



United States House of Representatives
One Hundred Eighteenth Congress
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

June 13, 2023

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F. Street NE
Washington, DC 20549-1090

Re: File No. S7-02-22, Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange”

Dear Ms. Countryman:

We write to express our concerns with the Securities and Exchange Commission (SEC)’s proposed amendments to Rule 3b-16 under the Securities Exchange Act of 1934 (Exchange Act) regarding the definition of exchange (Proposed Rule).¹ Last year, the Committee on Financial Services sent a letter to Chair Gensler expressing our concern that the Commission’s attempt to expand the definition of an exchange to include “Communication Protocol Systems”² exceeded its statutory authority.³ With this re-opening, it is clear that the Committee’s initial concerns were valid. The Proposed Rule will stifle innovation and harm digital asset market participants and the U.S. economy more broadly. We urge you to withdraw this proposal as it would effectively shut down development of the digital asset ecosystem and continue to stagnate U.S. technological innovation.

The Proposed Rule significantly expands the definition of exchange in the Exchange Act to include systems that “bring [...] together buyers and sellers of securities using trading interest” and “make [...] available [communication protocols] under which buyers and sellers can interact and agree to the terms of a trade.”⁴ For digital assets, the Proposed Rule would go well beyond regulating centralized digital asset platforms and apply to persons acting “in

¹ SEC Press Release: SEC Reopens Comment Period for Proposed Amendments to Exchange Act Rule 3b-16 and Provides Supplemental Information (Apr. 14, 2023), <https://www.sec.gov/news/press-release/2023-77>.

² SEC Amendments Regarding the Definition of “Exchange” and Alternative Trading Systems (ATSS) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities (Mar. 18, 2022), <https://www.federalregister.gov/documents/2022/03/18/2022-01975/amendments-regarding-the-definition-of-exchange-and-alternative-trading-systems-atss-that-trade-us>.

³ Letter from Representatives Patrick McHenry and Bill Huzienga to Chair Gary Gensler (Apr. 18, 2022), https://financialservices.house.gov/uploadedfiles/2023-05-10_fsc_chairs_custody_rule_comment_letter_-_final.pdf.

⁴ Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of “Exchange” of the Securities Exchange Act of 1934, Release No. 34-97309 (Apr. 14, 2023), <https://www.sec.gov/rules/proposed/2023/34-97309.pdf>.

concert” with each other. This could capture a wide range of individuals in the digital asset ecosystem, including software developers and participants in a blockchain network’s consensus mechanism.

The Proposed Rule relies on the electronic messages exchanged between what the SEC purports to be “buyers” and “sellers” to agree upon the terms of a trade in order to bring decentralized finance (DeFi) systems under the definition of exchange. In fact, Commissioner Hester Peirce compared this approach to requiring internet service providers and developers of internet protocols in the 1990s to be collectively responsible for ensuring that the electronic communication network complied with the federal securities laws.⁵

It is unclear how and why a software protocol that facilitates the exchange of messages about a transaction can and should be considered an exchange under the securities laws. Moreover, given the overly broad definition, it is not clear how a developer or any other person operating software critical to the functioning of blockchain network could be in compliance with the regulatory requirements for an exchange. For example, many of the most critical aspects of DeFi systems, including the system’s developers and the system’s participants, do not have access to or control over the necessary information to comply with the regulatory requirements of an exchange. Indeed, for truly decentralized DeFi protocols, their functioning is entirely independent of the entities that developed the source code that empowers them or the applications running on top of them.

In the supplemental information provided by the Commission, the SEC estimates that “an additional 15-20” systems trading digital assets would be designated as an exchange. However, given the breadth of the new definition, the Proposed Rule would have a much broader impact than what is accounted for in the proposal. Moreover, the Proposed Rule fails to consider how software developers and technologists could comply with the registration requirements for an exchange. A comprehensive analysis regarding the economic impact of this Proposed Rule is needed.

The Proposed Rule further states, “it is unlikely that systems trading a large number of different crypto assets are not trading any crypto assets that are securities, [and] these systems likely meet the current criteria of Exchange Act Rule 3b-16(a).” As Chair Gensler has stated on numerous occasions, the legal status of a digital asset depends on its individual facts and circumstances. The Commission should not be making sweeping judgments in rulemakings that would apply to multiple digital assets and any protocols in which they are used. This bias is underscored by Commissioner Uyeda’s dissent, which asserts, “this is simply a paper exercise under the Administrative Procedure Act so the Commission can finalize a decision that has already been made – namely that nearly all crypto assets are securities and are subject to the Commission’s jurisdiction.”⁶

⁵ SEC Commissioner Hester Peirce, *Rendering Innovation Kaput: Statement on Amending the Definition of Exchange* (Apr. 14, 2023), <https://www.sec.gov/news/statement/peirce-rendering-innovation-2023-04-12>.

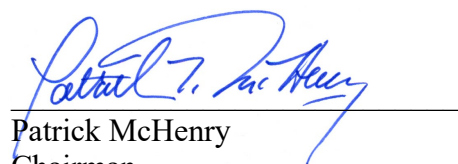
⁶ SEC Commissioner Mark Uyeda, *Statement on Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 regarding the Definition of “Exchange”* (Apr. 14, 2023), <https://www.sec.gov/news/statement/uyeda-statement-ats-041423>.

Given the goals of this Proposed Rule, it is clear that Chair Gensler is using this proposal to push his own personal views regarding digital assets. Chair Gensler has previously made statements on his own behalf claiming that DeFi exchanges are essentially equivalent to traditional intermediaries in financial markets even if they call themselves something different.⁷ He has also appeared before this Committee, testifying that “given that most crypto tokens are securities, it follows that many crypto intermediaries are transacting in securities and have to register with the SEC.”⁸ It appears this Proposed Rule is an attempt to assert this personal view as official SEC policy without adequate analysis or justification.

Finally, the Proposed Rule demonstrates the SEC’s hostility towards technology that is not perfectly compatible with the rules and regulations that exist today. Rather than create rules that would meet the SEC’s mission of consumer protection and protecting financial markets, the Proposed Rule seeks to shoehorn technology that operates fundamentally different into decades old rules for those traditional platforms. This will have significant effects on further development in the space. Indeed, the Proposed Rule acknowledges that expanding the definition of exchange would “make it more difficult to innovate.”⁹ Additionally, the proposal’s disregard for companies leaving the United States and “instead choos[ing] to operate outside the U.S. or exit the market,”¹⁰ is contrary to its mission to promote capital formation.

Given the questions included in the Proposed Rule, it is incredibly problematic that the SEC is attempting to propose amendments on a topic that it is still seeking to understand without direction from Congress.¹¹ Of most concern, is that the SEC is attempting to front-run Congress by promulgating a rule to regulate the digital asset ecosystem when the House Financial Services Committee and House Agriculture Committee are actively working on legislation to establish a market structure for digital assets. For these reasons, we respectfully request that the SEC withdraw this rulemaking.

Sincerely,



Patrick McHenry
Chairman
House Committee on Financial Services



French Hill
Vice Chairman
House Committee on Financial Services

⁷ SEC Chair Gensler, *Kennedy and Crypto* (Sept. 8, 2022), <https://www.sec.gov/news/speech/gensler-sec-speaks-090822>.

⁸ SEC Chair Gary Gensler, *Testimony of Chair Gary Gensler before the United States House of Representatives Committee on Financial Services* (Apr. 18, 2023), <https://www.sec.gov/news/testimony/gensler-testimony-house-financial-services-041823>.

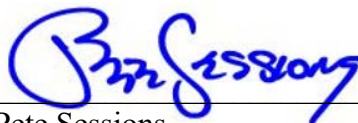
⁹ *Supra* note 4 at 133.

¹⁰ *Supra* note 4 at 138.

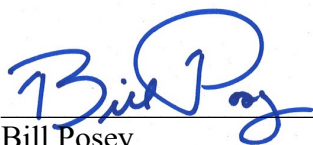
¹¹ *Supra* note 4 at 160-165.



Frank D. Lucas
Member of Congress



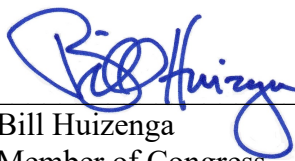
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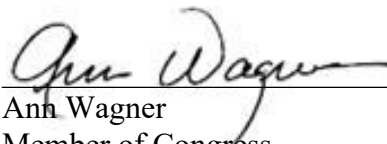
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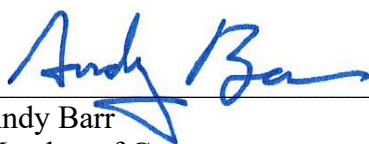
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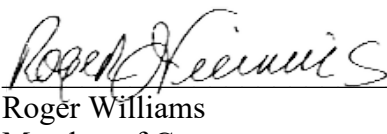
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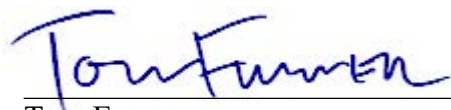
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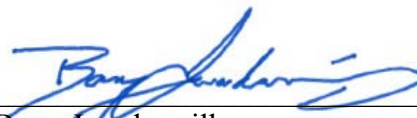
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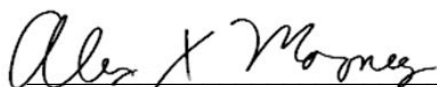
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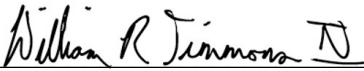
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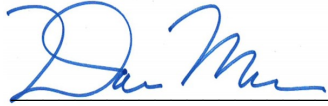
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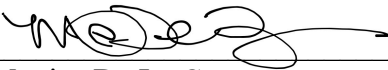
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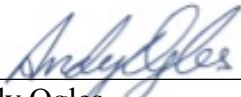
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