By Electronic Submission and Email

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 205499-1090

Re: Re-Opening of Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"
File Number S7-02-22

Dear Ms. Countryman:

The Crypto Council for Innovation (**CCI**)[1] appreciates the opportunity to comment on the Securities and Exchange Commission's re-opening of the comment period, and publication of supplemental information regarding amendments to the definition of "exchange" (the **Re-Proposal**) under Rule 3b-16 of the Securities Exchange Act of 1934 (**Exchange Act**).[2] We note that the Re-Proposal concerns the potential effects of the proposed amendments to the exchange definition on trading systems for crypto asset securities, including decentralized finance (**DeFi**) systems.[3] However, we question the extent to which the Re-Proposal truly appreciates the immense and likely very adverse implications of these proposed amendments for crypto and DeFi trading systems.

This letter responds to the Re-Proposal and is submitted in addition to our earlier comment letter (available here, the **First CCI Letter**) on the SEC's original proposal in January 2022 to amend Exchange Act Rule 3b-16 (the **Original Proposal**).[4] In the First CCI Letter, we requested that the Commission expressly clarify whether the Original Proposal covered crypto and DeFi protocols, and, if it did, to re-propose the Original Proposal in accordance with the Commission's statutory requirements under the Administrative Procedure Act (**APA**), the Exchange Act, and the Paperwork Reduction Act. We note the Re-Proposal's clarification that the proposed amendments to Rule 3b-16 apply to crypto and DeFi trading systems. However, we remain very strongly of the view that the Re-Proposal continues to suffer from significant, and even potentially fatal flaws under the APA and the Exchange Act. This letter addresses those flaws in more detail.

---

[1] CCI is an alliance of crypto industry leaders with a mission to communicate the opportunities presented by crypto and demonstrate its transformational promise. CCI members span the crypto ecosystem and include some of the leading global companies and investors operating in the industry. CCI members share the goal of encouraging the responsible global regulation of crypto to unlock economic potential, improve lives, foster financial inclusion, protect national security, and disrupt illicit activity. Achieving these goals requires informed, evidence-based policy decisions realized through collaborative engagement.

[2] *See* Exchange Act Release No. 97309 (Apr. 14, 2023), 88 FR 29448 (May 5, 2023) (the **Reopening Release**).

[3] Reopening Release at 294448.

[4] *See* Exchange Act Release No. 94062 (Jan. 26, 2022), 87 FR 15496 (Mar. 18, 2022).

Given our focus on the transformative promise of crypto, we are deeply concerned that the Re-Proposal misses an important opportunity to evaluate crypto and DeFi trading systems on their merits. We note with great disappointment that the Re-Proposal reflexively extends the Original Proposal to cover crypto and DeFi trading platforms with little recognition of the unique attributes of crypto. As recently as September 2022, SEC Chair Gensler spoke of asking Commission staff to "fine-tune compliance" for crypto assets and intermediaries[5] — but this Re-Proposal shows no evidence of such fine-tuning. Instead, the Re-Proposal seeks to force crypto and DeFi trading systems into regulatory models designed for traditional securities exchanges. The Re-Proposal fails to adequately consider the distinctive technological attributes of crypto, and DeFi systems in particular. Nor does the Re-Proposal sufficiently address the very significant adverse economic implications of extending the amended exchange definition to crypto and DeFi trading systems. These conspicuous failures render the Re-Proposal vulnerable to challenge under the APA and the Exchange Act.

We strongly urge the SEC to address a number of deficiencies and omissions in the Re-Proposal. In particular, we note that:

1. The Re-Proposal is impermissibly vague and provides no clarity to crypto trading platforms and crypto market participants.

    a. The Re-Proposal provides no meaningful guidance on when a group of persons would constitute, maintain, or provide a marketplace for securities. The Re-Proposal provides no meaningful guidance on when vendors or service providers to an exchange would be seen as forming part of that exchange.

    b. The Re-Proposal appears to misunderstand how DeFi systems operate,[6] and the extent to which such systems can comply, or should be required to comply with the re-proposed Rule 3b-16.

    c. Most fundamentally, the Re-Proposal provides no meaningful guidance on which crypto assets are securities, noting only that it is "unlikely that systems trading a large number of different crypto assets are not trading any crypto assets that are securities."[7] Crypto trading platform operators cannot determine whether they are operating an exchange unless they can first determine whether their platform facilitates trading in crypto assets that are securities.

---

[5] Chair Gary Gensler, Kennedy and Crypto (Sept. 8, 2022), available at *https://www.sec.gov/news/speech/gensler-sec-speaks-090822*.

[6] We note, but do not agree with the Commission's statement that "Commenters vary in their definitions of "DeFi," or what makes a product, service, arrangement or activity "decentralized." (Reopening Release at 29450, fn. 15.) Functionally, the concept of decentralization is well understood by most market participants. As an example, we would point the Commission to the definition of a "decentralized network" and a "decentralized organization," provided in Section 101 of the recent draft proposal on Digital Asset Market Structure, available at *https://financialservices.house.gov/uploadedfiles/digital_002_xml.pdf*. As those definitions note, the concept of decentralization contemplates the absence of unilateral authority to control or materially alter the functionality or operation of a blockchain network.

[7] Reopening Release at 29450-51.

2. The Re-Proposal claims, in excess of the SEC's authority and without any clear Congressional authorization, that exchanges and alternative trading systems (**ATSs**) may not trade crypto assets that are non-securities. The Re-Proposal proceeds on this mistaken basis to claim that upon registering with the Commission, crypto trading platforms must stop trading crypto assets that are non-securities. The Re-Proposal must find strong statutory support for extending the SEC's jurisdiction to non-securities and prohibiting exchanges and ATS from trading non-securities, or the Re-Proposal must re-consider this proposed prohibition. In any event, even if the Commission could find authority to regulate non-securities (which we would strongly dispute it can), the Re-Proposal must analyze the relative costs of preventing crypto trading platforms from trading non-securities, as opposed to letting such platforms continue with their current non-security trading practices.

3. The Re-Proposal violates the APA and the Exchange Act in multiple ways. Most notably, the Re-Proposal suffers from the near-complete absence of crypto asset-related data for reasons that the Commission cannot justify. The Re-Proposal makes baseless assumptions about crypto and DeFi platforms and as a result of such incorrect assumptions, fails to consider reasonable alternatives to the proposed registration of crypto trading platforms. The Re-Proposal fails to consider some major risks of requiring crypto trading platforms to register, especially the risk that such platforms may move offshore.

The Commission should take the steps required to remedy these shortcomings in the Re-Proposal, including by withdrawing the Re-Proposal until it can:

- collect significantly more data on crypto trading platforms, the manner of trading on such platforms, and the assets traded;

- evaluate further the nature and functioning of centralized and decentralized crypto trading platforms;

- provide more guidance on the circumstances under which crypto trading platforms, and DeFi platforms in particular, would be required to register with the Commission;

- defer to Congress on the question of where and under what circumstances platforms may trade non-securities, or identify clear Congressional authorization, if any, permitting the Commission to prohibit exchanges and ATSs from trading non-securities; and

- determine the volume of non-security crypto assets trading on these platforms, and the costs to platforms and retail and other investors of ceasing trading in such non-securities.

Our concerns and suggestions to the Commission are discussed in greater detail below. We welcome the opportunity to engage with the Commission and the Staff to address these concerns and to develop regulations and solutions together, in line with our requests.

* * *

I. The Re-Proposal is impermissibly vague and provides no clarity to crypto trading platforms and crypto market participants.

The Original Proposal proposed to expand the exchange definition significantly to include any organization, association, or group of persons that:

- constitutes, maintains, or provides a marketplace or facilities for bringing together buyers and sellers of securities; and

- "makes available" established non-discretionary methods (whether by providing a trading facility or communication protocols, or by setting rules) under which buyers and sellers can interact and agree to the terms of a trade.[8]

A number of commenters on the Original Proposal had pointed to the breadth and lack of specificity of this proposed new exchange definition.[9] These commenters noted that key terms in the definition, such as "group," "makes available," and "communication protocol," had either not been defined or not been adequately defined.[10] Commenters also noted that the Original Proposal provided little concrete guidance to market participants on how they might shape their conduct to not operate as an unregistered exchange.[11] A number of commenters had pointed to the specific problems that the expansive proposed exchange definition might pose for DeFi systems, with their widely dispersed operations.[12]

In brief, the Commission has received a number of detailed, and highly specific comments that:

- are critical of the overbreadth of the proposed definition;

- point to the vagueness of key terms in the proposed definition of an exchange; and

---

[8] Proposed Rule 3b-16(a)(2).

[9] *See, e.g.*, Consensys Letter (Apr. 14, 2022) available at *https://www.sec.gov/comments/s7-02-22/s70222-20123694-279940.pdf*; a16z Letter (Apr. 18, 2022) available at *https://a16z.com/wp-content/uploads/2022/04/a16z_comment_on_letter_on_file_number_S7-02-22.pdf*; Coinbase Letter (Apr. 18, 2022) available at *https://www.sec.gov/comments/s7-02-22/s70222-20123940-280077.pdf*; Bloomberg Letter (Sept. 16, 2022) available at *https://www.sec.gov/comments/s7-02-22/s70222-20143645-309017.pdf*.

[10] *See, e.g.*, a16z Letter, observing that "…the Commission proposes to adopt a broad new category of "established methods" that exchanges might use to facilitate trades— "communication protocols"—that is found nowhere in the text of the Exchange Act. The scope of the Commission's discretion under the Proposal is broader still: The Proposal offers only 'a non-exhaustive list of some Communication Protocol Systems' and notes that 'the determination of whether the system [falls under the definition of 'exchange'] would depend on the particular facts and circumstances of each system.'" [Internal citations omitted.]

[11] *See, e.g.* Consensys Letter, observing that "Developers such as those that work with ConsenSys, as well as others across the technology universe, would thus be left in an untenable position: the proposal requires them to register as an exchange if they "make available" "communication protocols," but refuses to tell them what either of those phrases means. This vagueness will leave hundreds of thousands of people and businesses uncertain about whether they are covered by the proposal's amendments and impose the costs of regulatory uncertainty on vital sectors of the American economy."

[12] *See, e.g.*, Coinbase Letter, Coin Center Letter (Apr. 14, 2022) available at *https://www.sec.gov/comments/s7-02-22/s70222-20123684-279908.pdf*; see also Delphi Digital Letter (Apr. 18, 2022) available at *https://www.sec.gov/comments/s7-02-22/s70222-20123874-280044.pdf*.

- raise serious questions regarding the workability of the proposed exchange definition in the DeFi and crypto contexts.

Despite the volume and gravity of these criticisms, the Commission appears to have not substantively addressed these critical comments. Instead, the Commission seems to have simply re-proposed the same overbroad definition of an exchange in the context of DeFi and other crypto trading systems, without any modification, or any acknowledgment of legal implications of the underlying technology.

Entities that operate unregistered securities exchanges (as defined by this proposal) in violation of the Exchange Act can face very severe adverse consequences. They may be required to pay civil money penalties, be subject to permanent injunctions and industry bars, be required to undertake a variety of remedial measures, and may suffer grave and often irreversible financial and reputational damage.[13] It is therefore appropriate, indeed essential, that the Commission give market participants "fair notice of the conduct that is forbidden."[14] As we describe below, providing clarity on these overly broad definitions is of utmost importance. This the Re-Proposing Release fails to do, and this failure is especially marked in the context of DeFi and crypto — areas where the Commission appears to proceed on the basis of mistaken assumptions regarding the underlying technology.

A. The Re-Proposal fails to give fair notice of what conduct is subject to liability.

The Re-Proposal states that the exchange definition covers an organization, association or group of persons that:

- constitutes, maintains or provides a marketplace for bringing together buyers and sellers of crypto asset securities, and

- "makes available" established non-discretionary methods (whether by providing a trading facility or communication protocols, or by setting rules) under which buyers and sellers can interact and agree to the terms of a trade.[15]

The Re-Proposal provides little to no clarity on when several persons will constitute a "group" for this exchange definition. It provides no real guidance on what it means to "make available" methods under which buyers and sellers can interact and agree to the terms of a trade — and this absence of guidance places practically every vendor that contracts with an exchange and every developer of open source code at risk of being considered to be part of the exchange. The Re-Proposal makes assumptions about the working of DeFi trading systems that are not borne out by reality, and that seek to treat decentralized networks of entities trading crypto assets in the same manner as a centralized exchange. These errors or omissions of the Re-Proposal contribute to the

[13] In the context of unregistered crypto asset exchanges, see, e.g., *In the Matter of Zachary Coburn* (Nov. 8, 2018) available at *https://www.sec.gov/litigation/admin/2018/34-84553.pdf*; and *In the Matter of Poloniex, LLC* (Aug. 9, 2021) available at *https://www.sec.gov/litigation/admin/2021/34-92607.pdf*.

[14] *F.C.C. v. Fox Television Stations, Inc.,* 132 S. Ct. 2307, 2317 (2012).

[15] Reopening Release at 29451.

vagueness of the proposed exchange definition and force market participants to constantly question whether they might be operating or involved in operating an unregistered securities exchange without ever consciously intending to do so.

We examine each of these errors and omissions further below.

1. The Re-Proposal fails to provide sufficient guidance on when a person would be a member of a group operating an exchange.

It is a central principle of administrative law that "regulated parties should know what is required of them so they may act accordingly."[16] It is equally well established that "precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way."[17] A regulation is vague not because it may at times be difficult to prove an incriminating fact but rather because it is unclear as to what fact must be proved.[18] The Re-Proposal, in its current form, makes it very difficult to determine "what fact[s] must be proved" for an entity to show that it is not part of a group that operates an unregistered securities exchange.

In the Re-Proposal, the Commission reiterates that a group of persons, whether incorporated or unincorporated, can together constitute, maintain, or provide a marketplace for securities or perform the functions commonly performed by a stock exchange.[19] According to the Commission, a group of persons can operate an exchange either by "acting in concert"[20] or by exercising or sharing control over the "organizational, financial, or operational aspects of such marketplace."[21] Unfortunately, the Commission provides little by way of workable guidance on what either of these concepts means for market participants. We agree with the Commission that whether persons "act in concert" or "exercise or share control" over a marketplace are both questions of facts and circumstances. But the factual nature of these questions does not relieve the Commission of its obligation to indicate what additional kinds of facts must be proved in order to establish whether a group of people are operating an exchange.

On the concept of "acting in concert," the Commission only notes that persons can act in concert through a formal or an informal agreement.[22] This bare formulation could cover all persons and entities with any arrangement with an exchange. Does every entity that contracts with an exchange "act in concert" with that exchange? What actions might constitute an "informal agreement" with an exchange? Are there some set of functions that are essential to the operation of an exchange that persons acting in concert must seek to perform? Does the Commission have to expressly prove the intention to agree among parties in order to establish that they acted as a group operating an exchange, or can such intention to agree be inferred from the facts? These are only some of the

---

[16] *Fox*, 132 S. Ct. at 2317 (citing *Grayned v. City of Rockford*, 408 U.S. 104, 108-109 (1972)).

[17] *Id.*

[18] *Id.*

[19] Reopening Release at 29454.

[20] *Id.*

[21] *Id.*

[22] *Id.*

many questions the Commission entirely fails to consider or address. The complete failure to address or provide any guidance on these questions may deter even independent third parties from contracting to provide goods or services to exchanges for fear that they might be viewed as "acting in concert" with the exchange.

Having failed to provide even rudimentary guidance on what it means to "act in concert," the Commission then proceeds to the other extreme by providing a diverse and bewildering range of factors that can be used to show whether a group of persons "exercise or share control" over a market place. The Commission notes that a person may exercise control over a marketplace place:[23]

- through ownership interests;
- through the corporate structure and management;
- through a significant financial interest;
- through the ability to determine or modify any of the following:
    - participant access,
    - securities traded,
    - operations or trading policies, or
    - non-discretionary methods of the market place or facilities.

This lengthy list of disparate factors would allow the Commission to establish the existence of "control" under almost any set of circumstances. For example, an independent issuer that successfully negotiated a material modification to an exchange's standard listing agreement could be viewed as exercising control over an exchange. An entirely passive investor in an exchange may be viewed as exercising control solely because of the size of its financial interest in the exchange. An ATS may modify its operations or trading policies to conform to the rules and requirements of the Financial Industry Regulatory Authority (**FINRA**) — would that imply that FINRA "exercises control" over the ATS? While these outcomes may seem extreme, they highlight the Commission's overly broad, seemingly arbitrary list of factors that could act as determinants of control. The Re-Proposal thus unfortunately fails to provide an intelligible and clear principle to determine when an entity controls an exchange. The breadth of the phrases "act in concert" and "exercises or shares control" may also place vendors, service providers, and technology providers to exchanges in a particularly difficult position. The Re-Proposal provides, as guidance, the following example of a software vendor who would not be considered to be acting as part of a "group" for the purposes of Rule 3b-16:

[23] *Id.* at 29455.

> "A software developer who, acting independently and separate from an organization, publishes or republishes code without any agreement (formal or informal) with any person for that code to be used for a function of a market place or facilities for bringing together buyers and sellers of securities may be less likely to be acting in concert to provide a market place or facilities for bringing together buyers and sellers.[24]"

Unfortunately, this example is not as helpful to all market participants as one would think. Many independent software providers may write or develop code specifically for use on an exchange, knowing that the code is intended for such use. This does not make the developer a part of the exchange — the developer is merely providing a discrete good and/or service to the exchange for consideration. The Commission appears to suggest that only software developers who develop code with no idea of how such code will ultimately be used can escape being included in the exchange definition. If the Commission intends to cast such a wide net, the term "exchange" will be expanded to the point where it ceases to have any meaning.

2. The Re-Proposal appears to fundamentally misunderstand how DeFi systems operate and the extent to which they can comply with the re-proposed Rule 3b-16.

The Re-Proposal states that both centralized and DeFi[25] systems that trade some amount of crypto asset securities would be required to register as a national securities exchange or comply with the conditions of Regulation ATS.[26] In support of this conclusion, the Commission states its belief that in DeFi systems, a single organization "typically" constitutes, maintains, or provides the marketplace or facilities for bringing together buyers or sellers of securities.[27] The Commission also notes that DeFi trading systems often rely on electronic messages that are exchanged between buyers and sellers so that they can agree upon the terms of a trade without negotiations. The Commission states that if these electronic messages constitute a firm willingness to buy or sell a crypto asset security, and if the orders of multiple buyers and sellers interact with each other through non-discretionary methods such as through the provision of certain smart contract functionality, the DeFi system's activities would be covered under existing Rule 3b-16(a).[28]

Here, the Commission appears to fundamentally misunderstand how DeFi systems work. First, it is unclear why the Commission insists that it is "typical" for a single organization to maintain the marketplace in a DeFi system. The Commission's sole piece of evidence for this view appears to be a single footnote extracted from a report stating that "claims about decentralization for many projects may not hold up to scrutiny of the technical reality of what can be changed in the system,

---

[24] *Id.* at 29455.

[25] *Id.* at 29456.

[26] *Id.* at 29454.

[27] *Id.*

[28] *Id.*

who can be involved in the decisions, and who actually is involved."[29] The Commission appears to take this single sentence about incomplete decentralization in certain projects and interpret it to mean that it is "typical" for a single organization to run DeFi projects. The report cited does not reach so strong a conclusion, and there appears to be no other support for the Commission's extreme view of DeFi projects.

Second, the Commission errs in viewing a smart contract's availability as akin to a centralized exchange. On a DeFi trading system, the smart contract code is redundantly stored on the computers of everyone who forms the peer-to-peer blockchain network.[30] On a DeFi system, contrary to the Commission's stated view, there is no single organization bringing together buyers and sellers — it is more accurate to say that buyers and sellers use the smart contract stored on their computers to come together on their own. What the Commission calls a "system" is more accurately understood as a network of independent transactions, each entered into for its own reason and without coordination with any other transaction or actor on the network.

The Commission counters this reality by stating that "the existence of smart contracts on a blockchain does not materialize in the absence of human activity or a machine (or code) controlled or deployed by humans."[31] The Commission goes on to state that the ability to modify the entering, storage, matching, or display of trading interest (for instance, by modifying the smart code) could constitute control over a marketplace.[32] Similarly, according to the Commission, control could be manifested by the ability to control access to the market, data regarding the market, order interaction processes, or trading policies and methods.[33] Each of these statements is questionable in the context of DeFi.

As the Commission acknowledges, and as commenters have pointed out, the smart contract, once launched, often cannot be controlled or modified, even by its original developer.[34] Further, the various examples of control that the Commission puts forward may be exercised by entirely different and unrelated entities in a DeFi system or may be controlled by consensus mechanisms to which all system users can contribute, for example, through a voting mechanism. These examples would make it extremely difficult for DeFi systems to comply and register as exchanges or ATSs.

In response to reasonable queries about how decentralized entities should comply with the re-proposed Rule, the Commission posits a solution that is hard to comprehend. The Commission begins by acknowledging that "there may be some existing systems of this type designed in such a way that the information necessary to comply with the disclosure requirements of Regulation ATS is

---

[29] The Board of the International Organization of Securities Commissions, IOSCO Decentralized Finance Report (Mar. 2022) at 8, fn. 13 (**IOSCO Report**), available at *https://www.iosco.org/library/pubdocs/pdf/ IOSCOPD699.pdf*.

[30] *See* Coin Center Letter at 14.

[31] Reopening Release at 29454.

[32] *Id.* at 29455.

[33] *Id.*

[34] *Id.* at 29456.

not possessed by any singular entity." [35] How should such truly decentralized systems comply? In such decentralized cases,the Commission states that it

> "believes that the entities responsible for compliance **may find it necessary to form an organization or designate a member of the group of persons to be responsible for compliance**, as discussed above, and that such an organization or member of the group of persons would be capable of collecting the information necessary to comply."[36] (Emphasis ours)

We find the Commission's proposed solution puzzling. The Commission first appears to concede that there may be truly decentralized trading systems, seemingly abandoning its earlier insistence that DeFi systems are typically run by a single organization. Having conceded that decentralization can be, and has been accomplished in some cases, the Commission then appears to suggest that users of a DeFi system should then proceed to voluntarily re-centralize solely so that they can register with the Commission. The Commission never appears even to consider the more logical alternative here – namely, that in a truly decentralized system, there is no identifiable "organization, association or group of persons" that constitutes, maintains, or provides a marketplace for bringing together buyers and sellers of crypto asset securities. As a consequence, and although the Commission fails to recognize it, decentralized systems are not currently covered and should not be covered by Exchange Act Rule 3b-16, in either its present or proposed forms.

3. The Re-Proposal cannot be understood or operationalized without further guidance on which crypto assets are securities.

Exchange Act Rule 3b-16 is predicated on the trading of securities. Even in its proposed form, the Rule would apply only to marketplaces for buyers and sellers of securities and to the entities, organizations, or groups that constitute, maintain, or provide for such marketplaces. There is no provision in the Exchange Act to prudentially register a securities exchange without first affirming that one or more securities are traded on such exchange. But the Commission makes no affirmative statement that crypto trading platforms are trading securities, observing only that it is "unlikely that systems trading a large number of different crypto assets are not trading any crypto assets that are securities."[37] As we note below and elsewhere in this letter, it is common for trading platforms to trade crypto in pairs, for example, against non-securities such as bitcoin or stablecoins.

If the Commission cannot arrive at a firm conclusion as to which crypto assets are securities, it is unfair to place that burden solely on crypto trading platforms. Yet, that is exactly what the Commission does in the Reopening Release, observing, through a footnote, that "Each system should analyze whether the crypto assets that it offers for trading meet the definition of a security under the federal securities laws and prior Commission statements."[38] The Commission offers no concession for, and no mechanism to address cases where systems disagree, in good faith, as to whether the crypto assets they trade are securities.

---

[35] *Id.* at 29485.

[36] *Id.*

[37] *Id.* at 29450.

[38] *Id.* at fn. 30.

B. The vagueness of the Re-Proposal gives the Commission ample room for arbitrary enforcement.

Market participants who seek to determine whether they form part of a "group" for the purposes of re-proposed Rule 3b-16 will likely find it difficult to make that determination in the absence of clarity around the key concepts of "acting in concert" and "exercising control." Vendors, technology providers, and service providers to exchanges will live in constant fear of whether their arrangements with exchanges and trading systems amount to operating an illegal exchange. Market participants in DeFi systems will continue to be confused by the Commission's insistence that such systems must register despite their decentralized status. Underpinning all this uncertainty is the continuing and unresolved controversy about which crypto assets constitute securities. In short, the ill-defined nature of the Re-Proposal, its overly broad sweep of various kinds of systems and service providers, and its fundamental misunderstanding of the nature of DeFi systems benefits no one — no one, that is, except the Commission.

As far as the Commission is concerned, the effect of the Re-Proposal will be to vest it with nearly unfettered discretion to enforce the Exchange Act against a range of systems and market participants. A law is impermissibly vague when it allows the government to rely on "untethered" and "wholly subjective judgments without statutory definitions, narrowing context, or settled legal meanings."[39] The Re-Proposal is vague in precisely these ways — well over a year after the amendments to Rule 3b-16 were first proposed, key terms continue to be undefined or defined only in the broadest manner possible. The Re-Proposal effectively ignores the specific technological context in which DeFi and other crypto trading platforms operate and requires them to adhere to Exchange Act Rule 3b-16 in the same way as traditional securities exchanges. The Re-Proposal makes no attempt to draw clear boundaries around the kinds of conduct that would be regulated, preferring instead to repeatedly fall back on the formulation that the Commission will be guided by "facts and circumstances." The Commission may be guided by facts and circumstances in making its enforcement decisions, but market participants must know which facts matter in the regulatory context. The Commission and its Re-Proposal provide no guidance in this regard.

A law cannot be "so standardless that it authorizes or encourages seriously discriminatory enforcement."[40] The standards by which the Re-Proposal would operate are difficult to discern. The Re-Proposal appears almost deliberately vague on which entities must register as exchanges or ATSs, and under what circumstances. Even after registering, however, the Re-Proposal would effectively require crypto trading platforms to give up much of their trading volumes by prohibiting them from trading non-securities. As we hope to show below, this proposed prohibition, like much else in the Re-Proposal, is not supported by the Exchange Act or the other federal securities laws.

---

[39] *Holder v. Humanitarian Law Project,* 561 U.S. 1, 20 (2010).

[40] *United States v. Williams,* 553 U.S. 285, 304 (2008).

II. The Re-Proposal misunderstands the importance of crypto asset non-securities on crypto trading platforms and has no authority to state that exchanges and ATSs cannot trade non-securities.

The Re-Proposal would require crypto trading platforms to determine whether any of the crypto assets they offer for trading meet the definition of a security — if they are trading securities, crypto trading platforms must register with the Commission as an exchange or as an ATS. The Re-Proposal then informs us that upon registering as an exchange or ATS, the crypto trading platform must stop trading all non-securities. Notably, the Re-Proposal does not clearly announce the prohibition on exchanges and ATS trading non-securities. Instead, it appears to note, as a matter of observable fact, that "Market places or facilities of, and the functions performed by, national securities exchanges and ATSs trade only securities quoted in and paid for in U.S. dollars."[41] Much later in the Re-Proposal, in its Economic Analysis, the Commission obliquely introduces this major and consequential prohibition on trading non-securities as a potential cost to crypto trading platforms registering as exchanges or ATSs. The Commission states that:

> "Many crypto asset securities are not traded in exchange for fiat currencies but are instead traded for other crypto assets. To the extent that a New Rule 3b-16(a) System enables the trading of crypto asset securities for crypto assets that are not securities, that entity may also incur the cost of having to stop enabling such trades, and the resulting loss of revenue."[42]

We strongly disagree with the Commission's view that crypto asset securities are commonly traded for non-securities. Even more importantly, however, the question of whether a registered exchange or ATS can trade a non-security has enormous significance to both the Exchange Act, as well as to the U.S. economy. There appears to be no basis in law for the Commission to regulate non-securities, whether such non-securities take the form of crypto assets or otherwise. The Re-Proposal cannot implicitly grant the Commission the authority to regulate non-securities thus introducing a sweeping prohibition on trading non-securities on crypto platforms without any support from statutory text, history, or structure. And even if the Commission has any basis for stating that exchanges and ATSs cannot trade non-securities (and we do not believe the Commission has any support for this view), the Commission must then accurately assess the immense costs to crypto trading platforms of ceasing trading in such non-security assets. The Commission fails to make even the most basic attempt to evaluate these costs, instead only observing that:

> "Furthermore, because existing national securities exchanges and ATSs currently do not facilitate trading between crypto asset securities and non-security crypto assets, the loss of New Rule 3b-16(a) Systems as platforms for engaging in such trades may be a **significant** cost for market participants in crypto asset markets."[43] (Emphasis ours.)

---

[41] Reopening Release at 29451.

[42] *Id.* at 29482.

[43] *Id.*

The Commission cannot dismiss the costs of ceasing to trade non-securities as being merely "significant." In reality, the trading of non-security crypto assets is vital to crypto trading platforms, and the inability to trade non-securities could pose an existential threat to many crypto trading platforms. As the Re-Proposal notes, many crypto asset trading systems offer "pairs trading," which typically involves two crypto assets that can be exchanged directly for each other using their relative price.[44] These trading pairs consist of both a base and quote asset; and stablecoins, bitcoin, or ether commonly feature in many trading pairs.[45] The trading of these non-security crypto assets is vital to both the business prospects of many crypto trading platforms, as well as to the smooth functioning of such platforms. Bitcoin, for example, is universally agreed to be a non-security and continues to be the most popular crypto asset by trading volumes on many major U.S. trading platforms.[46]

The role of stablecoins, another type of non-security crypto asset, in these trading pairs is crucial to the smooth functioning of crypto trading platforms. If a crypto asset could not trade against a stablecoin, the only way to replicate that trading pair would be to arrange for a fiat currency market for the relevant crypto asset. This would increase friction in the crypto trading system, delay and complicate settlement, and increase the fees paid to banks, custodians, and other intermediaries, thereby significantly increasing overall trading costs.

Even if the Commission were right in its very questionable claim that there are many crypto asset securities currently traded in pairs against crypto asset non-securities, we cannot agree with the Commission's implicit assumption that crypto trading platforms that register as exchanges or ATSs must immediately stop trading crypto asset non-securities. As noted above, the Commission informs us in the Re-Proposal that national securities exchanges and ATSs trade only securities quoted in and paid for in U.S. dollars.[47] On this basis, the Commission appears to take it as a given that upon registering as an exchange or an ATS, a crypto trading platform must give up all trading in non-securities. The Commission currently lacks any authority to regulate the trading of non-securities. The Commission provides no basis in statute, rule, or case law as to how the Re-Proposal can suddenly begin making regulatory pronouncements on the trading of non-securities. Nor, more specifically, does the Commission provide any basis in law as to why exchanges and ATSs must only trade securities. The Commission's reference only to the practice of certain national securities exchanges (ignoring the reality of many ATSs and broker-dealers) is an utterly inadequate answer to a question of such pronounced economic and political significance.

A. The trading of non-securities on an exchange is a "major question" under the Exchange Act.

If the Commission persists in its assumption that securities exchanges and ATSs cannot trade non-securities, the Commission must point to clear Congressional authorization for the Commission to prohibit the trading of non-securities on exchanges and ATSs. In the context of the Exchange Act, any claim that non-securities may not be traded on exchanges and ATSs raises a question of "vast

---

[44] *Id.* at 29451.

[45] *Id.*

[46] *See, e.g.* Coinbase, *https://www.coinbase.com/price/bitcoin*; Gemini, *https://coinmarketcap.com/exchanges/gemini/*.

[47] Reopening Release at 29451.

economic and political significance."[48] In effect, the Commission would be claiming, in a departure from all law and precedent, regulatory authority over non-securities. This major question cannot be answered by simply pointing to the current practice of securities exchanges and inferring that such practice amounts to a legal rule. As the Supreme Court recently noted in *West Virginia v. EPA*, "assertions of 'extravagant statutory power' over the national economy" are typically met with skepticism.[49]

In the Re-Proposing Release, the Commission asserts vast statutory power over exchanges by appearing to take it as a given that exchanges and ATSs can never trade non-securities. The Commission does so without ever locating such prohibition in the Exchange Act or in any other federal securities statute. The Commission's inability to find support for this prohibition in any federal securities statute is unsurprising — no such prohibition exists. Nor can any support for the prohibition be found in the Exchange Act's history or structure. The Exchange Act has existed for nearly 90 years, and the Commission has never before asserted that exchanges and ATSs have no power to trade non-securities under the Act.

If, in the complete absence of textual, historical, or structural support from the statute, the Commission's only basis for the purported prohibition against trading non-securities on exchanges and ATSs is current practice, then that basis is plainly insufficient. The Commission cannot solely point to the current practice of a handful of exchanges as the basis for a sweeping prohibition of enormous economic consequence. As Justice Scalia observed in *Whitman v. American Trucking Associations*, Congress "does not hide elephants in mouseholes."[50]

The question of where and when non-security crypto assets may trade is clearly within Congress's domain rather than the Commission's. Indeed, we note that this very question is currently being presented for deliberation in Congress — on June 2, 2023, the Chairmen of the House Financial Services Committee, and the House Committee on Agriculture, together released a discussion draft of legislation providing a statutory framework for crypto asset regulation intended to provide clarity, fill regulatory gaps, and foster innovation, while providing adequate consumer protections.[51] Among other things, that proposed legislation would provide for the dual registration with the SEC and Commodity Futures Trading Commission of platforms trading both crypto assets that are commodities as well as crypto assets that are securities.[52] The Commission cannot usurp Congress's prerogative to decide which crypto trading platforms may trade non-securities. We therefore urge the Commission to respect Congress's authority by not making any pronouncements on where and under what circumstances non-security crypto assets may be traded.

Finally, and as a minor digression, we should also note that we disagree with the Commission's claim that "national securities exchanges and ATSs trade only securities quoted in and paid for in

---

[48] *Utility Air Regulatory Group v. EPA*, 573 U. S. 302, 324 (2014).

[49] *West Virginia v. EPA*, 2022 WL 2347278; *Utility Air*, 573 U. S., at 324.

[50] 531 U.S. 457, 468 (2001).

[51] *McHenry, Thompson, Hill, Johnson Release Digital Asset Market Structure Proposal*, Washington June 2, 2023, Text available at *https://financialservices.house.gov/uploadedfiles/digital_002_xml.pdf*.

[52] *See, e.g.,* Section 308 (Dual Registration).

U.S. dollars."[53] The Commission's statement may be true of national securities exchanges, but it is less clearly true of ATSs, which are regulated as broker-dealers. Many broker-dealers have historically traded and continue to trade in non-security commodities, such as bullion or forex.[54] Neither history nor current practice supports the Commission's claim.

B. If non-securities can be traded on an exchange or an ATS, the Commission must withdraw the Re-Proposal and reconsider its economic analysis.

As we noted earlier, the Re-Proposal makes no real attempt to survey the importance of non-securities to the business of crypto trading platforms. If the Commission is correct in its statement that an exchange or ATS cannot trade non-securities, then the Commission must at least squarely confront and determine the likely costs of not trading non-securities for crypto trading platforms. The Re-Proposal fails to do this, stating only that the costs of stopping trading in non-securities are likely to be "significant" for crypto trading platforms.

If, as we believe more likely, the Commission is incorrect, and there is no prohibition on exchanges and ATSs trading non-securities, then the Re-Proposal must be reconsidered in its entirety. The Commission must consider how exchanges and ATSs (and ATSs, in particular) can trade crypto asset securities and non-securities side-by-side on the same platform, what oversight tools the Commission can effectively bring to bear on such trading, what the capital, customer protection, recordkeeping, reporting and other regulatory obligations of such platforms trading both types of crypto assets are likely to be, and a number of other regulatory questions. The Commission must consider its economic analysis anew, this time without reckoning the costs of having to cease trading non-securities, and instead, accounting for the benefits to crypto trading platforms of providing uninterrupted trading and other services in various crypto non-securities assets.

The Commission cannot obliquely address a major question of economic or political significance (namely, the trading of non-securities on registered platforms) without clear Congressional authorization to do so. Equally, the Commission cannot introduce a major prohibition on registered platforms without making any serious attempt to consider its economic ramifications accurately. For reasons we examine further below, the failure to fully consider the major economic implications of the Re-Proposal places the Commission in breach of its obligations under the APA and the Exchange Act. To remedy these failures and likely breaches of law, the Commission should withdraw the Re-Proposal, examine the legal basis (if any) for its proposed prohibition on non-securities trading on ATSs and exchanges, re-evaluate the economic impact of the prohibition against the current realities of crypto trading platforms that extensively trade non-securities, and then re-propose the amendments in a manner that is consistent with the Commission's obligations under the APA and the Exchange Act.

---

[53] Reopening Release at 29451.

[54] Consider, for example, the ETFS Gold Trust, a commodity trust registered with the Commission. The trust's filings with the Commission identify a number of prominent registered broker-dealers who periodically exchange gold for shares of the trust, and *vice versa*, in order to maintain the trust's arbitrage mechanism. See *https://www.sec.gov/Archives/edgar/data/1450923/000145092317000004/sgol-20161231x10k.htm*, (at p. 33) naming several broker-dealer firms as authorized participants who will regularly arbitrage gold against shares of the trust.

III. The Re-Proposal fails to perform a thorough economic analysis and to undertake required cost-benefit analyses, in violation of the Commission's obligations under the APA and the Exchange Act.

The Commission has long recognized that a thorough regulatory analysis should accompany a rulemaking exercise. The Commission's Office of General Counsel states that three of "the basic elements of a good regulatory economic analysis" include:

- the definition of a baseline against which to measure the likely economic consequences of the proposed regulation;
- the identification of alternative regulatory approaches; and
- an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis.[55]

Undertaking these three essential elements of a good regulatory economic analysis is not merely a matter of good Commission practice — the Exchange Act also mandates it. When the Commission engages in rulemaking under the Exchange Act, Section 3(f) of the Act requires the Commission to consider whether an action is necessary or appropriate in the public interest and to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[56] Several judicial precedents involving challenges to rulemaking also recognize the Commission's "statutory obligation to determine as best it can the economic implications of the rule."[57]

These statutory and judicial mandates for a thorough economic analysis are well-established. It is therefore gravely concerning to read the Commission's entirely inadequate economic analysis in support of the Re-Proposal, particularly in relation to crypto trading platforms. On several occasions, the Commission appears to resort to the same formulations to explain its absence of data collection and analysis — namely, that the Commission:

- has limited information with respect to crypto asset securities and that this limitation is partly due to the small number of entities registered with the Commission.[58]
- lacks data on the number of crypto trading platforms, particularly those trading crypto asset securities.[59]

---

[55] *See* Memorandum to Staff of the Rule Writing Divisions and Offices from RSFI and OGC (Mar. 16, 2012) ("OGC Memorandum") available at *https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf*.

[56] 15 U.S.C. 78c(f). In addition, Exchange Act Section 23(a)(2) requires the Commission, when making rules pursuant to the Exchange Act, to consider, among other matters, the impact that any such rule would have on competition and not to adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. *See* 15 U.S.C. 78w(a)(2).

[57] *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005); *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); *New York Stock Exchange LLC v. SEC*, No. 19-1042 (D.C. Cir. Jun. 16, 2020).

[58] Reopening Release at 29470.

[59] *Id.* at 29474.

- lacks data on the costs that would be incurred if a crypto trading platform was required to change its fee structures, order interaction procedures, trading protocols, access provisions, or its operating model.[60]

- possesses some trade data from crypto trading platforms but is uncertain as to its reliability, due to what the Commission calls "pervasive wash trading" on crypto trading platforms.[61]

- cannot determine what share of securities trading takes place on crypto trading platforms, because of such "wash trading."[62]

The Commission cannot cite the difficulties of collecting or evaluating data as a reason to make rules in its absence. Several governmental and international bodies have credibly collected and cited data relating to crypto platforms, and the Commission has itself cited reports or findings released by these bodies.[63] Some data relating to blockchains may be suspect, just as some data relating to traditional finance markets may be suspect, but equally, there are sophisticated blockchain forensic tools which the Commission has at its disposal.[64]

Most importantly, the Commission could have approached, and still can approach crypto trading platforms to ask such platforms to voluntarily supply the Commission with credible data. But the Commission appears to have not even attempted to take these relatively modest steps to collect and verify blockchain-based data. In the words of the D.C. Circuit Court of Appeals, "Uncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself — and hence the public and the Congress — of the economic consequences of a proposed regulation before it decides whether to adopt the measure."[65] The Commission, and especially its Division of Economic and Risk Analysis, has the resources and expertise to collect and analyze crypto market data — and we are confident that many crypto market participants may be willing to assist in a meaningful data collection exercise.

The pervasive absence of data, and the lack of any real effort to collect it, amounts to a breach of the Commission's best practices on rulemaking. The failure to collect and evaluate data prevents the Commission from fulfilling its obligations under the Exchange Act to assess the economic impact of the proposed rule. Worse yet, this failure lays aspects of the Re-Proposal open to

---

[60] *Id.* at 29479.

[61] *Id.* at 29471.

[62] *Id.*

[63] *See*, e.g., the President's Working Group on Financial Markets, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, Report on Stablecoins (Nov. 2021), available at https://home.treasury.gov/ system/files/136/StableCoinReport_Nov1_508.pdf; IOSCO Report at 29; Fin. Stability Oversight Council, Report on Digital Asset Financial Stability Risks and Regulation 119 (2022) ("FSOC Report"), available at *https://home.treasury.gov/system/files/ 261/FSOC-Digital-Assets-Report-2022.pdf*.

[64] *See*, e.g., Chris Cornillie, SEC Adding Blockchain Forensics to Investigate "Smart Contracts", Bloomberg (Aug. 4, 2020) available at *https://news.bloomberglaw.com/banking-law/sec-adding-blockchain-forensics-to-investigate-smart-contracts*.

[65] *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

charges of being "arbitrary and capricious" under the APA. We examine some of the more significant defects under the APA and the Exchange Act in greater detail below.

A. The Re-Proposal makes unjustifiable assumptions about crypto and DeFi trading platforms.

The absence of data leads the Commission to make unfounded and unjustifiable assumptions about crypto and DeFi trading platforms. For instance, the Commission states that it:

> "believes that the benefits detailed in the [Re-Proposing] Release would accrue in **broadly the same manner** to market participants who trade in crypto asset securities as they would to market participants who trade in the securities discussed in the Proposing Release. This is because the Commission believes that New Rule 3b-16(a) Systems that trade crypto asset securities are broadly similar in their functions to functions of other New Rule 3b-16(a) Systems."[66] (Emphasis ours.)

The Commission makes this incorrect assumption in the absence of data it could easily collect and review. There is little basis to believe that the benefits that accrue to platforms trading registered securities would "accrue in broadly the same manner" to platforms trading crypto asset securities. In fact, there are at least two reasons to think that the calculus for costs and benefits should be very different for crypto trading platforms.

First, the market for crypto asset securities relies far less on intermediation than markets for traditional securities. Only broker-dealers are permitted to participate in traditional securities exchanges, while, as the Commission has itself acknowledged elsewhere, retail participants play a much more significant role in crypto trading platforms.[67] Reduced trading costs and improvements to execution quality, both of which the Commission cites as likely benefits,[68] are unlikely to accrue as clearly by registering and regulating markets where broker-dealers already play a much less significant role.

Second, crypto trading platforms rely heavily on assets that are clearly non-securities for their viability and functioning. Bitcoin and ether, both non-securities, are the leading assets by trading volume and market capitalization. The use of stablecoins is often essential to the smooth functioning of crypto trading platforms.[69] The benefits that the Commission cites, including

---

[66] Reopening Release at 29475. The Commission immediately qualifies this broad statement by noting that it "has a greater degree of uncertainty in its analysis of the benefits that the [Re-Proposal] would provide to market participants in the market for crypto asset securities than it did in its discussion of benefits for non-crypto asset securities. This is because the Commission has less data on the functioning of the market for crypto asset securities."

[67] According to the Commission, "retail customers represent approximately 30% of trading in crypto asset securities at the largest centralized trading platforms." *See* Exchange Act Release No. 96496 (Dec. 14, 2022), 88 FR 5440, 5518 (Jan. 27, 2023).

[68] Reopening Release at 29475.

[69] See, e.g., the IOSCO Report at 16-17, observing that "Stablecoins are a key component of DeFi and have contributed to the exponential and continuing growth of DeFi, facilitating the transfer of assets between and among CeFi and DeFi platforms and protocols, and fuelling the development of DeFi products and services, such as those involving trading,

enhanced regulatory oversight and investor protection,[70] are far less likely to accrue if the Commission lacks regulatory jurisdiction over the most commonly traded assets on crypto trading platforms. The Commission also notes that benefits such as enhanced price discovery and liquidity would be improved by applying broker-dealer requirements to crypto trading systems that register as ATSs[71] — but would price discovery and liquidity be similarly enhanced if the majority of the crypto assets on such ATSs were non-securities over which the Commission had no regulatory authority (and if the Commission were wrong in its assumption that ATSs can only trade securities)?

B. The Re-Proposal fails to explore reasonable alternatives to requiring crypto and DeFi trading platforms to register as exchanges or ATSs.

Operating as it does on the flawed assumptions discussed above, it is perhaps inevitable that the Re-Proposal should fail to consider reasonable alternatives to requiring crypto trading platforms to register as exchanges or ATSs. The Re-Proposal believes, incorrectly, that non-securities cannot trade on an ATS or an exchange — therefore, the Re-Proposal would require all crypto trading platforms to register as ATSs or exchanges and immediately stop trading non-securities such as bitcoin and stablecoins.

The Re-Proposal never pauses to consider whether crypto trading platforms can feasibly register with the Commission without going out of business. The Re-Proposal fails to account for the significant volume of retail participation on crypto trading platforms, the extent to which registration as an exchange would reduce or eliminate such retail participation, and at what cost. As a result, the Re-Proposal fails to consider whether alternative arrangements might be more suitable for crypto trading platforms beyond forcing such platforms to register under existing regulated categories, which are clearly inappropriate for these platforms.

In any rulemaking exercise, the APA requires the Commission to consider alternatives to the proposed rule that are neither "frivolous nor out of bounds."[72] The Commission is required to address alternative ways of achieving its objectives and to provide adequate reasons for rejecting these alternatives.[73] The Commission is certainly not required to consider "every alternative ... conceivable by the mind of man ... regardless of how uncommon or unknown that alternative" may be,[74] but the Re-Proposal considers only a series of alternatives that have nothing to do with the central question of whether crypto trading platforms should be regulated as exchanges or ATSs. For example, the Re-Proposal considers delaying subjecting crypto securities trading platforms to

---

lending and borrowing, insurance, and derivatives or synthetics. Stablecoins are designed to be a less volatile alternative to other crypto-assets, and, because of their perceived stability, they have become DeFi's substitute for fiat currency, acting as the "stable" leg in trading transactions involving more or highly volatile crypto-assets or as the "collateral" for lending and borrowing. Stablecoins facilitate the instantaneous transfer of crypto-assets across the globe on a 24/7 basis and enable investors globally to "plug into" DeFi."

[70] Reopening Release at 29475.

[71] *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

[72] *Id*. at 145.

[73] *Motor Vehicle Mfrs. Ass'n,* 463 U.S. at 51.

[74] *Id*. at 51.

the Re-Proposal (as well as a number of other unrelated alternatives),[75] but it never considers whether a more suitable alternative might be to subject crypto trading platforms to a bespoke regulatory regime that recognizes the volume and importance of the non-securities traded on these platforms, and the significantly higher retail participation on these platforms.

The Commission cannot propose a rule and fail to address the single most important alternative to that rule. The Re-Proposal must consider alternatives that involve regulating crypto trading platforms in a manner that acknowledges that they trade huge volumes of non-securities not subject to the Commission's regulatory scrutiny.

C. The Re-Proposal does not adequately address major economic risks that may arise from requiring crypto trading platforms to register.

The Re-Proposal fails to address significant economic risks that may arise from the Commission's proposal to require crypto trading platforms to register as exchanges or ATSs. The failure to address these risks follows from the Re-Proposal's incorrect assumptions about crypto trading platforms and the Commission's mistaken belief that registration will not be a significant burden for crypto trading platforms. Specifically, the Commission attempts to address, but does not adequately consider, the risks that the Re-Proposal may cause many crypto trading platforms to relocate outside the United States and that U.S. development of DeFi technologies may be delayed.

The Commission acknowledges a commenter's question about whether the Re-Proposal might ''drive financial innovation offshore'' and ''would preclude the development in the U.S. of many software tools and applications, including, but not limited to, DeFi protocols.''[76] The Commission responds to this question by first acknowledging that the cost of complying with the Re-Proposal might affect an entity's choice of jurisdiction in which to base its business.[77] However, the Commission then states that an entity can mitigate these costs by developing its technology in an environment that does not enable investors to trade securities, such as a testnet.[78] The Commission also states that many systems that would experience higher costs "could be restructured to make less extensive use" of novel technologies such smart contracts, "although this could significantly reduce the extent to which these systems operate in accordance with 'DeFi' principles."[79]

The Commission's responses miss the central point and appear to unduly trivialize very significant issues. Technology developers are unlikely to be able to mitigate compliance costs and minimize regulatory risks by simply running a testnet. Instead, the major regulatory risk to technology developers in the crypto trading space comes from considerable uncertainty about which crypto assets are securities. Crypto trading platforms constantly live with the risk that the Commission might, without any notice, suddenly deem one or more assets they facilitate trading in as securities.

---

[75] Reopening Release at 29490.

[76] *Id.* at 29486, referring to the comment letter from the DeFi Education Fund (Jun. 13, 2022), available at *https://www.sec.gov/comments/s7-02-22/s70222-20131087-301122.pdf*.

[77] Reopening Release at 29486.

[78] *Id.*

[79] *Id*.

The Re-Proposal, and crypto market participants, would be far better served if this pervasive uncertainty were confronted and resolved.

We find it difficult to fathom the Commission's response that systems that experience higher compliance costs can minimize these by making less use of novel technologies. Is the Commission openly encouraging firms to reduce compliance costs by slowing down or rejecting technological innovation? Despite the seemingly clear meaning of the Commission's words, we doubt the Commission would take such a retrograde step. If the Commission is actually proposing that trading platforms should wholly or partially reject DeFi technologies so that they can comply with the Re-Proposal, then the Commission must openly factor in this view to its review of the Re-Proposal's efficiency and competition under the Exchange Act. We are aware of no other rulemaking where the Commission has openly called upon firms to deliberately reject or delay technological innovation, and we are deeply concerned about the implications of the Commission's statement to this effect.

We strongly urge the Commission to address the risk that the Re-Proposal may cause crypto trading firms to move offshore, thus depriving U.S. customers of the world's deepest and most liquid crypto markets. U.S. investors, U.S. competitiveness and innovation, and U.S. regulatory capacity would all be adversely affected by the large-scale offshoring of crypto trading platforms. The risks posed by the offshoring of many crypto trading platforms (both DeFi and centralized) are risks that the Commission must account for in its assessment of the economic implications of the Re-Proposal.

IV The Commission should withdraw the Re-Proposal and remedy its deficiencies.

The Re-Proposal states that the value of the global crypto market is $900 billion, by some estimates.[80] A market of this size, and of such promising technological innovation, deserves thorough and careful analysis. That analysis is missing from the Re-Proposal, which freely admits its lack of data on crypto assets and markets while simultaneously impugning the quality of crypto-related data. The failure to collect and analyze data relating to the crypto markets is unjustifiable but, fortunately, also remediable.

Continuing with the Re-Proposal in its present form would not only violate the APA and the Exchange Act but also compromise the Commission's tripartite mission of protecting investors, preserving markets, and promoting capital formation. We, therefore, request that the Commission withdraw the Re-Proposal until it can:

- collect significantly more data on crypto trading platforms, the manner of trading on such platforms, and the assets traded;

- evaluate further the nature and functioning of centralized and decentralized crypto trading platforms;

[80] *Id.* at 29470.

- provide more guidance on the circumstances under which crypto trading platforms, and DeFi platforms in particular, would be required to register with the Commission;

- determine the volume of non-security crypto assets trading on these platforms, and the costs to platforms and retail and other investors of ceasing trading in such non-securities; and

- defer to Congress on how and where non-security crypto assets may be traded, or, in the alternative, identify clear Congressional authorization, if any, permitting the Commission to prohibit exchanges and ATSs from trading non-securities.

CCI and its members stand ready and willing to work with the Commission towards remedying these deficiencies and putting in place a proposal that more accurately reflects the economic and technological realities of the crypto markets. We look forward to continuing to engage with the Commission and the Staff until these objectives are achieved.

* * *

Respectfully submitted,

/s/ Sheila Warren	/s/ Ji Hun Kim
Sheila Warren Chief Executive Officer Crypto Council for Innovation	Ji Hun Kim General Counsel & Head of Global Policy, Digital Assets Crypto Council for Innovation

Cc: The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
The Hon. Mark Uyeda, Commissioner
The Hon. Jaime Lizárraga, Commissioner
Haoxiang Zhu, Director, Division of Trading and Markets
Jessica Wachter, Chief Economist and Director, Division of Economic and Risk Analysis
Megan Barbero, General Counsel, Office of the General Counsel