



June 13, 2023

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

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

Re: Supplemental Information and Reopening Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange” (File Number S7-02-22, RIN 3235-AM45) (Release No. 34-97309; File No. S7-02-22; Fed. Reg. No. 2023-08544)

This comment letter is submitted on behalf of DirectBooks LLC (“DirectBooks”), which offers a SaaS platform that simplifies the primary issuance process for fixed income securities by streamlining communications workflows between underwriters and institutional investors. DirectBooks writes in response to the reopening of the comment period by the Securities and Exchange Commission (the “SEC”) with respect to its proposal to amend the interpretation of the definition of “exchange” in Rule 3b-16 (“Rule 3b-16”) of 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 DirectBooks had previously submitted a comment letter in response to the Proposal on April 18, 2023 (the “Prior Comment Letter”).

DirectBooks appreciates the SEC’s ongoing review of these rules and regulations and its desire to ensure that the appropriate platforms are properly captured by the definition of an “exchange” under the Exchange Act. We particularly appreciate the SEC’s acknowledgment of the points we made in the Prior Comment Letter and the SEC’s presentation of a potential path forward with respect to exempting primary market communications systems such as the DirectBooks system. We thus write to supplement the Prior Comment Letter in light of the Supplemental Release.

As we stated in the Prior Comment Letter, we respectfully believe that the amended version of Rule 3b-16 should not apply to the business of DirectBooks, or to other similarly situated primary market communication system operators.

A. Activities performed by DirectBooks

¹ Amendments to the Definition of Exchange; Alternative Trading Systems That Trade U.S. Government Securities, National Market System Stocks, and Other Securities; etc., Fed. Reg. No. 2022-01975 (Mar. 18, 2022).

² Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of “Exchange”, Fed. Reg. No. 2023-08544 (May 5, 2023).

As described in the Prior Comment Letter, and in response to Question 18³ in the Supplemental Release⁴ which asks for further detail and examples regarding primary market communications systems, DirectBooks' platform facilitates communications between, on the one hand, a syndicate of underwriting broker-dealers (the "Sell-Side Dealers") acting on behalf of an issuer, and on the other hand, the Sell-Side Dealers' institutional clients (the "Buy-Side Firms") that wish to be allocated newly issued corporate bonds in a primary offering. Each of the Sell-Side Dealers are broker-dealers that are registered with the SEC and are members of the Financial Industry Regulatory Authority ("FINRA"). Each of the Buy-Side Firms qualify as "Qualified Institutional Buyers" ("QIBs") as defined under Rule 144A under the Securities Act of 1933, or meet the equivalent investor sophistication level if located outside of the United States. In order to engage in any communication with a Sell-Side Dealer on the DirectBooks platform in respect of a particular deal announced over the platform, the relevant Buy-Side Firm must already have an existing, direct customer relationship with such Sell-Side Dealer. The DirectBooks platform is then utilized by the Sell-Side Dealer underwriting syndicate to announce a primary bond offering on behalf of an issuer, to permit connected Buy-Side Firms to transmit a structured, non-binding indication of interest message ("IOI Message") to the underwriting syndicate, and to permit the underwriting syndicate to transmit a structured, non-binding allocation message ("Allocation Message") to the Buy-Side Firm. DirectBooks is not involved in the allocation process, which is handled off-platform by the syndicate of Sell-Side Dealers. DirectBooks is also not involved in the execution or confirmation of any securities transactions that may ultimately result from such communications and, in fact, is not apprised regarding whether or not a securities transaction results between a Sell Side Dealer and any Buy-Side Firm.

DirectBooks (i) does not charge transaction-based compensation, (ii) does not intermediate or otherwise interfere with the substance of any IOI Messages or Allocation Messages, (iii) does not hold itself out as a broker-dealer and makes clear in its disclosures that it is not a broker-dealer, (iv) does not handle customer funds or securities, (v) does not open accounts, (vi) does not engage in marketing on behalf of Sell-Side Dealers or issuers and does not recommend any securities and (vii) does not send confirmations pursuant to Rule 10b-10 of the Exchange Act or otherwise confirm the final terms of any securities transaction. Moreover, DirectBooks does not facilitate any negotiation between Buy-Side Firms and Sell-Side Dealers – there is no "counteroffer" functionality in relation to IOI Messages and Allocation Messages – Buy-Side Firms ultimately confirm the terms of their transaction and purchase bonds in each case off the platform and at the issue price. Finally, as described above, all Sell-Side Dealers are SEC-registered and FINRA-member broker-dealers and all Buy-Side Firms are QIBs or the foreign equivalent.

3 Supplemental Release at 48 ("In light of comments that the concept of a communication protocol system could capture various types of technologies used by market participants for securities (e.g., GUIs, web chat providers, primary market communication systems, software solutions, or trading desks of a broker-dealer), please explain in detail and provide examples of the specific activities performed through the use of such technology identified by commenters.")

4 Please note that all references to exact Question numbers herein are intended to reference the corresponding Questions as numbered in the Supplemental Release.

Requiring primary market communications systems such as the DirectBooks platform to register as broker-dealers and/or an exchange is, to our understanding, inconsistent with the traditional hallmarks that merit such regulation. As we had noted in the Prior Comment Letter, the SEC has traditionally granted no-action relief from both broker-dealer and exchange registration requirements for primary market communication platforms such as the DirectBooks platform that do not collect transaction-based compensation and merely facilitate communications between broker-dealer underwriters and institutional buy-side investors in primary market transactions.⁵

Finally, we would like to reiterate the point that we made in the Prior Comment Letter, that we do not believe that a primary market communications services platform such as the DirectBooks platform is among the types of platforms that are intended to be captured by the proposed amended version of Rule 3b-16. Indeed, such platforms do not qualify as any of the communication protocol systems cited in the Proposal. Namely, DirectBooks does not operate a request-for-quote system, stream axe or another type of system that offer the use of non-executable trading interests, facilitate negotiations, improve price discovery (all Buy-Side Firms ultimately enter into primary market transactions – if any – off-platform, at the issue price) or allow for “auctions where the respondents compete to offer the best price.”⁶ While we recognize that the communication protocol system examples cited in the Proposal provide for a non-exclusive list, it is difficult for us to envision a space for DirectBooks or similar platforms in the regulatory scheme contemplated by the Proposal.

B. Rule 3b-16(b)(3) Exemption

a. Current Proposed Version of Rule 3b-16(b)(3)

To the extent that DirectBooks’ and similar primary markets operators’ business activities are deemed to fall within the scope of Rule 3b-16(a), we contend that they should be exempted from Rule 3b-16 pursuant to Rule 3b-16(b)(3). As discussed in greater detail in the Prior Comment Letter, Rule 3b-16(a) in its current unamended form requires “bring[ing] together the orders for securities of *multiple buyers and sellers*” (emphasis added). When initially adopting Rule 3b-16, the SEC had stated that it is including the phrase “multiple buyers and sellers” in order to exclude “systems in which there is only a single seller, such as systems that permit issuers to sell their own securities to investors.”⁷ The SEC states in the Proposal that it is proposing to remove the word “multiple” because, although the term was initially added “to help reinforce that single counterparty systems were not included in the definition of ‘exchange,’” the term “could be misconstrued to mean that RFQ systems, for example, do not meet the criteria of Rule 3b-16(a)

⁵ See, e.g., Neptune Networks, Ltd., SEC No Action Letter (Mar. 4, 2020) (recommending no enforcement action against a communications protocol that provides “a passive electronic data connectivity and communication system for institutional participants in the fixed-income market”); see also Evare LLC, SEC No Action Letter (Jul. 29, 1998); Prescient Markets, Inc. (Apr. 2, 2001).

⁶ See Proposal at 19-24.

⁷ Regulation of Exchanges and Alternative Trading Systems 63 Fed. Reg. 245 at 70849 (Dec. 22, 1998).

because a transaction request typically involves one buyer and multiple sellers or one seller and multiple buyers.”⁸ The SEC states in the Proposal, however, that, as a counterbalancing measure, it would propose adopting Rule 3b-16(b)(3), which would exempt a platform “that allows an issuer to sell its securities to investors.”⁹

DirectBooks believes that it operates such a platform. As described above, DirectBooks’ software platform effectively assists in automating a portion of the communication workflow involved in the primary offering of corporate bonds. Due to the structure of the corporate bond market, it is standard for primary issuances to be underwritten by regulated broker-dealers — communications facilitated by DirectBooks are therefore between the syndicate of underwriting broker-dealers (on behalf of the relevant issuer) and their institutional clients that wish to be allocated newly issued corporate bonds in a primary offering. Moreover, because each offering is made by a single issuer through a unified syndicate of underwriters, we believe that the communications workflow facilitated by DirectBooks does not involve “multiple sellers.”

As stated in the Prior Comment Letter, while DirectBooks believes that it should qualify for the Rule 3b-16(b)(3) exemption as proposed in the Proposal, given the potential ambiguity that may be caused by the removal of the term “multiple” from, and other expansions made to, Rule 3b-16(a), it respectfully requests clarification regarding whether primary market communications systems will be captured by the proposed amended version of Rule 3b-16. DirectBooks believes that an effective way to achieve such clarification will be through revising the language of Rule 3b-16(b)(3) in the two ways discussed below.

b. Revised Proposed Version of Rule 3b-16(b)(3)

The SEC asks in Question 27¹⁰ of the Supplemental Release whether it should revise Rule 3b-16(b)(3) from its current proposed version which reads “allows an issuer to sell its securities to investors” to read “allows *one or more issuers* to sell their securities to investors, *either directly or through placement agents or underwriters*” (emphasis added). We think that this language would further clarify that a primary market communications system such as DirectBooks qualifies for Rule 3b-16(b)(3), and we do not believe it would substantively expand the Rule beyond the parameters of the Proposal, as it would permit issuers to do what they may currently do (sell securities directly or through placement agents or underwriters), but in this case a technology

⁸ Proposal at 30.

⁹ Proposal at 37.

¹⁰ Supplemental Release at 55 (“Should the Commission adopt Rule 3b-16(b)(3), as proposed to be amended? Why or why not? Should the Commission adopt the proposed Rule 3b-16(b)(3) exclusion but with certain revisions? If so, please identify those revisions and explain. For example, should the Commission adopt, as suggested by one commenter, the proposed issuer exclusion with revisions to state 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”? In particular, should the Commission add “one or more issuers” to the proposed issuer exclusion? What types of systems would be covered under the revised issuer exclusion example above? Please explain. Is the inclusion of “either directly or through placement agents or underwriters” in the revised issuer exclusion example above necessary or appropriate to clarify its application? If so, why?”)

platform is utilized by the Sell-Side Dealers to facilitate such sales. Moreover, although we think that a primary market communications systems such as DirectBooks should qualify for the current proposed version of Rule 3b-16(b)(3) which references “an issuer” rather than “one or more issuers” since DirectBooks expects to only facilitate communications with respect to single issuer offerings and will not facilitate communications with respect to any multiple issuer offerings, we think that changing this reference from singular to plural will clarify that a system does not need to be specific to only one issuer in order to qualify for the exemption, but can facilitate communications with respect to offerings by different issuers.

Indeed, although the DirectBooks platform is utilized in connection with an issuers’ sales of their securities, given that such sales are made through the Sell-Side Dealers that are acting as underwriter for such offerings, it is the Sell Side Dealers and not the issuer itself that utilize the DirectBooks platform to communicate with Buy-Side Firms. In fact, it would be more in line with the intent of the Proposal for the SEC to determine to regulate issuer sales platforms that do not utilize regulated broker-dealers who underwrite the offering, and this view is in line with prior guidance in this area.¹¹ Accordingly, we believe that it would be helpful to clarify Rule 3b-16(b)(3) by also applying the exemption to systems that are utilized by underwriter broker-dealers; i.e., not requiring the system to be utilized solely by the issuer itself.

We note that the SEC also asks in Question 29¹² in the Supplemental Release whether to adopt an exemption for systems or portals that an exchange-traded fund (“ETF”) sponsor uses to facilitate ETF primary market operations (*i.e.*, creation and redemption of ETF shares) (“ETF Portals”) or that support primary market transactions in investment companies. We do not see any cogent rationale for limiting an exemption solely to ETF Portals and investment companies’ primary market securities transactions, rather than more broadly exempting all other types of primary market platforms, and therefore urge that ETF Portals and investment company primary markets should not be singled out for exemption under Rule 3b-16(b)(3). That said, if the SEC is considering exempting these entities/systems, we believe the rationale is closely linked to the reasoning set forth herein in respect of other primary market facilitation systems: such systems were not among those intended to be captured by the definition of an “exchange,” there are no obvious benefits to their being regulated, and therefore their activity either falls outside the scope of the new Proposal or deserves to be explicitly exempted.

C. Change from “Communications Protocol” to “Negotiation Protocol”

In the Supplemental Release the SEC acknowledged comments received regarding the term “communications protocol” being overly broad and vague, and solicited comments in response to Question 13¹³ regarding whether the term “communications protocol” should be replaced with the

¹¹ See *e.g.*, Neptune Networks, Ltd., SEC No Action Letter (Mar. 4, 2020); Evare LLC, SEC No Action Letter (Jul. 29, 1998); Prescient Markets, Inc. (Apr. 2, 2001).

¹² Supplemental Release at 57-58.

¹³ Supplemental Release at 45 (“To reflect systems that provide non-discretionary methods under which buyers and sellers negotiate terms of a trade, should the Commission adopt amendments to Exchange Act Rule 3b-16(a)(2)

term “negotiations protocol.” The Supplemental Release also set forth that “negotiations protocol” could be defined as a “non-discretionary method that sets requirements or limitations designed for multiple buyers and sellers of securities using trading interest to interact and negotiate the terms of a trade.”¹⁴ We support this change and agree that the term more accurately captures the intended scope of the Proposal and, if adopted, we do not believe that the DirectBooks platform and similar operators would be captured, because they do not facilitate any type of price negotiation – nor, due to the nature of the platforms, are they tools for any form of negotiation.¹⁵ As a primary market communications platform, DirectBooks does not set requirements or limitations whereby “multiple buyers and sellers” can use trading interest to “interact and negotiate the terms of a trade.” Indeed, it appears to us that this description would also clarify that the Proposal is meant to apply to secondary market platforms, where negotiation takes place between multiple buyers and sellers; primary markets platforms whereby issuers or their underwriters allocate primary offerings would not be captured.

In response to Question 16¹⁶, we do think that it would be helpful for the SEC to provide examples of what type of systems will qualify as “negotiation protocols”. As we described in the Prior Comment Letter, neither the DirectBooks platform nor, to our knowledge, any other typical primary market communications platform would fit into any of the categories that were illustratively described in the Proposal (*i.e.*, a “Request-for-Quote” system, stream axe or auction system).

D. Cost and Benefits if Rule 3b-16 Were to Apply

a. Costs

that replace the proposed term “communication protocols” with the term ‘negotiation protocols’ and adopt the following definition under a new Rule 3b-16(f): For purposes of this section, the term ‘negotiation protocols’ means a non-discretionary method that sets requirements or limitations designed for multiple buyers and sellers of securities using trading interest to interact and negotiate terms of a trade.”).

¹⁴ *Id.*

¹⁵ Per the description provided in Section A above, DirectBooks’ platform offers a communications channel between Sell-Side Dealers and Buy-Side Firms regarding the allocation of bond offerings. It does not offer a means of engaging in price negotiation or making counteroffers. Directbooks does not offer any type of functionality allowing Buy-Side Firms and Sell-Side Dealers to chat, discuss, make counteroffers or otherwise negotiate the terms of any securities transaction. In all cases, transactions are separately agreed to and executed off platform.

¹⁶ Supplemental Release at 46-47 (“As an alternative to adopting a definition of “negotiation protocols” in the rule text, should the Commission provide an explanation and examples of what negotiation protocols are and are not in any adopting release, similar to what the Commission did in the Regulation ATS Adopting Release when analyzing the application of Rule 3b-16 to hypothetical Systems A through T? In the Proposing Release, the Commission provided examples of trading systems that offer the use of non-firm trading interest and established protocols that would meet the criteria of Exchange Act 3b-16, as proposed to be amended (e.g., RFQ, conditional order systems, indication of interest systems). Should the Commission adopt those examples as hypotheticals that would meet the criteria of Rule 3b-16 similar to the hypotheticals in the Regulation ATS Adopting Release? Please explain. Should the examples that the Commission provided in the Proposing Release change in any way? Are there any other examples that the Commission should adopt to describe New Rule 3b-16(a) Systems? Please describe any such examples.”)

To the extent that DirectBooks, and primary market communications systems similar to it, are required to register as a broker-dealer and alternative trading system (“ATS”), they would be required to incur substantial costs. One such source of costs would be in connection with restructuring their business models to comply with the requirements that would be imposed on them as a broker-dealers and ATSS. Currently, the Sell-Side Dealers that are acting as underwriters on DirectBooks’ platform assume all regulatory responsibility with respect to their communications on the platform as well as underlying transactions that may result from them. DirectBooks does not intermediate communications that are sent through its platform, is not involved in the execution or confirmation of any securities transactions that result from such communications and, in fact, is not apprised regarding whether or not a securities transaction results. Registration as a broker-dealer and an ATS would require substantive involvement by DirectBooks and similar primary market communications systems in these communications and the potential transactions that result from them that such entities do not undertake, nor are equipped to undertake, today.

DirectBooks and other primary market communications system operators similar to it would also more generally incur significant costs, including legal costs, in trying to interpret how exactly certain seemingly incongruous requirements applicable to broker-dealers and ATSS would apply to them. For example, such operators would need to interpret how to comply with Form ATS reporting requirements without being able to provide a list of securities traded on the system at any given time. Similarly such primary market operators would need to determine how they could comply with the Fair Access rule, as these operators do not and would not have any trading volume to report.¹⁷

Of course, DirectBooks and other primary market communication systems similar to it would also incur substantial general costs in connection with becoming a broker-dealer and ATS including the organizational and tax restructuring required to apply for broker-dealer registration, the broker-dealer registration process itself, including filing of a New Membership Application with FINRA and a Form ATS with the SEC and correspondence with the SEC and FINRA in relation thereto, costs of legal counsel and/or compliance consultants in connection with the foregoing and expansion of their workforce to include FINRA registered personnel – costs that DirectBooks believes would significantly exceed the estimates provided by the SEC in the Proposal. Furthermore, because primary market communication system operators like DirectBooks do not perform broker-dealer functions and therefore their staff do not hold securities licenses, DirectBooks and such operators would both have difficulty determining which functions and staff would need to obtain such licenses, and to the extent securities licensing were required, the time, effort and opportunity cost involved in licensing such individuals would be significant.

Finally, both DirectBooks and other primary market communications systems similar to it would be required to pass such costs through to their clients and could potentially lose clients as a

¹⁷ Question 75: “For purposes of determining compliance with the Fair Access Rule and Regulation SCI, an ATS must determine its trading volume to assess whether the ATS is subject to these rules. Does an ATS have the ability to obtain the necessary information to calculate thresholds to determine if the ATS is subject to Regulation SCI and Regulation ATS? Why or why not?”

result. In sum, we believe that the cost of requiring primary market communications systems to register would result in one of two outcomes: the closure of many such platforms, which would result in a considerable net loss to the market, or the reworking of many platforms at significant cost in order to engage in activity in which they had never previously participated, if only to act more akin to a “broker-dealer” and thereby be able to register with the SEC and become members of FINRA. This would translate into a loss of efficiency and stifling of innovation with respect to primary market workflow improvements sought by issuers, broker-dealers and their institutional clients.¹⁸

b. Benefits

DirectBooks believes that any potential benefits to requiring it and other similar primary market communications systems to register as a broker-dealer and ATS are heavily outweighed by the costs described above. While DirectBooks supports the SEC’s efforts to promote transparency for investors through registration and reporting requirements, DirectBooks does not believe that additional relevant information would become available to market participants should DirectBooks and similarly situated systems register as an ATS and broker-dealer. For example, the Sell-Side Dealers that utilize the DirectBooks platform are already subject to a wide array of reporting and other regulatory requirements, as broker-dealers with underwriting authority, including extensive trade reporting and consolidated audit trail requirements, as well as net capital regulatory reporting and regulatory requirements related to the offering and underwriting activity in which they engage. All Sell-Side Dealers on the DirectBooks platform must report any transaction ultimately consummated on the basis of these communications via the Trade Reporting and Compliance Engine (“TRACE”), which was created to facilitate transparency in such transactions. And, as stated above, DirectBooks and similar primary markets operators would have no trades to report. With these mechanisms already at play, there is little to be gained by way of transparency in having such operators register as a broker-dealer and ATS.

E. Conclusion

DirectBooks recognizes the SEC’s efforts to regulate secondary market transactions on communication protocol systems where appropriate, and has every intention of complying with the final rules and regulations promulgated by the SEC to the extent that they are deemed to apply to primary markets systems such as the one operated by DirectBooks. At the same time, DirectBooks appreciates the SEC’s acknowledgment and proposal of potential solutions to address the concerns that DirectBooks raised in the Prior Comment Letter and that other commenters raised in their comment letters with respect to Rule 3b-16, as amended, being interpreted to apply to primary market communications systems such as the DirectBooks platform.

DirectBooks believes that requiring primary market communications systems such as its platform to register as broker-dealers and/or exchanges is inconsistent with the traditional hallmarks that merit such regulation. Moreover, DirectBooks believes that any benefits that will

¹⁸ See Supplemental Proposal at 347 (at which point the SEC discusses the likelihood that this Proposal will “stifle innovation.”)

be obtained by subjecting primary market communications systems to such regulation will be heavily outweighed by the costs.

DirectBooks therefore respectfully requests that the SEC: (i) clarify that the Proposal does not apply to primary market communication systems such as the one operated by DirectBooks, through a change to the Proposal itself or to its guidance in relation thereto (or by specifying that the Proposal does not supersede previous no-action relief granted to primary market communication systems); (ii) provide an explicit carve-out in Rule 3b-16(b)(3) with language that clearly covers primary market communications systems, whether used by an issuer or multiple issuers, or used by an underwriter or multiple underwriters for the benefit of such issuer(s); or (iii) to the extent that primary market communication systems such as that operated by DirectBooks would fall within the purview of the Proposal, (1) clarify how it envisions primary market communication platforms, such as that operated DirectBooks, that do not facilitate the trading of securities, should comply with the requirements imposed on broker-dealers operating ATs and appropriately exempt such systems from unnecessary or irrelevant requirements; and (2) in answer to Question 30¹⁹, for the reasons stated in Section D.a. above, extend the time period to come into compliance with the applicable regulations.

¹⁹ Supplemental Release at 59-60.