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Are Digital Asset Portals Akin to Stock Exchanges or Casinos?

The SEC's reopening release # 34-97309 for redefinition of "exchange" reiterated the applicability of existing rules to platforms that trade crypto digital asset securities, including so-called "DeFi" system. It shows the Commission's willingness in considering alternatives, such as providing a definition of *"negotiation protocols"* instead of the controversy of not providing a definition of *"communication protocols"* in the original release # 34-94062. The reopening release narrows the gap of regime differences between the US and the EU. It is still between a rock and a hard place. The SEC solicits comments on the possible exemption of 'ETF portals' in which authorized participants can communicate creation or redemption requests over it. It does not, however, provide explicit exemptions equivalent to, for examples:

- Inward looking OMS or Bulletin Board that the functioning of the arrangement met all 3 characteristics (Recital 8 MiFIR)
  - Consist of an interface that only aggregates and broadcasts buying and selling interests in financial instrument;
  - Neither allows for the communication or negotiation between advertising parties nor imposes the mandatory use of tools of the affiliated companies;
  - No possibility of execution or the bringing together of buying and selling interests in the system.
- Negotiated transactions benefited from a European waiver under MiFIR Article 4(1)(b).
- Pre-arranged transactions benefits from a European waiver under MiFIR Article 4(1)(c).
- Transactions that met conditions for waivers from pre-trade transparency in Article 9(1) of MiFIR.
- 'General-purpose communication system' that does not fit the definition of a 'system' or 'trading facility' and would not reach out to other clients to find a potential match when receiving an initial buying or selling interest and have no genuine trade execution.

Despite that the Commission stated *"custodial services is generally not relevant to Exchange analysis"*, the proposed Safeguarding Advisory Client Assets rule would extend the arm of the SEC to regulate custodian indirectly. Does "interact and negotiate a trade" mean *"reach out to other clients to find a potential match when receiving an initial buying or selling interest"*? Does it have to *"interact in the same system or facility"*? Will the Commission apply similar judgement to the FINRA response in footnote 17 of this, *"where the parties to a trade, aggregate individual prices obtained from a pricing list or service without further negotiation, it would not be considered within the scope of the rule"*.

The trimmed language of *"buyers and sellers interact"* can mean anything. What constitute as "*indirectly providing a trading facility"*? Would those qualified as *'an extension of the trading venue'* benefit from a waiver under Article 4(1)(b), 4(1)(c), and waivers from pre-trade transparency in Article 9(1) of MiFIR in Europe be brought within scope in the US? It could be quite subjective, and the scope is still overly broad.

It is a "Double-Edged Sword" if the Commission is overly aggressive in deterring Digital Assets players by enforcement. Not only would it hinder market innovations, we are concerned that "everybody is a trading venue, nobody is a trading venue". It increases costs to connect with additional venues for BestEx compliance.

Casino rules have existing perimeter to oversee online gaming, Linked licenses gambling software, Linked licenses gaming machine technical, Remote casino game host operating license, specified what 'actions' do not require a linked license. Instead of reinventing the wheel to add and/or modify existing Securities Laws to accommodate nuances with digital assets, why not let Casino rules be the first gatekeeper in supervising crypto?

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Casinos have existing governance provisions over non-cashable gambling chips versus cashable tokens, electronic cash, credits or cards for the purpose of (i) making wagers on games, (ii) redeeming for cash, or (iii) making a donation to charitable entities. It is a good fit comparable to non-security crypto assets versus securities, Stable Coins, Fungible, Non-fungible tokens, Central Bank Digital Currencies, etc.

Reference to our 2022 comment letter to the US Treasury,

- Sport bets, lottery, and other forms of consumer goods and services that provide "**entertainment**" or "**use value**" (tangible features of a "**commodity**") other than having resale or for commercial purposes, or motives or the pursuit of capital accumulation, then such buy, sell, or borrow activities over digital assets should be guarded under **Casino and consumer rights laws** rather than subjected to investor protection rules.
- For **consumption** of digital assets that warrant the government protection of **consumer rights**, the digital assets must be a **commodity** worthy of its use-value or worth in comparison to other **commodities** that can satisfy some human requirement, want or need. Consumer Financial Protection Bureau (CFPB) and Commodity and Future Trading Commission (CFTC) may be in a better position than the SEC to supervise these consumption activities.
- Businesses, including not-for-profit entities (NPE), holding or engaging in digital assets transactions for **resale or for commercial purposes** should not be protected by consumer rights laws. Whether digital assets transactions for businesses should be classified as investing, financing, or operating activities, we think the logic in IAS7 should apply:
  - The acquisition and disposal of long-term assets and other investments not included in cash equivalents are considered **investing activities**;
  - Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity are considered **financing activities**;
  - Principal revenue-producing activities of the entity and other activities that are not investing or financing activities are considered **operating activities**.

Securities Laws should focus on regulating investing activities, not financing nor operating activities. The *"functions commonly performed by a Stock Exchange"* that fall within the criteria of existing Exchange Act 3b-16(a) or Rule 3b-16(a) as proposed to be amended, is indeed identical or almost indistinguishable with many Casinos and linked license vendors, except the trading (betting) interest may or may not be "financial instrument".

Financial instruments priced in Fiat currency would NOT and should NOT be compatible with non-security crypto assets. 'Funny money' is more akin to 'non-cashable gambling chips'. We counter suggest that regulators may indeed ask Digital Asset Platforms to apply for licenses under Casino rules, and then wait for these platforms to demonstrate that the 'winning odds' are in favor of investors in the long-term before permitting them to apply and register as a National Securities Exchange or complying with the conditions of Regulation ATS.

This stackable approach would create a 2 tier hierarchy. It would afford the US Federal and State Governments the flexibility to consider both an offensive and a defensive strategy. It will provide a viable path in responsible development to Digital Assets. At the same time, the Commission can access whether the existing Exchanges and ATSs have long-term 'winning odds' and in whose' favor.

Please see our June 13, 2023 comment letter to the SEC for the analysis and additional information.

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*By **Kelvin To**, Founder and President of Data Boiler Technologies*

At Data Boiler, we see big to continuously boil down the essential improvements that fit for your purpose. Between my patented inventions and the wealth of experience of my partner, Peter Martyn, we are about finding rare but high-impact values in controversial matters, straight talk of control flaws, leading innovation and change, creation of viable paths toward sustainable development and economic growth.