June 27, 2023

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

Re: RIN #3235-AM45, File No. S7-02-22, Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange".

Dear Ms. Countryman,

This comment is provided by Robert Shilling, a rising 2L at the Hofstra University Maurice A. Deane School of Law. I am honored to have the opportunity to comment on the proposal. I support the rule with some slight modifications to the overall scope. Currently, I am taking an Administrative Law. In the course, we discuss the establishment and history of various administrative agencies, including the SEC, as well as the role these agencies play in the current era. In a small class, we debate the merits and drawbacks of the expanding role of agencies in judicial affairs. Prior to enrolling in Law School, I worked for several years in Trust Administration for several large banks. In this role, I administered monthly, quarterly, and yearly payments on various CDO and CLO investments, plus the necessary regulatory filings. As of the mid to late 2010s, my team and I were still sorting through many bankrupted Lehman Brothers' products and finishing winddown payments. This experience proved to me what a lack of oversight can produce. Additionally, I, like many retail investors, have dipped my toe in with so-called meme-stocks, crypto-assets, and many other new style investments. Seeing numerous friends and family gain and lose large amounts of money in these securities has made it apparent some oversight is needed.

However, though I do see the need for increased regulation in crypto, I oppose the proposal unless exemptions are made for decentralized exchanges. This comment letter will provide a brief overview on the current and proposed definitions of 'security' and 'exchange'. The ways in which Coinbase and similar exchanges fit within the model versus DEFI exchanges. The letter will specifically address, question 4 on page 33 of the proposal, on how the process of bringing to together buyer and seller through an AMM do seem to fit within the new proposed definition of 'exchange' (using the example of Uniswap's AMM). I will also address question 6 on page 34 of the proposal and suggest DEFI exchanges will likely desire to comply with Regulation ATS. Finally, I will address question 8 on page 34 and discuss the governance structure of DEFI exchanges (again using Uniswap as an example) and the issues that may arise with the current lack of a centralized governance.

i. **The current state of affairs in regulating crypto has led many to ask for more clarity on the issue.**

In a recent video interview with the Wall Street Journal, post SEC filing suit against Coinbase, CEO Brian Armstrong expressed a desire for regulators, Congress, or the law to provide clear definitions on what is a 'security'. Brian Armstrong co-founded Coinbase in 2012, providing a platform for retail investors to trade crypto. On June 6th, the SEC sued Coinbase for operating as an unregistered exchange, broker and clearing agency. The long-standing way to resolve this issue has been the 'Howey Test'. The test essentially contains four components: 1) A financial investment 2) A Common enterprise between investors 3) Expectation of profits 4) With those profits being generated by others. If an asset meets all the criteria, it is a security. If the asset is a security, it must be registered with the SEC and meet all regulatory requirements, as any other security would have to, for example any stock listed on the NYSE. If a company were to list any of these assets deemed to be securities, they must register with the SEC as an exchange, or alternatively as a broker-dealer. This essentially is the crux of the recently filed SEC suit against Coinbase. The SEC believes at least 13 cryptocurrencies on the exchange should be deemed as securities. Brian Armstrong disagrees on this classification and instead would label them 'crypto-commodities', thus not requiring registration.

Clarity has been provided for a few assets, or perhaps, at least one asset – BTC. Bill Henman, SEC Corporate Finance Director, in a speech in 2018, stated BTC and ETH were not securities since no third party promoted them, in essence, both were fully decentralized. Mr. Henman, explained further on CNBC's 'The Closing Bell', that both were 'up and running', no longer functioning as investments. While BTC seemingly still holds the label as something other than a security, things are hazier for ETH. SEC Chairman, Gary Gensler, refused to classify ETH as a security or non-security in a recent Conduct Oversight Hearing of the SEC held by Chairman Patrick McHenry. With ETH holding the second largest market cap of all cryptos, the Chairman's comments leave observers uncertain as to the status of many cryptos.

ii. General thoughts on the new proposed definition of 'Exchange' and the effect this will have for different types of crypto exchanges.

The current language of bringing together purchasers and sellers, in defining an 'exchange', brings to mind the NYSE trading floor of yesteryear. An actual location in which stocks were exchanged between physical parties. Parties contract on the buying and selling of securities. Rules may be established to govern these transactions and the behaviors of those on the floor. With the increased digitalization of the field, these floors no longer exist. However, the language was easily able to incorporate these transitions to the digital space. The players are mostly the same, now it's just done online. Coinbase, Binance and others seem to fit this mold, of course, provided that what they are selling are securities. But what about an 'exchange' that shares little analogous features to those of the past. New decentralized exchanges do not quite fit within the definitional scope of the term 'exchange' thus leaving the SEC with no power to regulate them. The new proposal would seem to suggest that decentralized exchanges would fit within the new meaning of 'exchange'. Many decentralized exchanges would likely be required to register as exchanges, or ATS, such as broker-dealers and submit to the regulatory measures that follow.

iii. The use of AMMs may place DEFI exchanges within the parameters of the new proposed definition of 'Exchange' (addressing question 4 on page 33 of the proposal).

An example of a decentralized exchange is UniSwap. UniSwap's own FAQ page, defines itself as '*an open-source protocol for providing liquidity and trading ERC20 tokens on Ethereum. It eliminates trusted intermediaries*.' The UniSwap protocol acts as an AMM (Automated Market Maker), which is a collection of smart contracts used to create liquidity pools. Again, according to the FAQ page, '*each liquidity pool contains two assets. The pools keep track of aggregate liquidity reserves and the pre-defined pricing strategies set by liquidity providers. Reserves and prices are updated automatically every time someone trades. There is no central order book, no third-party custody, and no private order matching engine*.' The FAQ page goes on to reiterate '*traders do not need to match with individual counterparties to complete a trade.*' Clearly, perhaps intentionally with insight about the proposed definitional change to 'exchange', UniSwap never mentions anything about bringing together buyer and seller. In contrast, they make clear to deny this. UniSwap's 'pool' may avoid being labeled an 'exchange' under the old definition. However, showing up at the 'pool', attempting to purchase crypto seems quite clearly to be the parties expressing 'trading interest', thus satisfying the first part of the new definition.

As for the second part of the definition, UniSwap may now evade the 'exchange' label, but with the proposed rule, it seems unlikely. Users on UniSwap can create an exchange by posting an ERC-20 token in conjunction with another token to a liquidity pool, collecting a small fee for doing so. An initial ratio is set between the tokens, one possibly a stablecoin (coin pegged to a traditional asset) which creates a constant that allows the algorithm to price swaps, since if one token is bought the ratio must adjust. If the prices relative to each other get out whack and diverge from the actual underlying price of the asset on other exchanges, arbitrage opportunities emerge. Investors, or other algorithms quickly pounce on such opportunities and proper relative pricing quickly returns. This, perhaps, would suggest a non-discretionary way for buyer and seller to agree on price. Perhaps, perhaps not. That being said, the new definition states an exchange is something that 'makes available *established, non-discretionary methods (whether by providing a trading facility or* communication protocols*, or by setting rules).'*

Communication protocol is not defined succinctly, but things like a 'chat feature', or the listing of price and quantity are listed as examples of such protocols. It would be hard to imagine the SEC being persuaded that all AMM's are not some sort of communication protocol. The algorithm signals prices which collect fees. This, in essence, is the ask price, even if execution of the trade may differ slightly from normal stock exchanges. DEX exchanges could be deemed to fit within the new proposed definition of 'exchange'.

iv. Decentralized Exchanges will likely choose to comply with Regulation ATS, if necessary (addressing question 6 on page 34 of the proposal). Some insights on the

governance structure of DEFi exchanges and the compliance issues that may result with the current governance structure (touching on question 8 on page 34 of the proposal).

Most 'exchanges', if required, would likely decide to register as ATS, rather than exchanges, due to the less stringent regulations. Coinbase, CEO Brian Armstrong, indicated in his WSJ interview that the company already has a 'dormant broker-dealer' license. While this registration and the regulatory requirements entailed with it, may be workable for companies like Coinbase, the same likely can't be said of DEFI networks, such as UniSwap without a restructuring and/or creating of management and new reporting operations.

UniSwap does, in some sense, have a form of governance. Governance tokens have been and will continued to be allocated to users on the platform. Community members can gain governance tokens by providing assets to liquidity pools. Team members and investors also have and will have access to these governance tokens. Community members have been allocated the greatest stake of tokens, at 60%. Token holders share in the governance of the exchange. Proposals and amendments to governance and the operation of the exchange are made and voted on within the community. No director, leader, or even figurehead is responsible or in some way the face of these proposals or amendments. The difficulty in mandating reporting from such communities quickly becomes apparent. If using the ATS exemption, Uniswap would have to register as a broker-dealer, become a member of a self-regulatory body, file a Form ATS and file ongoing compliance reports. One large issue facing decentralized exchanges in fulfilling these requirements are the 'KYC' (Know Your Customer) requirements placed on broker-dealers. Many current DEX exchanges do not require any 'KYC' measures. The modus operandi of decentralized exchanges, like Uniswap, is to provide privacy to its users by not requiring nor storing their personal information. In addition, DEX exchanges would be required to have some sort of governing official to collect and send compliance reports each period. In effect, the new requirements would be making decentralized exchanges more centralized. The costs of implementing such measures were contemplated in the proposal but ultimately found to be uncertain. Complying with regulations may make operating such exchanges unfeasible.

v. Conclusion.

I support the 3b-16(a) proposal with certain exemptions provided for decentralized exchanges. Defi communities, in many ways, are more transparent than traditional exchanges. Proposals, discussions, votes are made available to all who wish to seek this information. The Exchange Act requirements may be challenging for many decentralized exchanges without restructuring key elements of their business model. Many companies, such as Coinbase and Binance, would seemingly be able to fit within this framework without much change to their procedure. However, decentralized exchanges operate much differently. Further examination into the ability and cost of such exchange's capability to comply with Regulation ATS requirements is needed. Concerns regarding money laundering, scams and hacking are warranted. Many national news stories covering such issues have been in the press in recent years. However, at this time, too much uncertainty exists about the implications of the proposal on decentralized exchanges. The SEC should exempt such exchanges until clear information becomes available, including any alternative solutions that may be uncovered.

I wish to thank the SEC for the chance to share my opinion on the proposed rule.

Sincerely,

Robert Shilling