



TEMPLUM



April 4, 2019

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

Re: Rulemaking Regarding Digital Asset Mining – Templum Markets, LLC

Dear Mr. Fields,

Templum Markets, LLC ("Templum Markets"), a subsidiary of Templum, Inc., is a financial technology ("FinTech") company and broker-dealer registered with the U.S. Securities Exchange Commission ("SEC") and a member of the Financial Industry Regulatory Authority ("FINRA"). Templum Markets operates an alternative trading system ("ATS") for the secondary trading of digital assets that are securities. Templum Markets has engaged in extensive advocacy regarding digital assets and FinTech matters, including filing prior petitions on December 12, 2018, regarding the clearance and settlement of digital assets,¹ and on March 13, 2017, encouraging the SEC to undertake formal rulemaking regarding the regulation of digital assets and blockchain technology.² This petition is intended to supplement our previous advocacy efforts.

Chairman Clayton has stated that nearly every initial coin offering ("ICO") has involved the sale of a security.³ However, it is unclear if miners of digital assets that are securities may be required to register as a broker-dealer under the Securities Exchange Act of 1934 (the "Exchange Act"). We encourage the SEC to provide formal guidance to the industry on this issue.

¹ See Petition for Rulemaking (Dec. 18, 2018), available at: <https://www.sec.gov/rules/petitions/2018/petn4-736.pdf> (addressing when blockchain technology firms may have to register a clearing corporation or a transfer agent and the applicability of custody and the customer protection rule to digital assets).

² See Petition for Rulemaking (Mar. 13, 2017), available at: <https://www.sec.gov/rules/petitions/2017/petn4-710.pdf> (petition filed by the predecessor to Templum addressing when digital assets are securities and whether platforms trading digital assets must register as a broker-dealer or ATS).

³ Stan Higgins, *SEC Chief Clayton: 'Every ICO I've Seen Is a Security'*, Coindesk (Feb. 6, 2018) available at: <https://www.coindesk.com/sec-chief-clayton-every-ico-ive-seen-security>.

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I. Digital Asset Mining

Digital assets are commonly distributed to certain participants on a protocol through “mining.” Although definitions of mining differ, and although the precise activities that miners undertake varies, the SEC’s definition is instructive. The SEC has described mining as “applying computer power to try to solve complex equations that verify a group of transactions in that virtual currency.”⁴ The SEC has recognized that “[t]he first computer (or collection of computers) to solve such an equation is awarded new units of that virtual currency . . .”⁵ The SEC notes that “miners” include “the computer equipment used in this process, and the humans who own it.”⁶ Such work commonly includes the validation of transactions over a given digital asset’s protocol, which in turn supports the protocol’s growth and functionality. There currently exists a spectrum of activity that is described as mining in the digital asset space. Some protocols require miners to perform complex computations.

II. Whether and When Miners May be Acting as Unregistered Broker-Dealers

Section 3(a)(4)(A) of the Exchange Act defines a broker-dealer as a person or entity that is: (i) engaged in the business, (ii) of effecting transactions in securities, (iii) for the account of others. The terms used in the definition of a broker-dealer are not defined in the Exchange Act or SEC rules. The courts and the SEC have taken an expansive view of the scope of these terms, and base their determinations on a facts and circumstances analysis. If a person is deemed to be a broker, that person is required by Section 15 of the Exchange Act to register with the SEC, unless there is an applicable exemption under the federal securities laws. The question of whether and when a miner of digital assets may be engaged in broker-dealer activity should be guided by existing SEC guidance and case law.

A. Engaged in the Business

Courts have read “engaged in the business” as meaning a certain regularity of participation in purchasing and selling activities rather than a few isolated transactions.⁷ Two factors that are important in determining regularity of the “in the business” prong include: (i) the

⁴ *SEC v. Homero Joshua Garza, GAW Miners, LLC and Zeniner, LLC* (Dec. 1, 2015), available at <http://www.sec.gov/litigation/complaints/2015/comp23415.pdf>

⁵ *Id.* The two most commonly recognized blockchain consensus protocols are proof of work and proof of stake. This petition does not differentiate between these two types of consensus, though we believe that certain consensus mechanisms may look more like broker-dealer activity than others.

⁶ *Id.*

⁷ *SEC v. Am. Inst. Counselors*, Fed. Sec. L. Rep. (CCH) ¶ 95,388 (D.D.C. 1975); see also *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1 (D.D.C. 1998); *SEC v. Margolin*, 1992 U.S. Dist. LEXIS 14872 (S.D.N.Y. Sept. 30, 1992); *SEC v. Hansen*, 1984 U.S. Dist. LEXIS 17835 (S.D.N.Y. Apr. 6, 1984); *SEC v. Nat’l Exec. Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980); *Mass. Fin. Servs., Inc. v. Sec. Investor Prot. Corp.*, 411 F. Supp. 411, 415 (D. Mass.), *aff’d*, 545 F.2d 754 (1st Cir. 1976), *cert. denied*, 431 U.S. 904 (1977); *Landegger v. Cohen*, No. 11-cv-01760-WJM-CBS (D. Colo. Sept. 30, 2013); *SEC v. Collyard*, No. 11-cv-3656 (D. Minn. Dec. 9, 2015).

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number of transactions and clients,⁸ and (ii) the dollar amount of securities sold, as well as the extent to which advertisement and investor solicitation were used.⁹ Neither of these factors is determinative. While a single isolated instance of a person seeking to purchase or sell securities may not in all cases cause a person to be a broker, transactions by a person that represent the first step in a larger pattern of transactions could still be found to meet the regularity threshold.¹⁰ The dollar amount of the transactions can indicate regularity; however, courts have held that there is no requirement that such activity be a person's principal business or principal source of income.¹¹ The SEC has stated:

. . . nothing. . . would warrant a conclusion that a person is not "engaged in the business" merely because his securities activities are only a small part of his total business activities, or merely because his income from such activities is only a small portion of his total income. *On the contrary, if the securities activities are engaged in for commissions or other compensation with sufficient recurrence to justify the inference that the activities are part of the person's business, he will be deemed to be "engaged in the business."*¹²

Besides regularity of business, courts and the SEC have identified several other factors which indicate that a person is engaged in the business. These factors include:

- *receiving transaction-related compensation;*¹³
- *assisting others in settling securities transactions;*¹⁴ and

⁸*SEC v. Margolin*, 1992 U.S. Dist. LEXIS 14872 (S.D.N.Y. Sept. 30, 1992); *Landegger v. Cohen*, No. 11-cv-01760-WJM-CBS (D. Colo. Sept. 30, 2013) (declining to find that participating in seven transactions could not be sufficient regularity to constitute acting as a broker). Letter from Ezra Weiss, Chief Counsel, Division of Market Regulation, to Joseph McCulley (Aug. 2, 1972) (an individual seeking to purchase or sell securities may advertise on a single, isolated basis without being considered a "broker," however, one engaging in repeated advertising encompassing offers to buy as well as to sell must register as a broker-dealer).

⁹*Nat'l Exec. Planners*, 503 F. Supp. at 1073 (National Executive Planners solicited clients actively, and sold \$4,300,000.00 worth of TVM instruments. NEP thus had a certain regularity of participation in securities transactions at key points in the chain of distribution); *Kenton Capital Ltd.*, 69 F. Supp. 2d at 13. (citing *SEC v. Deyon*, 977 F. Supp. 510, 518 (D. Me. 1997), and *Nat'l Exec. Planners*, 503 F. Supp. at 1066, 1073).

¹⁰*Kenton Capital, Ltd.*, 69 F. Supp. 2d at 13 (defendants' securities transactions were not a single, isolated transaction, but rather the first step in a larger enterprise. Kenton was established for the exclusive purpose of participating in trading programs).

¹¹See *UFITEC v. Carter*, 20 Cal. 3d 238, 254 (1977); see also *Kenton Capital, Ltd.*, 69 F. Supp. 2d at 13 (a corporation could be a broker even though securities transactions are only a small part of its business activity).

¹²*InTouch Global, LLC*, SEC No-Action Letter (Nov. 14, 1995).

¹³See *SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003); *SEC v. Margolin*, 1992 U.S. Dist. LEXIS 14872, at *16 (S.D.N.Y. Sept. 30, 1992); *BondGlobe, Inc.*, SEC Denial of No-Action Request (Feb. 6, 2001); *Progressive Technology Inc.*, SEC Denial of No-Action Request (Oct. 11, 2000); *BD Advantage, Inc.*, SEC Denial of No-Action Request (Oct. 11, 2000); SEC Denial of No-Action Request, Transfer Online (May 3, 2000); Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation to Myles C.S. Harrington, President, MuniAuction, Inc. (Mar. 13, 2000).

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- soliciting securities transactions.¹⁵

Under the current regulatory framework, it is unclear when miners may meet the “engaged in the business” prong of the test if they are involved in a high number of transactions through their mining and if they are being paid transaction-related compensation. Additionally, it is unclear whether or when miners may also meet the engaged in the business prong of the test if they are assisting parties transacting in digital assets to settle transactions by recording data to a blockchain.

B. Effecting Transactions

Courts and the SEC have determined that a person “effects transactions in securities” if the person participates in such transactions “at key points in the chain of distribution.”¹⁶ Such participation may include, among other activities:

- helping an issuer to identify potential purchasers of securities;¹⁷
- screening potential participants in a transaction for creditworthiness;
- soliciting securities transactions (including advertising);¹⁸
- negotiating between the issuer and the investor;

¹⁴ See *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 13 (D.D.C. 1998); *BondGlobe, Inc.*, SEC Denial of No-Action Request (Feb. 6, 2001); *Progressive Technology Inc.*, SEC Denial of No-Action Request (Oct. 11, 2000); *BD Advantage, Inc.*, SEC Denial of No-Action Request (Oct. 11, 2000); *Transfer Online*, SEC Denial of No-Action Request (May 3, 2000); *Strengthening the Commission’s Requirements Regarding Auditor Independence*, SEC Release No. 34-47265 (Jan. 28, 2003) at n.82; Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, to Myles C.S. Harrington, President, MuniAuction, Inc. (Mar. 13, 2000).

¹⁵ See, e.g., *SEC v. Deyon*, 977 F. Supp. 510 (D. Me. 1997), aff’d, 201 F.3d 428 (1st Cir. 1998) (both defendants solicited investors by phone and in person); *SEC v. Century Inv. Transfer Corp.*, 1971 U.S. Dist. LEXIS 11364, at *13 (S.D.N.Y. Oct. 5, 1971) (defendant “engaged in the brokerage business” by soliciting customers through ads in the *Wall Street Journal*).

¹⁶ See *Mass. Fin. Servs., Inc. v. Sec. Investor Prot. Corp.*, 411 F. Supp. 411, 415 (D. Mass.), aff’d, 545 F.2d 754 (1st Cir. 1976), cert. denied, 431 U.S. 904 (1977); see also *SEC v. Nat’l Exec. Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980); SEC Denial of No-Action Request, *Transfer Online* (May 3, 2000). Distributions facilitated in an unconventional manner have also been found to give rise to broker-dealer status. See, e.g., *In re Intercontinental Capital Grp., LLC*, SEC Release No. 34-74172 (Jan. 29, 2015) (instituting proceedings for unregistered broker-dealer activity against person purporting to provide loans against microcap securities collateral, but raising cash for the loan through the sale of the collateral into the market).

¹⁷ See, e.g., David W. Blass, Chief Counsel, Division of Trading and Markets, SEC, Remarks to American Bar Association, Trading and Markets Sub-committee (Apr. 5, 2013).

¹⁸ See *SEC v. Margolin*, No. 93-7309, 1992 U.S. Dist. LEXIS 14872, at *15–16 (S.D.N.Y. Sept. 30, 1992).

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- taking, routing or matching orders, or *facilitating the execution of a securities transaction*,¹⁹
- handling customer funds or securities;²⁰ and
- *preparing and sending transaction confirmations* (other than on behalf of a broker-dealer that executes the trades).

Many of these factors are not in themselves sufficient to trigger broker-dealer registration, but rather indicate broker-dealer activity in conjunction with other criteria, especially compensation. Generally, evaluating the merits of investments and issuing confirmations are viewed by the SEC as relatively weak indicators of broker-dealer activity. Helping an issuer to identify potential purchasers, and handling customer funds and securities are moderate factors. Structuring issuances, soliciting transactions, negotiating with investors, and taking and executing orders are strong indicators of broker-dealer activity. The significance of each of these factors is substantially heightened when combined with transaction-based compensation.

Of the factors listed above, miners on many blockchain protocols could be deemed to be preparing and sending transaction confirmations when they process transaction related information that is added to a blockchain. There may also be cases where miners could be deemed to be participating in the execution of securities transactions or handling customer funds (i.e., digital assets that are not securities) or digital assets that are securities. These types of activities may fall within the scope of what is considered to be “effecting transactions” by the SEC.

C. For the Account of Others

In order to be considered a broker, a person must be effecting transactions in securities for others, not for the broker’s own account. It is unclear whether blockchain protocols in which miners may be helping the issuer to “effect” the sale of digital assets could result in the miners being deemed to be acting for the account of others.

D. Role of Compensation in the Analysis

In the SEC’s no-action guidance and enforcement actions, receiving commissions or other transaction-related compensation is one of the determinative factors in deciding whether a

¹⁹*Id.*

²⁰See *The Investment Archive*, LLC, SEC No-Action Letter (May 14, 2010). Handling customer funds may also include handling customer’s digital currencies, such as bitcoin, in connection with bitcoin-denominated securities transactions. See *In re BTC Trading, Corp.*, SEC Release No. 34-73783 (Dec. 8, 2014).



person is a broker-dealer subject to the registration requirements under the Exchange Act.²¹ Transaction-related compensation refers to compensation based, directly or indirectly, on the size, value or completion of any securities transactions.²² The receipt of transaction-related compensation often indicates that a person is engaged in the business of effecting transactions in securities.²³

If the digital assets sold are deemed securities and if the miners are compensated for their work based on the amount of digital assets sold, it is unclear whether or when miners may be acting as unregistered broker-dealers as the result of receiving transaction based compensation.

III. Recommendations

We request that the SEC provide guidance as to when miners of digital assets that are securities could be deemed to be acting as broker-dealers. It is unclear whether or when miners of digital assets may be deemed to be engaged in the business of effecting transactions in securities for the account of others. We believe that the SEC should give these issues heightened attention in order to help guide the industry as to the application of existing laws.

If Templum Markets or we can be of any further assistance to you in this matter, please do not hesitate to contact us at the above address or 646-595-1713 or our counsel Richard B. Levin of Polsinelli PC at 303-583-8261.

²¹See *Wolff Juall Investments, LLC*, SEC Denial of No-Action Request (May 17, 2005); *Birchtree Financial Services, Inc.*, SEC Denial of No-Action Request (Sept. 22, 1998); *Vanasco, Wayne & Genelly*, SEC Interpretive Letter (Feb. 17, 1999); *SEC v. FTC Capital Mkts., Inc.*, No. 09-cv-4755, 2010 U.S. Dist. LEXIS 65417 (S.D.N.Y. May 20, 2009); *SEC v. UBS AG*, No. 100-09-CV-00316, 2009 U.S. Dist. LEXIS 123034 (D.D.C. Feb. 18, 2009); *SEC v. Milken*, 98 Civ. 1398 (S.D.N.Y. Feb. 26, 1998).

²²See *GlobalTec Solutions, LLP*, SEC No-Action Letter (Dec. 28, 2005). The SEC will look behind the terms of a compensation arrangement to determine its economic substance, that is, to determine whether it is transaction-related. Thus, a fee arrangement designed to compensate a person for what that person would have received if the person directly received transaction-related compensation (for example, a flat fee that is recalculated periodically to reflect an increase or decrease in the number of transactions) would be the equivalent of transaction-related compensation. In this regard, a flat fee representing a percentage of expected future commissions could be considered transaction-related. See Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Exchange Act, SEC Release No. 34-44291, n.46 (May 11, 2001).

²³See *SEC v. Margolin*, 1992 U.S. Dist. LEXIS 14872 (S.D.N.Y. Sept. 30, 1992); *BondGlobe, Inc.*, SEC Denial of No-Action Request (Feb. 6, 2001); *Progressive Technology Inc.*, SEC Denial of No-Action Request (Oct. 11, 2000); *BD Advantage, Inc.*, SEC Denial of No-Action Request (Oct. 11, 2000); SEC Denial of No-Action Request, Transfer Online (May 3, 2000); Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, to Myles C.S. Harrington, President, MuniAuction, Inc. (Mar. 13, 2000).

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Very truly yours,

Vincent R. Molinari
Co-Founder of Templum, Inc.
Chief Executive Officer of
Templum Markets, LLC

DocuSigned by:

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Christopher J. Pallotta
Co-Founder of Templum, Inc.
Chief Executive Officer of
Templum, Inc.

cc: Jay Clayton, Chairman, Securities and Exchange Commission
Robert J. Jackson, Jr., Commissioner, Securities and Exchange Commission
Hester M. Peirce, Commissioner, Securities and Exchange Commission
Elad L. Roisman, Commissioner, Securities and Exchange Commission

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