BLOCKCHAIN ASSOCIATION

June 13, 2023

VIA EMAIL (rule-comments@sec.gov)

Vanessa Countryman
Secretary
US Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Reopening of the Comment Period: Proposed Amendments to Exchange Act Rule 3b-16; File Number S7–02–22

Dear Ms. Countryman:

The Blockchain Association submits this letter in response to the request for comments by the U.S. Securities and Exchange Commission ("SEC") with respect to its proposal to amend the interpretation of the definition of "exchange" in Rule 3b-16 ("Rule 3b-16") under the Securities Exchange Act of 1934 (the "Exchange Act") and to make certain other amendments to Regulation ATS and Regulation SCI under the Exchange Act (the "Proposal"),[1] further expanded upon in the Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange" (the "Supplemental Release").[2] We have previously submitted comment letters in response to the Proposal on April 18, 2023 (the "First Comment Letter") and June 13, 2022 (the "Second Comment Letter").[3]

The Blockchain Association is the leading nonprofit membership organization dedicated to promoting a pro-innovation policy environment for the digital asset economy. The Blockchain Association endeavors to achieve regulatory clarity and to educate policymakers, regulators, courts, and the public about how blockchain technology can pave the way for a more secure, competitive, and consumer-friendly digital marketplace. The Blockchain Association represents over 100 member companies reflecting the wide range of the dynamic blockchain industry, including software developers, infrastructure providers, exchanges, custodians, investors, and others supporting the public blockchain ecosystem.

---

[1] Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That TradeU.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, SEC Release No. 34-94062, 87 Fed. Reg. 15496, 15498 (March 18, 2022); https://www.sec.gov/rules/proposed/2022/34-94062.pdf (herein referred to as the "Proposal" with citations made to the published PDF).

[2] Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange", SEC Release No. 34-97309 (April 14, 2023) 88 Fed. Reg. 29448 (May 5, 2023); https://www.sec.gov/rules/proposed/2023/34-97309.pdf (herein referred to as the "Supplemental Release" with citations made to the published PDF).

[3] The Blockchain Association also submitted a preliminary letter on March 10, 2022, requesting an extension of the initial 30-day comment period.

We write to highlight the following concerns with the Proposal and Supplemental Release, as further discussed below. First, we believe that the concerns set forth in our First Comment Letter remain largely unaddressed by the Supplemental Release, and request further SEC action to appropriately address these outstanding points of consideration, including but not limited to our concerns that the Proposal exceeds the SEC's scope of authority. Second, we believe that the proposed rule change will stifle innovation and impose heavy financial costs while providing only limited benefits, and that the SEC has not provided an adequate cost-benefit analysis to reflect the economic effects of its proposal. We also believe that there is a significant fair notice issue with regard to forcing platforms to register to use various technologies, and we echo the statement of Commissioner Hester Peirce that the Proposal and Supplemental Release have created, in their ambiguity, a risk of undermining basic First Amendment protections.

I. The Supplemental Release does not Sufficiently Address Concerns Raised in First Comment Letter.

In our First Comment Letter, we stated that (i) the proposed expansions to Rule 3b-16 exceeded the scope of the SEC's statutory authority under the "exchange" definition in the Exchange Act; (ii) the proposed expansions to Rule 3b-16 violated statutory rulemaking requirements by eliminating the opportunity for meaningful stakeholder engagement in the rulemaking process by, among other things, not adequately discussing potential impacts on the decentralized finance sector; and (iii) we were concerned with the vagueness of the Proposal, given the fact that it did not mention digital assets at all. While the Supplemental Release makes clear the intention of the SEC to capture digital asset platforms (presumably, all along), the concerns we set out remain. Moreover, while the SEC makes a pro forma effort to build out its cost-benefit analysis with respect to digital assets, it significantly underestimates the potential costs and negative impacts that will be inflicted on the digital asset sector and fails to describe with any specificity the corresponding benefits.

a. *The Proposal Seeks to Expand the SEC's Interpretation of Rule 3b-16 without Authority for Extension of SEC's Jurisdictional Reach.*

The SEC's current interpretation of the definition of "exchange" in Section 3(a)(1) of the Exchange Act, codified in Rule 3b-16, outlines a two-part test whereby an "organization, association, or group of persons" shall be deemed an exchange "if such organization, association, or group of persons: (i) brings together the orders for securities of multiple buyers and sellers; and (ii) 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."[4] Rule 3b-16 defines an "order" as "any firm indication of a willingness to buy or sell a security, as either principal or agent, including any bid or offer quotation, market order, limit order, or other priced order."[5]

The Proposal seeks to expand the SEC's Rule 3b-16 interpretation of the definition of "exchange" under Section 3(a)(1) to encompass communications protocol systems that "(1) bring together buyers and sellers of securities using trading interest; and (2) make available established, non-discretionary methods (whether by providing a trading facility or communication

---

[4] 17 C.F.R. § 240.3b-16(a).

[5] 17 C.F.R. § 240.3b-16(c).

protocols, or by setting rules) under which buyers and sellers can interact and agree to the terms of a trade."[6] This overly expansive revision will allow the SEC to deem persons that merely provide access to decentralized digital asset trading protocols ("Decentralized Protocols") as exchanges. As a result, such persons would have to register as broker-dealers and alternative trading systems and be subject to SEC regulations and FINRA rules, despite the absence of any intermediary or any intermediary-like conduct (such as transaction-based compensation) in connection with securities transactions.

If adopted, the Proposal would amend Rule 3b-16 to shift the SEC's focus from interactions between orders on a platform to interactions between *actors* on a platform. It would also expand the definition to include "trading interests" that fall far short of firm orders. Any interaction on a platform in which counterparties merely identify a security in connection with either quantity, direction, or price would subject that platform to registration as an exchange or an alternative trading system, even if no orders are placed or transactions executed on such platforms. This is an extraordinarily broad definition, and goes far beyond the ordinary meaning of an "order" in any context.

As we discussed in our First Comment Letter, the intent to purchase a security alone — without any definitive terms — would be enough under this new, broadened definition to qualify as an "order." In defining an exchange, Section 3(a)(1) refers to "bringing together purchasers and sellers of securities." This definition does not include "prospective" purchasers and sellers, which the Proposal's inclusion of mere trading interests would capture. Merely indicating a possible interest in buying or selling a security without mentioning the quantity or pricing terms that would otherwise characterize an order would allow the SEC to deem a platform an exchange despite it otherwise not "performing with respect to securities the functions commonly performed by a stock exchange."[7] Therefore, this amended definition improperly and substantially exceeds the scope of the SEC's statutory authority under the Exchange Act.

Additionally, the fact that the new definition will include actors that merely "make available" non-discretionary methods under which this broadened notion of trading interests may interact will vastly widen the SEC's jurisdictional reach. As also stated in our First Comment Letter, the SEC has no corresponding statutory authorization for this extension of its jurisdictional reach, nor has it addressed this concern in the Supplemental Release.

Finally, the Proposal continues to leave wholly undefined the question of when a given digital asset may qualify as a security under U.S. federal securities laws, instead assuming that every digital asset traded on a Decentralized Protocol constitutes a security in and of itself. The assumption is flatly wrong and breaks with U.S. Supreme Court precedent requiring examination of individual transactions to determine when a transaction involves an investment contract and is therefore a security.[8]

Such an extreme expansion of statutory authority without congressional approval raises major questions of economic significance, as the Supreme Court recently explained in *West*

---

6 Supplemental Release at 6.

7 U.S.C. § 78c(a)(1).

8 SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

Virginia v. Environmental Protection Agency (EPA).[9] In this case, the Court specifically held that in "extraordinary cases"[10] where agency regulation is of "economic and political significance," a federal agency must be able to point to clear congressional authorization for the power it asserts.[11] As we discuss in greater detail in Section II below, the SEC's reinterpretation of the "exchange" definition will have an extraordinary economic impact on the digital asset sector. We thus urge the SEC to point to an explicit congressional authority that grants it the effective authority to broaden the statutory definition of "exchange," or refrain from finalizing this Proposal until Congress answers the major question of how, if at all, Decentralized Protocols should be regulated.

b. The Proposal Remains Improperly Vague, and this Persistent Ambiguity Imposes Practical and First Amendment Concerns.

Despite the SEC's efforts to provide further explanation in its Supplemental Release, there remains considerable ambiguity in the Proposal, including with respect to what will be considered "group" activity in the context of a Decentralized Protocol. There are no clear lines established by the SEC to determine whether a person is acting in agreement — whether formally or informally — with any other person, such that they are considered a "group of persons" for purposes of section 3(a)(1) of the Exchange Act.[12]

Specifically with regard to the blockchain ecosystem, the Supplemental Release states that "actors can form a group of persons if they act in concert to perform, or exercise control or share control over, different functions of a market place or facilities for bringing together buyers and sellers of securities that, taken together, satisfy the elements of existing Exchange Act Rule 3b-16(a) or Rule 3b-16(a), as proposed to be amended."[13] One factor to consider, the Supplemental Release continues, is "the extent to which a person acts with an agreement (formal or informal) to perform a function of a market place or facilities for bringing together buyers and sellers of securities."[14]

Yet, the substance of the release indicates that the SEC intends a broader scope than just persons acting in concert with each other. For instance, the SEC provides the example of a software developer who "acting independently… publishes or republishes code… without any agreement … for that code to be used for a function of a market place or facilities for bringing buyers and sellers together."[15] This unattached software developer, the Supplemental Release states, "may be less likely" to be acting in concert for sake of the new definition. At the same time, however, the SEC states that to the extent that such a developer is paid for publishing such

---

[9] *West Virginia v. Environmental Protection Agency (EPA)*, 142 S. Ct. 2587 (2022) (requiring regulation of economic significance to have clear congressional approval prior to its implementation)

[10] *Id*. at 2608 (2022).

[11] *Id*. at 2605.

[12] Supplemental Release at 23.

[13] Supplemental Release at 28.

[14] *Id.*

[15] *Id.*

software, the developer could be deemed to be "acting in concert with a group of persons to provide a market place or facilities for bringing together buyers and sellers."[16]

Moreover, the SEC recognizes that validators may be subject to registration under the rule. But a consensus mechanism relying on validators naturally depends on validators competing with one another to earn rewards for validating transactions. Certainly competitors are not acting in concert. Additionally, as essential components of blockchain infrastructure, validators are akin to internet service providers—providing the pipes in which information is communicated from person to person—and are not contemplated to be within the scope of the statutory definition of "exchange." The SEC must first receive authority from Congress in order to cast such a wide net that obligates validators to register.

These statements elucidate a significant ambiguity in the Proposal that appears contradictory at best, and will cause confusion and uncertainty in the industry. The SEC also states an organization that deploys a smart contract that is deemed to constitute a marketplace for securities under Rule 3b-16 will also be deemed to be acting as an "exchange" even if "it cannot alter or significantly control" the smart contract.[17] Again, this statement seems to be a contradiction in terms, as the "group" definition relies on "control" as a fundamental criterion.

Moreover, as discussed in our First Comment Letter, Section 3(a)(1) defines an "exchange" through the use of active verbs: to be regarded as an "exchange" under the statute, one must "constitute[], maintain[], or provide[] a marketplace or facilities" for the buying and selling of securities. The expansion of Rule 3b-16(a) to capture a software developer who deploys a smart contract that they can then no longer control would exceed this statutory definition. Such a smart contract developer can no longer be said to be constituting, maintaining, or providing such a marketplace or facilities.

In addition, the broad guidance the SEC has provided in its discussion of whether a group will be deemed to share "control" over an exchange could lead to the view that nearly all participants in a blockchain-powered platform — from developers to validators to governance token holders — could potentially be perceived as part of a "group."[18] In such case, unrelated parties that would not otherwise be regarded as acting in concert could be compelled to register in some capacity.[19] In effect, the SEC's vague and broad interpretation of a "group" (in light of the tortured use of "control" in this context) could prove a self-fulfilling prophecy, as unrelated parties — fearful that their limited interactions with others may constitute "group" activity — could be

---

16 *Id.*

17 Supplemental Release at 30.

18 *See* Supplemental Release at 28 ("These actors can form a group of persons if they act in concert to perform, or exercise control or share control over, different functions of a market place or facilities for bringing together buyers and sellers of securities that, taken together, satisfy the elements of existing Exchange Act Rule 3b-16(a) or Rule 3b-16(a), as proposed to be amended."); *see also* Supplemental Release at 24 ("In assessing whether a person would be acting in concert with a group of persons, one factor to consider, depending on other facts and circumstances, would be the extent to which a person acts with an agreement (formal or informal) to constitute, maintain, or provide a market place or facilities for bringing together buyers and sellers of securities or to perform with respect to securities a function commonly performed by a stock exchange.")

19 Supplemental Release at 26.

coerced into formally establishing a "group" for the sake of regulation. The SEC suggests as much by stating in the Supplemental Release that parties acting individually should form an organization for the purposes of complying with the rule. We assert that the SEC cannot simply force independent parties to create a group where one does not exist in order to sweep them into its regulatory boundary.

More generally, as noted by Commissioner Peirce in her dissenting statement in response to the Proposal,[20] the ambiguity regarding the reach of Rule 3b-16(a) allows the SEC to potentially capture a seemingly limitless range of activity that should be protected under the First Amendment. Commissioner Peirce provides a clarifying analogy: "My T-shirt might even get me in trouble: It is not just a pretty design; this shirt republishes the code submitted by a commenter who explained that buyers or sellers of tokens could use it to express non-firm trading interest. If I wear my T-shirt out in public after this rule takes effect, do I have to register? What if I sell this T-shirt to someone who then deploys the code?"[21]

Accordingly, these overly broad, vague and ambiguous elements of the Proposal could infringe upon the First Amendment rights of various blockchain and Decentralized Protocol users. The SEC seems to partially recognize these First Amendment concerns in the Supplemental Release, as it cites a long list of concerns provided by commenters on the Proposal touching on the vagueness of the Proposal and the fear that all validators, developers of smart contracts, website operators, and others will be captured in the scope of the newly proposed regulation. Despite the nodding reference to these concerns, the SEC has not made an effort to address the necessity for regulating this speech in its cost-benefit analysis or any other part of the Supplemental Release.[22] The SEC should more clearly define the scope of activity and speech it intends to capture under the Proposal, and it should weigh potential First Amendment concerns, especially with respect to Decentralized Protocols, against the benefits of its proposed expansion of Rule 3b-16.

c. Fair Notice Concerns.

Fair notice encapsulates "the principle that agencies should provide regulated parties 'fair warning of the conduct [a regulation] prohibits or requires.'"[23] If adopted, the Proposal would amend Rule 3b-16 to broaden the scope of the Exchange Act to subject actors and activities not covered by the definition of "exchange" under Section 3(a)(1) of the Exchange Act to substantial

---

[20] Comm'r Hester M. Peirce, *Rendering Innovation Kaput: Statement on Amending the Definition of Exchange* (Apr. 14, 2023), https://www.sec.gov/news/statement/peirce-rendering-inovation-2023-04-12.

[21] *Id.*

[22] Supplemental Release at 101-103. (In response to several paragraphs of quotes describing commenters' concerns about the vagueness of the Proposal, the SEC answered simply that the entities discussed would be considered an exchange if they met the criteria for an exchange, without providing further detail as requested by the quoted commenters. "The Commission believes that the entities these commenters describe would only be an exchange if they constitute, maintain, or provide a market place or facility that meets the applicable criteria, and would only incur compliance costs in connection with their activities that constitute, maintain, or provide that market place or facility.")

[23] See e.g., *Christopher v. SmithKline Beecham Corp.* 132 S. Ct. 2156, 2167 (2012); see also *FCC v. Fox Television Stations, Inc.,* 132 S. Ct. 2307 (2012).

regulation. This eliminates the opportunity for meaningful stakeholder engagement in the rulemaking process by offering insufficient analysis relating to the detrimental, and potentially fatal, impact of the Proposal on an entire industry.

As discussed above in Sections I.a and I.b, the rule change is vague and ambiguous, and the range of activities that may be captured within its scope are not yet fully fleshed out. Moreover, as discussed in Section II.b below, neither the Proposal nor the Supplemental Release are able to identify all the potentially impacted parties. Accordingly, there can be no meaningful stakeholder engagement in this case where it is unclear who the stakeholders may be.

The Supplemental Release states that the securities laws are flexible and "use of DLT, or any other technology, does not make compliance incompatible with the federal securities laws."[24] The SEC has additionally stated that whether a platform meets the definition of an exchange will depend on the activities performed, rather than the technology used.[25] However, in adopting a much broader definition of "exchange," the SEC has greatly expanded the scope of technologies that will, as a result of their basic functions, be brought within the definition, and has repeatedly failed to provide definitive parameters to allow market participants to understand if they will or will not be captured within the scope of the new definition.

The SEC claims that its Proposal is "technology neutral,"[26] but in consistently ignoring the unique challenges that persons using or providing access to Decentralized Protocols face in complying with the Proposal, the SEC is effectively discriminating against this specific type of technology. The SEC is explicit that the burden will be greater for companies who rely on distributed ledger technology and has even acknowledged that some players will be forced out of business due to their inability to meet the newly imposed registration requirements.[27] The SEC has also stated that, in order to comply with the Proposal, persons using or providing access to Decentralized Protocols would require restructuring, and as a result, would have to "significantly reduce the extent to which these systems operate in accordance with 'DeFi' (decentralized finance) principles."[28] Therefore the SEC's Proposal, while purporting on its face to be arguably "neutral," is discriminatory at its core, as it will force a range of technologies to be abandoned in order for platforms to meet regulatory requirements designed with an entirely different technological capability in mind.

The SEC states in the Supplemental Release that exchanges and alternative trading systems may "trade only securities quoted in and paid for in U.S. dollars."[29] The SEC does not cite any statutory or regulatory guidance or authority for this statement. Indeed, it is not apparent how or why this would be a requirement under U.S. securities laws. Without such a legal basis,

---

[24] Supplemental Release at 31.

[25] Supplemental Release at 46.

[26] Supplemental Release at 15.

[27] Supplemental Release at 136. ("However, the Commission acknowledges that because the compliance costs for entities that trade crypto asset securities may be higher than for those that trade non-crypto asset securities, the impact of those costs on innovation in crypto asset securities may be greater.")

[28] Supplemental Release at 137.

[29] Supplemental Release at 14.

the SEC's statement is circular, as Decentralized Protocols were previously not caught in the SEC's regulatory framework; now, as the SEC extends its authority to force as-yet unregulated entities under its purview, it simultaneously states that the new alternative trading systems and exchanges may only operate in the limited capacity in which prior, traditional exchanges and alternative trading systems have operated. This flies in the face of the SEC's argument that its new Proposal is "technology neutral" and will encourage innovation,[30] and goes against the basic tenets of fair notice discussed herein.

In fact, this new requirement will do just the opposite of encouraging innovation. The ability to exchange one digital asset for another without having to make payment in a national currency is a foundational aspect of many digital asset trading platforms, including those utilizing Decentralized Protocols in particular. The SEC itself acknowledges in the Supplemental Release the significance of pairs trading and includes a section on the "Costs Associated with Discontinuation of Non-Security-for-Security Pairs Trading."[31] An effective ban on pairs trading without legal basis raises fair notice concerns. Moreover, the SEC's discussion of costs related to the impact of this Proposal on pairs trading is lacking given the potentially catastrophic impact this would have on the decentralized asset trading sector.

We also realize that, in its discussion of whether Decentralized Protocols would be regulated under the Proposal, the Supplemental Release states that several such platforms are likely to be "exchanges" under the *existing* Rule 3b-16.[32] Therefore even if the changes proffered in the Proposal are not adopted, numerous Decentralized Protocols are at risk, by this reasoning, of being considered "exchanges" despite never having been provided fair warning that their activity would be regulated as such. All of our arguments herein regarding the SEC's lack of jurisdictional reach to implement the changes in the Proposal similarly apply to the SEC's reinterpretation of the existing rule, as the SEC is expanding its application of the current rule without the proper authority. So too does this violate basic due process,[33] which requires that legal matters be resolved according to established rules such that individuals and legal persons alike are entitled to equal protection under a defined set of laws. By reinterpreting well-established rules to capture a broader range of market participants without fair process, the SEC threatens to infringe upon the constitutional rights of countless persons and entities. Such reinterpretation should not be afforded deference.

II. The SEC's Cost-Benefit Analysis is Insufficient and Does Not Take into Account its Stifling of Innovation.

Agencies must further "assess both the costs and the benefits of [an] intended regulation," "propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs," and make decisions based on "the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and

---

30 Supplemental Release at 133.

31 Supplemental Release at 121.

32 Supplemental Release at 19.

33 U.S. Const. amend. V; U.S. Const. amend. XIV, § 2.

consequences of, the intended regulation."[34] The burden is higher for "significant regulatory action," which is defined in part as "any regulatory action that is likely to result in a rule that may…[h]ave an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities," as well as rules that may "[r]aise novel legal or policy issues."[35]

The SEC made clear in the Supplemental Release that part of its intention in expanding the definition of "exchange" is to capture in its rapidly expanding net decentralized systems and digital asset market participants, to the extent they facilitate communication regarding potential transactions in "digital asset securities." While we acknowledge that the Supplemental Release states the expanded "exchange" definition could be interpreted to capture smart contract code developers and publishers, blockchain miners and validators, providers of liquidity to automated market makers, website maintainers, and blockchain client software developers, it unhelpfully reiterates that they would only be deemed an exchange if they meet the exchange definition.[36]

It remains unclear how the expansions to Rule 3b-16 will be interpreted to capture which entities within the Decentralized Protocol ecosystem. Without further guidance from the SEC, persons using or providing access to Decentralized Protocols will be unsure whether they fit within the new category of "Communication Protocol Systems" that the SEC has included in its redefinition of "exchange." Persons using or providing access to Decentralized Protocols and similar platforms will bear the costs of this regulatory uncertainty, and will be forced to take on additional burdens as a result. This is a threshold question the SEC must address before adopting any update to Rule 3b-16. The answer to this question will also heavily impact the cost-benefit analysis the SEC must make prior to this rule change. The number of businesses impacted will, with such ambiguity still inherent in the language and interpretation of the amended rule, be far greater than the "15-20" digital asset platforms that the SEC has estimated will be captured by the amended rule.[37] Moreover, given that the present size of the decentralized finance sector is estimated to be close to $30 billion,[38] it is clear that the impact of a vague wide-ranging broker-dealer and ATS registration requirement imposed on market participants in this industry will have an impact significantly in excess of $100 million.

Persons using or providing access to Decentralized Protocols will often find it impossible to comply with the registration requirements imposed by the SEC; it may simply be infeasible to cause persons using or providing access to Decentralized Protocols, such as programmers that write the open-sourced code underlying Decentralized Protocols, website providers that provide access to Decentralized Protocols, or persons validating transactions on Decentralized Protocols to register as broker-dealers and as alternative trading systems and to comply with the relevant regulations in relation thereto. This looming likelihood that many such platforms will be shut

---

[34] Exec. Order No. 12,866, 3 C.F.R. 638 (1993).

[35] Exec. Order No. 12,866, 3 C.F.R. 638 (1993).

[36] Supplemental Release at 102-103.

[37] Supplemental Release at 65.

[38] *2023 Q1 Crypto Industry Report*, CoinGecko (May 15, 2023), https://www.coingecko.com/research/publications/2023-q1-crypto-report.

down entirely as a result of the SEC's Proposal will impact a significant number of businesses. Moreover, Decentralized Protocols committed to registering and willing to pay the many associated costs could, due to their decentralized structure and the lack of guidance by the SEC or FINRA regarding requirements for digital asset broker-dealers, as a practical reality, find it impossible to meet current requirements involving transaction reporting and custody, among other things. SEC and FINRA requirements would need to be updated to provide space for such registration-seeking entities, whether through a combination of additional rulemaking, targeted exemptions, or no-action relief. This will take time, effort, and – perhaps most importantly of all - a willingness on behalf of regulators to engage in such discussions with Decentralized Protocols. Accordingly, at minimum the SEC should address these issues at great length in its cost-benefit analysis. However, it remains silent on this issue in the Supplemental Release.

Even for those persons using or providing access to Decentralized Protocols that seek to register with the SEC after determining their activity falls within the purview of the expanded "exchange" definition, those that are able to register will face costs at every step: whether in implementing the required data collection and disclosures, registering as either an exchange or broker-dealer, or complying with the fair access rule. The SEC has underestimated the high cost of compliance these platforms will face. The Proposal conceded that the SEC "is unable to provide estimates on certain restructuring related costs for a non-broker-dealer operated Communication Protocol System because the SEC does not have information regarding the scope of its restructuring, such as the need and the extent of required changes in current business practices, the need and the extent of consulting services, and its choice of entity type for incorporation."[39]

In the Supplemental Release, the SEC makes an attempt to outline the costs "affecting entities that trade crypto asset securities,"[40] but discussion of these costs and the methods by which they have been estimated are lacking in depth and breadth, as they do not take into account the many additional costs imposed by practical realities. The SEC's table of anticipated expenses walks through several compliance actions with which the SEC anticipates approximately 20 newly regulated entities involved in trading crypto assets will be required to comply, and in so doing, estimates costs of initial filings and ongoing compliance at the exact same rate as those set forth in the original Proposal's cost-benefit section.[41] This means that the SEC has made no attempt to account for the unique challenges faced by decentralized platforms (which are likely to serve as platforms for crypto assets), applying the exact same cost analysis as it has for all other "exchanges" that may be brought within the regulatory purview of the SEC as a result of this amendment.

The SEC estimates a total of $1.4 million will be expended by an anticipated maximum of 20 "new Rule 3b-16(a) Systems that trade crypto asset securities."[42] This $1.4 million (or $70,000 per registrant) estimate is an absurdly low figure even for simple, traditional broker-dealer business models, and this does not come close to taking into account the sheer expense of determining how to force the square pegs of decentralized technologies and uniquely developed

---

39 Proposal at 465.

40 Supplemental Release at 100.

41 *See* Table VIII.8, Supplemental Release at 100; Proposal at 452.

42 Supplemental Release at 100.

systems into the round holes of narrowly constructed rules set forth for regulated broker-dealers. Without a clearer understanding of what exact activities will be regulated under the amended Rule 3b-16, it is impossible for the SEC to accurately estimate the number of platforms that will be brought under its regulatory purview. The cost-benefit analysis set forth in the Supplemental Release is not nearly robust nor thoughtful enough to accurately represent the impact this Proposal will have on our nascent industry.

The Supplemental Release discusses the "economic effects" the SEC anticipates will be incurred by platforms engaging in activity involving crypto asset securities.[43] In its discussion, the SEC states that it has "less data on the functioning of the market for crypto asset securities" and, as a result, is less certain that its analysis of costs, as set forth in the Proposal, are accurate. First, there is considerable data on the functioning of the crypto asset market that is publicly available, as these platforms operate on the transparent blockchain, an immutable distributed ledger on which every single transaction can be viewed.[44] As such, the SEC should have access to a vast amount of data on various crypto asset platforms that could be used to better understand, and therefore be in a better position to potentially regulate, crypto asset activity.

Second, the costs inherent in a crypto-asset platform registering as a broker-dealer and an ATS would be very significant and would in fact likely approach the SEC's estimated projection of $1.4 million for an individual platform, rather than for the entire industry. Such costs will include, but not be limited to, those incurred in relation to obtaining FINRA's approval of a New Membership Application and obtaining the SEC's approval of a Form ATS, both of which are known to be arduously detailed processes. This is especially the case when digital assets are involved; in order to provide "fair access" to their trading platforms, for example, the SEC has already noted such platforms will face additional costs as they are forced to change their entire business model to comply with these requirements.[45] Moreover, the SEC fails to consider the recurring annual costs companies would have to incur beyond the costs related to initial registration. Companies likely would have to hire FINRA registered personnel or have existing employees become registered with FINRA, to the extent they could even meet experience requirements, in order to fulfill compliance obligations year after year. Additional costs will also be faced in meeting books and records requirements that are not easily reconciled with the distributed ledger technologies that are often employed by such platforms.

It is telling in this regard that, to date, the SEC and FINRA have only approved one broker-dealer with the authority to custody digital asset securities. The path to FINRA membership and SEC registration for any digital asset security broker-dealer is laden with novel difficulties and these will be compounded for Decentralized Protocols, which often have no central controlling authority to steer through this process and do not act as intermediaries like those who are contemplated to be required to register.

By including in its "exchange" definition all systems offering communication protocols, the SEC will not succeed in fostering competition, but will conversely stifle innovation and cause

---

[43] Supplemental Release at 93.

[44] Charles Silver, *How The Transparency Of Blockchain Drives Value*, Forbes (Feb. 14, 2020, 7:15 AM), https://www.forbes.com/sites/forbestechcouncil/2020/02/14/how-the-transparency-of-blockchain-drives-value/?sh=a1d2e7931a6d.

[45] Supplemental Release at 110-111.

systems currently in operation to be driven from the market entirely. The costs are high, and the SEC has recognized that it has not yet effectively estimated the true expense associated with the adoption of its proposed rule change with respect to the digital asset sector. Without further guidance and clarity from the SEC, the costs imposed by the Proposal on persons using or providing access to Decentralized Protocols, such as programmers and website providers would be extensive. Moreover, without further guidance, it is not clear how such persons could achieve compliance with the relevant regulations. The ultimate result would be a stifling of innovation and competition in this nascent industry, as well as stifling of competition within the traditional securities industry. A failure to consider and analyze these consequences in connection with the Proposal is contrary to the requirements of the Administrative Procedure Act.

In addition to its limited analysis of the costs of its Proposal, the SEC has held back in its analysis of the benefits; the Supplemental Release cites generalized interests in "competition," "efficiency," and "capital formation" as primary reasons for implementing the change, while refraining from discussion of how each element of the Proposal furthers these goals.[46] As we discuss herein and as other commenters have noted in prior letters, this Proposal will chill innovation and hinder, rather than promote, competition. Although the SEC touts "transparency" for market participants as one of its primary goals,[47] it is not clear how the Proposal would lead to greater transparency in these markets, which are far more transparent than traditional markets given the public listing of every transaction on the blockchain. Moreover, the SEC does not take into account the innovations at the core of Decentralized Protocols, including frictionless, permissionless, and trustless smart contracts that power decentralized exchanges. These innovations provide considerable transparency and reliability on these platforms that the SEC has not yet acknowledged in the balance of its analysis.

In order to satisfy its "obligation to consider the economic implications" of a proposed rule, the SEC must assess the likely costs and benefits of the rule, as measured against the existing regulatory regime. Courts are known to closely scrutinize the SEC's cost-benefit analysis and have repeatedly vacated SEC rules for failing "adequately to assess [their] economic effects."[48] The SEC has by its own statement not yet assessed the economic effect this proposal may have on crypto asset platforms,[49] and though it has acknowledged that compliance with the Fair Access Rule will result in additional costs, the SEC has not provided estimated figures of costs it believes will be incurred by those platforms that choose to register as a result of this change. At the very least, the SEC should assess the costs to be incurred by crypto asset platforms prior to choosing to extend the scope of the "exchange" definition to include these platforms' activities.

---

46 Supplemental Release at 132.

47 Supplemental Release at 146.

48 Qtd. in a16z Response Letter; *see Business Roundtable*, 647 F.3d at 1148; *see, e.g., Chamber of Commerce,* 412 F.3d at 144; *American Equity Inv. Life Ins. Co. v. SEC,* 613 F.3d 166, 176-79 (D.C. Cir. 2010).

49 *Supra* note 2.

III. Conclusion.

First and foremost, we again request the SEC discuss the source from which it derives the jurisdictional authority to vastly expand its interpretation of an "exchange," as we initially asked in our First Comment Letter and which the SEC has not addressed in the Supplemental Release.

There exists a continued need for appropriately definitive parameters of the SEC's new definition and its anticipated application. "Each agency shall draft its regulations to be simple and easy to understand, with the goal of minimizing the potential for uncertainty and litigation arising from such uncertainty."[50] While an agency's interpretation of its own regulations is granted significant judicial deference, the Proposal's vagueness with respect to the application and reach of the possible expansion of Section 3(a)(1) through Rule 3b-16 has hindered adequate cost-benefit analysis and raises significant fair notice and First Amendment concerns.

We respectfully submit that the SEC should not promulgate a vague and ambiguous regulation without having adequately analyzed the true cost of its implementation. We therefore respectfully request that the SEC revise the Proposal and Supplemental Release to clarify its cost-benefit analysis with respect to Decentralized Protocols and provide clearer guidance on what specific technologies and activities will be captured by the expanded definition, rather than perpetuating and intensifying the existing regulatory uncertainty surrounding these novel and innovative technologies. If the SEC does finalize this rule with requisite modifications to bring the rule within the bounds of the SEC's statutory authority, we respectfully request the SEC consider implementing a longer compliance period for at least those projects utilizing distributed ledger technology.

The goals of the Blockchain Association and the SEC are aligned in seeking operational transparency and fair access, and we encourage the SEC to revise its Proposal to ensure clear and transparent regulatory oversight in this novel and innovative space. To that end, we appreciate the opportunity to provide comments with respect to this important rule-making. The staff of the Blockchain Association and our counsel are available to meet and discuss these matters with the SEC and to respond to any questions.

Respectfully submitted,

Jake Chervinsky
Chief Policy Officer

Marisa T. Coppel
Policy Counsel

[50] Exec. Order No. 12866, 58 Fed. Reg. 51735 (Sep. 30, 1993).

cc: Stephen Wink
Benjamin Naftalis
Douglas Yatter
Naim Culhaci
Robin Spiess
Latham & Watkins LLP