sifma
Invested in America

April 22, 2020

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

Re: ***Proposed Rule Change to Govern the Trading of Equity Securities through the Boston Security Token Exchange LLC, Securities Exchange Act Release No. 88300 (February 28, 2020), 85 FR 13242 (March 6, 2020) (SR-BOX-2019-19)***

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced proposed rule change (the "Proposal") filed by BOX Exchange LLC ("BOX" or "Exchange") with the Securities and Exchange Commission ("Commission") under Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"). In the filing, BOX is proposing to adopt rules governing the listing and trading of a new type of equity security on a facility of the exchange known as the Boston Security Token Exchange LLC ("BSTX").[2]

Introduction

BOX has submitted a set of proposed rule changes with the Commission, which collectively, would allow the Exchange to commence operations of BSTX.[3] If approved by the

[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 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, 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] See Exchange Act Release No. 88300 (February 28, 2020), 85 FR 13242 (March 6, 2020) (File No. SR-BOX-2019-19). The Commission recently extended the time by which it needs to act on the Proposal to June 14, 2020. See Exchange Act Release No. 88634 (April 14, 2020) (Notice of Designation of Longer Period for Commission Action on Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 2, to Adopt Rules Governing the Trading of Equity Securities on the Exchange Through a Facility of the Exchange Known as the Boston Security Token Exchange LLC).

[3] The Commission recently extended the time for its consideration of the Exchange's proposed rule change regarding the governance structure and administration of the BSTX facility. See Exchange Act Release No. 88536 (April 1, 2020), 85 FR 19537 (April 7, 2020) (File No. SR-BOX-2019-37) (Order Instituting Proceedings to

Commission, BSTX would be a facility of the Exchange that will operate a fully automated, price/time priority execution system for the trading of digital "security tokens," which would be equity securities that meet BSTX listing standards and for which ancillary records of ownership would be able to be created and maintained using distributed ledger (or "blockchain") technology. These ancillary records of ownership would reflect certain end-of-day security token balances as reported by BSTX market participants to BSTX. According to the Exchange, official records of security ownership would be maintained by BSTX participants at The Depository Trust Company ("DTC"), and attribution of a security token on the Ethereum blockchain would not convey ownership of shareholder equity in the issuer. Trades in the security tokens would clear at the National Securities Clearing Corporation ("NSCC") on a T+1 basis under BSTX rules. The Exchange further represents that the security tokens would qualify as NMS stocks pursuant to Regulation NMS.

Discussion

SIFMA respectfully submits that the BSTX Proposal contains aspects that are novel enough in the context of the current equity market infrastructure that they warrant further consideration outside the framework of a proposed rule change by a single exchange. For instance, the Exchange is proposing that the securities tokens listed and traded on BSTX settle on a T+1 basis. While the Commission's current securities settlement rule provides for the ability of parties to a trade to agree to a shorter settlement timeframe than T+2, the standard settlement timeframe for listed equity securities currently is T+2.[4] The entire equity market infrastructure is built and based on this standard settlement cycle of T+2. This includes firms' systems and processes for handling listed equity trades, including the reconciliation of errors and the operation of margin accounts.[5] SIFMA would like to highlight that new systems by firms may need to be created to process trades in security tokens listed on BSTX versus, for instance, trades in equity securities listed on the New York Stock Exchange or Nasdaq. While new systems can be created, the costs associated with such efforts could be non-trivial for industry participants.

Moreover, the security tokens' T+1 settlement cycle is incompatible with Regulation NMS. In this regard, for instance, Rule 611 of Regulation NMS only provides protected quotation status to orders that settle on a "regular way" basis. By settling on a T+1 basis, the security tokens would not settle on a regular way basis. Further, if the security tokens are traded pursuant to unlisted trading privileges ("UTP") by another exchange, there is a question as to how firms would comply with BSTX settlement rules and the settlement rules of another

---

Determine Whether to Approve or Disapprove a Proposed Rule Change in Connection with the Proposed Commencement of Operations of the Boston Security Token Exchange LLC as a Facility of the Exchange).

[4] See Exchange Act Rule 15c6-1(a).

[5] One SIFMA member firm noted that its trading system is set to automatically settle equity trades on T+2. The firm noted that if BSTX has a non-standard settlement date of T+1 for trades in security tokens, traders at the firm would have to remember to manually override these trades for T+1 settlement every time they effected one, which is unrealistic to expect in practice and would create issues for the firm.

exchange. In such a UTP scenario, firms may be required to facilitate the T+1 settlement for a client by executing a "street" facing trade in security tokens that settles on a T+2 basis, holding the positions in a facilitation account, and then taking on a risk position to settle the client on the shorter T+1 cycle. It is therefore difficult to understand how or why the security tokens should be deemed NMS stocks when they do not appear to be afforded protected quotation status under Rule 611 and otherwise do not trade in a manner that is compatible with Regulations NMS.[6]

The Exchange also is proposing what appears to be proprietary Ether-based distributed ledger technology to be used to track ownership on an ancillary basis of security tokens listed on BSTX. While the Exchange repeatedly notes that these blockchain records would not be official records of ownership of the security tokens, by putting forth the Proposal, the Exchange clearly is encouraging the adoption of this technology with the likely eventual goal of having it become a system for tracking equity security ownership outside of the current system maintained by DTC and broker-dealers. Moreover, in response to concerns raised by other exchanges about the possibility of being obligated to use this BSTX technology if the security tokens trade pursuant to UTP, the Exchange recently noted that other exchanges are free to adopt their own form distributed ledger technology to track ownership of equity securities traded on their markets.[7] As new technologies are leveraged by exchanges, SIFMA highlights that complications in the equity markets may arise if there are varying forms of this technology that is used to track equity security ownership.

Further, as indicated above, the Proposal does not explore in sufficient detail the costs or other impacts to firms associated with adopting systems to accommodate a T+1 settlement cycle for the security tokens and the infrastructure needed to manage the security tokens' distributed ledger technology, including whitelisted wallets and associated recordkeeping. It is difficult to judge the Proposal without some sort of exploration of these impacts. While the Proposal suggests that firms can avoid these impacts by not becoming BSTX participants, that would not be the case if the security tokens start trading on other exchanges pursuant to UTP. In such a scenario, firms likely would need to implement systems and other infrastructure to be able to process trades in the security tokens on a T+1 basis and submit reports of ancillary ownership to BSTX assuming they determine that they need to become participants of the facility. This reporting of ancillary ownership appears to be nothing more than a way to force industry participants to sign up for the Exchange's blockchain service, adding cost while providing no apparent value to firms, institutional clients, or retail investors.

In providing these comments, SIFMA notes that it is not against the adoption of new processes and technology to make the equity market infrastructure more efficient and robust. Indeed, SIFMA has long supported the use of technology to make the security settlement system stronger. SIFMA has concerns, however, when new processes and technology with wider

[6] SIFMA notes that it has raised these concerns in a call with the Exchange.

[7] See (https://www.sec.gov/comments/sr-box-2019-19/srbox201919-7055631-215391.pdf).

implications for the equity market infrastructure are considered in the framework of a proposed rule change by a single exchange. The adoption of ad hoc proposals by exchanges that implicate wider market infrastructure issues is not, in SIFMA's view, a good overall outcome for the equity markets, nor is it consistent with the goal set forth in Section 17A(a)(1) of the Exchange Act of facilitating the "the development of uniform standards and procedures for clearance and settlement" of securities transactions.

Accordingly, SIFMA recommends that the Commission consider the novel equity market infrastructure issues raised by the Proposal in the context of a concept release or other type of release by the Commission that is geared toward soliciting market-wide feedback. Such a release would allow affected market participants, including investors who might not otherwise track proposed rule changes by exchanges, the ability to thoughtfully and carefully consider the issues raised by the deployment of new processes and technology in the security settlement system, including the ability of new technology to potentially shorten the settlement cycle as well as any security considerations associated with using new technology to track security ownership. Indeed, the Commission has a history of such an approach in the context of the security settlement system. For instance, back in 2004, the Commission issued a concept release discussing, among other things, the potential benefits of moving to a shorter settlement cycle.[8] SIFMA believes that such an approach here could foster advancement in the security settlement system while maintaining the uniformity that has been so important for the current equity market infrastructure.

In addition to the forgoing comments, SIFMA has certain specific questions that it believes the Proposal does not sufficiently address. To the extent the Proposal is further considered by the Commission, SIFMA recommends that BOX submit additional detail to address the following areas.

Ancillary Recordkeeping

The BSTX Proposal provides that the security tokens would be equity securities that meet BSTX listing standards, and that trade on the BSTX System, and for which ancillary records of ownership would be able to be created and maintained using distributed ledger technology. These ancillary records of ownership that would be maintained using distributed ledger technology would not be official records of security token ownership.[9] The Proposal provides that the end-of-day security tokens positions would be public based on the wallet addresses established by the participants.

- Is the distributed ledger technology exclusive to BSTX? Will other exchanges have access to it or its source code? If other exchanges do not have access to it or its source

[8] See Securities Transactions Settlements, Exchange Act Release No. 49405 (Mar. 11, 2004), 69 FR 12922 (Mar. 18, 2004).

[9] See Proposal at 13242-13243.

code, what would they have to do to gain access to it? Could others have the ability to change the source code underlying the distributed ledger technology?

- What are the implications of having the end-of-day position data publicly available? Who is responsible for ensuring its accuracy? Can this ancillary recordkeeping system be gamed? For example, such as whether a firm could publish to the chain that it has a large holding when in reality it does not? Or vice versa?

Fungibility

The BSTX Proposal states that issuers on BSTX may "include both (1) new issuers who do not currently have any class of securities registered on a national securities exchange, and (2) issuers who currently have securities registered on a national securities exchange and who are seeking registration of a separate class of equity securities for listing on BSTX," and that "BSTX does not intend for security tokens listed, or intended to be listed, on BSTX to be fungible with any other class of securities from the same issuer."[10]

- Why wouldn't security tokens listed on BSTX be fungible with any other class of securities from the same issuer?

- What implications does this lack of fungibility have for the overall equity market infrastructure?

Whitelisted Wallet

Pursuant to proposed BSTX rules, BSTX participants are required under BSTX Rule 17020 to obtain a whitelisted wallet address and report certain end-of-day security token position balance information to BSTX for security tokens listed on BSTX.[11]

- How is a whitelisted wallet obtained? How is permissioning determined for the whitelisted wallet, and who controls it?

- How is the whitelisting maintained for the entire life-cycle of a security token and for the life-cycle of participant accounts?

UTP

The proposed BSTX rules provide that security tokens would be eligible for trading on other national securities exchanges that extend UTP to them. As a result, security tokens appear to be able to trade on other exchanges and OTC. The Exchange asserts that the end-of-day

[10] Id. at 13245.

[11] Id. at 13244.

security token position balance reporting by BSTX Participants and the publication of such balance information on the blockchain does not impact the ability of security tokens to trade on other exchanges or OTC.[12]

- Are other exchanges truly in a position to offer UTP to BSTX? Are other national securities exchanges able to trade security tokens? If other national securities exchanges are not currently able to trade security tokens, what would they have to do to be able to do so?

- Under the current Proposal, it is unclear if BSTX can or could limit UTP trading in BSTX-listed securities in the future.

* * *

SIFMA greatly appreciates the Commission's consideration of the issues raised above and would be pleased to discuss these comments in greater detail. If you have any questions or need any additional information, please contact Ellen Greene (or) or Thomas Price (or).

Sincerely,

Ellen Greene
Managing Director
Equities & Options Market Structure

Thomas F. Price
Managing Director
Operations, Technology, Cyber & BCP

cc: The Honorable Jay Clayton, Chairman
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Allison Herren Lee, Commissioner

Brett Redfearn, Director, Division of Trading and Markets

[12] Id. at 13253.