essential feature of exchanges and remains one today. Modern trading systems, as described by the Commission, are venues where participants are able to develop a “reasonable expectation” of the going market price and decide whether or not they wish to execute at that price.<sup>12</sup> Indeed, without pricing transparency, there can be no continuous and predictable liquidity.

In contrast, “trading interest” platforms do not require any pricing information much less firm orders and therefore might not display securities pricing for users. As envisioned by the Commission in the Proposal, the mere ability to communicate about securities transactions would suffice, which eliminates any requirement to show prices. A user may use a CPS to seek trading counterparties for hours before receiving information regarding the price of the security they wish to trade. Alternatively, a user may be unsuccessful at obtaining a price from a counterparty all together despite their best efforts on the CPS.

Furthermore, prices delivered over a CPS are fundamentally different from the prices contemplated in the Exchange Act. Today, securities pricing is available on registered exchanges and reflect the going market price. The going market price is available to all members of the exchange and represents the aggregate views of a given marketplace. In contrast, the prices which may be

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<sup>10</sup> Order Granting Temporary Registration as a Clearing Agency, Exchange Act Release No. 34-27611, 55 Fed. Reg. 1890 (1990).

<sup>11</sup> Section 2 of the Exchange Act.

<sup>12</sup> Order Granting Temporary Registration as a Clearing Agency, Exchange Act Release No. 34-27611, 55 Fed. Reg. 1890 (1990).

transmitted using a CPS are bespoke prices from private negotiations between individual users of the platform.

### 3. Effecting Transactions and Earning Compensation

Exchanges also earn compensation for their activities. Often, that compensation is based on the transactions effected on the exchange. Exchanges also earn other types of compensation associated with their listing of securities and their membership requirements, discussed next. In all events, the Proposal does not seek to require that a CPS would earn compensation associated with the transactions discussed (or even negotiated) on the platforms. ATSS, which must register as broker-dealers, also receive transaction-based compensation for their services. Indeed, the Commission's core hallmark of a broker is the receipt of transaction-based compensation.<sup>13</sup>

### 4. Listing and Membership Requirements and Trading Floors

Exchanges are generally understood to feature listing and membership requirements and floors which members can use for trade completion. The Exchange Act describes exchanges as being composed of "members" who apply to the exchange based on their financial experience and operational abilities.<sup>14</sup> Floors are also a generally understood feature of an exchange and are mentioned throughout the Exchange Act.<sup>15</sup> Floors provide members a centralized location, whether it be a physical area or an electronic order book, where members of the exchange can find liquidity, see pricing, and promptly complete their trades. In the ATS context, the concept of "members" is replaced by "subscribers" of the ATS and they leverage the listing requirements of exchanges.<sup>16</sup> ATSS are required to establish "written standards" which applicants must meet before being allowed to trade on the platform as a subscriber.<sup>17</sup>

By expanding the definition of an exchange to systems that simply "make available" sets of rules for trading, the Proposal would regulate platforms without any material listing standards, membership, or subscriber qualifications or floors (physical or virtual) for trade execution. For example, "make available" is such broad language that a chat app which provides suggested links for locations to complete trades could qualify as "making available" rules for trading. Therefore, systems where users sign up with an email and then chat among users about securities, despite never being able to trade on the platform, could still qualify as an exchange or ATS. Indeed, the Proposal acknowledges this possibility by describing negotiation protocols where users "may complete a trade outside the system" as platforms which are intended to be regulated as exchanges under the Proposal.<sup>18</sup> Further, the Proposal states "a Communication Protocol System can still

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<sup>13</sup> 1st Global, SEC No-Action Letter, 2001 WL 499080 (May 7, 2001) ("Persons who receive transaction-based compensation generally have to register as broker-dealers under the Exchange Act because, among other reasons, registration helps to ensure that persons with a 'salesman's stake' in a securities transaction operate in a manner consistent with customer protection standards governing broker-dealers and their associated persons, such as sales practice rules.").

<sup>14</sup> Section 3(a)(3)(A) of the Exchange Act.

<sup>15</sup> See, e.g., Section 6(c)(4) of the Exchange Act.

<sup>16</sup> Reg ATS, 300(b).

<sup>17</sup> Reg ATS, 301(b)(5)(2)(a).

<sup>18</sup> The Proposal, p. 22.

meet the criteria of Exchange Act Rule 3b-16 even if it has no role in matching counterparties nor displays trading interest.”<sup>19</sup>

## Negative Consequences

By expanding the definition of “exchange” under Rule 3b-16 beyond the intended scope of the Exchange Act, the Proposal not only goes beyond the Commission’s statutory authority but will also result in a variety of negative consequences, whether intended or unintended.

### 1. Violation of Statutory Authority

As the Supreme Court has firmly established, Congress must “speak clearly if it wishes to assign to an agency decisions of vast ‘economic and political significance.’”<sup>20</sup> The term “exchange” was carefully defined by Congress under the Exchange Act to only apply to a very specific subset of capital markets participants. By regulating platforms as exchanges which currently fall outside the statutory definition of exchange under the Exchange Act, the Proposal violates the firm boundaries of the Commission’s authority granted by the Exchange Act. We urge the Commission to let Congress do its job under the Constitution of the United States. The appropriate first step here would be for the Commission to discuss changes to the Exchange Act with Congress instead of unilaterally modifying legislation.

### 2. Harms to U.S. Innovation and Competitiveness

The Proposal’s broad application of exchange regulations to a wide variety of CPSs will likely harm innovation for communication platforms that are enhancing access to securities products and services through technology. The access points these technology providers reach are always regulated entities, whether they are exchanges, brokers, dealers, or ATs. The Proposal simply seeks to move regulation to an earlier point in the investment or trading process.

A large number of market participants that may fit the definition of CPSs are early-stage technology companies that have not traditionally been subject to regulation by the federal securities laws. The Proposal provides no firm rationale or evidence explaining why regulation of these platforms is now required. Imposing significant regulatory burdens on companies that simply facilitate communication may have the unintended consequence of driving many early-stage technology companies offshore or out of business. This result makes no sense for companies that did not intend to offer a securities exchange business. As such, the Commission will be inadvertently hindering financial innovation by implementing the Proposal as currently drafted.<sup>21</sup>

Furthermore, the broad language of “trading interest” and “makes available” under Rule 3b-16 would likely cause chilling effects and deter further innovation and activity among early-stage technology companies due to uncertainty over which technology services would satisfy the new and expanded definition of exchange. Forcing businesses to segment their activities will add

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<sup>19</sup> The Proposal, p. 44.

<sup>20</sup> *Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2444 (2014).

<sup>21</sup> This potential impact is especially worrisome in light of the “Executive Order on Ensuring Responsible Development of Digital Assets,” signed by President Biden on March 9, 2022, which established that it is imperative the United States maintain technological leadership and support financial innovation in digital assets.

additional expense and technical difficulty without commensurate investor protection. Indeed, investors arguably will be harmed due to the loss of the ability to communicate with each other about ideas for securities transactions and investments.

To demonstrate the potentially disastrous effects to the United States' technology sector, any of the following types of commonly used retail communication platforms might be required to register as an exchange under the Proposal as currently written:

- Social networking websites, where users can organize into groups and find like-minded individuals;
- Peer-to-peer messaging applications, where users can create specific groups to send messages to one another;
- Business communication platforms, where users can create specific channels for discussion;
- Financial information systems, where users can chat with one another regarding specific securities;
- Blockchain technology nodes, which facilitate the transfer of peer-to-peer network data; and
- Smart contracting platforms, whereby users can communicate with one another.

While the Proposal does attempt to limit its breadth by mentioning a list of specific features that could qualify a platform as a CPS, such a list is not exhaustive and is not included in the text of the proposed changes to Rule 3b-16. Therefore, the Proposal, as drafted, provides little comfort to technology companies which offer communication platforms, especially in light of the Proposal's statement that the Commission would take an "expansive view of what would constitute 'communication protocols'" for Rule 3b-16(a).<sup>22</sup>

Moreover, the list of factors that might qualify a platform for exclusion indicates the extreme breadth of what types of platforms would be captured by the Proposal, further indicating why the four hallmarks of exchanges discussed above are critical to a solid definition.

### 3. Overlap with Existing Regulation

We also worry that brokers and dealers, two other forms of already-regulated entities, will be caught within the expanded definition of "exchange." The term "broker" is defined under Section 3(a)(4) of the Exchange Act as "any person engaged in the business of effecting transactions in securities for the account of others."

Expanding to all platforms that involve "trading interest" and "make available" rules for matching orders may capture the activities of brokers and blur the line as to which activities can be performed by a broker and which activities will trigger the requirement to separately register as an exchange

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<sup>22</sup> The Proposal, p. 44.

or ATS. This confusion would require additional guidance for the market and FINRA to make a determination as to what activities may be performed by a broker without the need to separately register as an exchange or ATS.

Simply excluding those already regulated entities does not solve the problem but rather begs the question of why this additional regulation is needed. Why should CPSs be forced to register as exchanges or ATSs when brokers or dealers are not, even though the same activity occurs on both types of platforms? The Proposal is likely to make everyone involved in any securities-related communications an exchange or ATS. This in turn would lead to the bizarre outcome where nascent trading interest about a single transaction could pass through multiple venues which are each regulated as an exchange or ATS. For example, if negotiation protocols where users do not execute trades are classified as exchanges by the Proposal, then both the negotiation protocol and the ultimate destination for execution may both be regulated as exchanges. The Commission has previously tailored rules to avoid such unnecessary overlap.<sup>23</sup> The web of confusion that would result is mind-numbing, as would the unintended overlapping regulatory burden for certain transactions, which would generate additional costs that investors would bear, but without the added benefit to investor protection.

#### 4. Excessive Regulatory Burden

Expanding the definition of “exchange” to include CPSs that are merely technology companies that do not have the hallmarks of exchanges as discussed above will significantly burden the resources of the Commission and FINRA. If the Proposal were adopted, the Commission and FINRA would need to review registrations and provide ongoing oversight and supervision for potentially hundreds of novel types of exchanges, including providing interpretations on how existing Commission and FINRA rules apply to the CPSs. Indeed, regulation of CPSs is not contemplated in any part of the Exchange Act or the Securities Act of 1933, as amended, or anywhere in FINRA’s rulebook.

Effective implementation of the Proposal will require major new rulemakings by both agencies, major new programs to process applications from the multitude of newly designated regulated entities, and major investments in education. This significant expansion of registration and oversight responsibilities will strain the financial and professional resources of already busy regulators, inhibiting their ability to perform their existing duties. As a result, regulators may provide decreased quality of investor protection by reallocating oversight resources, not to mention the confusions that the investing public will experience about these platforms and the new regulations applicable to them. For example, only certain of the platforms’ activities are likely to require registration and conformity with exchange or ATS rules, yet users of the platforms will need specific guidance as to when they are functioning in the regulated world and when in the unregulated sections. Investors will also need guidance about when their own activities on the platform constitute those of a broker or dealer or exchange or ATS such that they must become regulated or meet listing or membership requirements.

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<sup>23</sup> For example, the Regulation ATS Release noted that the rules were tailored to avoid order routing services needing to register as an exchange or ATS. Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70850 and 70898 (December 22, 1998).



Similarly, the broader definition of “exchange” will likely require more broker-dealers to seek FINRA approval to operate ATSS. Such ATS rules will not map easily onto these organizations which were not contemplated in the rules’ original release. Therefore, FINRA will require more guidance from the Commission on how to implement the expanded definition of “exchange” to communication protocols that may seek to register. If the Commission intends to implement the Proposal, then we urge the Commission to provide specific guidance to FINRA in advance of implementation of the Proposal so as to avoid unnecessary delays in the application process that will also stifle innovation.

## Conclusion

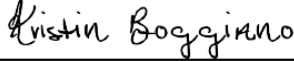
As drafted, the Proposal as it relates to including CPSs within the definition of exchange is an overly broad, imprecise, and unauthorized expansion of the definition of “exchange” as contemplated under the Exchange Act that will have numerous negative consequences. Adoption would damage rather than enhance investor protection and create significant regulatory uncertainty for the trading and investing community, technology companies and any other types of communications systems. In light of the above, we strongly urge the Commission to not adopt the amendments in the Proposal relating to CPSs.

Thank you for the opportunity to comment. If you have any questions or need additional information, please contact Lilya Tessler, Partner and Head of the FinTech and Blockchain group at Sidley Austin LLP, by email at [ltessler@sidley.com](mailto:ltessler@sidley.com) or by phone at (214) 969-3510.

Sincerely,



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