sifma
Invested in America

June 13, 2023

Via E-Mail: rule-comments@sec.gov

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington DC 20549

Re: **File No. S7-02-22; Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"**

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] respectfully submits this letter to the U.S. Securities and Exchange Commission ("Commission" or "SEC") to comment on the above-referenced release (the "DeFi Release")[2] that provides supplemental information and reopens the comment period for the Commission's January 2022 proposal to amend Rule 3b-16 and Regulation ATS (the "Proposal").[3] SIFMA appreciates the opportunity to provide further comment on the Proposal as supplemented by the DeFi Release, which seeks to amend Rule 3b-16 under the Securities Exchange Act of 1934 ("Exchange Act") by expanding the definition of "exchange" and to apply such definition to, among other systems, certain decentralized finance or "DeFi" systems.

As stated in SIFMA's initial comment letter submitted on April 18, 2022 ("SIFMA Letter I") and its subsequent comment letter submitted on June 13, 2022 ("SIFMA Letter II"), while SIFMA supports certain discrete components of the Proposal, SIFMA opposes the proposed expansion of the definition of "exchange" under Exchange Act Rule 3b-16, including with respect to the proposed change of "orders" to "trading interest" and the inclusion of "communication protocol systems."[4] SIFMA broadly supports the policy goal of ensuring that rules governing trading venues keep pace with technological and market

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly one million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional invests, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] Securities Exchange Act Release No. 97309 (Apr. 14, 2023), 88 Fed. Reg. 29448 (May 5, 2023).

[3] Securities Exchange Act Release No. 94062 (Jan. 26, 2022), 87 Fed. Reg. 15496 (Mar. 18, 2022).

[4] *See* Letter from Securities Industry and Financial Markets Association to Vanessa Countryman, Secretary, SEC, dated Apr. 18, 2022, available at https://www.sec.gov/comments/s7-02-22/s70222-20123991-280133.pdf; Letter from Securities Industry and Financial Markets Association to Vanessa Countryman, Secretary, SEC, dated June 13, 2022, available at https://www.sec.gov/comments/s7-02-22/s70222-20131150-301347.pdf. SIFMA also submitted a comment letter requesting an extension of the comment period of the Proposal. *See* Letter from Securities Industry and Financial Markets Association to Vanessa Countryman, Secretary, SEC, dated Feb. 11, 2022, available at https://www.sec.gov/comments/s7-02-22/s70222-20115547-267557.pdf.

developments but continues to believe that the Proposal, as supplemented by the DeFi Release, is not appropriately tailored to these ends. Both the scope of proposed Rule 3b-16 and the Commission's reasons for expanding the Commission's interpretation of an "exchange" remain unclear.

Executive Summary

SIFMA's further comments regarding the Proposal and DeFi Release can be summarized as follows:

(i) ***The Proposal Continues to Lack Conceptual Coherence and a Clear Rationale for the Significant Expansion of Rule 3b-16 –*** As discussed in Part I below, SIFMA remains concerned that the proposed interpretation of an "exchange" lacks conceptual coherence and has become untethered to how actual exchanges operate. The Commission has not provided a clear rationale for why many systems, such as those used for negotiation, are appropriately considered exchanges and why a major expansion of Rule 3b-16 is necessary. This leads to an inconsistent and arbitrary application of Rule 3b-16.

(ii) ***The Commission Should Pursue an Incremental Approach Toward the Expansion of Rule 3b-16 and Regulation ATS*** – As discussed in Part II below, the Commission should take an incremental approach to any expansion of Rule 3b-16 and Regulation ATS, such as by first extending Regulation ATS to systems supporting trading in government securities pursuant to the originally proposed Form ATS-G.[5] Further industry comment and discussion (*e.g.*, through roundtables or a concept release) are needed to ensure that any amendments to Rule 3b-16 would be appropriately calibrated to capture systems that should be subject to the exchange/ATS regulatory framework while excluding those broker-dealer systems (*e.g.*, order and execution management systems ("OEMSs")) that should be excluded from such framework.

(iii) ***The Commission Has Not Addressed Numerous Questions from Commenters Unrelated to DeFi*** – As discussed in Part III below, the Commission has not addressed numerous questions from commenters including SIFMA unrelated to DeFi, resulting in lingering confusion and ambiguity in the proposed application of Rule 3b-16.

(iv) ***The Proposed Scope of Rule 3b-16 Remains Vague and Overbroad*** – As discussed in Part IV below, the DeFi Release has exacerbated confusion and ambiguity in the Proposal in particular with respect to the still undefined term "communication protocol system." To help mitigate these issues, the Commission should separately propose rules to address DeFi systems rather than expanding Rule 3b-16. It is also difficult to comment meaningfully on the Proposal, as amended by the DeFi Release, given the sea of choices of different proposed Rule 3b-16 text the Commission has now proposed. At a minimum, substantially greater clarification and clearer lines need to be drawn between in-scope and out-of-scope systems as well as clarification regarding how certain systems would comply with Regulation ATS.

(v) ***An Extended Compliance Period Would Be Necessary for Market Participants to Comply with Any Adopted Proposal*** – As discussed in Part V below, a significantly longer compliance deadline (*i.e.*, at least 24 months) would be necessary for market participants to come into compliance with any adopted rules.

SIFMA appreciates the difficulties the Commission faces with respect to regulating trading on DeFi systems. However, SIFMA is concerned that in attempting to bring DeFi systems within the scope of Rule 3b-16 and Regulation ATS, the SEC may also subject many non-DeFi systems to regulation as an exchange without a clear rationale. If DeFi systems are the primary focus of the Commission's efforts in proposing to

[5] *See* Exchange Act Release No. 90019 (Sep. 28, 2020), 85 Fed. Reg. 87106, 87156–59 (Dec. 31, 2020).

expand Rule 3b-16, it would be more appropriate to propose separate rules tailored to the specific functioning, risk profile, and complexities of DeFi systems specifically—rather than ballooning Rule 3b-16(a) in a way that would also improperly scope in a multitude of other broker-dealer systems that the Commission says it does not want to capture.

The overbroad nature and numerous unresolved ambiguities in the Proposal and DeFi Release, if adopted, would translate to tremendous costs to market participants who would be required to evaluate systems that, until the Commission introduced the Proposal, have exclusively been considered broker-dealer systems rather than exchange systems. To the extent the Commission proceeds with adoption, clearer lines can and should be drawn to facilitate compliance with the Commission's Proposal and to avoid an outcome in which market participants would persistently face an uncertain facts and circumstances analysis of whether every system they use to facilitate trading is a Rule 3b-16 system. Leaving such interpretive determinations to examiners will lead to inconsistent application of Rule 3b-16 and significant costs to market participants. The stakes are very high as the Commission has made clear that even a market participant that in good faith mistakenly believes its system is outside the scope of Rule 3b-16 risks operating an unregistered exchange in violation of Section 5 of the Exchange Act.[6] Given this enforcement risk, it is imperative that the Commission provide greater clarity and articulate a coherent rationale for any change in the scope of Rule 3b-16.

I. The Proposal Continues to Lack Conceptual Coherence and a Clear Rationale for the Significant Expansion of Rule 3b-16

The DeFi Release has not addressed SIFMA's concern that the Commission has not clearly articulated why it is necessary to make *any* of the fundamental changes to the definition of "exchange" set forth in the Proposal and to capture the types of systems that would potentially be in scope, such as "communication protocol" systems or "negotiation protocol" systems, as the Commission has alternatively proposed.[7] The Proposal makes some general mention of a regulatory disparity or competitive imbalance the Proposal seeks to address, but such references are oblique and have not been articulated clearly as a rationale for the expansive amendments to the definition of "exchange" that are reflected in the Proposal.[8] Indeed, SIFMA still does not understand why the Commission believes such amendments to Rule 3b-16 are necessary.

Fundamentally, the purpose of Rule 3b-16 is to provide additional interpretation of the definition of an "exchange" as set forth in Section 3(a) of the Exchange Act, the core components of which are that an entity or group: (i) provides a market place or facilities for bringing together purchasers and sellers of securities, or (ii) otherwise performs with respect to securities the functions commonly performed by a stock exchange.[9] The Commission appears to have lost sight of these first principles in its increasingly expansive interpretation of what should be considered an exchange.[10] The expanded interpretation of an "exchange"

---

[6] Proposal at 15499.

[7] *See* DeFi Release at 29460 (Comment 13, seeking comment on whether the proposed term "communication protocols" should be replaced with the term "negotiation protocols").

[8] *See, e.g.,* Proposal at 15498 ("by Communication Protocol Systems falling outside the definition of exchange, a disparity has developed among similar markets that bring together buyers and sellers of securities, in which some are regulated as exchanges and others are not. This regulatory disparity can create a competitive imbalance and a lack of investor protections.").

[9] 15 U.S.C. 78c(a)(1).

[10] When initially adopting Rule 3b-16, the Commission stated that "Rule 3b-16 defines terms in the statutory definition of exchange to include markets that engage in activities functionally equivalent to markets currently registered as national securities exchanges." Regulation ATS Adopting Release at 70848. The clear intent was therefore to keep Rule 3b-16

seems no longer meaningfully tethered to the Exchange Act definition or how national securities exchanges operate today. In particular, the Proposal attempts to regulate pre-order communications in the same manner as the regulation of orders without explanation as to why this is appropriate.

As discussed below, the conceptual dissonance between what is an "exchange" under Section 3 of the Exchange Act versus what the Commission proposes to capture under the Proposal is visible on several fronts including with respect to: (A) why systems used for negotiation are an exchange; (B) why the Commission appears to view a RFQ system currently as an exchange when they were explicitly excluded under the Regulation ATS Adopting Release; (C) the Commission's all-encompassing view of what constitutes "nondiscretionary methods;" (D) distinguishing between an automated market maker and a single dealer platform; and (E) how the "technology neutral" application of Rule 3b-16 creates an arbitrary and unworkable application of the rule.

A. The Proposed Amendments Represent a Fundamental Shift from Primarily Capturing Execution Systems to Negotiation Systems – the Commission Should Explain Why Negotiation Systems Are Exchanges

Systems that provided negotiation-only functions were not in scope for the original Rule 3b-16. Negotiation is a bilateral process that by its nature involves discretion of the parties to a potential trade, and has traditionally been recognized as a broker-dealer function. Rule 3b-16 was not originally intended to scope in the automation of these negotiation processes.[11]

The Commission has not explained why systems that facilitate the negotiation of a potential transaction, such as RFQ systems, should now be considered an exchange within the meaning of Section 3 of the Exchange Act. The negotiation of the terms of a potential transaction is fundamentally the function of a broker-dealer, which may seek out different potential counterparties to find the best possible terms of a trade before an order is even formed, let alone executed. That a market participant uses a chat or communications technology that is also used by other market participants (including potential counterparties) does not make such system an exchange—especially when it may be used to gather information which may or may not lead to an order.

SIFMA is not aware, for example, of any national securities exchange that allows market participants to negotiate the terms of a particular trade prior to its execution. It is also not clear how such a negotiation system could even be considered a marketplace. Similarly, SIFMA is not aware of exchanges offering RFQ system (or similar) functionality outside of the context of certain options trading. Exchanges also do not support the use of indications of interest, which is one reason why the Commission expressly limited Rule 3b-16 to systems that bring together firm "orders" rather than merely non-firm trading interest, and why SIFMA opposes the proposed change from "orders" to "trading interest" under the Proposal.[12]

The Commission's stated rationale for including communication/negotiation protocol systems under Rule 3b-16 is because they "perform similar market place functions bringing together buyers and sellers as

---

tethered to the functions actually performed by stock exchanges rather than to leverage Rule 3b-16 as a tool to regulate systems that do not perform similar functions to a stock exchange.

[11] Exchange Act Release No. 40760 (Dec. 8, 1998), 63 Fed. Reg. 70844, 70851 (Dec. 22, 1998) ("Regulation ATS Adopting Release") ("systems that merely provide information to subscribers about other subscribers' trading interest, without facilities for execution, do not fall within paragraph (a) of Rule 3b–16.").

[12] That some ATSs today support both orders and non-firm trading interest does not mean that such ATSs' use of non-firm trading interest makes such system an exchange. This is a logical fallacy. For example, if all birds have wings and some birds are red, it does not follow that being red is an attribute of a bird.

registered exchanges and ATSs" using non-firm trading interest.[13] If no exchanges today (i) support the use of non-firm trading interest, (ii) the ability to negotiate the terms of an execution, or (iii) function by merely identifying parties who may wish to transact at a certain price level with execution occurring on a separate trading venue or bilaterally between the counterparties, then it is unclear in what respects communication/negotiation protocol systems are, in fact, attributes of an exchange.

The Commission also emphasizes that the statutory definition of an "exchange" under the Exchange Act is written in the disjunctive as "a market place or facilities for bringing together purchasers and sellers of securities *or* for otherwise performing with respect to securities the functions commonly performed by a stock exchange . . ."[14] The Commission appears to concede that a communication/negotiation protocol is not something commonly performed by a stock exchange, but fails to explain how a communication/negotiation protocol is a market place or a facility for bringing together purchasers and sellers.

B. The Commission Should Explain Its Apparent Policy Shift Regarding Why RFQ Systems Are Exchanges

The Proposal indicates that the Commission may have changed its view with respect to the status of RFQ systems (and in particular "one-to-many" RFQ systems) without explanation. In the Proposal, the Commission states that:

> "Under **current** Rule 3b-16(a), whether a system meets the 'multiple' prong depends on whether the system, when viewed in its entirety, includes more than one buyer and more than one seller and is not determined on a transaction-by-transaction basis. A system, such as an RFQ system, that is designed to provide the ability of more than one buyer to request quotes from more than one seller in securities at the same or different times would meet the 'multiple' prong of Rule 3b-16(a) because such systems do not include a single counterparty."[15]

The Commission thus suggests that it *currently* believes that such RFQ systems are subject to Rule 3b-16. However, RFQ systems were *explicitly excluded* from Rule 3b-16 under the Regulation ATS Adopting Release in the "System N" example, which provided:

> "System N allows participants to post the names of securities they wish to buy or sell. Other participants view this 'bids wanted list' or 'offers wanted list' and place bids or offers for the specified securities during a defined auction period. The participant who posted the security on the 'bids wanted list' or 'offers wanted list' may either accept or reject the best bid or offer at the close of the auction. System N is not included under Rule 3b–16 because there is only one seller."[16]

There appears to be effectively no difference between System N and many of today's RFQ systems. The Commission even notes in the Proposal that a RFQ system may be referred to as a "Bid Wanted in Competition ('BWIC') or Offer Wanted in Competition ('OWIC')" system.[17] System N also contemplates the plural "participants" suggesting that more than one buyer and seller could avail themselves of the System

[13] Proposal at 15498.

[14] DeFi Release at 29458.

[15] *S*ee Proposal at 15505 (emphasis added).

[16] *See* Regulation ATS Adopting Release at 70855–56.

[17] Proposal at n.58.

N functionality.[18] Yet, System N was nonetheless expressly stated to be outside of Rule 3b-16 because it failed the "multiple" buyers and sellers prong.[19]

The Commission does not explain this apparent policy shift or even acknowledge that a shift in policy has occurred. Instead, the Proposal implies that RFQ systems have been subject to Rule 3b-16 all along. This has real and direct implications for market participants who could potentially be subject to an enforcement action under Section 5 of the Exchange Act for operating a RFQ system as an unregistered exchange, notwithstanding reasonable reliance on the System N guidance. The appropriate means to effect such a policy change is to propose, through a proper notice and comment process consistent with the Administrative Procedure Act ("APA"), to redefine Rule 3b-16 to incorporate systems that meet the criteria of System N and provide a reasonable basis for such rule modification.

C. The Commission Has Inappropriately Expanded the Concept of "Non-discretionary Methods" Far Beyond an Actual Exchange

SIFMA is concerned that the Commission is proposing to inappropriately expand the concept of "non-discretionary methods" to capture *every* form of an established process, whether manual or automated, and overlooks many forms of discretion that distinguish many systems from *actual* exchanges.[20] The Commission has effectively expanded the meaning of "non-discretionary methods" to only exclude systems where the broker-dealer operator applies "its discretion in matching counterparties on the system."[21] Yet, even here, the Commission also states that if a system includes "the ability of the system operator to apply its discretion for handling trading interest, these activities employing discretion by the system operator would be within the meaning of a system that meets the criteria of Rule 3b–16(a)."[22]

The concept of "discretion" is rendered meaningless under the Proposal. Even if a system operator imbeds its own discretion to select counterparties, the Commission indicates that this too would be a form of non-discretionary methods. And, any form of system automation, which necessarily requires programming and sequencing of operations, would likewise appear to be a "non-discretionary method."

The Commission has taken far too broad a view of the scope of non-discretionary methods, which directly discourages greater efficiencies achievable through automation of processes to find trading counterparties. Consider, for example, a RFQ system that: (a) does not provide for executions (*i.e.*, executions occur away from the platform); (b) provides a user with discretion as to who it wishes to interact with from among pre-established counterparties; (c) provides the user with discretion to choose from among counterparty responses (*e.g.*, the system does not require a match against the best priced response); (d) requires the RFQ initiator to then route a request to trade to the selected counterparty; and (e) the counterparty then has discretion whether to execute that request ("**System X**"). Many OEMSs today provide this type of functionality and would potentially be subject to Rule 3b-16 under the Proposal.

---

[18] If instead System N was the proprietary system of and used by a single broker-dealer, it would appear to clearly only involve one counterparty to every transaction. Yet, the Commission's statement in the Proposal appears to suggest that if such a proprietary RFQ system were licensed to *any* other market participant, it would now involve more than one buyer and more than one seller when the system is viewed in its entirety. This distinction appears to be arbitrary.

[19] In fact, in contemplation of the "non-discretionary methods" prong of Rule 3b-16(a)(2), System N appears to provide even less discretion than how many RFQ systems currently operate by requiring the user to either accept or reject "the best bid or offer," whereas many RFQs allow a user to elect the RFQ response to which they would like to send an order.

[20] SIFMA provides these comments in response to Question 12 of the DeFi Release, calling for Commission provide guidance on what "non-discretionary methods" means under Exchange Act Rule 3b–16. DeFi Release at 29460.

[21] Proposal at 15506–07.

[22] Proposal at n.113. This presumes that the other elements of Rule 3b-16(a) are met.

System X operates as a "one-to-many" system, which, until the Commission's unexplained policy shift described above in Part I.B, would have been excluded from Rule 3b-16.[23] System X also has multiple levels of discretion, including the initiator's selection of potential counterparties, the initiator's ability to choose from among various responses to which it would like to send an order, and the counterparty's discretion whether to fill any order received. The mere automation of these forms of discretion should not render a system (such as System X) an exchange.[24] Conversely, exchanges do not allow for the types of discretion available in System X. **Rather, the hallmark of an exchange is that the party that submits an order thereto may not choose *either* its counterparty *or* the order with which it interacts**.[25]

SIFMA strongly urges the Commission to reconsider the meaning and scope of "non-discretionary" methods and to exclude systems that have real discretion, including System X. To the extent that the Commission instead proceeds with its all-encompassing view of non-discretionary methods, the Commission needs to articulate why systems that maintain discretion with respect to the terms of trading are appropriately considered an exchange under Section 3 of the Exchange Act.

D. The Discussion of Automated Market Makers ("AMMs") in the DeFi Release Highlights the Need for a Separate Rulemaking

Under the DeFi Release, the Commission indicates that it views "automated market makers" as a type of DeFi system subject to Rule 3b-16 under the Proposal.[26] However, based on the Commission's description, AMMs appear more similar to a single dealer platform, which is explicitly excluded from the definition of an exchange under Rule 3b-16(b)(2).

---

[23] Excluding System X is also consistent with the recommendations of the Commission's Fixed Income Market Structure Advisory Committee ("FIMSAC"). Fixed Income Market Structure Advisory Committee, *Recommendation Regarding Defining "Electronic Trading" for Regulatory Purposes*, at 2 n.2 (Oct. 5, 2020) ("The nature of the RFQ protocol allows for only the requestor to interact with bids or offers sent in response to a request. As such, this functionality (one-to-many) does not constitute bringing together orders for securities of multiple buyers and sellers (many-to-many) as required under §240.3b-16(a)(1). In addition, the RFQ requestor may have the ability to transact against any quote provided in response to his or her request for quote. This trading discretion puts the protocol outside the requirement that the platform use "established, non-discretionary methods under which such orders interact with each other" as required under §240.3b-16(a)(2).").

[24] Treating System X as a system that falls outside of Rule 3b-16 would be consistent with the SEC's previously articulated discussion of discretion—for example, the Regulation ATS Adopting Release stated "systems that merely provide information to subscribers about other subscribers' trading interest, without facilities for execution, do not fall within paragraph (a) of Rule 3b–16." *See* Regulation ATS Adopting Release at 70851.

[25] *See* Proposal at 15500 (quoting the Regulation ATS Adopting Release at 70900 in stating that "an essential indication of the non-discretionary status of rules and procedures is that those rules and procedures are communicated to the systems users' and '[t]hus, participants have an expectation regarding the manner of **executions** – that is, if an order is entered, it will be **executed** in accordance with those procedures and **not at the discretion** of a counterparty or intermediary.")(emphasis added). Additionally, while some options exchanges allow for market participants to route orders to a "preferred market maker" on the exchange, this is more akin to automating routing functionality and the execution against that market maker is not guaranteed. For example, a broker-dealer could simply route its option order to that preferred market maker away from the exchange in the first instance – rather than by using the exchange's functionality to indicate a preferred market maker.

[26] DeFi Release at 29471–72. The Commission generally describes an AMM as "designed as an alternative to a limit order book. An AMM typically offers liquidity by exchanging one crypto asset for another, with the exchange rate typically set according to a pre-specified formula . . . The inventory that an AMM uses to fill orders is typically supplied by market participants, and the details of the smart contract may specify compensation for supplying inventory (e.g., by dividing up transaction fees among the inventory suppliers). In some cases, the AMM may permit the inventory suppliers to restrict the use of their liquidity to pre-specified price ranges."

The Commission describes AMMs in the DeFi context, as "an alternative to a limit order book"[27] whereby users will trade against the inventory or "pool of liquidity" of the AMM with prices determined by a pre-specified formula.[28] The Commission's description does not suggest that an AMM is akin to a limit order book because there is no matching or crossing of the orders of multiple buyers and sellers. Rather, each buyer and each seller is trading against the same inventory or pool of liquidity – similar to trading against the inventory of a single dealer.[29]

These conceptual problems in the DeFi Release underscore the need for a separate rulemaking to address DeFi. Finally, SIFMA notes that the Commission has referenced "automated market makers" and "automated market making" in a variety of contexts over the years.[30] The Commission should clarify distinctions between these "automated market making" references historically used by the Commission from the AMMs it contemplates under the DeFi Release.

E. The Supposed "Technology Neutral" Application of Rule 3b-16 Creates an Arbitrary and Unworkable Application of the Rule

The Proposal and the DeFi Release also create uncertainty about the scope of application of proposed Rule 3b-16 due to the Commission's statement that it intends for the application of Rule 3b-16 to be "technology neutral." The DeFi Release states:

> "When adopting Exchange Act Rule 3b-16, the Commission stated that the exchange framework is based on the functions performed by a trading system, not on its use of technology. Notwithstanding how an entity may characterize itself or the technology it uses, a functional approach (taking into account the relevant facts and circumstances) will be applied when assessing whether the activities of a trading system meet the definition of an exchange."[31]

As a threshold matter, it is unclear where the Commission's support for these statements is found in the Regulation ATS Adopting Release.[32] By contrast and in seeming tension with them, Regulation ATS was adopted precisely because of new advances in technology that the Commission noted had "increasingly

---

[27] DeFi Release at 29471.

[28] DeFi Release at n.219 ("The inventory held by an AMM for providing liquidity is typically called a pool. A single AMM protocol will typically have many pools, one for each combination of crypto asset trades offered.").

[29] For example, a dealer raises capital from its shareholders which it uses to create an inventory of cash or securities to trade against buyers and sellers.

[30] *See, e.g.*, Exchange Act Release No. 88216 (Feb. 14, 2020), 85 Fed. Reg. 16726 (Mar. 24, 2020) ("The Commission preliminarily believes that access to this new, faster consolidated market data could encourage new entrants into the **automated market maker** business. This would not only improve the competitiveness of this business but also may increase liquidity in the corresponding markets. . . . It is also possible that potential participants in the sophisticated SOR, **automated market making**, and other latency sensitive trading businesses find that they cannot compete effectively without using the data that would remain exclusive to proprietary feeds.") (emphasis added); Exchange Act Release No. 49325 (Feb. 26, 2004), 69 Fed. Reg. 12876 (Mar. 18, 2004) ("A significant strength of the current NMS is the competition among market centers that encompass a variety of trading models, from traditional exchanges to electronic communications networks ('ECNs') with automated limit order books to **automated market maker** systems. This competition particularly has benefited retail investors, for whom a primary component of execution quality is spread costs.") (emphasis added).

[31] DeFi Release at 29452.

[32] The Commission cites to page 70902 of the Regulation ATS Adopting Release, which does not appear to speak to this point at all. DeFi Release at n.46. There does not appear to be any relevant discussion in the Regulation ATS Adopting Release of "facts and circumstances," a "functional approach" or that the Commission would apply Rule 3b-16 in a technology neutral manner.

blurred" distinctions between broker-dealers and exchanges.[33] Indeed, Regulation ATS was born out of a concept release studying "ways to respond to rapid technological developments affecting securities markets."[34]

If it is true that Rule 3b-16 is intended to apply in a technologically neutral manner that includes "computers, networks, the internet, cloud, telephones, algorithms, [and] a physical trading floor"[35] then it seems that the Commission may intend to capture considerably more systems and processes that meet the elements of Rule 3b-16 than are acknowledged in the Proposal or the DeFi Release. For example, consider the following three methods of performing a RFQ for a quantity of 100 units of bond XYZ:

(1) *Telephone* – A broker calls multiple dealers individually to obtain a quote for 100 units of bond XYZ and then selects the desired quote from among the responses and then routes an order to potentially trade bilaterally with the selected dealer.

(2) *Free Form Chat* – A broker uses a free-form chat (*i.e.*, one that allows a user to write anything without any required fields or information) to solicit non-firm quotes for 100 units of bond XYZ from various dealers with whom it has a relationship. The free form chat service is available to any market participant that downloads the appropriate software. The broker chooses from among these responses and routes an order to potentially trade bilaterally with the selected dealer.

(3) *Structured Chat* – A broker uses a structured chat designed for soliciting quotations (*e.g.*, one that requires the broker to populate the desired security, and either side, quantity, or price) to solicit non-firm quotes for 100 units of bond XYZ from various dealers with whom it has a relationship. The structured chat service is available to any market participant that downloads the appropriate software. The structured chat allows the broker to choose from among the responses and point-and-click on the desired response to route an order to potentially trade bilaterally with the selected dealer.

Under the Proposal, it appears that the Commission intends to capture the Structured Chat within the scope of Rule 3b-16. It appears that both the Telephone and Free Form Chat services would likely also be subject to Rule 3b-16 as they are carrying out precisely the same functions as the Structured Chat, albeit in a less automated fashion (or to the extent that they would not be, the Commission should explain why not).[36]

If the Telephone and Free Form Chat *are* subject to Rule 3b-16, it is unclear how market participants would comply with Regulation ATS with respect to these functions and why it would be necessary to do so. If the Telephone and Free Form Chat *are not* subject to Rule 3b-16, it requires explanation as to why these less automated methods are outside of Rule 3b-16 while a more automated method is within it.[37] Excluding the Telephone and Free Form Chat while including Structured Chat would seem to encourage and incentivize

---

[33] Regulation ATS Adopting Release at 70847 ("Advancing technology has increasingly blurred these distinctions, and alternative trading systems today are used by market participants as functional equivalents of exchanges.").

[34] *Id.* at 70845.

[35] DeFi Release at 29452–53.

[36] Like the Structured Chat example, both the Telephone and Free Form Chat examples would also involve the communication of "trading interest" under the Commission's proposed definition as they communicate the security (XYZ bond) and the quantity (100 units) (as well as the side). *See* proposed Rule 300(q) defining "trading interest" to include "any non-firm indication of a willingness to buy or sell a security that identifies at least the security and either quantity, direction (buy or sell), or price."

[37] As the Commission noted in adopting Regulation ATS, it did "not intend for the distinction between exchanges and broker-dealers to turn on automation," suggesting that the Commission *would* consider the Telephone and Free Form Chat to be subject to Rule 3b-16. Regulation ATS Adopting Release at 70849.

market participants to return to using less automated methods of trading or finding counterparties, discouraging greater efficiencies and innovation (directly contrary to Regulation ATS) for what are ultimately arbitrary distinctions between the different RFQ methods.[38]

The current state of the Proposal and DeFi Release puts the burden on market participants to have to determine, based on the "facts and circumstances" and without more clear guidance, whether these common broker-dealer functions of finding a counterparty to a securities trade will put a system at risk of operating as an unregistered exchange in contravention of Section 5 of the Exchange Act.

II. If the Commission Decides to Proceed with the Proposal, the Commission Should Pursue an Incremental Approach Toward the Expansion of Rule 3b-16 and Regulation ATS

SIFMA urges the Commission to take an incremental approach to its proposed changes to Rule 3b-16 and the expansion of Regulation ATS. Specifically, the Commission should proceed with extending Regulation ATS to apply to systems (within the scope of current Rule 3b-16) that support trading of government securities pursuant to Form ATS-G but should proceed no further.[39] The proposed changes to Rule 3b-16, as highlighted by the significant concerns and ambiguities raised by commenters, requires significantly more work and industry input to arrive at a clear and appropriately scoped interpretation of an "exchange."

To that end, a concept release or industry roundtables are necessary for the Commission to gather further input from market participants regarding the appropriate scope of Rule 3b-16.[40] The Commission originally adopted Regulation ATS in 1998 only after issuing a concept release to invite discussion on the best approaches for how new technologies and methods for trading securities should be regulated.[41] The resulting Regulation ATS framework that emerged from that concept release was thoughtfully designed to "strengthen the public markets for securities while encouraging innovative new markets" and has served the industry well for 25 years.[42]

SIFMA sees no reason why the Commission should not follow the same approach today and believes that not following this tried-and-true path, and instead proceeding with the adoption of the Proposal, risks degrading the public markets for securities and discouraging innovation. Pursuing an incremental approach with greater industry engagement would allow the Commission and market participants the opportunity to consider, among other things: (i) systems that should and should not be within the scope of Rule 3b-16 and the methods for distinguish between different systems, ultimately promoting greater compliance with adopted rules, and (ii) whether the current Regulation ATS framework is appropriate for DeFi systems.

It is evident from the DeFi Release that there were systems, such as DeFi systems, that the SEC contemplated as within the scope of the Proposal but that were not explicitly discussed in the Proposal. SIFMA is concerned that additional systems not discussed in the Proposal—in particular, systems that might fall under the undefined and ambiguous concept of a "communications protocol" or "negotiation protocol"—might be viewed as subject to proposed Rule 3b-16. Without a clear understanding of exactly which systems

---

[38] Regulation ATS Adopting Release at 70847 ("This regulatory framework should encourage market innovation . . .").

[39] As SIFMA previously noted, changing current Form ATS-N to incorporate disclosures targeted for Government Securities ATSs rather than simply creating a new Form ATS-G would hinder and reduce transparency that the SEC provided with the adoption of Forma ATS-N for NMS Stock ATSs. SIFMA Letter I at 4, 17–19.

[40] SIFMA Letter I at 2 (requesting concept release).

[41] Exchange Act Release No. 38672 (May 23, 1997), 62 Fed. Reg. 30485 (June 4, 1997).

[42] Regulation ATS Adopting Release at 70845.

the Commission views as subject to the Rule, it is impossible to provide meaningful comment as discussed in Parts III and IV below.

III. The Commission Has Not Addressed Numerous Questions from Commenters Unrelated to DeFi

While SIFMA appreciates the supplemental information and economic analysis provided in the DeFi Release regarding the applicability of the Proposal to DeFi systems, conspicuously absent from the DeFi Release is *any* meaningful guidance on the numerous questions raised by SIFMA (and other commenters) unrelated to DeFi systems or crypto assets. The Commission's decision to not address material questions and concerns related to the application of the Proposal to non-DeFi Systems appears to suggest that the Commission believes that the Proposal was sufficiently clear as to its application outside of the context of DeFi Systems. This is not the case—as evidenced by this letter, SIFMA's prior comment letters and the prior comment letters of many others.

For example, SIFMA specifically requested that the Commission provide hypothetical examples "through the use of 'systems' A through T" as it did in the Regulation ATS Adopting Release of systems that the Commission believes are either in or out of the scope of Rule 3b-16.[43] Rather than taking the opportunity in the DeFi Release to provide and solicit comment on such examples, the Commission instead asks commenters in Question 16 of the DeFi Release whether:

> "the Commission [should] provide an explanation and examples of what negotiation protocols are and are not in any adopting release, similar to what the Commission did in the Regulation ATS Adopting Release when analyzing the application of Rule 3b–16 to hypothetical Systems A through T."

SIFMA's answer to this question is "yes." And, SIFMA reiterates its request for such examples and is concerned that if there is no other release prior to action by the Commission to adopt changes to Rule 3b-16, the public will never have had an opportunity to provide comment on such examples. SIFMA believes that clarifying examples are needed in particular with respect to: (i) OEMSs; (ii) sell-side broker-dealer systems that provide capital / liquidity in a dealer capacity to their clients; (iii) buy-side trading systems (*e.g.*, those operated by institutional investors); and (iv) online self-directed platforms for retail customers that are already subject to regulation.[44]

Notwithstanding these requests for examples and clarifications, the proposed scope of Rule 3b-16—especially with respect to communication/negotiation protocol systems—should be abandoned (or significantly scaled back at minimum) for the reasons discussed in our prior letters, as well as below.

IV. The Proposed Scope of Rule 3b-16 Remains Vague and Overbroad

The proposed scope of the expanded Rule 3b-16 is vague and overbroad and, as noted, lacks a reasoned explanation for why it is necessary and appropriate to regulate so many systems as exchanges. The Commission is currently and actively using its existing authority under Rule 3b-16 to bring enforcement actions against what it believes are unregistered exchanges.[45] Given these current enforcement actions, it's

---

[43] SIFMA Letter I at 10 (". . . guardrails should nevertheless be established in one or more of a variety of ways, including via the provision of numerous examples (similar to how the Commission provided guidance through the use of "systems" A through T in the 1998 Regulation ATS Adopting Release for systems that would and would not be captured)").

[44] *See* SIFMA Letter I at 11-12 for a more fulsome description of these systems.

[45] *See e.g.*, *SEC v. Coinbase, Inc., et al.*, No. 23 Civ. 4738 (S.D.N.Y. filed June 8, 2023); *SEC* v. *Binance Holdings Limited, et al.*, No. 1:23-cv-01599 (D.D.C. filed June 7, 2023). *SEC v. Bittrex, Inc., et al.*, No. 2:23-cv-0580 (W.D. Wash. filed April 17, 2023). Each of these actions brings charges for operating an unregistered exchange.

unclear why a broader definition of an "exchange" is needed. As Commissioner Uyeda stated when the Commission published the DeFi Release,

> "[T]he Commission has the responsibility to demonstrate that such an extension will benefit investors. For the Commission simply to posit that there currently exist intermediating activities which resemble what exchanges accomplish is not enough."[46]

Not only is it unclear *why* the Commission proposes to capture so many different systems under its interpretation of what is within the meaning of an "exchange," it is also unclear *what* activities the Commission contemplates as within the scope. These ambiguities translate to tremendous compliance costs and enforcement risk for market participants, as acknowledged by the Commission, without any clear benefit to regulating the numerous systems that would be newly subject to Rule 3b-16.[47]

A. The Commission Should Separately Propose Rules to Address DeFi Systems

If the intended target of the Commission's Proposal is DeFi Systems, then the Commission should propose rules that specifically apply to DeFi Systems rather than establishing the undefined and overbroad "communication protocol systems." Specifically, the Proposal and DeFi Release do not appear to be appropriately tailored to both: (a) exclude broker-dealer systems that should not be regulated as exchanges or ATSs; or (b) regulate the DeFi systems which appear to be the impetus for the significant expansion of Rule 3b-16.[48] Accordingly, SIFMA urges the Commission to pursue a more incremental approach, as further discussed in Part II above.

B. It Is Unclear Which Version of Rule 3b-16 the Commission Is Actually Proposing

SIFMA appreciates the Commission's efforts to provide additional clarity with respect to the Proposal. Unfortunately, however, the DeFi Release has exacerbated ambiguities surrounding the scope and application of proposed Rule 3b-16. Rather than providing more definitive guidelines responsive to commenters, including SIFMA, the Commission has instead introduced numerous possible variations to the text of Rule 3b-16 through its questions. It is now unclear exactly what the Commission is actually proposing. The different permutations of proposed Rule 3b-16 make it impossible to provide meaningful public comment pursuant to APA, as the public cannot effectively determine which version of Rule 3b-16 is on the table. The Commission has also not provided a meaningful discussion of the trade-offs and implications of each permutation, instead simply offering these alternative rule text formulations in a handful of the Commission's 75 questions in the DeFi Release.

---

[46] Hon. Mark T. Uyeda, Commissioner, SEC, *Statement on Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 regarding the Definition of "Exchange"* (Apr. 14, 2023) (emphasis in original).

[47] DeFi Release at 29482 ("The proposed functional-test-based exchange definition could result in increased legal costs for market participants. Specifically, the Proposed Rules could cause market participants to engage in a more thorough and expansive compliance review of any changes in operations out of concern that a large range of activities might meet the proposed definition of exchange. This approach could also increase uncertainty about the application of the Proposed Rules, which in turn may further increase legal costs.").

[48] As just one example of why the Regulation ATS framework may not be appropriate for DeFi systems, the SEC states in its economic analysis that operating a DeFi system in a manner that complies with applicable regulations could "significantly reduce the extent to which the system is 'decentralized' or otherwise operates in a manner consistent with the principles that the crypto asset industry commonly refer to as 'DeFi.'" DeFi Release at 29486. The Proposal would seem to limit one of the core features of DeFi system (*i.e.*, their decentralized nature). The Proposal is thus overbroad in capturing broker-dealer systems that need not be subject to Rule 3b-16/Regulation ATS and not appropriately tailored to the systems the Commission intends to capture (*i.e.*, DeFi systems) through its expansion of Rule 3b-16.

For example, in Question 10 of the DeFi Release, the Commission asks whether it should adopt alternative language to "makes available."[49] It also asks whether the addition of the phrase "directly or indirectly" would align Rule 3b-16 more closely with the Commission's prior statements in the Regulation ATS Adopting Release and focus the rule text on a function that a party performs in the provision of an established, non-discretionary method to bring together buyers and sellers.[50] Similarly in Question 11, the Commission proposes to remove the term "uses" and insert the term "makes available" before "established, non-discretionary methods." The Commission also notes that "communication protocols" would be in addition to a "trading facility." The Commission next asks whether, alternatively, instead of using the terms "uses" and "makes available", it should adopt amendments to Exchange Act Rule 3b-16(a)(2) that state "[E]stablishes non-discretionary methods (whether by providing, directly or indirectly, a trading facility or…)."[51] To illustrate these differences, set forth below is a non-exhaustive list of the different variations of Rule 3b-16 with the possible changes introduced in the DeFi Release.[52] The **green**-colored font represents a new term from the Proposal; **red** font stands for changes from the original Rule 3b-16 text; and **blue** is new language from the DeFi Release:

> Proposed Rule 3b-16(a) under the Proposal (with deleted text from current Rule 3b-16 shown with ~~**strikethrough**~~):
>
> (1) Brings together ~~**the orders for**~~ buyers and sellers of securities ~~**of multiple buyers and sellers**~~ using trading interest; and
>
> (2) ~~**Uses**~~ Makes available established, non-discretionary methods (whether by providing a trading facility or communication protocols, or by setting rules) under which ~~**such orders**~~ buyers and sellers can interact ~~**with each other, and the buyers and sellers entering such orders**~~ and agree to the terms of a trade.
>
> Proposed Variation of Rule 3b-16(a)(1) under the DeFi Release, Question 10:
>
> (1) Brings together buyers and sellers of securities using trading interest; and
>
> (2) Uses established, non-discretionary methods (whether by providing directly or indirectly 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.
>
> First Proposed Variation of Rule 3b-16(a)(1) under the DeFi Release, Question 11:
>
> (1) Brings together buyers and sellers of securities using trading interest; and
>
> (2) Establishes, non-discretionary methods (whether by providing directly or indirectly 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.
>
> Second Proposed Variation of Rule 3b-16(a)(1) under the DeFi Release, Question 11:
>
> (1) Brings together buyers and sellers of securities using trading interest; and

---

[49] DeFi Release at 29459.

[50] *Id.*

[51] *Id.*

[52] In addition to the permutations set forth in the list below, the Commission also solicits comments in questions 14, 15, 19, and 20 of the DeFi Release that might similarly result in a different version of Rule 3b-16.

(2) Establishes, 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.

Proposed Variation of Rule 3b-16(a)(1) under the DeFi Release, Question 13:

(1) Brings together buyers and sellers of securities using trading interest; and

(2) Makes available established, non-discretionary methods (whether by providing a trading facility or negotiation protocols, or by setting rules) under which buyers and sellers can interact and agree to the terms of a trade.[53]

Providing market participants with a sea of additional choices in the DeFi Release without detailed discussion of the significance of the proposed variations—particularly when the overwhelming majority of comments to the Proposal uniformly found that even the originally proposed changes to Rule 3b-16 were vague and ambiguous—neither facilitates public comment nor promotes the public interest by providing comprehensible rules for market participants to follow.[54]

C. Meaningful Guidance Regarding the Status of OEMSs As "Communication/Negotiation Protocol Systems" Is Needed

The DeFi Release also included some additional guidance and solicitation of comments not specific to DeFi systems, including OEMSs, GUIs, and trading desks, *etc.* While suggesting that these are not intended to be included, the Commission says that they *could* be included.[55] Without further guidance or examples, such as those specifically requested by SIFMA in its prior letter, market participants are still left without a clear understanding of when a system would and would not be considered a Rule 3b-16 system. Indeed, regulatory changes that would result in a fundamental shift in U.S. market structure deserve far more deliberate and nuanced evaluation and a much clearer articulation of a compelling policy rationale than what has been presented thus far.

As an example, OEMSs operated by asset managers are generally used to connect an investment adviser to other trading venues and are not a trading venue in and of themselves. These systems are more analogous to the Commission's proposed exemption for systems that allow issuers to sell their own securities to investors and should similarly be exempted from Rule 3b-16.

D. The Proposed Distinction between Communications vs. Negotiation System Protocols Does Not Provide Greater Clarity

The SEC also solicited comment on whether "communications protocol" should be replaced with "negotiation protocol."[56] This solicitation of comment appears to recognize shortcomings with the proposed term "communications protocol." The Commission did not define the key term communication protocol but instead described it as "an established method that an organization, association, or group of persons can

[53] The Commission then proposes to define "negotiation protocols" to mean "a nondiscretionary method that sets requirements or limitations designed for multiple buyers and sellers of securities using trading interest to interact and negotiate terms of a trade."

[54] *See e.g.*, DeFi Release at n.123–29 and accompanying text regarding commenters concerns *solely* with respect to the term "communications protocol systems."

[55] For example, the SEC noted that it did not intend the Proposal to capture within the definition of an exchange the activities of brokers, dealers, and investment advisers who use an OEMS to carry out their functions (*e.g.*, organizing and routing trading interest). DeFi Release at 29461.

[56] DeFi Release at 29460.

provide to bring together buyers and sellers of securities."[57] In the DeFi Release, the Commission now proposes to define a negotiation protocol in a new Rule 3b-16(f) as "a nondiscretionary method that sets requirements or limitations designed for multiple buyers and sellers of securities using trading interest to interact and negotiate terms of a trade."[58]

Although SIFMA appreciates the staff's efforts to provide greater clarification regarding the intended meaning or scope of Rule 3b-16, the "negotiation protocol" term does not resolve the ambiguity and confusion arising from the "communication protocol" term when applying it to "systems."[59] The DeFi Release provides no examples or meaningful description of the intended meaning of the term "negotiation protocols" as distinct from "communication protocols." However, taking the proposed negotiation protocol definition on its face, this proposed definition would create arbitrary and ambiguous standards. For example, if a firm uses a free form chat to solicit trading interest from potential counterparties, arguably there are no "requirements or limitations"—the firm could ask for whatever it wants in any form that it wants.[60] At the same time, the chat functionality would **require** some text to be sent to solicit an order and it might **limit** the number of characters in any single message. Accordingly, it is unclear that a meaningful distinction has actually been created between a communication protocol versus a negotiation protocol.

To the extent that the Commission intends to exclude free form chat from Rule 3b-16 while including structured chats/messaging (*i.e.*, chat functionality that requires certain specified information such as price, symbol, and quantity) within the scope of Rule 3b-16, the Commission will, as noted previously, simply incentivize market participants to use less automated or structured methods (*e.g.*, telephone or free form chat) of finding liquidity. Using less automated methods for negotiation may increase operational risk or confusion as to the terms of a particular transaction (or even whether they are contemplating a transaction in the same security given the vast number of different CUSIPs for different securities). This ultimately degrades the efficiency of trading and finding liquidity for market participants, harming markets.

E. <u>It Remains Unclear How Reg ATS Would Apply to Many Systems</u>

To the extent the SEC adopts the Proposal largely as proposed, greater clarity or exceptions are needed regarding how it would apply to various systems. Using System X from above, the Commission would presumably attribute any matched trading interest as transaction volume attributable to such system for purposes of Form ATS-R and determining whether such system is subject to Regulation SCI or the Fair Access Rule.[61] Doing so makes little sense. For example, because System X (or similar matching systems) only allows for a user to communicate with potential counterparties with whom the user has a pre-existing relationship, a market participant that does not have access (or is denied access) to System X would not in any way be limited in its ability to access counterparty liquidity available through the RFQ system. It could simply reach out to those counterparties directly, which frequently occurs today.[62] Similarly, if the RFQ system experienced a systems disruption or outage, a user of System X would in no way be impaired in its ability to source liquidity given that the user has a preexisting relationship with every potential counterparty.

---

[57] Proposal at 15504.

[58] DeFi Release at 29460.

[59] If, as the DeFi Release states in Question 13 at 44, the term negotiation protocol would "replace the proposed term" communication protocol, then it is highly relevant to define negotiation protocol systems since the Proposal refers to "Communication Protocol System(s)" nearly 640 times.

[60] *See supra* Part I.E for further discussion regarding the arbitrary differences between free form versus structured chat functionality.

[61] 17 CFR 242.301(b)(5).

[62] For example, after tentatively agreeing to the terms of a trade, counterparties often contact each other directly to amend the terms without using the RFQ system.

At a minimum, only systems in which orders actually execute should have volume attributed to them for purposes of Rule 301(b)(3), Rule 301(b)(5) and Regulation SCI. SIFMA urges the Commission to provide clarity on this point.

Moreover, given that the Commission appears to include a system such as System X within the scope of Rule 3b-16 as proposed, the Commission should articulate why and how exactly System X is considered an exchange. Specifically, SIFMA respectfully requests that the Commission explain how the operator of System X might complete Form ATS-N, Part III, Item 11 (assuming System X trades NMS stocks), in particular regarding how System X has created established, non-discretionary rules and procedures. It would be helpful for the Commission to try to place itself in the shoes of market participants that will actually face these interpretive disclosure questions. Doing so may help the Commission reevaluate the scope of proposed Rule 3b-16 consistent with SIFMA's comments. Additionally, assume, for example, that System X allows for a user to solicit orders in both corporate bonds and NMS stocks. The Commission should make clear whether it expects such a system to separately file Form ATS-N and Form ATS and include these burdens as appropriate within its cost and benefit considerations. Similarly, the Commission should clarify System X's obligations under Rule 611 of Regulation NMS and how a system that today undertakes no Rule 611 obligations may need to be modified to comply with Rule 611.[63] These considerations are a matter of policy that cannot be sufficiently addressed via staff FAQs and enforcement actions. The Proposal is a reconceptualization of the securities market structure[64] and appropriate notice and comment of these matters in necessary, consistent with the APA, to adequately consider the effects and impacts of the Proposal.

Finally, the DeFi Release relies far too much (13 times) on "facts and circumstances" as answers to questions and in interpretive guidance—particularly when such phrase was used only once when the Commission first adopted Rule 3b-16 (regarding whether an "order" would be considered firm).[65] While SIFMA appreciates that the application of Rule 3b-16 will depend on the facts and circumstances of a given system, these statements could have been replaced with substantive examples and specific criteria that would help market participants actually conduct a facts and circumstances analysis.[66]

V. An Extended Compliance Period Would Be Necessary for Market Participants to Comply with Any Adopted Proposal

To the extent that the Commission proceeds with adoption of the Proposal largely in its current form, SIFMA strongly urges (and reiterates its request for) the Commission to provide a substantially longer time for market participants to comply.[67] As SIFMA noted previously, a minimum of 24 months to comply would be necessary. This is in contrast to the compliance time periods contemplated under the Proposal of 30

[63] The Commission should also address how TRACE correction reporting obligations might apply to System X if it is considered an ATS (assuming System X supports RFQs for fixed income securities).

[64] *See* SIFMA Letter I at 8.

[65] The Regulation NMS Adopting Release did not rely on "facts and circumstances" at all. *See* Exchange Act Release No. 51808, 70 Fed. Reg. 37496 (June 29, 2005).

[66] Hon. Hester M. Peirce, Commissioner, SEC, *Rendering Innovation Kaput: Statement on Amending the Definition of Exchange* (Apr. 14, 2023) https://www.sec.gov/news/statement/peirce-rendering-inovation-2023-04-12 ("Perhaps the Commission finds value in keeping the term [Communication Protocol System] ambiguously broad. This flexibility comes at the cost of unnecessary increased regulatory risk, particularly for new and small firms which may not even realize they have tripped over the hazy communications protocol system threshold.").

[67] SIFMA provides these comments in response to the Commission's further solicitation of comment on compliance dates set forth in questions 30-38 of the DeFi Release.

calendar days after the effective date of any final rule for a newly designated ATS to file an initial operation report and 210 calendar days to comply with the broker-dealer registration requirement.[68]

Evaluating the scope and applicability of any adopted rules can take several months alone. Market participants will need time to identify impacted systems and consider whether they wish to take on the operational and administrative costs of Regulation ATS compliance (in the case of broker-dealers) or simple retire the system. And, while FINRA may be able to process some broker-dealer applications in approximately six months, it takes several times that amount of time (*i.e.*, 1.5 – 2 years at a minimum) for firms to, among other necessary activities, hire and register personnel to operate the broker-dealer, register with state regulators, develop appropriate policies and procedures, and prepare and enter agreements with clients/subscribers. The Commission should consider a two-step approach with separate compliances dates: (1) to identify Rule 3b-16 systems within the scope of the adopted rule; and (2) to complete broker-dealer registrations and submit the appropriate Form ATS, Form ATS-N, or Form ATS-G.

VI. Miscellaneous Items

SIFMA submits the following additional comments with respect to the Proposal that should be addressed as part of any adopted rules:

- Recordkeeping for Communication/Negotiation Protocol Systems – Communication/negotiation systems that today merely facilitate the communication of the terms of an order/trading interest that become subject to Rule 3b-16 under the Proposal would also become subject to the recordkeeping requirements of broker-dealers and Regulation ATS—*i.e.*, all orders or trading interest flowing through such communication/negotiation system would now have to be kept centrally as records of the broker-dealer operator. Many of these systems, particularly those used by institutional investors, are desirable precisely because they do not store records of a user's orders or trading interest.[69]

  While the Commission has separately proposed to subject ATSs to cybersecurity rules[70] and ATSs are subject to Rule 301(b)(10) to protect the confidential trading information of subscribers, investors trading information will be at significantly greater risk of exposure than such information is today.[71] The Commission should acknowledge and address the increased vulnerability of market participants' confidential trading information through its proposed expansion of Rule 3b-16 to include communication/negotiation protocol systems.

- Interactions of the Proposal with Other Commission Rules – The Commission has not discussed the application of additional rules to systems that would be newly subject to Rule 3b-16 under the Proposal, including in particular Rule 15c3-5 ("Market Access Rule") and Rule 611 of Regulation NMS. For example, it is unclear how the operator of System X would know the appropriate credit limits for all the users of System X, and why it would be necessary for these systems to be subject to the Market Access Rule, particularly when such systems involve non-firm trading interest and operate without issue in the absence of market access controls today.

---

[68] *See* Proposal at 15512.

[69] For example, many of these systems simply operate as a downloadable software operating exclusively on an institutional investor's systems without any central repository of orders or trading information.

[70] Exchange Act Release No. 97142, 88 Fed. Reg. 20212 (April 5, 2023).

[71] For example, today, an institutional investor using a communication/negotiation system operating on its internal systems is exposed to cyber risk and information leakage only insofar as it's systems are vulnerable. Under the Proposal, that same institutional investor's trading information would not be exposed to potential cyber risk through both its own systems *and* the broker-dealer operator of the ATS operating such system (along with all other users of such system in the latter case).

- Concerns Surrounding the Fair Access Rule – SIFMA notes that the Fair Access Rule would appear to hold ATSs to a higher standard than is applicable to national securities exchanges. Specifically, under Section 6(b)(2) of the Exchange Act, exchanges are only required to allow registered broker-dealers or persons associated with a broker-dealer to become members of the exchange, subject to certain express authority in Section 6(c) for where an exchange may deny or limit access to broker-dealers in certain circumstances.[72] In contrast, an ATS subject to the Fair Access Rule as amended by the Proposal would be required to, among other things, establish and apply reasonable written standards for granting, limiting, and denying access to the services of the ATS and justify why each standard (including any differences in access to the services of the ATS) is fair and not unreasonably discriminatory.[73]

  This appears to mean, for example, that if an ATS subject to the Fair Access Rule allows for both broker-dealer and non-broker-dealer subscribers, it must ensure that its access/denial standards are fair and not unreasonably discriminatory for *all* subscribers. Given that exchanges need only provide access to broker-dealers pursuant to Section 6 of the Exchange Act, the Fair Access Rule should similarly only apply with respect broker-dealers. The Commission should also explain the intended meaning of "fair and not unreasonably discriminatory" standards given that the standard applicable to exchanges rules is that they not be designed to "permit unfair discrimination."[74]

  Additionally, under the Commission's FAQ guidance for the Fair Access Rule, differences in fees among subscribers are considered a means by which an ATS might "limit" access to ATS services.[75] As a result, it is unclear if the Commission expects an ATS subject to the Fair Access Rule to need to account for different fees assessed to each different subscriber and be able to justify why these are fair and not unreasonably discriminatory.[76] Reporting on Exhibit C of Form ATS-R would also raise complications to the extent differing fees are considered to be a form of limitation on access. The fees for subscribers of many ATSs are determined based on the range of different services that a subscriber receives from the broker-dealer.[77] It is consequently unclear in what way differing fees would be viewed as a limitation on one firm versus another and how this would be reported on Exhibit C.[78]

  Finally, SIFMA questions the need for the continued existence of the Fair Access Rule or, at a minimum, why it needs to be expanded so broadly. The Commission has not provided any evidence to indicate that market participants are unable to access ATSs. Broker-dealer operators are

[72] 15 U.S.C. 78f.

[73] Securities Exchange Act Release No. 90019 (Sep. 28, 2020), 85 Fed. Reg. 87106, 87156–59 (Dec. 31, 2020).

[74] 15 U.S.C. 78f(b)(5).

[75] *Responses to Frequently Asked Questions Concerning Rule 301(b)(5) Under Regulation ATS "Fair Access Rule"*, FAQ 8, last modified Dec. 9, 2022, https://www.sec.gov/tm/faq-regulation-ats-fair-access-rule ("ATSs might limit services, for example, order display features, order entry means, **or fees**, to one subscriber or a class of subscribers." (emphasis added)).

[76] This is inconsistent with Form ATS-N, which requires NMS Stock ATSs in Part III, Item 19 to describe a "range of fees." Thus, differing fees appear to be both contemplated for an ATS while at the same time serving as a limitation on access. It is unclear how to reconcile this.

[77] For example, some broker-dealers may provide access to their ATS free of any specific charge, but fees will differ between different subscribes based on the other services the subscriber receives from the broker-dealer (e.g., execution services, research, clearing *etc.*).

[78] For example, assume Subscriber 1 receives access to the ATS, execution services and clearing services from the broker-dealer operator for $1,000 per month while Subscriber 2 receives access to the ATS and execution services only the broker-dealer operator for $500 a month. Which of these two subscribers has been limited in their access to the ATS given their differing fees?

incentivized to onboard as many subscribers as possible and most market participants are able to access ATSs to which they are not subscribers indirectly (*i.e.*, through an existing subscriber). It is also unclear why the Commission could not accomplish the objectives of the Fair Access Rule through significantly less onerous means.[79]

- ATSs for Restricted Securities – The Commission should consider the application of Regulation ATS and associated rules to the trading of restricted securities, such as pre-IPO companies.[80] Restricted securities tend to be highly illiquid and transactions may take several weeks to complete. Notwithstanding these important differences from other types of securities, systems supporting matching/trading of restricted securities are subject to the full scope of Regulation ATS as well as Regulation SCI. Pursuant to FINRA Rule 6622(a)(3), transactions in restricted securities must be reported to FINRA. As a result, ATSs supporting matching or trading in restricted securities could be subject to both the Fair Access Rule and Regulation SCI, which are both triggered upon an ATS exceed the volume threshold for the required time for an equity security that is not a NMS stock.[81]

  Given the illiquid nature of restricted securities, a single trade in a private company could easily represent 100% of the volume in that security for many months or an entire year, triggering compliance with these heightened requirements. It does not appear that the Commission intended to subject these ATSs to the Fair Access Rule or Regulation SCI, and SIFMA respectfully requests that the Commission provide clarifying guidance or revised rule text to that effect. Without so doing, SIFMA is concerned that the Commission will severely impede secondary trading of already thinly-traded securities by subjecting such ATSs to additional, burdensome and unnecessary regulatory requirements.

- Systems for Borrowing and Lending Securities – The Commission should provide clarity with respect to the application of Rule 3b-16 and Regulation ATS to systems used to facilitate the borrowing and lending of securities and the reasons for such inclusion or exclusion from Rule 3b-16. Systems that facilitate borrowers and lenders finding each other do not result in executed trades in the manner that exchanges operate. For example, these systems do not contribute to price discovery as trades on exchanges do. Additionally, its unclear that such systems fit within Rule 3b-16, both currently and as proposed, as these systems do not bring together "buyers and sellers" of securities. No buy or sell transaction occurs. Rather, these systems bring together borrowers and lenders of securities.

* * *

SIFMA greatly appreciates the Commission's consideration of these comments and would be pleased to discuss them in greater detail. If you have any questions or need any additional information, please contact the undersigned at (212) 313-1124 or any of the following colleagues: Joe Corcoran at (202) 962-7383, Ellen Greene at (212) 313-1287, Chris Killian at (212) 313-1126, or our counsel, Andrew Blake and Charlie Sommers of Sidley Austin LLP at (202) 736-8977 and (202) 736-8125.

---

[79] For example, it would seem that simply requiring that an ATS report on Exhibit C of Form ATS-R those firms that were denied access to the ATS could be a sufficient policing mechanism to ensure that high volume ATSs are not denying access inappropriately.

[80] 17 CFR 230.144(a)(3) (defining restricted securities).

[81] 17 CFR 242.1000; 17 CFR 242.301(b)(5)(i)(B).

Respectfully Submitted,

Robert Toomey
Head of Capital Markets
Managing Director, Associate General Counsel
SIFMA

Cc: The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
The Hon. Mark T. Uyeda, Commissioner
The Hon. Jamie Lizárraga, Commissioner