Bain Capital Crypto

baincapitalcrypto.com

799 Broadway, 10th Floor
New York, NY 10003
+1 212 896 4602

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BY ELECTRONIC SUBMISSION

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

Re: Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange," File No. S7-02-22

Dear Ms. Countryman:

Bain Capital Crypto, LP welcomes the opportunity to provide these comments to the Securities and Exchange Commission ("SEC" or "Commission") in response to the above-captioned release (the "Reopening Release")[1] providing supplemental information and requesting further comment on the Commission's January 2022 proposal (the "Proposal") to amend Rule 3b-16 under the Securities Exchange Act of 1934 ("Exchange Act"), which defines certain terms used in the statutory definition of "exchange."[2]

Bain Capital Crypto, LP is Bain Capital's crypto-dedicated venture capital fund adviser launched in 2021 and registered with the Commission as an investment adviser. Its team of investors, researchers, and regulatory experts support projects building blockchain-based infrastructure and applications from the seed through growth stage with a highly technical and collaborative approach.

We appreciate the Commission's decision to seek further comments on how its proposed "exchange" definition might apply to the use of distributed ledger or blockchain technology ("DLT").[3] There are respects, however, in which the guidance set forth in the Reopening Release would seem to treat DLT differently from other, similar technologies. If adopted, this guidance risks harming investors, impeding market efficiency and competition, and ultimately raising questions about the enforceability of the Proposal. We respectfully recommend that the Commission modify this guidance and related aspects of the Proposal in order to address these issues.

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[1] Release No. 34-97309 (Apr. 14, 2023), 88 Fed. Reg. 29,488 (May 5, 2023).

[2] Release No. 34-94062 (Jan. 26, 2022), 87 Fed. Reg. 15,496 (Mar. 18, 2022).

[3] Our comments should not be viewed as an endorsement of the view that crypto assets are securities subject to the federal securities laws.

INTRODUCTION

We support the Commission taking a "technology neutral" and "functional" approach to assessing whether an organization, association, or group of persons meets the definition of an "exchange."[4] This approach would help promote innovation by creating a level regulatory playing field between new and old technologies. It also is necessary in order for the Commission to satisfy its Exchange Act mandates and comply with the rulemaking requirements of the Administrative Procedure Act ("APA").

Technology neutrality does not mean treating all technologies the same. Different technologies can be used differently and in so doing present different risks and benefits. DLT, in particular, permits parties to transact with each other on a peer-to-peer basis while self-custodying their assets using open-source, transparent communication standards and protocols. Although DLT can be used by an organization, association, or group of persons to offer a market place or facility for securities trading, the technology does not inherently require involvement of such an organization, association, or group. Nor does the technology necessarily relate to securities trading.

In addition, given that the Exchange Act does not generally require parties to transact through an exchange or other intermediary, we respectfully submit that the Commission should not interpret the "exchange" definition to require otherwise unrelated parties who use DLT to act in concert to form an organization or association to register as a national securities exchange or comply with Regulation ATS. Such a requirement would discourage investors from using modern technology by mandating that they interpose an intermediary where one does not otherwise exist, and in fact where one of the purposes of the technology is to protect against the risks that an intermediary would pose.

The Reopening Release does not appear to impose such a requirement in non-DLT contexts. For example, it contemplates that certain software used by broker-dealers and investment advisers to manage their orders and communicate with each other, as well as certain general connectivity technologies, may not fall within the "exchange" definition. In our view, the same treatment should apply to DLT protocols and applications that operate in similar ways.

In contrast, subjecting DLT to more stringent treatment, which is contrary to its peer-to-peer nature, would stifle this new technology just as it is beginning to develop. The likely outcome would be to force this technology to develop offshore, thus denying American investors its benefits, without any clear pathway for a return. We think that a more incremental and targeted approach, in line with the proposed treatment of other technologies, would better protect investors and promote efficiency and competition.

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[4] Reopening Release at 29,452-53.

More generally, the Reopening Release includes references to "systems" or other technologies that could fall within the "exchange" definition depending on how people use them. We respectfully suggest that greater precision is needed in order for this guidance to promote compliance by providing the fair notice that the law requires and for the Commission to conduct a robust cost-benefit analysis.

DISCUSSION

I. The Commission should apply the same, technology neutral guidance to DLT as other technologies

The Reopening Release could be read to suggest that parties who use DLT protocols or applications to transact with each other would be required to involve a registered national securities exchange or ATS, even if the protocol or application consists of asset-agnostic, open-source or passive technology operating on a peer-to-peer basis. The Reopening Release does not suggest the same treatment for parties using functionally similar technology that does not make use of DLT. We respectfully recommend that the Commission clarify these matters in order to remain consistent with the technology neutral approach it espouses and the Exchange Act and APA require.

a. The Commission should not require designation of an intermediary for peer-to-peer transactions where no intermediary otherwise is involved

The fact that buyers and sellers of securities are able to use a technology protocol or application that incorporates established, non-discretionary methods for the parties to interact with each other and agree to the terms of a trade does not necessarily mean that an "exchange" is present. Section 3(a)(1) of the Exchange Act defines that term to require that there be an "organization, association, or group of persons" who "constitutes, maintains, or provides a market place or facilities for bringing together" those buyers and sellers. In other words, there must be an intermediary (some "organization, association, or group of persons") actively involved (*i.e.*, "bringing together" securities buyers and sellers) in order for exchange or ATS registration to be required.

The Reopening Release implies that this element of the "exchange" definition will necessarily be satisfied in the case of relevant DLT protocols, asserting that "[t]he existence of smart contracts on a blockchain does not materialize in the absence of human activity or machine (or code) controlled or deployed by humans."[5] Such an interpretation would elide the statute's use of active, present and present progressive tense verbs ("constitutes," "maintains," "provides," "bringing") to describe the role of an "exchange"; passively publishing software code or other technology standards or protocols, without more, does not rise to this level.

[5] *Id.* at 29,454.

The Reopening Release further indicates that a variety of unrelated parties, such as application or user interface providers, developers of DLT code, decentralized autonomous organizations, validators or miners, and issuers or holders of governance or other tokens, could together form a "group of persons" within the meaning of Section 3(a)(1) if they "act in concert" or "exercise control" or "share control" over the relevant technology.[6] It also indicates that the deployment of a smart contract on a blockchain, without the ability to alter or control that technology, is sufficient to satisfy the "exchange" definition if some other party provides buyers and sellers of securities with a user interface or website to access that smart contract.[7]

In non-DLT contexts, on the other hand, the Reopening Release more narrowly describes when multiple persons would form a "group of persons" as that term is used in the "exchange" definition. For example, the Reopening Release explains that, even in the context of *affiliated* persons, a "group of persons" may *not* be present where they each have independent governance, management, and oversight, among other factors.[8] It would seem that a similar analysis should apply when assessing the status of a smart contract developer and an unrelated party who provides a user interface or website for others to access the smart contract, or when analyzing an even broader group of validators or miners or holders of governance tokens, many of which do not even know each other or manifest any shared desire to facilitate securities trading.

There would be significant costs and consequences if the Commission adopted such a broad view of when parties using DLT triggered exchange or ATS registration. As the Commission observes in its economic analysis, if control over a smart contract is given to a token-based voting mechanism, a large number of token holders would need to form an organization or association, or designate one of those token holders, to act as the exchange and accordingly register with the Commission.[9] Or if the relevant smart contract is immutable, then miners or validators on the underlying blockchain for the smart contract would need to "fork" the blockchain so that the smart contract could be operated as part of a registered exchange or ATS.[10] So in these instances, the Commission's exchange regulation itself—not market participants' actions—would bring into existence the sort of organization, association or group the Exchange Act subjects to that exchange regulation.

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[6] *Id.*

[7] *Id.*

[8] *Id.* at n. 66. This same section of the Reopening Release also approvingly cites the opinion in *Intercontinental Exch., Inc. v. SEC*, but notably that court also cautioned that "the outer boundary of the term 'group of persons' remains murky, and vigilance is necessary to ensure the term is not stretched too far." 23 F.4th 1013, 1025 (D.C. Cir. 2022).

[9] Reopening Release at 28,483.

[10] *Id.*

We respectfully note that the exchange registration requirement is generally designed to protect market participants from unfair or inequitable practices by exchanges. A requirement for those participants to form and transact through an exchange would conflict with that objective because it would expose them to the risk of those practices when that otherwise would not have been the case.

In this connection, it is also noteworthy that, except in highly limited contexts (mainly the trading of certain derivatives), the Exchange Act does not mandate the use of a securities exchange.[11] Peer-to-peer securities trading is lawful under the Exchange Act. In fact, many private market transactions take place this way today, whether they involve institutional investors negotiating a secondary sale of their interests in a private fund or an entrepreneur selling a stake in his or her company to a family friend. Of course, this sort of trading is more difficult when parties do not already know and trust each other. A key reason for this difficulty is that parties face significant settlement and credit risks when their changes in securities ownership take place manually, *e.g.*, through the physical exchange of paper stock certificates, where the delivery of securities against payment over any physical distance requires intermediaries such as escrow agents. DLT can help solve that issue by enabling parties to self-custody their assets and use transparent and immutable software to transfer those assets simultaneously against payment. But these risk-mitigating attributes of DLT do not detract from the peer-to-peer nature of the transaction or foster a need to regulate transactions making use of DLT more stringently.

In addition, the consequences of interpreting use of open-source, peer-to-peer technology to trigger exchange or ATS registration would extend beyond DLT contexts. For years, trading in equities and other securities has benefitted from the use of common messaging standards and electronic communication protocols (such as the FIX Trading Protocol), which are maintained on a non-profit or open-source basis by diverse communities of users. The guidance offered by the Reopening Release for DLT protocols and applications would seem equally applicable to the bodies setting, designing and deploying those longstanding standards and protocols. Those standard-setting bodies would face similar challenges to compliance as DLT protocol developers. This concern

[11] The Exchange Act specifically authorizes the Commission to impose exchange-trading requirements in four limited contexts: (1) certain mandatorily-cleared security-based swaps (under Section 3C(h)); (2) security futures products (under Section 6(h); (3) security-based swaps effected with or for a person that is not an eligible contract participant (under Section 6(l)); and (4) after making several specified findings, with respect to broker-dealers effecting transactions in registered securities (under Section 11A(c)(3)). Interpreting use of modern communication technologies, including DLT protocols, to trigger exchange registration across *all* types of securities would contravene these limits on the Commission's authority to dictate market structure.

is not theoretical: the FIX Trading Community itself had sufficient concern to submit a comment on this issue in response to the Proposal.[12]

b. The Commission should not treat peer-to-peer transactions more stringently than those involving a broker, dealer, or investment adviser

Several "traditional finance" commenters on the Proposal expressed concern that commonly used trading technologies could be captured by revised Rule 3b-16. They thus requested that the Commission clarify that order management systems, order execution systems, and order execution management systems (collectively referred to as "OEMS" technology) do not meet the revised rule's criteria.[13] In response, the Commission stated, "The proposed amendments to Rule 3b-16 were not designed to capture within the definition of exchange the activities of brokers, dealers, and investment advisers who use an OEMS to carry out their functions (*e.g.*, organizing and routing trading interest)."[14]

Many DLT protocols function similarly to OEMS technology. A broker-dealer, for example, might stream its quotations to its customers using an industry standard FIX application programming interface that connects to those customers' OEMS technology, which allows those customers to execute against those quotes. Similarly, a market participant could use an open-source smart contract (such as an automated market maker) to make known to other market participants its willingness to trade digital assets at specified prices, and those other market participants could trade against those prices by accessing the smart contract.

In both cases, the parties have interacted using a common messaging or communication protocol, which enables them to agree to the terms of a trade by honoring the actionable prices communicated by one party to others. And in both cases, the messaging or communication protocol is not being operated under the control of some particular third party. The only difference between the cases is that the first one involves a broker-dealer on one side of the interaction (and possibly an investment adviser on the other), whereas the second one could involve a fully peer-to-peer interaction.

In our view, a DLT protocol should not be treated more stringently just because it is available openly and freely, and not just provided to market professionals. Section 3(a)(1)'s "exchange" definition does not carve out functions when they are performed by technology used by brokers, dealers, or investment advisers. Indeed, the Exchange Act does *not* require involvement of a broker-dealer *unless* there already is a registered national securities exchange involved. Only then does Section 6 of the Act kick in,

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[12] *See* Letter from FIX Trading Community, dated May 24, 2022, *available at* https://www.sec.gov/comments/s7-02-22/s70222-20129429-295561.pdf.

[13] *See* Reopening Release at n.134 and accompanying text.

[14] *Id.* at 29,461.

requiring parties to access the exchange through a broker-dealer member. To carve out technology used by broker-dealers and investment advisers, but not equivalent technology used by others, would have the effect of treating the presence of non-exchange intermediaries as an exception from exchange registration, even though the statute requires the presence of a registered exchange in order for intermediaries also to be required. Again, the Exchange Act permits peer-to-peer securities trading; there is no general intermediation requirement.

c. The Commission should not treat DLT protocols differently from other general connectivity technology

The Proposal states, and the Reopening Release reiterates, that "systems that provide general connectivity for persons to communicate without protocols containing requirements and limitations to negotiate trades for securities (*e.g.*, utilities or electronic web chat providers) would not fall within the definition of exchange, as proposed to be amended."[15] The distinction that the Commission seems to be drawing is between systems that have requirements and limitations that are designed with securities trading in mind, on one hand, and those systems that do not have such requirements or limitations, on the other.

Today, DLT protocols are generally not designed with securities trading in mind. Although they may contain requirements and limitations designed to permit parties to transmit value over the Internet, such as communicating price and quantity, the same is true for many other general purpose Internet-based technologies, such as auction and other e-commerce websites. But in the DLT context, the Commission indicates that such a neutral technology would be required, in order for the various parties connected to the technology not to trigger registration, to be reconfigured to prevent securities trading.[16]

Given its similarity to other forms of general connectivity technologies, the Commission should treat DLT similarly to those technologies. Specifically, developers or publishers of general connectivity technology, whether using DLT or otherwise, should not be required to police the potential use of the technology for securities trading. Such an approach would prohibit the sort of content neutrality that is the foundation of the modern Internet and present a variety of constitutional and other issues for the Commission, as other commenters have observed.[17]

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[15] *Id.*

[16] *Id.* at 29,484.

[17] *See* Letter from Coin Center, dated Apr. 14, 2022, *available at* https://www.sec.gov/comments/s7-02-22/s70222-20123684-279908.pdf; *see, also* Letter from DeFi Education Fund, dated Apr. 18, 2022, *available at* https://www.sec.gov/comments/s7-02-22/s70222-20123960-280119.pdf. Also, the Supreme Court has recently shown its skepticism toward efforts to impose requirements or liability on parties for creating neutral communication platforms that others might use for improper purposes. *See Twitter, Inc. v.*

d. More stringent treatment of DLT relative to other technologies would harm investors and impede efficiency, competition, and capital formation

Section 3(f) of the Exchange Act requires the Commission, in adopting its rules, to consider, in addition to the protection of investors, the promotion of efficiency, competition, and capital formation. Treating DLT more stringently than other technologies would run contrary to all of these objectives.

Many of the requirements of the Exchange Act, including both the regulation of national securities exchanges under Section 6 and the regulation of broker-dealers under Section 15 and Regulation ATS, are designed to protect investors against the risks they face when trading through intermediaries. For example, Section 6 addresses areas such as an exchange's membership criteria, governance, and fees, which are areas where the exchange's market power and conflicts of interest could lead it to take advantage of investors. Regulation ATS likewise addresses fair access, confidentiality, and market transparency areas, which are where similar issues could manifest. Related regulation of custodial practices by clearing agencies and broker-dealers impose capital and customer asset protection requirements intended to address the risks investors face when another party has custody of their assets.

DLT enables investors, for the first time, to maintain custody and instruct transfer of their assets electronically without involving a third-party intermediary. As a result, none of these sorts of requirements are necessary because investors do not entrust their assets to others, cede control of their trading information or activity to some third-party market operator, or face counterparty risk that assets or funds will not be transferred. Against this backdrop, requiring investors to transact through an intermediary, even one regulated by the Commission, would harm them by exposing them to risks that they would not otherwise face, and that the technology is designed to avoid in the first place.

The use of DLT to permit peer-to-peer trading also promotes efficiency, competition, and capital formation by reducing the ability for intermediaries to collect economic rents. As Chair Gensler has explained:

> "The markets in the middle are almost like the neck of an hourglass. Let's visualize that for a minute. Imagine grains of sand flowing through the hourglass every single day. The sand, in this analogy, is money and risk. Financial intermediaries, like market makers, exchanges, and asset managers, sit at the neck of that hourglass, collecting a few grains in each transaction. With trillions of grains flowing through daily, a few grains of sand can really add up. Those grains may potentially become excess

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Taamneh, 598 U.S. ___ (2023) (declining to extend aiding and abetting liability to Twitter, Facebook, and Google for terrorism-related content shared over their platforms).

> profits above what robust market competition would provide — also known as economic rents."[18]

Chair Gensler went on to describe the Commission's tools for addressing concentration among intermediaries in the middle of the market, namely, transparency, access, and fair dealing.[19] By enabling fully transparent, open trading protocols with fair rules (enshrined in code and knowable to all participants in advance), DLT natively provides these tools. But by requiring parties using DLT to trade through one or more intermediaries, the Proposal would reintroduce the very issues that the Commission is seeking to address in non-DLT contexts, which would harm investors.

e. <u>More stringent treatment of DLT relative to other technologies would be arbitrary and capricious</u>

It is a core requirement that agency rulemaking under the APA not be arbitrary and capricious.[20] Courts have held that agency action "is at its most arbitrary when it treats similarly situated people differently[.]"[21] Stated differently, an agency acts arbitrarily and capriciously if it applies different standards to similarly situated parties without providing a reasoned explanation.[22] A corollary rule is that agencies must take account of circumstances that warrant differential treatment for similarly situated parties.[23]

Here, the Proposal, as further reinterpreted by the Reopening Release, raises issues on both fronts. As described above, it would seem to treat financial market messaging standards and protocols, OEMS technology and various Internet-based general connectivity technologies differently from analogous DLT protocols and applications, exempting the former from exchange regulation but not the latter. It would also fail to take into account the absence of intermediaries in the case of various DLT protocols and

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[18] SEC Chair Gensler, "Competition and the Two SECs," Remarks Before the SIFMA Annual Meeting (Oct. 24, 2022), *available at* https://www.sec.gov/news/speech/gensler-sifma-speech-102422.

[19] *See id.*

[20] *See* 5 U.S.C. § 706(2)(A) **(**providing that to the extent necessary, a court reviewing agency action shall hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law).

[21] *Etelson* v. *Off. of Pers. Mgmt*., 684 F.2d 918, 926 (D.C. Cir. 1982).

[22] *See Burlington N. & Santa Fe Ry*. v. *Surface Transp. Bd.*, 403 F.3d 771, 777 (D.C. Cir. 2005); *Willis Shaw Frozen Express Inc.* v. *ICC*, 587 F.2d 1333, 1336 (D.C.Cir.1978); *Ace Motor Freight, Inc.* v. *ICC*, 557 F.2d 859, 862 (D.C.Cir.1977)

[23] *See Petroleum Commc'ns, Inc*. v. *F.C.C.*, 22 F.3d 1164 (D.C. Cir. 1994) (FCC rules failing to differentiate between "water-based" and "land-based" licensees, despite the substantially different circumstances faced by waterborne carriers, were arbitrary and capricious).

applications, even though the risks posed by intermediaries is what justifies exchange regulation in the first place. We respectfully recommend that the Commission address these issues before finalizing the Proposal.

II. The Commission should clarify the overall scope of the "exchange" definition

In order to provide fair notice and promote compliance, the Commission should further clarify what actions trigger "exchange" status. As the Supreme Court has explained, "laws which regulate persons or entities must give fair notice of conduct that is forbidden or required," and regulated parties must "know what is required of them so they may act accordingly."[24] Here, the Proposal would not satisfy this requirement because it lacks clarity on key terms, as commenters comprising a diverse range of constituencies have raised.[25] And we respectfully submit that the Reopening Release does not address this issue; indeed, it raises its own, new questions, such as:

- What sort of concert, absent a formal agreement or common control, is sufficient to form of "group of persons" required to register with the Commission?

- When or how might a "system," which is not itself a person, be found to "arrange" for another party to provide a trading facility such that the system "makes available" that trading facility or "indirectly" provides it?

- What sort of a "requirements" or "limitations" within a communication protocol would be sufficient to trigger registration?

The lack of precise answers to these and other questions not only presents fair notice issues, but it also raises questions about the Commission's cost-benefit analysis. The Commission estimates that there are 15-20 crypto asset security systems that would fall within revised Rule 3b-16, but it does not explain how it arrived at that estimate, nor why its estimate differs so substantially from those offered by commenters on the Proposal.[26] This difference strongly suggests that greater clarity and precision would be helpful to market participants.

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[24] *FCC v. Fox Television Stations, Inc.,* 567 U.S. 239, 253 (2012*); see also Fortyune v. City of Lomita*, 766 F.3d 1098, 1105 (9th Cir. 2014) ("Entities regulated by administrative agencies have a due process right to fair notice of regulators' requirements.").

[25] *See* Letter from Bloomberg, L.P., dated Sept. 16, 2022, at Appendix A, *available at* https://www.sec.gov/comments/s7-02-22/s70222-20143645-309017.pdf.

[26] *See* Reopening Release at 29,465.

CONCLUSION

Bain Capital Crypto, LP appreciates the Commission's efforts to obtain additional input from the public on the important topic of how its regulations apply to use of DLT. We welcome discussing our comments with the Commission and its staff to work toward a practical regulatory regime that encourages the growth of this nascent industry while protecting investors.

Respectfully submitted,

Tuongvy Le
Partner and Head of
Regulatory & Policy
Bain Capital Crypto, LP

cc: Counsel to Bain Capital Crypto on this matter:

Colin D. Loyd
James M. McDonald
Sullivan & Cromwell LLP