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April 18, 2022

Submitted via email to: rule-comments@sec.gov

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: 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; [Release No. 34-94062; File No. S7-02-22]

Dear Ms. Countryman:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") in response to the request for comments by the Securities and Exchange Commission (the "SEC" or the "Commission") with respect to its proposal to amend rule 3b-16 under the Securities Exchange Act of 1934 (the "Exchange Act") ("Exchange Act Rule 3b-16") regarding the definition of exchange, as more fully set forth below.¹

This letter was prepared by members of the Committee's Trading and Markets Subcommittee. The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and should not be construed as representing the official policy of the ABA. In addition, this letter does not represent the official position of the Section, nor does it necessarily reflect the views of all members of the Committee.

The Committee supports the Commission's effort to enhance investor protection by promoting fairness and increased transparency, as well as efforts to promote orderly and efficient securities markets. In furtherance of those goals, the Committee would like to bring to the Commission's attention certain aspects of the Proposal.

As background, the proposed amendments to Exchange Act Rule 3b-16 would require a Communication Protocol Systems ("CPS") to either register as an exchange or register as a broker-dealer and comply with Regulation ATS. The Commission seeks public comment on all aspects of its proposal to amend

Exchange Act Rule 3b-16(a) to include CPSs within those systems that would fall within the definition of “exchange,” and to expand existing exchange regulatory requirements appropriate to a CPS (together, the “Proposal”).

The Committee’s comments are as follows:

A. The Commission should extend the comment period for an additional 60 days.

The comment period of 30 days is inadequate given the importance, size, scope and potential implications of the Commission proposal, as further discussed in this comment letter. For example, the Proposal includes 224 separate requests for comment, many of which include multiple parts.

B. The Commission should provide more explanation as to why its authority to define and interpret terms in the Exchange Act allows for expanding the statutory definitions of “exchange” and “broker” or “dealer” to require the broker-dealer registration of CPSs

The Proposal requests comment on whether the Commission should adopt a more expansive or limited interpretation of the definition of “exchange.”ⁱⁱ In response, we believe that the Proposal does not adequately address the Commission’s authority to amend Rule 3b-16 to expand the application of the terms used in the statutory definition of “exchange” beyond the definition in the Exchange Act. The Exchange Act defines an “exchange” as “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.”ⁱⁱⁱ This statutory definition, as determined by Congress, is fundamental to the Exchange Act.

In 1998 the Commission adopted Regulation ATS to provide a new regulatory framework for securities markets to address the impact of technological developments on the way securities were traded.^{iv} Included in the adopting release for Regulation ATS the Commission adopted Exchange Act Rule 3b-16 to define terms used in the statutory definition of exchange in the Exchange Act.^v In doing so, the Commission departed from its narrow interpretation of exchange espoused in the “Delta Release” in 1990,^{vi} which was upheld by the Seventh Circuit on review.^{vii} The Commission’s actions rested in part on the authority which Congress provided the Commission with in Section 36 of the Exchange Act as part of the National Securities Markets Improvement

Act of 1996 (“NSMIA”).^{viii} As amended by NSMIA, Section 36(a) of the Exchange Act provided the Commission with greater flexibility to regulate new trading systems by giving the Commission broad authority to exempt any person from the provisions of the Exchange Act and impose appropriate conditions on their operation.^{ix}

In reliance on this authority and its authority to define terms used in the Exchange Act, in adopting Exchange Act Rule 3b-16 the Commission defined certain terms used in the definition of exchange to include “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.”^x

As stated in the Regulation ATS 1998 Release, advancing technology increasingly blurred the distinctions between exchanges and broker-dealers, and alternative trading systems, previously known and regulated as Electronic Communications Networks (ECNs), were used by market participants as functional equivalents of exchanges.^{xi} Accordingly, the Commission’s new interpretation of exchange contained in Rule 3b–16 was intended to encompass these equivalent markets and the Commission’s new general exemptive authority enabled it to craft a new regulatory framework.^{xii}

However, notably, in the Proposal the Commission acknowledged that CPSs did not meet the then current definition of exchange and were not subject to regulation as an exchange or an ATS.^{xiii} We believe the Commission should further expand the discussion of its authority to expand the definition of exchange, including its exemptive authority under Section 36 of the Exchange Act. While the Commission may have exemptive authority and authority to define terms used in the Exchange Act, it is not clear whether the scope of such authority extends the reach of regulation to persons and entities not included in the statutory definition. Yet, the Proposal, by amending Exchange Act Rule 3b-16, significantly expands the effective definition of exchange beyond the statutory definition to include persons who merely “make available” CPSs. For these reasons we believe that the Proposal should address with more specificity how the Commission’s authority to amend Rule 3b-16 in the manner proposed is authorized under the Exchange Act.

Further, the Proposal includes scant discussion of what it means for CPSs to register as broker-dealers and ATSS. That is, there should be further explanation of why CPSs should in fact be considered to be broker-dealers, which would be required to comply with the conditions of the Regulation ATS exemption.^{xiv} We believe that if the Commission is of the view that CPSs meet

the statutory definition of broker-dealer it should state that and provide the corresponding analysis.

C. The Proposal is being issued concurrently with the Commission’s proposed expansion of the definition of dealer, which makes analysis of the economic effects of the Proposal challenging.

On March 28, 2022, the SEC proposed two new rules to further define the phrase “as a part of a regular business” as such terms are used in the definitions of “dealer” and “government securities dealer” under Sections 3(a)(5) and 3(a)(44), respectively, of the Exchange Act (the “Dealer Proposal”).^{xv} In the Dealer Proposal the SEC is proposing to further define “as part of a regular business” to focus on activities rather than status or labels and is proposing standards to identify market participants that are providing liquidity in securities markets. Any person that meets the activity-based standards identified in the new rules would be considered a dealer or government securities dealer and be required to register, absent an otherwise available exemption or exception. According to the Dealer Proposal, the SEC is expecting that principal trading firms, proprietary trading firms and certain investment advisers and private funds, among others, may be required to register as dealers because of their role providing liquidity to markets. The application of the proposed rules would be to include liquidity providers in any market, including decentralized exchanges and markets in digital assets that are considered securities. Investment companies registered with the SEC under the Investment Company Act of 1940 and a person that has or controls total assets of less than \$50 million are excluded from the application of the proposed rule.

Taken together, the ATS Proposal and the Dealer Proposal would subject many persons, businesses and algorithmic systems that are now unregulated to broker-dealer registration and an extensive broker-dealer regulatory regime under the Exchange Act, which includes registration with the SEC and FINRA and one or more state regulatory authorities, compliance with a vast array of financial, compliance, recordkeeping and reporting obligations, as well as periodic examination by regulatory authorities. While the Committee recognizes and acknowledges that the SEC proposals are intended to protect investors and even the playing field for registered and unregistered entities, the imposition of an overlay of regulation on markets and market participants is a complex undertaking and the transition from the current landscape to the future state envisioned by the Commission is likely to take time. Accordingly, the Committee recommends that the ATS Proposal and the Dealer Proposal be re-proposed in tandem so that the potential implications of their adoption be fully vetted, including consideration of the economic effects, costs, benefits and effects on efficiency, competition and capital formation. It is overly complicated and

essentially unfeasible to attempt to assess the impact of the two proposals on markets, market participants and innovation in the financial industry in the separate manner in which they were proposed.

We also note that the Release requested comment on whether the Commission should allow a Newly Designated ATS that is not registered as a broker-dealer to operate pursuant to the Rule 3a1-1(a)(2) exemption on a provisional basis?^{xvi} In addition, the Commission requested comment on whether the allowance of a maximum time period of 210 calendar days to Newly Designated ATSs to comply with the broker-dealer registration requirement is appropriate. To the extent that the Proposal is adopted as proposed, we believe that a Newly Designated ATS should be allowed to operate on a provisional basis under an exemption and that it should be granted a time period of at least a year to become registered as a broker-dealer and ATS such as to allow the Newly Designated ATS sufficient time to prepare its application for registration with FINRA, organize its corporate structure to provide required capitalization, have appropriate personnel become qualified under FINRA examination standards, organize its financial, operational and recordkeeping systems, prepare an application that will meet FINRA's "substantially complete" standard for review, and achieve approval from FINRA and the SEC, a process that could easily exceed 180 days from submission of the application, especially in cases in which orders (and presumably Indications of Interest) in digital assets will be displayed.^{xvii}

D. The Proposal would have a chilling effect on technological innovation, particularly in the blockchain industry, and is being made at a time when the Biden Administration is taking a multi-agency approach to digital assets.

By subjecting CPSs to registration as a broker-dealer and compliance with Regulation ATS, the Proposal would require CPSs to comply with a regulatory scheme that includes a broad array of regulatory requirements under the federal securities laws and FINRA Rules. Compliance with such requirements is costly and time-consuming and the imposition of such requirements on CPSs which are technology companies is likely to have a chilling effect on the development of new systems and technologies. This is particularly of concern in the blockchain industry. In March, the Biden Administration issued an Executive Order which takes a multi-agency approach to addressing the risks and potential benefits of digital assets and their underlying technology (the "Executive Order").^{xviii} While the Proposal does not contain any reference to digital assets, it clearly applies to trading any type of security and could apply to protocols used by decentralized and centralized exchanges for trading digital assets. To the extent that the Proposal does apply to such trading venues, it would appear to conflict with the approach being taken by the Biden Administration, which calls for coordination

among a broad range of government agencies to develop an appropriate approach to digital assets. The Commission should clarify how the Proposal is intended to apply to activities involving digital assets or blockchain, or defer the application of the Proposal to digital asset intermediaries and their underlying technology pending completion of the mandates in the Executive Order.

E. The Proposal to amend Exchange Act Rule 3b-16(a)(2) to replace “uses established, non-discretionary methods” with the phrase “makes available established, non-discretionary methods (i) would adversely impact bulletin boards by narrowing the exception from regulation over their activities; and (ii) would impose burdensome operational and compliance requirements on trade management systems that were not developed with a view to having to comply with Regulation ATS and related requirements applicable to broker-dealers.

The Commission proposes to amend Exchange Act Rule 3b-16(a)(2) to replace “uses established, non-discretionary methods” with the phrase “makes available established, non-discretionary methods.”^{xxix} According to the Commission, the proposed change to use the word “makes available” rather than “uses” is designed to capture established, non-discretionary methods that an organization, association, or group of persons may provide, whether directly or indirectly, for buyers and sellers to interact and agree upon terms of a trade. The Commission further stated that, 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.^{xx} In addition, under the Proposal the exemption for passive systems under Rule 301(b)(5)(iii) of Regulation ATS would be removed.^{xxi}

The Commission has requested comment on whether it should revise Exchange Act Rule 3b-16 to focus on bringing together buyers and sellers, rather than bringing together orders (or trading interest)?^{xxii} In response we believe that the Commission’s proposal to expand Exchange Act Rule 3b-16(a)(2) to include parties who simply “make available” such methods creates regulatory uncertainty for systems that passively display trading interests, such as a bulletin boards, and would impose burdensome operational and compliance requirements on software developers and others who will be unable to comply with legal and regulatory requirements applicable to an ATS.

With respect to bulletin boards, we note that the Commission stated in the Release that 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.^{xxiii} However, this statement does not provide sufficient regulatory clarity that bulletin boards would not be required to register as exchanges under the Proposal. These organizations operate in reliance on no-action authority issued by the Commission at a time when the technology for such systems was still evolving.^{xxiv} The Commission should provide further guidance on the application of the Proposal to passive bulletin boards to remove any doubt as to the application of the Proposal to such systems. Furthermore, it is unclear how a system that could not provide a method for interested buyers and sellers to contact each other would be able to be utilized; further clarification on this point is needed.

In addition, the Proposal could be interpreted to encompass various order management systems offered by software vendors, other systems used by buy-side firms (including proprietary systems) to aggregate and manage their internal trading interests, electronic communications protocols for automatic trading^{xxv} and other industry connectivity solutions, and structured chat systems. We believe that many of the software developers and others who make these systems available do not have control over, or visibility into, trading that takes place by those market participants using the systems and would be unable to comply with the ongoing obligations of an ATS, such as market access controls under Rule 15c3-5, recordkeeping requirements^{xxvi}, trade reporting^{xxvii}, CAT^{xxviii}, Regulation NMS, etc.

Similarly, those systems that merely facilitate the display of trading interest but where trade execution occurs elsewhere (*e.g.*, a system where a customer can send an RFQ or order to multiple broker-dealers which result in the “winning” broker-dealer handling execution away from the system) are not set up to comply with many of the rules now applicable to an ATS because the rules are drafted to apply to a person falling within the existing definition in Exchange Act Rule 3b-16, which encompasses only systems that facilitate execution through interaction of “orders.” Such systems would be unable to comply with requirements applicable to an ATS without making costly changes to their systems and operations. In sum, should the SEC move forward with the Proposal, we recommend that the Commission and FINRA should adopt conforming changes to these other rules to exclude ATSs falling outside the current definition.

- F. The Proposal would have unintended consequences by subjecting a CPS to burdensome broker-dealer regulatory reporting and compliance obligations with no evidence that, in so doing, the SEC promotes investor protection or fair, orderly, or efficient markets.**

We note that the Proposal requests comment on the following:

Should Communication Protocol Systems that choose to comply with Regulation ATS be subject to all of the requirements of Regulation ATS?

Are there certain requirements of Regulation ATS that should or should not be applicable to Communication Protocol Systems, or certain Communication Protocol Systems? For example, are the current Regulation ATS recordkeeping requirements appropriate for Communication Protocol Systems? Should the Commission require a Communication Protocol System that chooses to operate as an ATS to create and maintain records that are not otherwise required by Rule 301(b)(8) of Regulation ATS? Is there anything that is not currently among the conditions to the Regulation ATS exemption that a Communication Protocol System and/or an existing ATS should comply with as part of Regulation ATS? And if so, why?^{xxx} The Proposal also asks, Should the Commission amend Regulation ATS, Form ATS, Form ATS-R, or Form ATS-N in any way to be more tailored to Communication Protocol Systems?^{xxx}

We believe that the questions posed are important to understand and resolve. The Commission's questions deserve full consideration, or CPSs will be unable to comply with applicable standards. For these reasons, we believe that the Commission, perhaps in conjunction with FINRA, should conduct a top to bottom review of all of the requirements that would be applicable and limit the application of such requirements that in the Commission's view, are necessary to achieve the investor protection and transparency that the Proposal seeks to achieve.

G. The Exclusion in Proposed Rule 3b-16(b)(3) Should Be Revised to Make It Clear That It Applies to Systems That Allow Multiple Issuers to Sell Their Securities

The Commission proposes to remove the reference to securities of "multiple" buyers and sellers from Exchange Act Rule 3b-16(a)(1) and to codify in Rule 3b-16(b)(3) an example the Commission provided in the Regulation ATS 1998 Release for systems that allow issuers to sell their own securities to investors. As currently proposed, the exclusion in Exchange Act Rule 3b-16(b)(3) would apply to a system that "allows an issuer to sell its securities to investors." We believe that the Commission intended the exclusion to apply to a system that allows multiple issuers to sell their own securities to investors. In order to remove any ambiguity, we suggest that the exclusion should be revised to say that it applies to a system that "allows one or more issuers to sell their securities to investors, either directly or through placement agents or underwriters." As the Commission notes in the Release,^{xxx} "The term 'multiple' was added to Rule 3b-16(a) to help reinforce that single counterparty systems were not included in the

definition of ‘exchange.’” A system that allows more than one issuer to sell its own securities is a single counterparty system because for any particular security, there is only one counterparty, the issuer of the securities. The addition of the phrase, “or through placement agents or underwriters” is necessary to make clear that the exclusion is not lost if the system permits an issuer to use brokers or underwriters, and desirable because it permits the interposition of registered brokers, who provide a multitude of services protective of the rights of investors.^{xxxii}

We greatly appreciate the opportunity to provide comments with respect to this important rule-making effort and thank the SEC staff for its efforts and thoughtful approach to the issues addressed by the Proposal. Members of the Drafting Committee are available to meet and discuss these matters with the SEC staff and to respond to any questions.

Very truly yours,



Jay H. Knight
Chair of the Federal Regulation of
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^{i i} See SEC Release No. 34-94062 (January 26, 2022) (the "Release").

ⁱⁱ Question 1, the Release.

ⁱⁱⁱ Exchange Act, Definitions, Section (a)(1).

^{iv} See Securities Exchange Act Release No. 40760 (December 8, 1998) (the "Regulation ATS 1998 Release"). Regulation ATS consists of Rules 300 through 304 under the Exchange Act.

^v *Id.*, Section III.

^{vi} See Securities Exchange Act Release No. 27611 (Jan. 12, 1990), 55 FR 1980 (Jan. 19, 1990).

^{vii} Board of Trade of the City of Chicago v. SEC, 923 F.2d 1270 (7th Cir. 1991).

^{viii} Pub. L. 104-290.

^{ix} See Introduction, Regulation ATS 1998 Release.

^x Exchange Act Rule 3b-16.

^{xi} Section II.A., Regulation ATS 1998 Release.

^{xii} *Id.*

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- ^{xiii} See Introduction and Section II.B.3 , the Release.
- ^{xiv} See Section II.B.3, the Release.
- ^{xv} Exchange Act Release No. 34-94524; Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer; March 28, 2022 (the “Dealer Release”)
- ^{xvi} Question 11, the Release.
- ^{xvii} See FINRA Rule 1013(a)(3).
- ^{xviii} See the Executive Order on Ensuring Responsible Development of Digital Assets, <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>
- ^{xix} See Section II.C.3, the Release.
- ^{xx} Id.
- ^{xxi} See Section V.A.5, the Release.
- ^{xxii} Question 4, the Release.
- ^{xxiii} See Section II.C.3, the Release.
- ^{xxiv} See, e.g., Portland Brewing Co., SEC No-Action Letter (Dec. 14, 1999); Flame-master Corp., SEC No-Action Letter (Oct. 29, 1996); PerfectData Corp., SEC No-Action Letter (Aug. 5, 1996); Real Goods Trading Corp., SEC No-Action Letter (June 24, 1996).
- ^{xxv} FIX messaging, for example, may be impacted.
- ^{xxvi} See, e.g., Rule 302 of Regulation ATS and Exchange Act Rule 17a-3
- ^{xxvii} See, e.g., Rule 301 of Regulation ATS
- ^{xxviii} CAT" is defined to mean the consolidated audit trail contemplated by Rule 613 of SEC Regulation NMS. FINRA Rule 6810(g).
- ^{xxix} Question 7, the Release.
- ^{xxx} Question 8, the Release.
- ^{xxxi} Text at n. 102.
- ^{xxxii} In the no-action letter to Prescient Markets (April 2, 2001), which proposed to operate an electronic execution platform for commercial paper offered by issuers pursuant to Section 3(a)(3) and 4(a)(2) of the Securities Act of 1933, one of the factors supporting relief was that important customer-related functions would be handled by an affiliate of Prescient Markets registered as a broker.