

February 12, 2020

J. Matthew DeLesDernier  
Assistant Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: File Number SR-BOX-2019-19**

Dear Mr. DeLesDernier:

This letter is submitted on behalf of a client of the firm with respect to a rule proposal submitted to the Securities and Exchange Commission ("SEC" or "Commission") by the Box Exchange LLC ("Exchange") on September 27, 2019 (the "Proposal"), requesting approval of rules that would govern the trading of equity securities on the Exchange through a facility of the Exchange to be known as the Boston Security Token Exchange LLC ("BSTX").<sup>1</sup> The equity securities would consist of security tokens that meet BSTX listing standards and for which ancillary records of ownership would be able to be created and maintained using blockchain technology.

We offer the following comments:

*The purpose and design of the ancillary records is unclear and therefore cannot be evaluated under the Securities Exchange Act of 1934, as amended ("Exchange Act").*

The Proposal states that "ancillary record keeping of ownership can be thought of as a digital representation of shareholder equity in a legal entity organized under the authority of state or federal law and that meet BSTX's listing standards. Having a security token attributed to a particular address, however, would not convey ownership of shareholder equity in the issues because the official records of ownership would be maintained by participants at DTC."<sup>2</sup>

The Proposal then goes on to link the ancillary recordkeeping mechanism to the "first step toward potential integration of blockchain technology to securities transactions."<sup>3</sup>

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<sup>1</sup> See Release No. 34-87287; File No. SR-BOX-2019-19 (October 11, 2019); 84 FR 56022 (October 18, 2019), and Release No. 34-87641; File No. SR-BOX-2019-19 (November 29, 2019); 84 FR 66701 (December 5, 2019), extending the 45-day time period for Commission action on the proposed rule change until January 16, 2020. See also Release No. 34-88002; File No. SR-BOX-2019-19 (January 16, 2020), providing Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1. In this letter, the rule proposal submitted to the Commission on September 27, 2019 is referred to as the "Proposal" and Amendment No. 1 is referred to as the "Amended Proposal".

<sup>2</sup> Release No. 34-87287 at p. 17. See also the Amended Proposal at p. 4, stating that the records reflected on the blockchain may not be current to reflect the most recent transactions in the marketplace and may not reflect ownership by all market participants.

<sup>3</sup> Release No. 34-87287 at p. 28. See also *id.* at p. 119, stating: "The Exchange believes that using blockchain technology as an ancillary recordkeeping mechanism that operates in parallel with the traditional trading, recordkeeping, and clearance and settlement structures that market participants are familiar with is an important first step toward exploring the potential uses and benefits of blockchain technology in securities transactions."

While we appreciate that the Proposal is intended to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to transactions in securities tokens, the Proposal does not provide sufficient detail regarding the ultimate purpose of the ancillary record and its specific content and design so as to enable a review of the Proposal under Section 6 of the Exchange Act. For example, a reader of the Proposal cannot currently identify and evaluate the ways in which the ancillary record may benefit investors and/or add to transactional, operational, and other types of risk. In this regard, we note that the Proposal does not describe all the ancillary data and metadata that will be stored in the blockchain. Proposed Exchange Rule 26138 (BSTX Security Token Protocol) will require a security token to follow the BSTX Security Token Protocol as distributed by the Exchange via a Regulatory Circular, but currently there is no draft of the circular or other documentation that identifies the differences, if any, between the records maintained by the Exchange, the Depository Trust Company ("DTC"), the National Securities Clearing Corporation, and the ancillary record. Without the necessary detail, readers of the Proposal cannot determine the record's potential impact (either positive or negative) on the anti-fraud, customer protection, and other purposes of the Act.

We believe that all the investor protection concerns that potentially flow from the creation of ancillary records need to be articulated and analyzed, e.g., for whose benefit is the record; who will have access to it; if access is limited to certain persons, how will the Exchange assure that unauthorized users do not have access; does the ancillary record have any potential impact on the safeguarding of customer non-public information; since the transfer of ownership does not take place through the blockchain, what is the utility of the token for investors (in other words, should readers assume that the token is intended to function only as an asset in which one invests with the hope of positive return, and is not intended to function as a currency or alternative form of payment); would SEC-approved custodians be insulated from liability for differences in record ownership between records maintained by DTC and the ancillary record; what records would regulators examine and surveil for purposes of determining compliance with all applicable rules? These questions and others need to be raised and addressed before the Proposal can be approved.

*The pre-conditions imposed by the Proposal on trading away from the BSTX are inconsistent with the Exchange Act.*

The Proposal addresses the issue of trading the securities tokens on other national securities exchanges by noting the requirements of Exchange Act Rule 12f-5, specifically that an exchange may not extend unlisted trading privileges ("UTP") to any security unless the exchange has in effect rules providing for transactions in the class or type of security to which the exchange extends the privilege. The Proposal notes that another exchange would be required, first, to adopt rules requiring its members to obtain a wallet address compatible with the BSTX Security Token Protocol in order to attribute security token balances with that exchange member; and second, adopt some mechanism to report end-of-day security token balances to BSTX in order to facilitate updates of ownership to the blockchain.<sup>4</sup> The Proposal states that since no other national securities exchange currently trades securities tokens, an exchange would need to adopt rules for UTP purposes in anticipation of listing and trading its own securities tokens.<sup>5</sup>

The Exchange also states in the Proposal that it believes there are numerous ways in which another exchange could comply with the ancillary recordkeeping requirement, such as by developing its own wallet manager software compatible with the BSTX Security Token Protocol, by coordination with BSTX, or otherwise.<sup>6</sup>

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<sup>4</sup> Id. at p. 30.

<sup>5</sup> Id. at p. 31. The Proposal and the Amended Proposal also contemplate trading security tokens through the OTC market.

<sup>6</sup> Release No. 34-87287 at p. 126.

These requirements are inconsistent with Exchange Act Section 12(f). Section 12(f) permits an exchange to extend unlisted trading privileges (UTP) to any security listed on an exchange, subject to certain limitations which do not include requirements imposed by the listing exchange. The Commission has rulemaking authority to prescribe additional requirements for extending unlisted trading privileges, but none of the rules adopted by the Commission permit a listing exchange to impose requirements on UTP exchanges. The Proposal states that Rule 12f-5 imposes the burden on exchanges to have in place rules to facilitate transactions in a particular type of security, "so it is not the case that the Exchange's proposal imposes this burden."<sup>7</sup> We do not believe the requirements of Rule 12f-5 can be read to mean that a listing exchange can impose requirements on UTP exchanges with respect to rules governing the trading of the subject security that the UTP exchange must have.

In addition, the Proposal's imposition of ancillary recordkeeping requirements on UTP exchanges and OTC trading imposes a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. BSTX has not sufficiently justified the difficulties imposed on other exchanges and OTC markets by the ancillary recordkeeping requirements and why such requirements are not a burden on competition or why such burden is necessary or appropriate in furtherance of Exchange Act purposes. We also note in this regard that the Amended Proposal provides, with respect to trading not on an exchange, that the Exchange will use an omnibus entry on the blockchain so that non-BSTX Participants do not need to obtain a wallet address prior to trading a security token, and are not subject to the end-of-day position reporting that applies to BSTX Participants and UTP transactions. The different treatment between OTC transactions and exchange transactions is not explained. Further details regarding the operation of the blockchain and the data which it will record may help other exchanges and interested commenters understand how UTP could operate for tokens listed on the BSTX.

*The Proposal is inconsistent with Section 6(b)(5) of the Exchange Act.*

Section 6(b)(5) specifies that exchange rules may not "regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the exchange." The Proposal's requirements with respect to maintaining an ancillary record are inconsistent with Section 6(b)(5) because this record, by definition, does not appear to be necessary for the clearance and settlement of the securities, the fair and orderly trading of securities tokens, or any purpose regulated by the Exchange Act.

Thank you for your consideration of these comments.

Very truly yours,

  
Holly H. Smith

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<sup>7</sup> Id. at p. 126.