May 26, 2022

Vanessa A. Countryman,
Secretary,
Securities and Exchange Commission
100 F Street NE, Washington, D.C. 20549

Re: Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer, RIN 3235—AN10, File No. S7-12-22

Dear Ms. Countryman:

We write to urge the Commission to reconsider its proposal in the above-captioned matter. That proposal would dramatically expand the scope of the Commission’s authority by regulating as “dealers” many people and firms just for trading their own securities. The proposal presents an issue of special concern to the blockchain community because, to the extent digital currencies are erroneously labeled securities, the proposal could be read to cover participants in the decentralized exchanges that support the growth of the digital economy as well as the use of digital currencies for their core purpose of storing value and facilitating commerce—including in one of the most important and growing applications of digital currencies, use in retail. The Exchange Act of 1934 cannot be read so broadly, and the proposal’s attempt to do so is arbitrary and capricious in violation of the Administrative Procedure Act.

INTRODUCTION

ConsenSys is a market-leading blockchain technology company building the digital economy of tomorrow. Our suite of products serves millions of users, supports billions of queries, and has handled billions of dollars in digital assets. Together with the programmable blockchain development community, we are paving the way for new economies that are more open, efficient, and secure.

The key to these new economies is blockchain. Blockchain’s core innovation is the storage of data across a network, the participants of which could be anyone around the world, and who collaborate to own, monitor, and run the network. This decentralized architecture means that no one person or organization owns the data—or the power that comes with an exclusive ownership role—and that network participants are able to interact on a peer-to-peer basis rather than depending on an intermediary such as a bank or network provider. Blockchain thus offers freedom from the risks of bad action by intermediaries, such as abuse of market power, fraud, censorship, or failure to secure assets and data against inside or outside attack, as
well as from costs inherent in intermediation such as delay or negligence. It also offers new abilities for the small businesses and individuals who make up our communities to engage with each other and the broader world.

To date, ConsenSys has focused its efforts on the Ethereum protocol, which is the largest programmable blockchain ecosystem in the world. Ethereum leads the field in business adoption, developer community, consumer participation, and in the creation and use of new, alternative rails to engage in commercial and financial transactions and to build global, online communities.

Our suite of products enables developers, enterprises, and people around the world to build and utilize next-generation web applications, launch novel, community-created and managed financial networks, cryptographically safeguard their identity and other personal data, and access the decentralized web. Our products include MetaMask, which is the world’s most popular digital wallet and decentralized web gateway; Infura, which provides instant, reliable, and scalable access to Ethereum and other networks; Truffle, which is the most utilized tool for developing Ethereum applications; Codefi, which allows businesses to digitize assets and decentralize financial instruments; Diligence, which offers comprehensive security audits and tools for decentralized smart contracts; and Quorum Business Services, which assists businesses build applications on permissioned implementations of the Ethereum technology. We also provide class-leading professional services to advise clients around the world on how they might harness this new technology to create new opportunities and to more efficiently address challenges, clients which include countries currently exploring the functionality of central bank digital currencies.

Digital currencies are one of blockchain’s many applications, and among its most exciting. A digital currency is a measure of value just like the dollar, pound sterling, or euro; unlike these traditional currencies, however, digital currencies do not depend on centralized banks controlled by the governments of nation-states. Instead, a digital currency is managed by a peer-to-peer computer network based on community-managed software that records every transaction in a blockchain distributed across network participants and constantly reverified. This architecture means that the blockchain and the transactions it records operate transparently by a set of community-dictated rules and cannot be controlled or falsified by any one actor or set of actors. Network participants can initiate and settle transfers of value nearly instantaneously among themselves using unhackable public-private key cryptography; they need not work through a bank or other financial institution. Blockchain thus enables fast, reliable, and secure transactions between anyone on the network without financial intermediation; digital currency users enjoy the convenience and security of the banking system while avoiding ceding control of their assets.

As its name suggests, digital currency is currency; its point is to enable the storage and transfer of value without the specter of a single authority dictating the rules of the monetary system. That is the source of its utility and appeal to users. Of course, some people view it as an investment; they buy ether, bitcoin, or other digital currencies as they would commodities, for instance, because they believe it will increase in value over time. But that digital currency may
appreciate as their networks become larger and more important is not the purpose of digital currency. Indeed, its investment appeal derives from its role as currency, as an alternative means of storing and transferring value, as well as the means of participating in blockchain networks: in order to transact on one of these global, permissionless networks, you must use the applicable digital currency. Just as investors may buy other assets because they believe the demand for those assets might increase, investors may buy digital currency because they expect the demand for its primary use—the non-mediated storage and transfer of value on a permissionless, global, encrypted computer network—will prove strong over time.

Events justify that expectation, for in the last few years digital currencies have begun to come into their own as currencies. The blockchain economy has started to blossom, with more and more users paying for digital assets such as digital art with digital currency. Further, more and more retailers have begun accepting digital currencies as payment or have announced future plans to do so. Household names like Home Depot, Starbucks, Overstock, and Microsoft now accept payment in one or more digital currencies. Travel companies and high-end fashion retailers have begun to do the same. Consumers can now pay their grocery and phone bills with digital currency. And just last month saw the release of the first digital currency-backed payment card. Bit by bit, digital currencies are beginning to fulfill their promise of serving as an alternative, and in many cases superior, option for the storage and transfer of value.

The growth of digital currencies and the enterprises they support has been powerfully assisted by the growth of trading platforms and other money services businesses which allow the conversion of traditional fiat currencies to digital currencies, and decentralized exchanges, or DEXes, which allow the conversion of one digital currency to another. DEXes, true to the

---


4 See supra n. 1.


“foundation and animating spirit of the [blockchain] ecosystem,” lack the central intermediaries that characterize traditional exchanges. Rather, they support the ability for network participants to change currencies through software-based liquidity pools or peer-to-peer transactions. This decentralized architecture means that the liquidity of DEXes is provided by individual participants—sometimes thousands at a time—each of whom chips in an amount, sometimes quite modest, of currency of one sort or another to form the liquidity that DEXes offer their users who have one type of token but need another. While DEXes facilitate transactions in a variety of ways, ranging from automated market making to request for quote systems, the core operation is the same: DEXes marry up individual buyers and sellers of currency using software, rather than a person or other entity, as an intermediary.

To unlock digital currencies’ great promise, it is vital that liquidity providers, merchants, and others who are considering their first foray into the new digital ecosystem have a legal framework that provides space to innovate while giving new participants confidence regarding where the regulatory lines are drawn. We write out of concern that the instant proposal would imperil both the space to innovate and any certainty. In the first place, the proposal appears to extend dealer coverage to DEXes and even to certain individual liquidity providers who use them, insofar as those DEXes facilitate transactions in digital currencies that may be erroneously (in our view) deemed securities. But the proposal expands coverage in this way without any discussion of whether DEXes raise the concerns that Congress intended to address in the Exchange Act of 1934 (the “‘34 Act”) or how dealer coverage would impede the burgeoning use of DEXes and hence the entire blockchain economy. This failure to give consideration to the merits and drawbacks of coverage of DEXes as dealers would render such coverage arbitrary and capricious in violation of the Administrative Procedure Act (“APA”), and the Commission should clarify that the proposal does not cover DEXes or those who interact with them.

Moreover, the proposal would expand the meaning of the term “dealer”—and thus the scope of the comprehensive regime to which dealers are subject—to certain people and firms just on the basis of the way they trade their own securities. That expansion goes far beyond what Congress authorized in the ’34 Act, which restricts dealer coverage to those who trade securities professionally as a service. The proposal’s apparent application to digital currencies illustrates its profound overreach. Read on its face, the proposal would sweep in many merchants and others who buy and sell in digital currencies—thus dramatically impeding the adoption of digital currencies as a means of payment. The need to afford space to innovate as well as sufficient regulatory certainty to the blockchain ecosystem demands that the Commission make perfectly clear that the proposal does not cover retail and similar use of digital currencies.

Even if the ’34 Act authorized the Commission to expand the term “dealer” as the proposal would do, the Commission has failed to offer rational justifications for that expansion.

---


8 To be clear, we recognize that some digital assets do qualify as securities—but certainly not digital currencies.
and the proposal would therefore be arbitrary and capricious if finalized. First, the proposal does not articulate an actual problem that its drastic expansion of dealer coverage would remedy. Second, even assuming a problem that the proposal could solve, it fails to show that the remedy is better than the disease, instead simply declining to decide whether the proposal would leave key attributes of the markets better or worse than it found them. Third, the proposal hinges application of the dealer regulation regime on terms that it refuses to define, thus creating needless and costly confusion. And fourth, the proposal acknowledges the need to exclude minor market participants from draconian dealer regulation but then fails to do so effectively.

DISCUSSION

I. The Proposal Would Unreasonably Cover Decentralized Exchanges.

As we discussed at length in a comment in another of the Commission’s rulemakings, the Commission is not an all-purpose securities regulator. Rather, in the ’34 Act Congress gave the Commission authority to regulate persons and institutions that are central to the national securities markets rather than to govern all securities buyers, sellers, and transactions across the country. Congress was concerned in part about the ability of these central intermediaries, including dealers, to engage in various forms of bad action, such as abuse of market power, fraud, coercion against unpopular viewpoints, or failure to secure assets and data against inside or outside attack. It created a rigorous framework to govern these central intermediaries, including requiring their membership in self-regulatory organizations with the authority to make rules and enforce discipline, to prevent these intermediaries from taking advantage of their central role to engage in malfeasance which, because of their centrality, can affect vast numbers of market participants.

As their name suggests, decentralized exchanges set out to remedy precisely the centralization that was of such concern to Congress in the ’34 Act. DEXes achieve this by facilitating peer-to-peer trading by using software rather than an intermediary like a dealer or broker. By eliminating dealers and brokers, and by maintaining their code on the transparent blockchain data structure, DEXes also eliminate the possibility that intermediaries will abuse their position. Consider a few examples:

- On a centralized exchange a dealer who is the only market maker for a particular security may take advantage of his or her exclusive status to charge non-competitive prices, or a small group of dealers may conspire to set non-competitive prices. But on a DEX, where liquidity is provided directly by thousands of people, whether by locking tokens into liquidity pools or by filling the bid-side of a RFQ system, the potential for such anti-competitive conduct is scant.

See supra n.7 at 3-5. We hereby incorporate the arguments and evidence of this earlier comment by reference.

’34 Act § 19.
• On a centralized exchange, if the only dealer for a particular security fails to retain adequate margin to cover unexpected eventualities, all buyers and sellers of that security may experience a sudden elimination or diminution of liquidity if the unexpected occurs. But that is much less of a risk on a DEX, where the thousands of liquidity providers all serve as fail-safes for each other, each stepping in to provide liquidity if any of their number experiences financial difficulties.

• On a centralized exchange, a single dealer or small set of dealers may have sensitive financial information about millions of counterparties, presenting a valuable target to hackers and others who seek to access and exploit this data. But on a DEX, because there is no central intermediary, there is no motherlode of data to be attacked. Indeed, even individual liquidity providers do not acquire sensitive financial information about their counterparties other than perhaps a blockchain public address.

It should thus be apparent that DEXes do not raise the same concerns as dealers do. Yet the proposal on its face would apply to DEXes trading in digital currencies to the extent those assets are treated (in all likelihood erroneously) as securities. Such DEXes “[r]outinely express[] trading interests that are at or near the best available prices on both sides of the market and that are communicated and represented in a way that makes them accessible to other market participants.”11 If the individual liquidity providers who participate in a DEX are deemed subject to “common control” with all other liquidity providers due to their use of a common algorithm or platform,12 the trading activity of all providers would be aggregated to establish the pattern and volume of transactions necessary to trigger coverage under the proposal’s qualitative tests.13 The impression that the proposal would cover DEXes is reinforced by the proposal’s going out of its way to explain that it would cover qualifying transactions in digital currencies.14

But nothing in the proposal displays awareness of, let alone grapples with, the unique structures of DEXes or the risks they do or do not present. As noted, those unique structures mean that DEXes do not raise the concerns that motivated Congress when enacting the ’34 Act. Likewise, they mean that the imposition of dealer coverage would be particularly harmful to DEXes. Requiring that DEXes register as dealers and accept the demanding regulatory regime

---

11 87 Fed. Reg. at 23105.

12 While the “common control” test does not specifically address the unique structures of DEXes, it does apply broadly to “the power to direct or cause the direction of the management and policies of a person, whether through the ownership of securities, by contract, or otherwise.” Id. at 23074.

13 Id. at 23075. Even if the various liquidity providers are not swept within the common control test, individual liquidity providers who transact on both sides of the market would facially be covered as dealers.

14 Id. at 23057 n.36.
that would thus apply to them would impose enormous costs that would deter the development of DEXes by U.S. developers and, by extension, the digital economy that they assist. Indeed, it is not even clear (and the Commission certainly has not explained) how a decentralized exchange—which after all is not a person or an entity with staff but rather a network and set of protocols—would register in the first place.

That deterrent effect would be especially pronounced if—as the proposal seems to indicate on its face—many of the *individual liquidity providers* that participate in DEXes would be required to register as dealers too.15 Requiring individual providers to register would drive smaller providers16 from the U.S. markets, leaving the largest providers, who can most easily accept and pass on the costs of registration and regulation, to provide vital liquidity, all the while promoting the growth of non-U.S. based DEXes where such smaller providers could be active. By *promoting* the centralization about which Congress was concerned in the ’34 Act, the proposal would undermine the ’34 Act’s goals.

To be clear, we do not believe that the proposal would actually cover DEXes as dealers if the broader questions regarding regulatory status of digital currencies were correctly answered. That is so, first and foremost, because digital currencies are not securities. Rather, as we explained above, their role and principal source of value is as *currency* that stores and facilitates the transfer of value and that facilitates access to the blockchain networks, rather than as investments.17

But even if some digital currencies were erroneously deemed securities, extending dealer coverage to DEXes without considering either the need for doing so in light of their decentralized structure or the costs of such coverage for the burgeoning digital currency markets would be the epitome of arbitrary and capricious decision-making in violation of the APA. There is reason to believe that the Commission does not actually intend such coverage or that the proposal would actually effectuate it, among other reasons because the proposal does not discuss DEXes even in passing. (If we thought the Commission did intend such coverage, we and other members of the public would offer many additional reasons to dissuade the Commission from this ill-advised approach.) Yet the proposal’s careless wording raises the specter of such coverage, and the Commission ought to dispel it by making abundantly clear in any final rule that DEXes are outside the scope of dealer coverage. The Commission should do so even if it erroneously believes that the statutory definition of “dealer” applies to DEXes, such as by invoking its exemptive authority under § 36 of the ’34 Act in light of the unique structure and

15 The proposal would appear to require the aggregation of the trading patterns and frequencies of individual liquidity providers under common control and, if the aggregated activities trigger one of the qualitative tests, each entity under common control would be required to register as a dealer. *Id.* at 23074-76.

16 The very smallest liquidity providers would be exempted by the $50 million threshold.

17 *See supra* at 2.
circumstances of DEXes. If, contrary to our expectation, the Commission does intend to cover DEXes, then before finalizing such coverage, it must issue a supplemental proposal making clear that it intends to cover DEXes and why it plans to do so, thereby giving the public the congressionally-mandated opportunity to comment on the choice and its rationale.

II. The Proposal Would Unreasonably Expand Dealer Coverage Far Beyond the Contemplation of the ’34 Act.

A. The Proposal Would Untether Dealer Coverage from the ’34 Act’s Text and Purpose and from the Commission’s Own Precedent.

The Commission should not cover DEXes or their participating liquidity providers as dealers for another reason: the proposal cannot be finalized as written, because it flies in the face of the statutory text and is unreasonable under the APA.

1. In the ’34 Act, Congress sought to regulate those who, by merit of their critical role in intermediating transactions for investors across the country, affect investors and securities prices nationwide, all the while leaving intact the freedom of private persons to buy or sell securities as they wish. The ’34 Act reflects an accommodation between the need to regulate these central actors and the wish of private American investors to chart their own financial course free of government control and thus (in the words of some constituents at the time of the Act’s passage) to “exercise [the] traditional American right to fight out of the rut of financial mediocrity.”

The ’34 Act’s dealer provisions are of a piece with this congressional design. In the Act, Congress defined a “dealer” as someone who is “engaged in the business of buying or selling securities … for such person’s own account.” A dealer is thus not someone who merely buys or sells securities, be those transactions never so frequent; rather, a dealer buys and sells securities as a business. Lest there be any ambiguity, Congress further explained that a dealer is not someone who “buys or sells securities … for such person’s own account … but not as a part of a regular business.”

It is clear from the statutory text that dealer status does not turn merely on the frequency of trading, for engaging in an activity frequently does not mean one is engaged in that activity as a business. Playing tennis frequently does not make one a professional tennis player any more than frequent gardening makes one a professional landscaper or frequent pro se court appearances make one an attorney. Elsewhere in the ’34 Act Congress draws distinctions based

---

18 See supra n.7 at 3-6.


20 ’34 Act § 3(a)(5)(A) (emphasis added).

21 Id. § 3(a)(5)(B).
just on frequency, for instance in the definition of “broker” which immediately precedes the definition of “dealer.” In that definition, Congress provided that broker coverage is not triggered by a bank’s transactions “in a fiduciary capacity in its trust department or other department that is regularly examined by bank examiners for compliance with fiduciary principles and standards” if certain other conditions are met.\(^\text{22}\) But Congress took a different approach in defining “dealer,” excluding from dealer coverage anyone not engaged in buying and selling “as a part of a regular business.”\(^\text{23}\) Had Congress wished to hinge dealer coverage just on regularity and not also on trading as a business, it could simply have said so; its joining of the word “business” to the word “regular” shows that more than frequency is required. The Commission must give independent meaning to the word “business” rather than running it together with the word “regular.”

What does it mean to trade securities for one’s own account \textit{as a business}? It means, at the very least, to conduct such trading as a service to others rather than just for oneself. Offering a service to others is what distinguishes the landscaper from the frequent gardener, the attorney from the frequent litigant, and the professional from the recreational tennis player.\(^\text{24}\) A person engaged in his own private affairs is not at work in a “business” as someone who offers a service to third parties is. At least, offering a service to others is what doing something as a “business” usually means, and the Commission has failed to offer any reason to read that word another way here or to explain what any broader meaning might be.\(^\text{25}\)

In fact, the Commission itself has read the definition of dealer through the decades to turn on factors other than mere frequency. In its 2002 proposal cited frequently in the instant proposal, the Commission explained that a person could qualify as a dealer on the basis of transacting in securities if the person \textit{also} “conduct[ed] any of an assortment of professional market activities such as providing investment advice, extending credit and lending securities,” etc.\(^\text{26}\) Even the instant proposal admits that both the Commission and courts have looked not just to frequency but also to “the nature of the trading activity”\(^\text{27}\) in determining whether someone is a trader or a dealer.

\(^{22}\) \textit{Id.} § 3(a)(4)(B)(ii) (emphasis added).

\(^{23}\) \textit{Id.} § 3(a)(5)(B) (emphasis added).

\(^{24}\) It may be that compensation from offering the service to others is also required for the offering to constitute a “business,” but we need not reach that point for our purposes here.

\(^{25}\) If the Commission indeed reads the word more broadly, then the proposal would need to explain precisely what type of activity beyond trading as a service to others constitutes trading “as a business.”

\(^{26}\) 67 Fed. Reg. at 67499.

\(^{27}\) 87 Fed. Reg. at 23058.
The distinction that the ’34 Act and the Commission itself have drawn makes perfect sense in light of Congress’s objectives in the Act. Those who transact in securities as a service to others are a critical part of the central securities architecture upon which investors throughout the country, and the broader national economy, depend. Such dealers perform a variety of central functions, including underwriting and market making; they thus have an outsized effect on investors and securities prices nationwide in a way that mere traders, even frequent traders, do not. This outsized effect justifies the “comprehensive regulatory regime” that applies to dealers along with brokers. Dealers must register with the Commission, must join a self-regulatory organization with authority to issue binding rules governing the conduct of its members, and must adhere to a number of other strict requirements.

Application of this “comprehensive regulatory regime” to Americans who simply want to manage their own portfolios through frequent trading would be utterly inappropriate, for it would impede the “traditional American right” to chart one’s own financial course. Nor do mere frequent traders serve the same central functions that dealers do. While they do contribute to maintaining liquidity in the securities markets, that does not set them apart from every other buyer or seller of securities. Congress did not choose to extend the Commission’s jurisdiction to every person who contributes to the markets’ liquidity, so the mere provision of liquidity is not enough, standing alone, to judge that someone is a dealer.

2. Notwithstanding the clear statutory text and the Commission’s own past interpretations, the proposal seeks to expand dealer coverage to certain persons and firms on account of the frequency with which they trade their own securities. Specifically, the proposal seeks to cover as dealers certain frequent traders just because their “trading activity in the market has the effect of providing liquidity to other market participants.” By decoupling the definition of “dealer” from both the statutory text and Congress’s purposes, the proposal runs afoul of the ’34 Act.

---


29 87 Fed. Reg. at 23078.

30 Id.; ’34 Act § 19.


32 Supra n.18.

33 87 Fed. Reg. at 23061-62 (internal quotation marks omitted).
To its credit, the Commission does acknowledge that all buyers and sellers of securities provide liquidity. That is why the proposal explains that its expansion of dealer coverage would sweep in only those whose “liquidity provision is not incidental to their trading activities.” But this putative limitation is no limitation at all, for the proposal makes clear that a person is a dealer if the effect of his or her trading is the provision of liquidity, even if (unlike a market maker or other sorts of dealers) the person had no purpose of providing liquidity. So we are back where we started: the Commission’s principle for distinguishing dealers from frequent traders is that the former have the effect of providing liquidity—which is what every buyer and seller of securities does.

By advancing this principle, the Commission radically departs from its own prior position without a legally adequate rationale. The proposal glosses over this departure, claiming to draw its new principle from its prior interpretations. But that is clearly not the case. The Commission cites prior statements that dealers include market makers and “de facto market maker[s],” but mere provision of liquidity has never been enough to qualify as a market maker (whether de facto or de jure), who rather is a person who buys and sells on both sides of the market as a service, for the purpose of ensuring that buyers and sellers may always find someone with whom they may transact. While the market does indeed look to market makers for liquidity, as the proposal notes, that fact does not mean that all persons who provide liquidity are engaged in market making and therefore qualify as dealers. The Commission’s new principle, then, has no basis in its prior interpretations—and the Commission’s failure to recognize as much is itself arbitrary and capricious in violation of the APA, as is its failure to give an adequate rationale for its change of position.

---

34 Id. at 23062. The Commission puzzlingly states that “all market participants who buy or sell securities arguably contribute to a market’s liquidity,” id. (emphasis added), but there is nothing arguable about this most basic fact and central justification of the secondary securities markets.

35 Id.

36 Id.

37 Id. at 23061.

38 Id.

39 Id.

40 See, e.g., FCC v. Fox Television Stations, Inc., 556 U.S. 502 (2009) (“the requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it is changing position,” and the agency must also “show that there are good reasons for the new policy”).
Of course, the Commission does not and could not seek to cover as a dealer every person who provides liquidity in the securities markets. Instead, it sets forth three “qualitative” tests for dealer status. But the proposal fails to offer a reasonable justification for the tests. In the first place the purpose of these tests, the proposal makes clear, is simply to identify those who “assume dealer-like roles” by providing liquidity. Because under the ’34 Act the provision of liquidity is not enough to transform a trader into a dealer, the Commission has not offered an adequate justification for use of the three tests to establish dealer status, thus violating both the ’34 Act and the APA.

Second, because all buyers and sellers of securities provide liquidity regardless of whether they fall within the three tests, the tests fail to separate those who ought to qualify as dealers from those who ought not under the Commission’s own reasoning. Someone who regularly trades near the best price on both sides of the market for a particular security certainly provides liquidity—but so does someone whose buying and selling does not conform to this pattern. The proposal’s irrational distinction is arbitrary and capricious.

Third and most importantly, because the tests do not ask whether a trader transacts in securities “as a business”, i.e. professionally as a service, they would sweep in many traders who fall outside the ’34 Act’s definition of “dealer.” They would, for instance, cover many high-frequency directional traders who simply aim, as School House Rock taught us all, to “buy low, sell high” and whose contribution to the markets’ liquidity is just the same as that of anyone else who follows the old adage. And as we will see below, they would appear to cover some people even further from professional securities dealers.

For all these reasons, the proposal’s three qualitative tests violate the ’34 Act, and the Commission’s reasoning in their support fails to pass muster under the APA.

B. Illustrating How Far It Strays from the Statute, the Proposal Could Be Read to Cover Merchants Who Accept Payment in Digital Currencies.

The proposal’s irrationality and its lack of connection to the text and purpose of the ’34 Act is most evident in its apparent coverage of garden-variety retailers and others who happen to transact in digital currency. One of the proposal’s three qualitative tests imposes dealer status on a person who “[r]outinely express[es] trading interests that are at or near the best available prices on both sides of the market” if those interests are communicated to other market participants.

41 87 Fed. Reg. at 23061.
42 Id. at 23065.
43 School House Rock, Walking on Wall Street, available at https://www.youtube.com/watch?v=dpa9vY8AkQY.
44 87 Fed. Reg. at 23105. We note that the coverage of persons based on their expression of “trading interest” violates both the ’34 Act and the First Amendment for the reasons set forth in our earlier comment. See supra n.7 at 13-14, 20.
This test is broad enough to sweep in the growing number of merchants and others who buy and sell in any digital currencies that have (erroneously) been deemed securities, for such merchants (which grow in number every day) regularly offer to sell goods to customers in exchange for digital currency and to buy goods from suppliers in exchange for digital currency.\(^{45}\) Indeed, the proposal appears to cover even merchants who accept digital currency and then “routinely” exchange that digital currency for more traditional forms of currency. Because digital currency-friendly retailers offer to transact on both sides of the market, they would appear to trigger coverage as dealers.

But of course, retailers are nothing like securities dealers, no matter which currency they use. Merchants who transact in digital currency are just like those who buy and sell in dollars, pounds sterling, or euros. They retail the same sorts of goods as other retailers, from groceries to lumber to rugs to pumpkin spice lattes.\(^{46}\) They do not underwrite, make markets, or offer any of the other services that the Commission has previously identified as the work of dealers.\(^{47}\) They do not magically transform into securities firms by allowing customers to pay in digital currency—but that is the apparent result of the proposal as written. Any rulemaking that on its face would cover ordinary retailers as securities dealers based on the type of currency they accept has gone badly awry.

This absurd result points up the inadequacy of the qualitative tests to identify the persons that Congress intended to regulate as dealers. It likewise shows the proposal’s irrationality. The proposal nowhere even mentions coverage of retailers who accept payment in digital currency, let alone gives good reason for this coverage or indicates awareness of the barriers that coverage would erect against the growth of digital assets in the United States—growth that the President has identified as a national priority.\(^{48}\) The proposal’s failure to articulate a reasoned basis for covering retailers who accept digital currency as dealers is arbitrary and capricious.

To be clear, we do not believe digital currencies are securities, and on that basis alone, this proposal would not cover merchants who accept digital currency. But even if digital assets were securities, the proposal’s text would not actually cover merchants upon judicial review, because (among other reasons) reading the ’34 Act to transform retailers into SEC-regulated dealers would run afoul of the major questions doctrine.\(^{49}\) That doctrine holds that Congress

\(^{45}\) The test would sweep in such merchants if they value the digital currencies in which they trade at their market value, as they would certainly try to do to prevent price arbitrage on the part of their customers or suppliers.

\(^{46}\) See supra at 3 (listing prominent retailers that accept cryptocurrency).

\(^{47}\) 67 Fed. Reg. at 67499.

\(^{48}\) See E.O. 14067.

“does not alter the fundamental details of a regulatory scheme in vague terms . . . it does not, one might say, hide elephants in mouseholes.”\textsuperscript{50} Sweeping retail use of digital currency under the Commission’s jurisdiction surely qualifies as altering the fundamental details of the Commission’s regulatory scheme—and the dealer provision is just as surely among the vaguest imaginable means to do so.

Nevertheless, companies should not be left to the careful employment of the canons of legal construction to discover whether they are dealers under the proposal. The Commission should make abundantly clear in any final rule that such merchants are outside the scope of dealer coverage. The need for clarification is all the greater because the proposal expressly states that it would apply, all things remaining the same, in the context of digital assets.\textsuperscript{51} Moreover, as we explained in our earlier comment, regulatory certainty is especially important in fast-growing industries like blockchain and in the decentralized finance sector it enables.\textsuperscript{52}

If, contrary to our understanding, the proposal is intended to cover merchants who transact in digital currency as dealers, the Commission will be unable to finalize that coverage based on the proposal as written. That is because the proposal fails to make clear whether it does indeed intend such coverage or discuss whether doing so is appropriate. The APA requires that the Commission, before it may finalize coverage, first make available for public comment both its intended regulation and the rationale underlying it.\textsuperscript{53} Because coverage of merchants would be both entirely unnecessary and tremendously harmful, we and others would submit many arguments to dissuade the Commission from finalizing such coverage, if we thought the Commission intended to do so and if we were privy to its rationale. The Commission must offer us and other members of the public the opportunity to comment before finalizing any regulation that would cover merchants transacting in digital currency.

If, contrary to our expectation, the Commission does intend to cover merchants who transact in digital currency, then it should instead afford them an exemption under § 36 of the ’34 Act, because these merchants present none of the concerns that motivated Congress to regulate dealers (or even the concerns that motivate the Commission to propose to expand its jurisdiction) and because coverage of them as dealers would effectively stop retailers from adopting digital currency as a payment option—thus stymying one of the principal values that digital currency offers.

\textsuperscript{50} \textit{Id.}

\textsuperscript{51} 87 Fed. Reg. at 23057.

\textsuperscript{52} \textit{See supra} n.7 at 9.

\textsuperscript{53} \textit{See, e.g., Honeywell Int’l, Inc. v. EPA}, 372 F.3d 441, 445 (D.C. Cir. 2004) ( “a notice of proposed rulemaking must provide sufficient … rationale for the rule to permit interested parties to comment meaningfully”) (internal quotation marks omitted).
III. The Proposal, If Finalized, Would Be Arbitrary and Capricious.

The proposal does not just exceed the authority given the Commission in the ’34 Act; it also runs afoul of the APA, for the Commission has not given adequate reasons in support of the proposal as that statute demands.

A. The Proposal Fails to Identify a Problem in Need of Its Putative Remedy.

A regulation aiming at a problem is “highly capricious if that problem does not exist.” An agency is therefore obliged to demonstrate that its rules respond to real-world problems. But the Commission has failed to do that here; accordingly the proposal, if finalized, would be arbitrary and capricious.

The Commission does not cite a single unlawful or harmful act that its three new qualitative tests would have stopped. It does not show that frequent traders have harmed investors or the markets. To the contrary, the Commission concedes that these traders perform a valuable service by providing liquidity; indeed, their provision of liquidity is the basis of the proposal. The proposal refers briefly to the “flash rally” of October 2014 but fails to explain how its proposed new approach would have addressed that event.

Rather than demonstrate a concrete problem, the proposal relies on speculative assertions to justify tinkering with the securities markets. For instance, the proposal asserts that at present different regulatory requirements apply to similarly-situated entities and that its approach would remedy this “uneven playing field.” But as we have shown, private traders who happen to trade frequently are not similarly-situated to dealers who serve a central role in the U.S. securities markets, and regulating the two groups differently, as they have been for years, therefore is perfectly reasonable. Moreover, the proposal does not adduce a single real-world example of harm from this assertedly uneven treatment.

The proposal also claims that unregulated private traders may take on more leverage than regulated dealers and that this greater leverage may expose the traders to greater risk of failure, particularly during periods of financial upheaval. But risk of that sort is inherent in a free market; Congress did not give the Commission the paternalistic task of protecting traders from themselves. The Commission asserts that one trader’s failure may adversely affect others, but it admits that a trader’s counterparties “can seek to estimate [the trader’s] probability of failure.”

---

54 Alltel Corp. v. FCC, 838 F.2d 551, 561 (D.C. Cir. 1998).

55 See, e.g., E.O. 12866 § 1(b)(1) (“Each agency shall identify the problem that it intends to address….”).

56 87 Fed. Reg. at 23056.

57 Id.

58 Id. at 23085.
and price that risk into their transactions with the trader.\textsuperscript{59} And while the Commission asserts that unregulated traders can pose systemic risks to the broader U.S. financial ecosystem, that assertion is sheer \textit{ipse dixit}.\textsuperscript{60} Conclusory assertions such as this do not satisfy the Commission’s burden under the APA, not least because they deny the public an opportunity to scrutinize the Commission’s evidence and reasoning (if any) and respond.

The proposal further suggests that expanding the scope of dealer coverage is needed to foreclose the “potential for market manipulation or fraud.”\textsuperscript{61} But the SEC does not further explain how private traders who simply buy and sell at market prices for their own accounts pose a meaningful risk of defrauding other investors; similarly, the proposal does not explain what manipulative practices private traders engage in or how its proposal would stop them.

The Commission also claims that expansion of the scope of dealer coverage is necessary so the Commission can adequately “study” the markets in which private traders participate. But while the Commission’s need for information might be a good reason to sponsor studies or conduct surveys, it does not justify imposing onerous requirements on the ability of Americans to chart their own financial course. Even if the Commission’s need for information warranted the filing of reports by some private traders, it would not justify applying to them the other strictures that come along with dealer status, and the Commission should therefore grant an exemption from these strictures under ’34 Act § 36.

Because the Commission has failed to show that the problems it claims to solve are real, the proposal would, if finalized, be arbitrary and capricious in violation of the APA.

\textbf{B. The Proposal Fails to Show It Would Do More Good Than Harm.}

The Supreme Court has made clear that “reasonable regulation ordinarily requires paying attention to the advantages and disadvantages of agency decisions.”\textsuperscript{62} A rulemaking that fails to evaluate reasonably whether its benefits are worth its costs is generally arbitrary and capricious, for a regulation that does substantially more harm than good is irrational, and therefore so is the failure to inquire as to the relation of a regulation’s costs to its benefits.\textsuperscript{63}

The proposal fails to adhere to this basic norm of reasoned regulation for, even assuming \textit{arguendo} that the Commission has shown a problem that its proposal could remedy, it has not shown that the cure is better than the disease. The proposal’s assertion that its benefits justify its costs depends on a single data point: some private trading firms provided less liquidity during the

\textsuperscript{59} \textit{Id.}

\textsuperscript{60} \textit{Id.}

\textsuperscript{61} \textit{Id.} at 23086.


\textsuperscript{63} \textit{Id.}
March 2021 volatility in the Treasuries market than registered dealers. Relying on this single piece of data to justify its conclusion requires the Commission to take many logical leaps, none of which it spells out. It is sufficient here to note one of them: a single episode in the Treasuries market cannot justify applying the three qualitative tests to traders in all securities. Absent an adequate reason to conclude that its benefits warrant its costs, the proposal fails to pass muster as a reasonable regulation under the APA.

Further, the proposal fails to account for many costs. Important among them is the cost of the delay and potential refusal of self-regulatory organizations to register the many trading firms—and potentially even individual people—that would be swept into dealer coverage under the proposal. As we noted above, all traders qualifying as dealers are obligated to register with a self-regulatory organization. But as firms specializing in digital currency have discovered in recent years, those organizations sometimes decline or, at best, drag their feet in providing the registration that the '34 Act demands broker-dealers obtain. For such firms and others like them, the costs of the proposal are not merely the burden of filing appropriate paperwork and complying with the strictures on dealer conduct, but the potentially much greater costs of suspending activity until a self-regulatory organization can be prevailed upon to register them. Yet the proposal nowhere mentions this cost or shows that it is justified by the proposal’s putative benefits.

The proposal’s failure adequately to compare its costs and benefits is all the more remarkable in light of Congress’s special directive to the Commission to consider whether its proposed rules “will promote efficiency, competition, and capital formation.” The proposal does not carry out that congressionally-imposed duty. In fact, the proposal expressly concedes that it “would have uncertain impacts on efficiency, competition, and capital formation.” That is because, according to the Commission, the proposal may well drive firms to cease providing

---

64 87 Fed. Reg. at 23086, 23091.

65 See supra n.10.


67 The proposal likewise fails to account for the costs of attempting to exercise jurisdiction over DEXes that are not based in the United States or primarily active here or the confusion that would be created by that attempt. See supra n.7 at 11.

68 E.g., '34 Act § 3(f).

69 87 Fed. Reg. at 23078.
the very liquidity the safeguarding of which is the proposal’s asserted core purpose, thus adversely affecting the three goals assigned to it by Congress.\footnote{70}{Id. at 23091.}

It would be unreasonable for the Commission to finalize the proposal without first forming a view as to whether the proposal would promote or impede the goals Congress assigned to it in statute. It is textbook administrative law that an agency’s failure to take into account factors it is obligated to consider renders its rule arbitrary and capricious.\footnote{71}{See, e.g., Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).} And forming no view as to whether the rule would advance or impede such factors is, absent a showing that the agency is unable to access data that would allow it to form a view, just the same as failing to consider those factors at all. The Commission therefore must, before finalizing the proposal, use best efforts to reach a judgment—and adequately explain to the public—whether the proposal would promote or impede the three goals Congress assigned it and then decide whether to finalize the proposal in light of that judgment. Anything less would be arbitrary and capricious.

C. The Proposal Creates Unnecessary Confusion by Declining to Define Its Key Terms.

The proposal hinges coverage as a dealer on whether a trader “routinely” buys and sells “roughly comparable” quantities of the same securities in a given day or “routinely” expresses trading interest at or near the market price on both sides of the market.\footnote{72}{87 Fed. Reg. at 23105.} These are the proposal’s key terms; whether someone is an unregulated trader or a highly regulated dealer comes down to what they mean.

Yet the proposal refuses to define them. The only guidance the proposal gives as to the meaning of “routinely” is to state the obvious: the word “means more frequent than occasional but not necessarily continuous.”\footnote{73}{Id. at 23066.} But the decisive question for traders is how much more frequent than occasional and how much less than continuous—and on this question the proposal has nothing to say.

So too for the phrase “roughly comparable.” The proposal explains that the phrase “would generally capture purchases and sales similar enough … to permit liquidity providers to maintain near market-neutral positions by netting one transaction against another transaction,”\footnote{74}{Id. (emphasis added).} but it gives no guidance on how much similarity and nearness are enough. Instead, it urges
traders to assess whether they must register as dealers by asking themselves whether their purchases and sales “fall within a reasonable range” that “generally” would offset transactions. 75

These vague formulas do not give traders the clear markers they need to determine whether they are subject to “comprehensive” regulation as dealers. The proposal acknowledges that its standards are not “bright-line test[s]” but defends their opacity, undoubtedly because giving a bright-line rule would constrain the Commission’s flexibility in unanticipated scenarios. But while administrative flexibility can sometimes be a virtue, so is regulatory certainty, and the Commission has not explained why flexibility should come at the expense of certainty here or why, if only one is possible, flexibility is more valuable than certainty. The Commission’s unreasoned choice to impose the costs of uncertainty is arbitrary and capricious.

D. The Proposal’s Numeric Threshold Is Irrationally Keyed to Overall Assets Rather than Assets Used in Covered Trading.

Because the Commission seeks to tie dealer coverage to the provision of liquidity, it must decide how much liquidity a trader must provide to trigger coverage. To the Commission’s credit, it recognizes that relatively modest trading patterns do not have an effect on America’s supermassive liquidity markets that warrant application of the burdensome requirements of dealer coverage. 76 It therefore establishes a threshold of $50 million below which traders will not be deemed dealers on the basis of the new qualitative tests. 77

But the proposal spoils even this saving grace by conditioning it on the amount of assets the trader owns or controls rather than the amount of assets the trader uses to trade in covered transactions, e.g., in buying and selling on both sides of the market for the same security. 78 Under the proposal’s framework, a trading firm managing $50 million that employs $50,000 of it in playing both sides of the market would be a dealer while a firm that employs all of its $49 million under management in the same strategy would not. But of course, the magnitude of a trader’s assets has no effect at all on the market’s liquidity, which is affected only by the use to which the trader puts those assets. The proposal’s numeric threshold is thus keyed to a metric that has nothing to do with what it seeks to achieve.

This error may seem minor, but it would matter for persons and modest-sized firms that provide liquidity on DEXes (if activity on DEXes were to fall under the proposal). Such persons and firms may place only a small portion of their assets in use providing liquidity on DEXes. By imposing dealer coverage on persons or firms with at least $50 million under ownership or management if they use any of their funds in trading that (either by itself or when combined with

75 Id.

76 Id. at 23062-63.

77 Id.

78 Id. at 23105.
the activity of other traders) triggers one of the three qualitative rules, the proposal would
discourage persons and firms from contributing small amounts of liquidity to DEXes, leaving
this vital role exclusively to those who are willing to contribute large amounts and thus
concentrating the provision of liquidity on DEXes among a few major players. That is the case
even though the contribution of small amounts of liquidity would, on the proposal’s own
reasoning, have negligible effects on the liquidity markets which the proposal aims to protect.

Because it conditions its numeric threshold on a criterion that is irrelevant to the goal the
threshold is meant to serve, the proposal is arbitrary and capricious.

CONCLUSION

For the reasons we have given, we urge the Commission to reconsider its proposal. The
Commission should withdraw the proposal or, if it chooses to proceed, should amend the
regulatory text in line with the analysis set forth above. At the very least, the Commission
should make clear that the new regulatory requirements do not extend dealer coverage to
merchants on account of their acceptance and use of digital currencies that may be deemed
securities.

If the Commission chooses not to withdraw the proposal, it should at least pause the
rulemaking during the pendency of the Regulation ATS rulemaking.\textsuperscript{79} That rulemaking
substantially overlaps with the instant one, and the public cannot evaluate and comment
intelligently on these multiple moving, related parts.

For instance, the instant proposal cites the Regulation ATS proposal in support of its
notion of conditioning coverage on “trading interest” rather than on firm offers to trade.\textsuperscript{80} The
Commission received comments on the Regulation ATS proposal’s use of trading interests,
comments that it has yet to resolve. Commenters in the instant proceeding would benefit from
knowing the final formulation of the trading interest provision in the Regulation ATS
amendments, so we can express views on whether that formulation and the justifications the
Commission advances for it should apply in the context of this proceeding.

Further, as we documented in our earlier comment, the purpose and effect of the
Regulation ATS proposal would be to expand dealer coverage\textsuperscript{81}—precisely what the instant
rulemaking seeks to do. The Regulation ATS proposal may well result in coverage of some of
the same market participants as would be covered by the instant proposal and may therefore
address some of the needs that the Commission claims warrant the instant proposal. But absent a

\textsuperscript{79} Proposed Amendments Regarding the Definition of “Exchange” and Alternative Trading
Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS)

\textsuperscript{80} 87 Fed. Reg. at 23068.

\textsuperscript{81} Supra n.7 at 15-16.
finalized version of the Regulation ATS amendments, commenters are unable to opine on this vital question.

The public’s difficulties in commenting are compounded by the fact that the Commission, for reasons known only to it, has decided to rush the instant rulemaking. The Commission has cited no reason to justify departure from Executive Order 12866’s longstanding demand for a 60-day comment period, and as our analysis above shows, there simply is no real-world urgency that warrants rushing forward with simultaneous overlapping rulemakings. The Commission should slow down to get it right and give the public the time it needs to comment.

Respectfully Submitted,

CONSENSYS SOFTWARE INC.

by:

/s/ William C. Hughes

William C. Hughes
Senior Counsel & Director of Global Regulatory Matters

____________________________
82 § 6(a)(1).