



December 12, 2018

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: Rulemaking Regarding Clearance and Settlement**

Dear Mr. Fields,

Templum, Inc. is a technology innovator that provides regulated market infrastructure for the digital asset sector. Our wholly-owned subsidiary, Templum Markets, LLC, is a broker-dealer registered with the U.S. Securities Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA") and is the operator of our alternative trading system ("ATS") for the secondary trading of digital assets that are securities. We have engaged in extensive advocacy regarding digital assets and financial technology ("FinTech"), including filing a prior petition on March 13, 2017, encouraging the SEC to undertake formal rulemaking with respect to the regulation of digital assets and blockchain technology.<sup>1</sup> This petition is intended to supplement our previous advocacy efforts.

We encourage the SEC to provide needed guidance related to post-trade activities in the digital asset space. We believe FinTech and blockchain have tremendous potential. However, as this technology develops, regulators must foster innovation without stifling it through unclear regulations. U.S. and foreign regulators have noted the disruptive potential of FinTech and blockchain. They have also recognized the potential of FinTech to revolutionize the financial services industry.<sup>2</sup> We share this belief in the potentially transformative nature of FinTech and support the important role of regulators in ensuring that this revolutionary technology develops in a sustainable manner that promotes fair and orderly markets, protects consumers, and benefits industry participants.

**I. Background**

**A. The Current State of the Post-Trade Securities Laws**

The SEC's duties are to: protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.<sup>3</sup> The trading of digital assets has spread beyond the developers of the digital assets to large financial institutions that see the value of blockchain technology. Developing a tailored regulatory framework for digital assets would not only help to protect

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<sup>1</sup> See Petition for Rulemaking (Mar. 13, 2017), available at: <https://www.sec.gov/rules/petitions/2017/petn4-710.pdf>.

<sup>2</sup> See Written Testimony of Chairman Jay Clayton before the Senate Banking Committee, Washington, D.C. (February 6, 2018), available at: <https://www.banking.senate.gov/public/cache/files/a5e72ac6-4f8a-473f-9c9c-e2894573d57d/BF62433A09A9B95A269A29E1FF13D2BA.clayton-testimony-2-6-18.pdf>.

<sup>3</sup> Michael S. Piowar, Acting Chairman, SEC, Remarks at the "SEC Speaks" Conference 2017: Remembering the Forgotten Investor (Feb. 24, 2017), available at: <https://www.sec.gov/news/speech/piowar-remembering-theforgotten-investor.html>.

investors, but would help to promote market integrity, capital formation, and the protection of the investing public.

There are several specific parts of the securities laws that need to be amended to address the development of blockchain technology and digital assets and to protect investors, maintain fair and orderly markets, and to facilitate capital formation. From 1934 through 1975, trading, clearance and settlement of securities in the United States was governed by the Securities Act of 1933 (the "Securities Act"), and the Securities Exchange Act of 1934 (the "Exchange Act"). The clearance and settlement of trades was governed by state laws. It was not until the late 1960s that the SEC began focusing on how securities transactions were cleared and settled. The SEC has provided important informal guidance regarding the trading of digital assets, and in particular when a digital asset may be deemed to be a security, but the agency has not provided clear guidance on how to treat these assets post-trade. We have been an active voice in encouraging more formal regulation of FinTech, as evidenced by our March 13, 2017 petition for rulemaking to the SEC requesting regulation of digital assets of securities. In addition to formal rulemaking regarding digital assets as securities, we believe that the SEC must address how digital assets are regulated once a trade occurs.

#### B. The Paperwork Crisis

In the late 1960s and early 1970s, securities markets in the United States experienced a back-office crisis (the "Paperwork Crisis") caused by increasing volumes and back-office inefficiencies in processing securities transactions.<sup>4</sup> During the Paperwork Crisis, a brokerage firm used approximately 33 different documents to execute and record a single securities transaction.<sup>5</sup> These paper-based transactions slowed processing to the point where exchanges shortened the trading day to alleviate back-office delays, creating significant administrative issues.<sup>6</sup>

The confusion and delays in the back offices of brokers and dealers were magnified by inadequate clearance and settlement facilities, particularly in the over-the-counter market.<sup>7</sup> Systems designed for the three million share days of 1960 proved incapable of dealing with astonishing volume of thirteen million share days around the end of the decade. Operational deficiencies caused fail rates and customer complaints to soar. Losses in 1967–1968 caused an unprecedented number of broker-dealer firm failures.<sup>8</sup> Approximately 160 New York Stock Exchange ("NYSE") member firms went out of business while others either merged or liquidated.<sup>9</sup>

By the early 1970s, Congress examined the back-office crisis and asked the SEC to: (i) compile a list of unsafe and unsound practices employed by brokers and dealers in conducting their business, (ii) report to Congress on steps being taken to eliminate these practices, and (iii)

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<sup>4</sup> Bergmann, L., 2004. Speech: International Securities Settlement Conference – "The U.S. view of the role of regulation in market efficiency" ("Bergmann"). Available at <https://www.sec.gov/news/speech/spch021004leb.htm>.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

recommend additional legislation that might be needed to eliminate these unsafe and unsound practices.

After extensive studies and hearings, Congress agreed that a fundamental weakness in the U.S. clearance and settlement system was the absence of a mechanism to give direction to, and ensure cooperation and coordination among, the entities engaged in securities processing – clearing corporations, securities depositories, transfer agents, and issuers.<sup>10</sup> Industry practice combined with a lack of uniformity had failed to effectively support transaction processing in the U.S., and legislation soon followed.<sup>11</sup>

### C. Securities Act Amendments

In 1975, Congress enacted amendments to the Exchange Act finding that: (i) *the prompt and accurate clearance and settlement of securities transactions is necessary for the protection of investors*; (ii) inefficiency imposes unnecessary costs on investors and intermediaries; (iii) new data processing and communication techniques present opportunities for more efficient, effective, and safe clearing procedures; and (iv) linking of clearance and settlement facilities, and the development of uniform standards and procedures, would reduce unnecessary costs and increase investor and intermediary protection.<sup>12</sup>

The Securities Acts Amendments of 1975 (the “Securities Acts Amendments”), made sweeping changes to the federal securities laws, established the national market system and the national clearance and settlement system as they exist today.<sup>13</sup> Congress directed the SEC to, among other things: (i) facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities and (ii) end the physical movement of securities certificates in connection with the settlement among brokers and dealers of transactions in securities.

Two basic themes recur throughout the legislative history of the securities processing provisions of the Securities Acts Amendments: (i) prevent another paperwork crisis in the securities industry and (ii) establish a safe, efficient, and modern national clearing and settlement system. Section 17A of the Exchange Act gave the SEC the authority to facilitate: (i) the establishment of a national system for prompt and accurate clearance and settlement in securities and (ii) linked or coordinated facilities for clearance and settlement of related financial products. Congress directed the SEC in 1975 to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions when it added Section 17A to the Exchange Act as part of the Securities Acts Amendments. At the time of the adoption of the Securities Acts Amendments, the Senate Committee on Banking, Housing and Urban Affairs stated the “banking and security industries must move quickly toward the establishment of a fully integrated national system for the prompt and accurate processing and settlement of securities transactions.”

A key component of the SEC’s supervision of the securities clearance and settlement system is its authority to regulate clearing agencies. Before performing clearing agency functions,

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<sup>10</sup> *Supra* at note 6.

<sup>11</sup> *Supra* at note 13.

<sup>12</sup> 15 U.S.C. § 78q-1(a)(1)(A)-(D).

<sup>13</sup> 15 U.S.C. §78q-1(a)(2).

including trade comparison, netting, matching, and settlement activities, intermediaries must either register with the SEC or apply for an exemption from registration. The SEC's ability to achieve these goals and its supervision of securities clearance and settlement systems is based on the regulation of registered clearing agencies.

While blockchain technology was not available in 1975, many technologists believe the technology could help the financial services industry accomplish many of the goals of the Securities Acts Amendments. The question that remains is how such technologies should be regulated by the SEC.

#### D. Clearing Agencies

Clearing agencies are self-regulatory organizations that are required to register with the SEC. There are two types of clearing agencies: clearing corporations and depositories. Clearing corporations compare member transactions (or report to members the results of exchange comparison operations), clear those trades and prepare instructions for automated settlement of those trades, and often act as intermediaries in making those settlements. Clearing corporations provide several essential services to the market, including comparing and confirming trade data submitted by participants (or reporting to participants the results of trade comparisons submitted by the exchanges), acting as the common counterparty and guaranteeing the completion of the trade if either side defaults or goes out of business, and preparing instructions for their participants regarding their settlement obligations. Clearing corporations generally instruct depositories to make securities deliveries that result from settlement of securities transactions.

A blockchain technology platform could be required to register as a clearing corporation if it compares the trades of users of the platform, clears the trades, and prepares instructions for automated settlement of the trades. The platform could also be required to register as a clearing corporation if the platform acts as the common counterparty and guarantees the completion of trades. We encourage the SEC to clearly define when a blockchain technology platform must register as a clearing corporation and to define how blockchain technology may be used by such firms.

#### E. Transfer Agents

Blockchain and digital assets represent a fundamental change in the financial services industry and hold the potential to make traditional aspects of the industry obsolete. One area of the securities laws that can be improved through the introduction of blockchain is the role of transfer agents. Traditionally transfer agents perform functions such as: countersigning securities upon issuance, monitoring the issuance of securities with a view to preventing unauthorized issuance, a function commonly performed by a person called a registrar, registering the transfer of securities, exchanging or converting securities, or transferring record ownership of securities by bookkeeping entry without physical issuance of securities certificates.<sup>14</sup> Transfer agents record changes of ownership, maintain the issuer's security holder records, cancel and issue certificates, and distribute dividends. Because transfer agents stand between issuing companies and security holders, efficient transfer agent operations are critical to the successful completion

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<sup>14</sup> Securities Exchange Act of 1934 Section 3(a)(25).

of secondary trades. Section 17A(c) of the Exchange Act requires that transfer agents be registered with the SEC, or if the transfer agent is a bank, with a bank regulatory agency.

A blockchain technology platform could be required to register as a transfer agent if it monitors the issuance of securities or registers the transfers of securities. While it is unlikely a blockchain technology platform would countersign securities, platforms operating their own blockchain to track the issuance and trading of digital assets could be deemed to be monitoring the issuance of securities with a view of preventing unauthorized issuance (i.e., a registrar, registering the transferring of such securities). Other blockchain platforms could be deemed to be registering the transfer of securities, exchanging or converting securities, or transferring record ownership of securities by a bookkeeping or ledger entry without physical issuance of securities certifications.

The SEC released a concept release regarding transfer agents in 2015, noting the potential value of blockchain technology in streamlining the industry.<sup>15</sup> We encourage the SEC to provide clear guidance to the industry as to when a blockchain technology platform must register as a transfer agent and to provide guidance to issuers of digital assets as to when they must use a transfer agent.

#### F. Custody

Section 15(c)(3) of the Exchange Act and Rule 15c3-3 (the "Customer Protection Rule"), are designed to protect customer funds with two main requirements: possession or control of securities, and reserve formula. The requirements have the objectives of establishing guidelines to calculate customer assets to be segregated, methods to segregate and practices to prevent broker-dealers from using segregated customer assets to finance their proprietary activities, satisfying deliveries and covering customer short transactions. Specifically, the rule requires that customer funds involved in an applicable securities transaction be held at a bank as defined in the Exchange Act. The Rule also requires a broker-dealer to maintain physical possession or control over customers' fully paid and excess margin securities. Physical possession or control generally means that the broker-dealer must hold securities in one of several locations specified in the rule and that they be held free of liens or any other interest that could be exercised by a third-party to secure an obligation of the broker-dealer. Appropriate control locations under the Customer Protection Rule include ***clearing corporations and depositories***.

The SEC has also addressed the issue of custody in the context of registered investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act"). Under the Advisers Act, the SEC has stated that ***no qualified custodian is required for uncertificated or certificated private shares***. While the SEC has provided guidance to registered investment advisers, it has not provided guidance to broker-dealers. The Customer Protection Rule serves a laudable goal, under both the Exchange Act and Advisers Act. However, the application of the rule is unclear in a world of digital assets that are securities and blockchain technology. It is unclear if digital assets that are unregistered securities must be held in compliance with the Customer Protection Rule and any applicable custody rule.

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<sup>15</sup> Securities Exchange Act Release No. 76743 (Dec. 22, 2015), 80 Fed. Reg. 81948 (Dec. 31, 2015). Available at [www.sec.gov/rules/concept/2015/34-76743.pdf](http://www.sec.gov/rules/concept/2015/34-76743.pdf).

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We believe blockchain technology has the potential to reshape how banks act as custodians, particularly with respect to digital assets that are securities. Blockchain has the ability to store digital assets that are securities and record their transfer. We encourage the SEC to examine the Custody Rule and the Customer Protection Rule in light of blockchain technology. By allowing issuers or trading platforms to use blockchain technology in lieu of banks as custodians, the SEC could significantly streamline securities trading and reduce transaction costs, producing savings for investors. Such efficiencies created by blockchain have great potential when used on a large scale. To facilitate this, the SEC needs to modernize its traditional rules and regulations to embrace blockchain technology.

## **II. Recommendations**

We believe that blockchain is a potent modernizing force in financial services. Blockchain has the potential to increase efficiencies in post-trade mechanics and increase auditability, both benefits that would greatly benefit the industry. In order to best take advantage of this potential, the SEC must modernize regulations related to clearance and settlement. We recommend the following

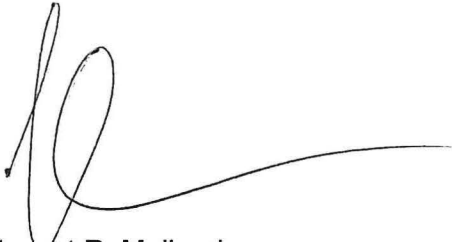
- The SEC should clearly define when a blockchain technology platform must register as a clearing corporation and define how blockchain technology may be used by such firms.
- The SEC should provide clear guidance to the industry as to when a blockchain technology platform must register as a transfer agent and provide guidance to issuers of digital assets as to when they must use a transfer agent.
- The SEC should modernize the Custody Rule and the Customer Protection Rule to take into account and encourage the use of blockchain technology's ability to track securities transactions.

Modernizing regulations relating to these post-trade elements will provide needed clarity to the industry and help to promote the use of this important technology.

If Templum can be of any further assistance to you in this matter, please do not hesitate to contact either the undersigned at (646) 973-3350 or our counsel, Richard B. Levin of Polsinelli PC, at 303-583-8261.

Brent J. Fields  
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Very truly yours,



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