CHAMBER OF DIGITAL COMMERCE

June 19, 2023

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

Via email: rule-comments@sec.gov

Re: Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange" (File No. S7-02-22; Release No. 34-97309); 88 Fed. Reg. 29,448 (May 5, 2023)("Reopening Release")

Dear Ms. Countryman:

The Chamber of Digital Commerce (the "Chamber") is the world's largest digital asset and blockchain trade association. It represents an exceptionally diverse spectrum of more than 200 entities that utilize blockchain technology, ranging from some of the world's largest banks and investment firms, to digital asset exchanges, to early-stage startups offering a wide array of products and services. Since its founding in 2014, the Chamber has educated members of the public and private sectors regarding the transformative promise of blockchain; formed the Blockchain Alliance, which regularly assists over 100 governmental and commercial entities in their efforts to combat blockchain-related criminal activity; and, through its Token Alliance working group, provided the technical resources policymakers and market participants need in order to make informed decisions and facilitate the effective and responsible adoption of blockchain technology across an ever-increasing array of use cases.

These initiatives all stem from the Chamber's foundational desire for regulatory certainty and clear compliance standards that are appropriate for the nature of digital assets and blockchain technology, their benefits to users, and the potential risks they may present. In furtherance of those same goals, the Chamber is submitting this letter with respect to the Reopening Release published by the U.S. Securities and Exchange Commission (the "SEC" or the "Commission"). The original release was

published by the SEC in the Federal Register on March 18, 2022 (the "Original Release"), and proposes to amend the rule under the Securities Exchange Act of 1934 (the "Exchange Act") that defines certain terms used in the statutory definition of the term "exchange" (the "Proposed Rules"). The Reopening Release includes supplemental information and economic analysis specific to systems that facilitate trading of crypto asset securities and would meet the new definition of exchange under the Proposed Rules. Although we disagree that most tokens are securities, we submit this letter recognizing that it is possible that at least some tokens that are transacted using "automated market maker" software are securities. This letter responds to the Reopening Release and is supplemental to the Chamber's comment letter in response to the Original Release dated March 24, 2022.

We appreciate the opportunity to respond, and we have the following concerns regarding the Reproposing Release:

1. **The Reopening Release Misses an Opportunity to Assess Smart Contract-Based Systems that Facilitate Programmatic Crypto-Asset Transfers**

The Reopening Release continues an ill-fated attempt to regulate the activities of a disparate and dynamic group of persons from around the world utilizing open-source software, known as an "automated market maker" ("AMM") smart contracts, as a single securities intermediary. The Securities Exchange Act of 1934, as amended (the "Exchange Act") defines "exchange" to mean:

> [A]ny 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.

However, a collective and dynamic group of independent software users do not and cannot "constitute, maintain, or provide" a "market place" or other "facility" in any manner consistent with the objectives of the Exchange Act. These software users may have radically different interests, objectives and motivations and are not organized or coordinated in any way that would allow them to enforce the interpretive stance of U.S. or other global regulators from time to time. In fact, while there are undoubtably users of AMM software in the United States, there are also users based across virtually all jurisdictions around the world where access to the open Internet is possible.

Attempting to subject these software users as a collective group to a complex system of regulation in just one jurisdiction (which may in fact conflict with the regulatory position applicable in many other jurisdictions) is tantamount not to regulation of legal activity (the use of open-source software) but a ban on the use of that software on all users

around the world. This is plainly far beyond the remit of the SEC and needs to be carefully reconsidered.

Instead, the Commission should consider adopting a flexible approach to the uses of AMM software by persons in the United States that is tailored to the actual risks that these users may face. In doing so, the Commission should think about whether technology that functions programmatically based on user instructions can be effectively regulated as a securities intermediary or whether it would be more appropriate for these issues to be addressed by Congress in a manner that takes into account the technological nature of these systems and seeks to address regulation in a more bespoke manner.

2. The Reopening Release Does not Provide Operators of Crypto Trading Systems with a Workable Means of Determining Whether a Particular Crypto Asset is a Security at Any Given Time

As noted in our prior response, the Reopening Release fails to recognize the dynamic nature of the collective group of users of AMM software. Whether they are operating nodes that validate transactions, sending crypto assets to smart contract addresses that can be accessed by other users, or making calls on these smart contracts to effect state transitions in a given blockchain network, the Reopening Release does not provide anything resembling a workable or practicable framework for this "group of persons" to understand, much less comply with, U.S. regulations.

For example, a node operator in Nairobi validating transactions, a "liquidity provider" in Lisbon sending assets to be held in a smart contract address, or an individual in Indonesia seeking to send an instruction to a blockchain network to effect a state change in the ledger reducing the number of one type of crypto asset associated with a network address she controls and increasing another have no way of knowing (or caring) whether, as software users, one particular jurisdiction may take the position that certain of these crypto assets are considered "securities" in that jurisdiction. In fact, the Commission has no way of determining whether the users of AMM software who happen to be interacting with each other at any given time have any jurisdictional nexus to the United States at all.

Any regulation of AMM software must be done in a way that is tailored to U.S.-based users and provides a means of allowing these users to determine whether they are subject to the jurisdiction of the Commission as the result of engaging in a securities transaction.

In order to do this effectively, the Commission should identify specific crypto assets that it believes are securities as one component of any such regulation. This would allow users of these systems that engage in transactions in crypto assets to better understand when such transactions might trigger obligations under U.S. securities laws.[1] In

[1] We note that this would be provisional as the ultimate determination will be made by a court.

addition, to the extent that the Commission believes crypto-asset securities can "morph" into non-securities, the Commission should update its list of crypto asset securities regularly as needed to provide such information to users. Finally, to the extent that the Commission believes crypto assets that were once crypto asset securities can "morph" back into crypto asset securities, the Commission should similarly update the information it provides to users.

As it stands, the Reopening Release simply indicates that it is unlikely that crypto asset trading platforms through which a large number of crypto assets trade do not involve some crypto-asset securities. If the Commission does not provide more specific information about the crypto assets it believes are securities at any given time, then: (i) users of these systems will be left to make such determinations on their own, (ii) such determinations may not be consistent with the Commission view at any given time, and (iii) different users will likely make different determinations about the nature of the same asset at any given time. Overall, this would result in an unworkable and highly confusing environment.

3. **The Economic Analysis in the Reopening Release is Insufficient**

The economic analysis in the Reopening Release is insufficient. It does not analyze relevant and available data to perform an adequate assessment of the economic impact of the proposed rule, the alternative regulatory approaches, and the cost benefit analysis with respect to the proposed rule.

We expressed this same concern in our initial comment letter on this rulemaking proposal. The Original Release did not contain any specific data or analysis with respect to AMMs or other similar platforms that might meet the new definition of Exchange. As a result, we had significant concerns regarding that the analysis of the scope of impacted market participants or the economic burden that would be imposed by the proposed expansion of the definition of "exchange" to include digital asset trading platforms was flawed and insufficient.

The Reopening Release makes clear that the Commission still does not have a clear understanding of how many AMMs or similar systems would meet the new definition of exchange proposed and constitute New Rule 3b-16 Systems (as defined in the Reopening Release).[2] The Reopening Release estimates that 15-20 New Rule 3b-16 Systems trading crypto asset securities were not included in the Original Release. The Commission further notes that it is unclear whether certain similar systems identified to the Commission operate in the U.S. or otherwise meet the other elements of the new definition of exchange.

[2] See FN 176 of the Reopening Release.

Before the Commission finalizes the Proposed Rule, it must complete and make available to the public the required analysis. This involves reviewing available information to determine what systems involved in crypto asset activities are operating in the U.S., whether crypto asset securities can be traded through those systems, and whether those systems are likely to meet the other elements of the definition of exchange and are therefore New 3b-16 Systems. Not only is this analysis required by the Administrative Procedure Act, it is particularly important to the evaluation of alternative means of regulating activity involving this new technology that does not fit neatly within the existing securities law focus on intermediaries. In addition, because the SEC has not specified which crypto assets it believes are securities, and activity involving securities is required for the Proposed Rule to apply, there is not an objective way to assess the adequacy of the economic analysis.

4. Responses to Specific Questions

In addition to the foregoing general concerns, the Chamber also offers the following responses to specific questions raised in the Reopening Proposal.

Questions 4 and 5

> Which, if any, activities performed on so-called "DeFi" trading systems meet the criteria of Rule 3b-16(a), as proposed to be amended? For example, does the use of AMMs alone bring together multiple buyers and sellers of securities through the use of non-firm trading interest? Please explain. Please identify any relevant data, literature, or other information that could assist the Commission in analyzing this issue.
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> Please give examples of New Rule 3b-16(a) Systems for crypto asset securities that use DLT or are so-called "DeFi" systems. Approximately how many such systems exist? Please identify the types of non-firm trading interest used and how participants use non-firm trading interest on such systems. Please explain what these systems trade (crypto asset securities or crypto assets) and the type of participants (e.g., retail or institutional). How do participants on a New Rule 3b-16(a) System for crypto asset securities that use "DeFi" systems, as characterized by commenters, negotiate trades for crypto asset securities? Please identify any relevant data, literature, or other information that could assist the Commission in analyzing these issues.

To effectively answer the questions, there first needs to be a thorough analysis and discussion of the different elements of decentralized systems. Without that context, answering the one-off questions in the Reopening Release is not an effective way to determine whether or how to regulate users of this technology.

Throughout the Reopening Release the Commission refers to "so-called De-Fi" in an attempt to bring this activity within the Proposed Rules. One of the fundamental questions asked above is how many systems exist. As described above, it appears that the Commission does not know the answer to this question itself. The Commission needs to better understand the scope of the potential impact of the Proposed Rule in order to better evaluate the costs and benefits of pursuing rulemaking as opposed to other regulatory approaches. It also appears that the Commission has not taken the time to analyze and understand the myriad ways that new systems through which crypto assets can be exchanged prior to including these systems in the Reopening Release. While it may take time for the Commission to better understand this new technology, the Commission should take the time it needs before pursuing the Proposed Rules further.

Although not dispositive, in adopting the Markets in Crypto Assets Regulation, the European Union did not include decentralized finance systems within its scope. The European Union concluded that it would be premature for them to do so without a full understanding and further work will likely be done. It is also telling that various proposed legislative efforts in the U.S. to adopt a regulatory framework for digital assets have proposed to study decentralized activities prior to addressing and potentially getting it wrong.

Question 6

> Would an organization, association, or group of persons that is a New Rule 3b-16(a) System and uses DLT to trade crypto asset securities likely elect to register as a national securities exchange or comply with the conditions of Regulation ATS? Please explain.

As noted above, the dynamic collective of persons and entities who from time to time utilize AMM software would likely not attempt to register as a national securities exchange or comply with the conditions of Regulation ATS. The Reopening Release, on its face, provides little guidance and takes a "go figure it out" approach. This is not an appropriate means by which to regulate individuals and entities who will have little guidance as to their obligations. In fact, when describing what constitutes an organization, association or group, the Reopening Release is extremely vague and indicates that in some instances registration may be required and, depending on the facts and circumstances, in other instances registration may not be required.

The Reopening also suggests that individuals acting independently could just go ahead form an organization to satisfy the Proposed Rule. It is not logical to think that independent individuals would form an organization, if they are otherwise not acting as a group with a common purpose, goals, staffing, etc., solely to elect to be governed by the Proposed Rules.

Overall, the Reopening Proposal leaves individuals and entities in peril of getting it wrong (and facing potentially severe regulatory consequences) as there is no clear standard or guidance.

Question 13

> 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) 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.

As noted in the Reopening Proposal, many commentators observed that the term "communication protocol" is too broad and vague. While attempting to be more specific, if the Proposed Rules expand the definition of "exchange" to encompass "negotiation protocols" instead of "communication protocols", it will be nevertheless broad and vague, reaching beyond the limits of the statutory definition of "Exchange" under the Exchange Act, as described earlier in the letter.

If the intent behind the term "negotiation protocol" is to cover DeFi Systems, the term, in itself, still fails to address how smart contract code deployed on a blockchain and utilized directly by an ever-changing set of individuals and businesses without any intermediaries, can be considered an association or a group of persons that constitute an "exchange". Additionally, various AMM protocols function differently – some can be forked, others cannot; some can be upgraded, others cannot. Even if a so-called decentralized autonomous organization (referred to as a "DAO") might exist with some level of influence over smart contract code, the governance structure of DAOs and the voting rights granted to different DAO token holders vary. These diverse groups of individuals and businesses generally lack individual control over the relevant code. And thus, by simply including "negotiation protocols" as part of the definition of "exchange" under the Proposed Rules, the SEC does not provide any guidance as to how the registration and compliance requirements applicable to exchanges could be imposed on users of smart contract protocols – for example, whether a DAO would be deemed to be responsible for these regulatory obligations, and if so, would that mean that all DAO token holders are indirectly responsible (and if so, which of the DAO token holders would have to take responsibility, and by which criteria)? There would still be a need for the SEC to clarify how registration and compliance requirements could be imposed on various users of AMM software, regardless of whether the term "exchange" includes the term of "communication protocol" or "negotiation protocol".

Question 55

> Would the Proposed Rules enhance regulatory oversight and investor protection in the market for crypto asset securities? Would requiring New Rule 3b-16(a) Systems that trade crypto asset securities to register as broker-dealers help lead to these benefits? Would the Proposed Rules lead to improvements in the safeguarding of confidential information in the market for crypto asset securities?

The Proposed Rules will not enhance regulatory oversight and investor protection in the market for digital assets. In the Reopening Release, the SEC explained that whether a person would be part of a "group" that is an exchange would depend on the facts and circumstances, in particular, considering whether the persons share control "over the organizational, financial, or operational aspects of a marketplace or facilities for bringing together buyers and sellers of securities."[3] The concept of control is very broad and vague. As the SEC illustrates using an example in the Reopening Release that depending on the facts and circumstances, an entity that engages service providers to provide services to a market place would likely be deemed to have control over the market place and such service providers might not be deemed to have control; however, it is possible that such service providers in fact have sufficient control over aspects of the market place to be considered a part of the "group of persons" that constitutes an "exchange". This explanation illustrates the difficulty of providing any certainty to market participants who may be subject to the definition of "exchange", and even the SEC cannot provide any concrete guidance that would allow market participants to obtain certainty.

Further, the Reopening Release illustrates that a software developer who independently publishes or republishes code without any agreement with any person for that code to be used in connection with the operation of a market place is unlikely to be deemed to be part of a "group" that constitutes an exchange, even if the code is later adopted and implemented into a market place. However, it is still unclear what a software developer may be able to do or not do in order to stay outside of a "group of persons" that constitutes an exchange. For example, can the software developer engage with any other users of the platform to improve the user experience? Can the software developer receive any compensation for its services (including digital assets native to the relevant protocol)? The general statement that it depends on facts and circumstances fails to provide any certainty to market participants.

The Proposed Rules, if adopted, could result in an effect contrary to their stated purpose, which is to enhance regulatory oversight and investor protection. By imposing burdensome and costly requirements on persons deemed to control an AMM protocol without clear guidance as to how to comply with these requirements, it is foreseeable that many of these persons (who may be outside U.S. jurisdiction) may elect not to make efforts to comply with the Proposed Rules. Consequently, users of AMM software

[3] See FN 66 of the Reopening Release.

may seek alternative ways to access these platforms, which may be outside of the US, resulting in an increase in activity that is outside the purview of the Proposed Rules. For crypto assets in particular, the Proposed Rules may reduce, rather than enhance, SEC oversight, potentially diminishing investor protection.

Questions 58 and 59

> Do commenters agree with the Commission's assessment of the entities that would incur costs in the crypto asset security market as a result of the Proposed Rules? If not, please provide examples of additional entities that would incur costs.
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> Do commenters agree with the Commission's assessment of the implementation costs estimated in the Reopening Release? If not, please provide as many quantitative estimates to support your position on costs as possible.

The Chamber does not agree with the Commission's assessment of the entities that would incur costs. Further, the Chamber does not agree with the Commission's assessment of the implementation costs estimated in the Reopening Release.

The Chamber is concerned that the Commission's economic analysis is inherently flawed as it is not based on actual, reliable or accurate data regarding the costs or benefits with respect to the inclusion of decentralized crypto asset systems within the framework of the Proposed Rules. A proper economic analysis of the costs and benefits is a fundamental requirement of any rulemaking and here, it is lacking.

As the Commission itself states, regarding costs, "Throughout the discussion in this Reopening Release, the Commission has a greater degree of uncertainty in its analysis of the costs that the Proposed Rules would impose on market participants for crypto asset securities than it did in its discussion of costs for non-crypto asset securities. This is because the Commission has less data on the functioning of the market for crypto asset securities."

The Commission states that it "understands that some amount of trading in crypto asset securities is facilitated through New Rule 3b-16(a) Systems. The Commission lacks information on the entities involved providing New Rule 3b-16(a) Systems in the market for crypto asset securities, and consequently, is uncertain as to the precise number of such entities. Nevertheless, the Commission is providing a rough estimate that there are 15-20 New Rule 3b-16(a) Systems trading crypto asset securities. Table V.1 provides estimates for the aggregate compliance costs for New Rule 3b-16(a) Systems that trade crypto asset securities. These aggregate costs reflect an estimate of 20 additional affected New Rule 3b-16(a) Systems that were not included in the estimates provided in the Proposing Release, which is the upper end of the Commission's estimate of the number of affected systems. The Commission is uncertain as to how precise these estimates are because it lacks sufficient data on crypto asset securities.

Throughout Table V.I. in the Reopening Release, the Commission uses the possible number of "entities" potentially impacted to be 15-20. Yet there does not exist in the Reopening Release a reliable analysis and explanation of how that number was arrived at and seems to be nothing more than a blind guess. Nonetheless, that is the fundamental basis for the analysis in the Reopening Release and it is a flawed rationale.

Question 68

> Do commenters agree with the Commission's assessment of the impact of the Proposed Rules on efficiency, competition and capital formation? Do commenters agree that the Proposed Rules would allow for competition among trading systems on a more equal basis? Do commenters agree with the Commission's assessment as to the risks of increasing barriers to entry and causing current trading systems to exit the market? Please explain.

No, the Chamber does not agree with this assessment in the Reopening Release and it is lacking in many required and important aspects.

To the extent that software developers and other persons using AMM software are unsure whether they are part of a "group or organization" that would become regulated if the Proposed Rules were to be adopted, many of these persons may likely not participate or contribute, in even a small way, for fear of violating the Proposed Rules. This will clearly have an adverse effect on competition as there will be less highly skilled individuals willing to contribute to the development of this technology. The Commission seems to acknowledge this but does not, in any defined or detailed manner, accurately assess the impacts.

Question 70

> How would the Proposed Rules affect innovation? Please explain. Which provisions of the Proposed Rules would affect innovation the most and how? Please explain.

The Commission itself states, "While the Commission does not believe that innovation will be impossible under the Proposed Rules, we acknowledge that there could be less innovation as a result of the uncertainty and compliance costs associated with the broad formulation of the Proposed Rules."

If that is the case, and the costs and benefits have not been properly assessed, the Commission should not be proceeding with the Proposed Rules.

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The Chamber greatly appreciates the opportunity to comment on the Proposals and appreciates the Commission's consideration of the above comments and concerns.

Please feel free to contact us with any questions regarding our comments.

Very Truly Yours,

Cody Carbone
Vice President, Policy

Chamber of Digital Commerce