MAXINE WATERS, CA
CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
Washington, DC 20515

PATRICK McHENRY, NC
RANKING MEMBER

April 18, 2022

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: Release No. 34-94062; File No. S7-02-22; Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange;" Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities

Release No. 34-94524; File No. S7-12-22; Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer

Dear Chair Gensler:

We write to express our concern with two recently proposed Securities and Exchange Commission ("SEC") rulemakings and the impact that such rules may have on digital asset market participants.[1] We are particularly concerned the proposed rules can be interpreted to expand the SEC's jurisdiction beyond its existing statutory authority to regulate market participants in the digital asset ecosystem, including in decentralized finance (DeFi).[2] As you know, DeFi has the potential to reduce market participants' reliance on intermediaries. If these two rulemakings are left unaddressed, they have the potential to stifle innovation and harm market participants.

Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange;" Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities

On January 26, 2022, the SEC proposed to expand the definition of exchange, a term that is already defined in the Securities Exchange Act of 1934 (the "Exchange Act"). The Exchange Act defines the term "exchange" to include "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange."[3]

---

[1] Proposed Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange" (Release No. 34-94062; File Number S7-0-22); Proposal to Further Define "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer (Release No. 34-94524; File No. S7-12-22).

[2] *Id.*

[3] 15 U.S.C. 78c(a)(1).

In 1998, the SEC adopted Rule 3b-16 to clarify terms used in the statutory definition of "exchange" under the Exchange Act. Specifically, under Rule 3b-16, an exchange is defined as "any organization, association, or group of persons that: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade."[4]

The proposed rule would expand this definition further to include "Communications Protocol Systems" as exchanges, a step that exceeds the SEC's statutory authority. While the SEC does not specifically define a "Communication Protocol System" in the proposed amendments to Rule 3b-16, it is our understanding the SEC intends to take an expansive view. This will cause significant uncertainty for market participants that currently do not meet the requirements of an "exchange." This potential outcome is concerning and likely to stifle innovation.

Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer

On March 22, 2022, the SEC proposed another rule that would further define the term "as a part of a regular business" for purposes of registering under Section 15 and 15C. Currently, Section 3(a)(5) of the Exchange Act defines the term "dealer" as any person that is "engaged in the business of buying and selling securities . . . for [its] own account," unless it is not doing so as "part of a regular business."[5] Under the SEC's proposed rule, the buying and selling of securities, for one's own account will be deemed "a part of a regular business" if such person "engages in a routine pattern of buying and selling securities [or government securities] that has the effect of providing liquidity to other market participants," thus requiring registration with the SEC. [6] Most concerning, the SEC indicates in a footnote, but nowhere else in the rule, that the proposed rule would also encompass digital assets deemed to be securities without any additional information or related cost-benefit analysis.

Insufficiency of the Rulemakings

The SEC's analysis in both proposals is insufficient to justify such proposed changes. Neither analysis fully defines the scope of the impacted market participants nor does the SEC's justification provide sufficient details on the cost of compliance. Moreover, the rulemakings fail to define the SEC's statutory authority. Most importantly, the SEC fails to identify the problem that the rulemakings are intended to solve, particularly as it relates to requiring certain market participants facilitating digital asset transactions to register with the SEC.

---

[4] 17 CFR § 240.3b-16.

[5] *See* Section 3(a)(5) of the Securities Exchange Act (defining the term "dealer" to mean "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise" and to exclude any "person that buys or sells securities … for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business").

[6] *See* Proposed Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange" (Release No. 34-94062; File Number S7-0-22); Proposal to Further Define "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer (Release No. 34-94524; File No. S7-12-22), *supra* note 1.

Regulators as well as Congress must approach this technology with a balanced approach, that allows the ecosystem to reach its full potential while simultaneously protecting market participants. We do not need more regulatory ambiguity in the digital asset ecosystem. To that end, we request that you provide a cost-benefit analysis for the impact of the proposed rulemakings on digital asset market participants; provide information on the harm these rulemakings intend to address, and the SEC's statutory authority for such rulemakings.

The SEC's Decision to Shorten the Rulemaking Process

Separately, we are concerned the proposed rulemakings total nearly 800 pages and include more than 300 questions for comments combined.[7] As we have previously emphasized, the notice-and-comment process is intended to be a dialogue with the public and stakeholders. That dialogue is critical to an effective rulemaking process.[8] The SEC must provide adequate time for the public and stakeholders to review and analyze the proposals. This allows for robust analysis, including identifying potential unintended consequences and alternative approaches, prior to finalizing the proposals.

Furthermore, the SEC has many other proposed rulemakings currently out for public comment. Like the comments above, it is extremely challenging for the public to provide comprehensive analyses to each one in a truncated time period. This is particularly true when potentially broad sweeping changes are tucked into proposed rulemakings that lack transparency regarding the intent of the changes; fail to identify the harm to the market that the proposed changes intend to mitigate; or provide the SEC's authority to make such changes.

We reiterate our call to the SEC that it provide public comment on all rulemakings consistent with the executive branch recommendation of at least 60 days after notice of the proposed rulemaking is published in the Federal Register.[9] We also request that the two rulemakings discussed above be re-proposed with sufficient economic analysis, justification, and greater clarity surrounding the intent of the rulemaking as applied to the digital asset ecosystem.

We request a response with the information sought above no later than May 18, 2022. Thank you in advance for your attention to this important matter.

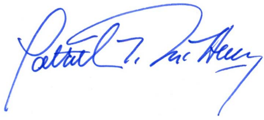
---

[7] *Id.*

[8] House Committee on Financial Services Ranking Member Patrick McHenry and Senate Committee on Banking, Housing, and Urban Affairs Ranking Member Pat Toomey Letter to Chair Gensler (Jan. 10, 2022), *available at* https://republicans-financialservices.house.gov/uploadedfiles/2022-01-10_pmc_toomey_letter-gensler_sec_comment_period.pdf.

[9] Executive Order 13563, Improving Regulation and Regulatory Review (Jan. 18, 2011), 76 Fed. Reg. 3821 (Jan. 21, 2011); *see also* Executive Order 12866, Regulatory Planning and Review (Sept. 30, 1993), 58 Fed. Reg. 51735 (Oct. 4, 1993) ("each agency should afford the public a meaningful opportunity to comment on any proposed regulation, which in most cases should include a comment period of not less than 60 days"); Memorandum for the Heads of Executive Departments and Agencies, Modernizing Regulatory Review (Jan. 20, 2021), 86 Fed. Reg. 7223 (Jan. 26, 2021) ("This memorandum reaffirms the basic principles set forth in [Executive Order 12866] and in Executive Order 13563 of January 18, 2011 (Improving Regulation and Regulatory Review), which took important steps towards modernizing the regulatory review process. When carried out properly, that process can help to advance regulatory policies that improve the lives of the American people.").

Sincerely,



Patrick McHenry
Ranking Member

Bill Huizenga
Ranking Member Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

cc: The Honorable Hester M. Peirce, Commissioner
The Honorable Allison Herren Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
Ms. Sharon Block, Acting Administrator, Office of Information and Regulatory Affairs