



April 16, 2022

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

Via Electronic Mail: rule-comments@sec.gov

Re: *File Number S7-02-22, Amendments Regarding the Definition of “Exchange” and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities*

Dear Ms. Countryman:

Chia Network Inc. (“Chia”) welcomes the opportunity to respond to the Securities and Exchange Commission’s (“Commission”) request for comments to its proposed “Amendments Regarding the Definition of ‘Exchange’ and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities”, Release No. 34-940602, as published in the Federal Register dated March 18, 2022 (“Proposal”).

I. The proposed amendment of Rule 3b-16 under the Securities Exchange Act of 1934 uses a shotgun approach to accomplish a goal that in reality demands precise language instead of broad, overreaching drafting

Chia applauds the intent of the Commission in attempting to reduce the “disparity [that] has developed among similar markets that bring together buyers and sellers of securities, in which some are regulated as exchanges and others are not.” *Proposal* at p. 15498. Investors and consumers could be harmed by a lack of transparency and disparities across exchanges, Alternative Trading Systems (“ATS”) and similar systems. Chia also agrees with the Commission that there have been significant innovations in technology since Regulation ATS was adopted in 1998. *Proposal* at p. 15497.

The Commission’s Proposal, however, looks to an overly broad amendment of Exchange Act Rule 3b-16(a) to solve a narrow problem. The inclusion of Communications Protocol Systems (“CPS”) to fall within the definition of “exchange”, where the definition of CPS is broadly defined, is taking a shotgun approach. A more surgical method is warranted. Indeed, the Commission has acknowledged in the Proposal that it is targeting an exceedingly small number of CPSs. For example:

- In aggregate, the “Commission estimates the total number of Communications Protocol Systems to be 22, and some or all of this total number will be subject” to various filings and collections of information. *Proposal* at p. 15586 (emphasis added).

- In the market for government securities, the “Commission estimates that there are 3 Communication Protocol Systems operating . . . that may meet the definition of [an] exchange.” *Proposal* at p. 15601.
- “The Commission estimates that 6 Communication Protocol Systems for corporate bonds are not currently operated by registered broker-dealers.” *Proposal* at p. 15606.
- “The Commission estimates that there are currently 3 Communication Protocol Systems operating in the municipal debt market that may meet the definition of exchange.” *Proposal* at p. 15609.
- “As the Commission understands, there is currently 1 Communication Protocol System trading in listed options.” *Proposal* at p. 15615.

This is also the case for the remainder of markets where the Commission is concerned about the lack of regulation of CPSs. *Proposal* at pp. 15613 (NMS stocks), 15614 (secondary market for restricted shares), 15616 (reverse purchase agreements), 15617 (asset-backed securities). Too much ink is being spilled for twenty-two systems that could be more appropriately targeted.

Further, the Commission has described in detail the practices of particular CPSs that it desires to regulate more thoroughly in its Proposal: RFQ protocols, stream axes, and conditional order protocols. *Proposal* at p. 15594. These are specific and narrow use cases:

- RFQ system: “an RFQ protocol system typically allows market participants to obtain quotes for a particular security by simultaneously sending messages to one or more potential respondents. The initiating participant is typically required to provide information related to the request in a message, which may include the name of the initiating participant, CUSIP, side, and size. Participants that observe the initiating participant’s request have the option to respond to the request with a price quote. These respondents are typically dealers in the relevant asset class, and are often, though not always, pre-selected.” *Proposal* at p. 15594.
- Stream axes: “Dealers submit an indication or indications of interest (‘axe’ or ‘axes’), which may include price quotes and sizes for buying and selling securities. Axes are streamed to participants, updating continuously as dealers adjust prices and inventory offerings. A market participant may choose an axe with which to trade at the broadcasted price and size.” *Proposal* at p. 15595.
- Conditional order protocols: “often allow the matched parties to modify the attributes of the non-firm trading interest before accepting the firm-up invitation. If both matching parties accept the firm-up invite, the parties would agree upon the terms of the trade and an execution would occur.” *Id.*

Instead of using its considerable resources to craft narrow language to target all of twenty-two (22) systems across RFQs, stream axes, and conditional order protocols, the Commission’s proposed amendments puts entire internet and connectivity businesses in jeopardy of tripping over the Securities Act of 1934. The “reasonable alternatives” proposed by the Commission do not include any alternate options for the definitions of an Exchange or a Communications Protocol System, instead focusing on different filing and transparency requirements for CPSs. See *Proposal* at p. 15639. In the following sections, this letter will discuss specific issues caused by the current proposed amendments. The Commission can and should better target its amendments instead of upsetting entire industries.

II. The insertion of “trading interest” to Rule 3b-16 in place of “orders” encompasses substantial amounts of communications that are at best marginally related to legitimate transactions for securities

The Commission has proposed the use of trading interest as follows:

“Trading interest,” as proposed, would include “orders,” as the term is defined under Rule 3b-16(c), or any non-firm indication of a willingness to buy or sell a security that identifies at least the security and **either** quantity, direction (buy or sell), or price.

Proposal at p. 15504 (emphasis added). A non-firm indication, however, means more or less any indication. As long as a particular security is named and one of quantity, direction, or price, that constitutes trading interest. This definition is far too loose. For example, completely non-committal statements about a desire to load up on shares or a price threshold on a retail site such as Stocktwits could be included:



This could include statements made in a joking manner:



Or even a desire to obtain shares, such as the number of shares that a user was not able to purchase:



Magnite Inc 12.00 ↓ 0.05 (0.42%)



Geckomeister Bullish 4/7/22, 11:29 AM

[\\$MGNI](#) liquidity non existent on the offer. Bought a few but now I can't even get a quote for 2,500 shares (UK based if that makes any difference).



Or even devoid of numbers, a user's desire to purchase more stock:



Pulte @pulte

I don't drink whiskey, but I'm buying.

Just made six figure buy on Gamestop [\\$GME](#).

Although the Commission's proposed amendment seems germane on its face, it ends up capturing enormous amounts of communications that were likely never intended to be securities transactions. This is problematic for two reasons. First, actual exchanges and the Commission's intended CPS targets must tightly regulate speech across their platforms. Any random message could constitute trading interest even if no such interest is there. This is fundamentally different than an order which a consumer would understand is concrete and binding. Second, when coupled with the other amendments objected to in this comment letter in the next sections, huge swathes of the internet and telecommunications gets swept up in the drag net of the proposed Rule 3b-16 rather easily. An exchange being a system where "buyers and sellers can interact and agree to the terms of a trade" where the bar is "trading interest" is far too low. See *Proposal* at p. 15505. That potentially includes popular platforms such as Twitter, Reddit, or the comments section of Yahoo! Finance. The potential for the Commission to have to monitor thousands of websites and apps rather than twenty-two is more possible than the Proposal seems to indicate.

While the Commission's concern that "orders" are too narrow is legitimate, further amendments are required. For example, amendments to the definition of exchange could also focus on concepts of the provider who takes or provides a service in taking custody of securities transacted. Or as alternative, the concept of "trading interest" should be intermediated or verified by the exchange in question. Chia is confident that further thought and reflection by the Commission can yield better results here. Without including more limiting language in either of section (a)(1) or (a)(2) of Rule 3b-16, the Proposal is overbroad and defective.

- III. **The expansion of parties that "make available" established, non-discretionary methods that includes CPSs under the proposed Rule 3b-16 potentially drags in large numbers of internet and telecommunications providers and creates regulatory uncertainty for all such entities**

Most problematically, the Commission has proposed that an exchange Under Rule 3b-16(a)(2) includes any person who “makes available established, non-discretionary methods” for buyers and sellers to trade securities. *Proposal* at p. 15506. Specifically, the Commission desires to use this amendment to include CPSs:

In contrast to the term “uses,” the Commission believes the term “makes available” would be applicable to Communication Protocol Systems because such systems take a more passive role in providing to their participants the means and protocols to interact, negotiate, and come to an agreement.

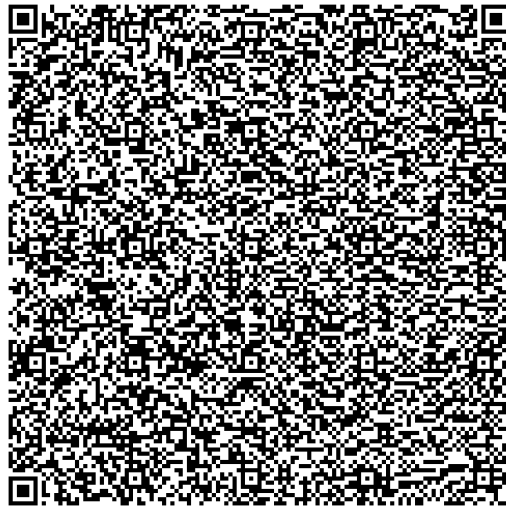
Id. Rather than create bright line rules, the Commission intends to examine “whether the system meets Rule 3b-16(a)(2) would depend on the particular facts and circumstances of each system. Nevertheless, as proposed, the Commission would take an **expansive view** of what would constitute ‘communication protocols’ under this prong of Rule 3b-16(a).” *Proposal* at p. 15507 (emphasis added). The Commission has a stated intent to “monitor market developments to ascertain whether such systems may warrant further regulation.” *Id.*

The Proposal preemptively attempts to assuage the doubts that Chia and others would have with such expansive language by backpedaling and signaling that the Commission would not take an expansive view to all internet and telecommunications providers yet. The Commission postulates “systems that passively display trading interest, such as systems referred to in the industry as bulletin boards, but do not provide means for buyers and sellers to contact each other and agree to the terms of the trade on the system would not be encompassed by Rule 3b-16(a) as proposed to be amended.” *Id.* Examples of these passive systems “that only provide general connectivity for persons to communicate without protocols, such as utilities or electronic web chat providers, would not fall within the communication protocols prong of the proposed rule because such providers are not specifically designed to bring together buyers and seller of securities or provide procedures or parameters for buyers and sellers for securities to interact.” *Proposal* at pp. 15507-15508. Of course, the Commission notes that even for such passive systems, “[t]o the extent that such systems are designed for securities and provide communication protocols for buyers and sellers to interact and agree to the terms of a trade, such systems would fall within the criteria of Exchange Act Rule 3b-16(a) as proposed to be revised.” *Proposal* at p. 15508.

As a Silicon Valley technology company, Chia is concerned that the tension between passive systems and the Commission’s expansive view of CPSs only creates regulatory uncertainty for any company that makes any sort of messaging system available to internet users, who under the First Amendment and Section 230 of the Communication Decency Act, can use systems in a way providers cannot always predict. Communications companies such as Twitter and Reddit make available forums for users to interact about a number of topics, including securities trading, and enable private messaging for users. Telecommunications companies such as AT&T and Verizon make communications devices available to consumers who can use SMS or any number of iOS or Android applications to communicate about any number of topics, including securities. The Commission’s expansive view of what constitutes an exchange and/or a CPS only creates a mountain of regulatory uncertainty and worry for any such technology company. Short of the issuance of private letter rulings, companies will always be under the presumption that the Commission may later declare their technology to be a covered CPS and have

regulatory burden that includes detailed disclosures about securities trades, users, cybersecurity details, and the like. *See e.g., Proposal* at pp. 15583-15584.

To further illustrate, the posting of this QR code below by the Commission could subject the Commission itself to potential scrutiny for allowing a method of communication that brings a buyer of securities together with a seller who has made this [Chia Offer](#) available:



This transaction offers a commodity, chia or XCH, for an asset token named [GAD](#) that was issued by a South American entity. The GAD asset token would likely be considered a security in the United States. It is a firm offer until canceled on the Chia blockchain by the maker. Anyone who reads this can take the offer at any time before it is canceled. This is a slippery slope for any internet or telecommunications provider to be most wary of as a single set of messages or even a QR code can serve as the basis for classification as an exchange under the proposed Rule 3b-16.

The Commission has also pointed out that internet and telecommunications providers must “specifically design” protocols to “bring together buyers and seller[s] of securities”. *Proposal* at pp. 15507-15508. Assuming arguendo that the Commission intends to use this as a bright line test to determine whether a CPS should or shouldn’t be considered an exchange, this still does not insulate such companies. There is a lack of regulatory clarity that can be created by other parties engaged in the use of platforms or communications tools created by internet and telecommunications providers. The Commission notes that “in the event that a party other than the organization, association, or group of persons performs a function of the exchange, the function performed by that party would still be captured for purposes of determining the scope of the exchange under Exchange Act Rule 3b-16.” *Proposal* at p. 15506. Thus, the actions of a company’s users—not its directors, officers, employees, contractors or agents—can still spell trouble for a technology company.

For example, a group of users can set up a server in Discord to interact and trade securities via messages exchanged within Discord. Discord could still potentially be regulated as an exchange by the Commission under this very possible and realistic scenario. The same applies to subreddits within Reddit, public channels created within Slack (acquired by Salesforce), and other generic communications tools such as Microsoft Teams, breakout rooms in Zoom, and the like. The regulatory chill from the Commission on such companies is palpable. At this point, we have only mentioned mainstream

technology and not delved into more esoteric use cases such as decentralized exchanges and decentralized finance for web3 technology companies. Chia believes that complexity and innovation thrive when regulations are properly scoped to address the risks.

The Commission should seriously reconsider the expansion of Rule 3b-16 to exclude internet and telecommunications companies broadly and re-scope the amendments to consider narrowly the 22 CPSs it had in mind.

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Chia appreciates the opportunity to provide our comments to the Commission regarding the proposed amendments regarding the definition of exchange and to Rule 3b-16. Please do not hesitate to contact us. We would be pleased to meet with the Commission or its staff to discuss our comments at any time.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Gene Hoffman", with a long horizontal flourish extending to the right.

Gene Hoffman
President & Chief Operating Officer
Chia Network