April 18, 2022

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

Submitted via rule-comments@sec.gov

Re: File No. S7–02–22

Dear Ms. Countryman:

I am pleased to provide these comments regarding the Amendments Regarding the Definition of ‘Exchange’ and Alternative Trading Systems (ATSs) that Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities.¹

The proposing release is 591 pages long and seeks comments on over 250 issues (once multipart questions and non-enumerated requests for comment are considered). The proposed rule would make changes to, or has regulatory implications with respect to, Regulation ATS, Regulation S–T, Regulation M, Regulation SHO, Regulation AC, Regulation NMS, Regulation SBSR and customer margin requirements for security futures. The primary changes, however, are to Regulation ATS. It makes major changes to Form ATS, Form ATS-R and Form ATS-N. Yet the Commission has provided a comment period of only 30 days after publication in the Federal Register. Numerous commentators have criticized this short comment period for a regulation of such scope and potential impact. It will affect how trillions of dollars in securities are traded. If the Commission is serious about getting this rule right and not doing unintended damage to the U.S. capital markets, it should extend the comment period to at least 90 days. This is particularly true given the large number of other rules that the Commission has recently proposed. Regulation by ambush should not be in the SEC’s toolkit. The Commission should be better than that.

Given the short comment period provided by the Commission, I do not pretend to have been able to fully analyze the proposed rule, consider the implications of all of the many proposed changes and provide detailed input on more than 250 legal and economic questions for which the Commission is seeking input. I am sure that is also the case for most analysts and market participants who would ordinarily give the Commission detailed feedback.

The most irresponsible aspect of the proposed rule seems to be the provision in the proposed rule that would bring “communications protocols” within the regulatory ambit of the definition of an

exchange without bothering to define what a “communication protocol” or “communication protocol system” is.\textsuperscript{2} This new, undefined term has the potential to cause immense practical problems. It is a new provision that has extraordinarily broad scope. It was not discussed in the ATS concept release or previous proposed rule.\textsuperscript{3} The failure to define this central term makes the entire regulatory initiative about as clear as mud.\textsuperscript{4} Given that the proposed rule does not bother to define this key term, we will undoubtedly see another episode of regulation by enforcement as the Commission selectively enforces this purposefully ambiguous rule against market participants.

Forcing countless businesses into the extremely burdensome regulatory regime that governs exchanges is no small thing. It will have an adverse impact on innovation and the efficiency of markets. It will raise costs to investors. It will suppress competition to the advantage of incumbent firms. It is therefore inconsistent with the statutory mission of the Commission, to wit, to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.\textsuperscript{5}

\textsuperscript{2} Proposed 17 CFR §240.3b–16(a)(2). See 17 CFR § 240.3b-16 - Definitions of terms used in Section 3(a)(1) of the Act. Section 3(a)(1) of the Securities Exchange Act [15 U.S. Code § 78c(a)(1)] in turn defines the term ‘exchange.’

\textsuperscript{3} “Regulation ATS for ATSs that Trade U.S. Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATSs that Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Market,” Securities and Exchange Commission, Proposed rule; Request for Comment; Concept Release, Federal Register, Vol. 85, No. 251, December 31, 2020, pp. 87106-87253.

\textsuperscript{4} The language in footnote 5 of the proposing release is not helpful: “A ‘Communication Protocol System’ would include a system that offers protocols and the use of nonfarm trading interest to bring together buyers and sellers of securities.” Nor is the discussion in the proposing release at Federal Register at p. 15498 which does nothing more than inform us that, in the view of Commission staff, a ‘Communication Protocol System’, without bothering to define the term, does not currently fall within the definition of an exchange. The discussion at Federal Register p. 15501, to wit, that “[c]onditional order systems may be Communication Protocol Systems that offer the use of trading interest that may not be executable until after a user takes subsequent action” is similarly unhelpful.

“The proposed change to use the word ‘makes available’ rather than ‘uses’ is designed to capture established, non-discretionary methods that an organization, association, or group of persons may provide, whether directly or indirectly, for buyers and sellers to interact and agree upon terms of a trade. In contrast to the term ‘uses,’’ the Commission believes the term ‘makes available’ would be applicable to Communication Protocol Systems because such systems take a more passive role in providing to their participants the means and protocols to interact, negotiate, and come to an agreement.” at p. 15506 is conclusory and unhelpful.

“In addition, neither the current rule nor the proposed amendments require that, for a system to be an exchange, an execution occur on the system; rather, that the buyers and sellers agree to the terms of the trade on the system is sufficient.” at footnote 116 “clarifies” to some degree one point but is similarly unhelpful in addressing the general question of what is and is not a ‘Communication Protocol System.’ It is also inconsistent with the statutory definition of an exchange.

The legal relevance of any of the language discussed in this footnote is quite unclear given that it is a staff discussion in a proposing release and not language in the actual rule. But even if we assume arguendo that a court would give weight to this staff discussion in a proposing release, a responsible Commission would define this key term in the actual rule and not compel market participants to wade through the proposing release staff discussion in an attempt to discern what the Commission means by its rule. The rule should be written with sufficient clarity and specificity that market participants, courts and policymakers have a reasonable idea what the rule actually means.

\textsuperscript{5} “The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation,” http://www.sec.gov/about/whatwedo.shtml#intro. The statutory
I understand that agencies increasingly like to exploit Auer deference\(^6\) and make the rules up as they go along but that is not how a responsible Commission seeking to provide clear rules to market participants would regulate. Market participants should not have to guess what a rule means based on opaque and purposefully ambiguous language or grapple with entirely undefined terms that are central to a regulation’s purpose. The Commission has an obligation to write its rules with reasonable clarity and specificity. This proposed rule does not meet that obligation.

The proposed rule is inconsistent with the statutory definition of an exchange. Section 3(a)(1) of the Securities Exchange Act [15 U.S. Code § 78c(a)(1)] defines an exchange as follows:

The term “exchange” means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a marketplace 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 marketplace and the market facilities maintained by such exchange.

Stating the obvious, there is nothing in the statutory definition of an exchange relating to a ‘Communication Protocol System’ or a ‘communication protocol.’ This poses a serious problem for the Commission. Even under Chevron deference, the Commission can’t just blow past the statutory definition of an exchange. As the Supreme Court put it: “If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.”\(^7\)

It is, for example, manifestly doubtful that a court will hold that the Commission staff’s stated view in the proposing release that

“In addition, neither the current rule nor the proposed amendments require that, for a system to be an exchange, an execution occur on the system; rather, that the buyers and sellers agree to the terms of the trade on the system is sufficient.”\(^8\)

is consistent with the statutory definition of an exchange. There is, of course, a chance that I will be proved wrong given the deference that courts currently accord to agencies. But most people would think that “the functions commonly performed by a stock exchange as that term is generally understood” would include actual trades. There is little doubt in my mind that this issue will be litigated. Increasingly, the Commission is losing important cases when challenged in court because the Commission is increasingly seeking to regulate beyond its statutory authority

\(^8\) Proposing release, footnote 116.
and ignore statutory definitions. This rule, unless modified, is likely to be another example of Commission overreach.

The economic analysis in the proposing release does not support the proposed rule. The proposed rule is fundamentally a solution in search of a problem. ATSSs are more lightly regulated than exchanges. They serve an absolutely vital function for small capitalization equity markets (because they allow broker-dealers to make markets for thinly traded securities and offer lower cost secondary markets to small issuers) and in debt securities markets. In general, they work very well and there is absolutely nothing in the economic analysis of the proposed rule establishing that they do not. The first rule of SEC rulemaking should be “do no harm.” The proposed rule has tremendous potential to do harm to both equity and debt securities markets by suppressing competition, reducing the efficiency of secondary markets and raising costs to investors.

The proposed rule is designed to address a “problem” that the economic analysis in the proposing release does not even begin to establish actually exists. In the relevant analysis of the “benefits” of the rule, all a reader will find is a bald assertion that, notwithstanding higher costs and adverse effects on competition, “improved regulatory oversight” will have benefits that exceed the costs. It does, however, contain the admission that “the Commission is unable to quantify these benefits to market participants because the Commission lacks data on the amount of information that is currently available to different market participants …” The manifest deficiencies in the economic analysis may also cause the Commission problems when the rule is subject to judicial review.

The Commission needs to slow down, seriously seek input from market participants and other analysts and modify the proposed rule so that it does not do serious damage to capital markets.

Sincerely,

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9 For the analysis of the benefits of the rule, see proposing release pp. 15618-15621.