



April 5, 2021

Via email ([rule-comments@sec.gov](mailto:rule-comments@sec.gov))

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

Re: File No. S7-25-20; Custody of Digital Asset Securities by Special Purpose  
Broker-Dealers (Release No. 34-90788)

Dear Ms. Countryman:

The Chamber of Digital Commerce (the “Chamber”) appreciates the opportunity to comment on the U.S. Securities and Exchange Commission (the “Commission”) Statement and Request for Comment regarding “Custody of Digital Asset Securities by Special Purpose Broker-Dealers” (the “Statement”).<sup>1</sup>

The Chamber is the world’s largest blockchain trade association. Our mission is to promote the acceptance and use of digital assets and blockchain technology, and we are supported by a diverse membership that represents the blockchain industry globally. Through education, advocacy, and close coordination with policymakers, regulatory agencies, and industry across various jurisdictions, our goal is to develop a pro-growth legal environment that fosters innovation, job creation, and investment. We represent the world’s leading innovators, operators, and investors in the blockchain ecosystem, including leading edge startups, software companies, global IT consultancies, financial institutions, insurance companies, law firms, and investment firms.

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<sup>1</sup> Custody of Digital Asset Securities by Special Purpose Broker-Dealers, 86 Fed. Reg. 11,627 (proposed Feb. 26, 2021), <https://www.federalregister.gov/documents/2021/02/26/2020-28847/custody-of-digital-asset-securities-by-special-purpose-broker-dealers> (the “Statement”).

## I. Overview

On December 23, 2020, the Commission issued the Statement with an intent to encourage innovation around the application of Rule 15c3-3 (the “Customer Protection Rule”)<sup>2</sup> to digital asset securities. The Statement sets forth a five-year temporary safe harbor for broker-dealers seeking to custody “digital asset securities” that becomes automatically effective on April 27, 2021. While the Commission does not consider the Statement to be a formal rule proposal, the Commission notes that it will consider the public’s comments in connection with any future rulemaking in this area, and at least for a period of five years (the duration of the Statement). In addition, the Commission notes that any broker-dealer operating under the circumstances set forth in the Statement will not be subject to a Commission enforcement action for a period of five years from the publication of the Statement.

In the Statement, the Commission establishes, and solicits input on, a bifurcated regulatory structure for broker-dealers seeking the ability to custody securities based on whether the broker-dealer operates in the traditional securities space or in the digital asset securities space. The Statement requires a broker-dealer seeking to custody digital asset securities to limit its business to digital asset securities in order to isolate certain perceived risk. The Commission also establishes, and solicits input on, a range of unique policies and procedures that a special purpose broker-dealer would be required to adopt. These include requiring that the broker-dealer, among other things, assess a given digital asset security’s distributed ledger technology and protect the private keys necessary to transfer the digital asset security.

It appears that the Commission’s premise around the proposed bifurcated regulatory structure is that, while the Customer Protection Rule requires a broker-dealer to physically possess or “control” customer fully paid and excess margin securities they are carrying, it may not be possible for a broker-dealer to establish control over a digital asset security with the same control mechanisms used in connection with traditional securities (*i.e.*, securities issued in certificated or traditional book-entry format). The Commission goes on to state that “the traditional securities infrastructure contains checks and controls that can be used to verify proprietary and customer holdings of traditional securities by broker-dealers, as well as processes designed to ensure that both parties to a transfer of traditional securities agree to the terms of the transfer,” implying that broker-dealers operating in the digital asset securities space are not able to provide similar protections and, therefore, must operate this business in a separate entity.

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<sup>2</sup> 17 C.F.R. § 240.15c3-3.

We also note that the Statement is consistent with the themes set out by the Commission and the Financial Industry Regulatory Authority (“FINRA”) in the July 2019 Joint Statement on Broker-Dealer Custody of Digital Asset Securities (the “Joint Statement”), which stated that “[t]he nature of distributed ledger technology, as well as the characteristics associated with digital asset securities, may make it difficult for a broker-dealer to evidence the existence of digital asset securities for the purposes of the broker-dealer’s regulatory books, records, and financial statements, including supporting schedules.”<sup>3</sup>

The Statement also reflects the position expressed in the Joint Statement that:

“The purpose of the Customer Protection Rule is to safeguard customer securities and funds held by a broker-dealer, to prevent investor loss or harm in the event of a broker-dealer’s failure, and to enhance the Commission’s ability to monitor and prevent unsound business practices. Put simply, the Customer Protection Rule requires broker-dealers to safeguard customer assets and to keep customer assets separate from the firm’s assets, thus increasing the likelihood that customers’ securities and cash can be returned to them in the event of the broker-dealer’s failure. The requirements of the Customer Protection Rule have produced a nearly fifty-year track record of recovery for investors when their broker-dealers have failed. This record of protecting customer assets held in custody by broker-dealers stands in contrast to recent reports of cybertheft and underscores the need to ensure broker-dealers’ robust protection of customer assets, including digital asset securities.”<sup>4</sup>

The Chamber welcomes the Statement as a positive and constructive step toward grappling with the complex requirements of federal securities laws, and the Customer Protection Rule in particular, as they apply to digital asset securities and transactions in those securities, which could pave the way for increased participation in the marketplace for digital asset securities by traditional investors. We commend the Commission for its willingness to engage with the digital asset community on these issues through consultation.

The Chamber, however, has the following specific concerns regarding the Statement:

### **1. Scope of the Temporary Safe Harbor.**

The Statement provides an important road map for broker-dealers seeking to demonstrate that they have good control over digital asset securities they custody as required by the Customer Protection Rule set forth in Rule 15c3-3, especially as the method for maintaining control over digital asset securities

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<sup>3</sup> Sec. and Exch. Comm’n and Fin. Indus. Reg. Auth., *Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities* (July 18, 2019), <https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities>.

<sup>4</sup> *Id.*

differs considerably from the process applicable to certificated securities due to the nature of the technology used in relation to digital asset securities.

The Commission's bifurcated regulatory structure is narrowly focused. According to the Statement, the "Commission's position is expressly limited to paragraph (b) of Rule 15c3-3." We understand – and we believe that industry participants also understand that –

- the Statement requires only those broker-dealers that themselves seek to custody digital asset securities to be special purpose broker-dealers. That is, broker-dealers that transact in, but do not intend to custody, digital asset securities can engage in both a traditional and digital asset securities business (*e.g.*, such a broker-dealer could effect transactions in digital asset securities solely on an agency basis not involving the broker-dealer custodying the digital asset securities). The Commission should confirm that the requirements set forth in the Statement apply only to the narrow category of broker-dealers seeking to custody customers' digital asset securities under the temporary safe harbor and not to other broker-dealers operating in the digital asset securities space;
- introducing broker-dealers should be able to establish clearing arrangements with special purpose broker-dealers and not be subject to the Statement solely as a result of their introducing activity to the extent that it does not itself seek to custody digital asset securities; and
- an alternative trading system that matches orders in digital asset securities away from a blockchain should be able to execute transactions in digital asset securities custodied by a special purpose broker-dealer without being subject to the Statement.

We believe that the Commission should expressly confirm each of these points.

## **2. Definition of "Digital Asset Security."**

The stated purpose of the Statement is "to encourage innovation around the application of the Customer Protection Rule to digital asset securities." The Commission also states that:

"For purposes of this statement, the term "digital asset" refers to an asset that is issued and/or transferred using distributed ledger or blockchain technology ("distributed ledger technology"), including, but not limited to, so-called "virtual currencies," "coins," and "tokens." The focus of this statement is digital assets that rely on cryptographic protocols. A digital asset may or may not meet the definition of a "security" under the federal securities laws. *See, e.g.*, Report of Investigation Pursuant to Section

21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 (July 25, 2017). As used in this statement, a “digital asset security” means a digital asset that meets the definition of a “security” under the federal securities laws. A digital asset that is not a security is referred to herein as a “non-security digital asset.”

However, because much of the Statement concerns the means by which “physical possession or control” is obtained over digital asset securities for purposes of the Customer Protection Rule, it is critical also to consider the following two points:

- the potentially overbroad nature of the Commission’s definition, and
- how applicable state law (the Uniform Commercial Code (“UCC”)) provides for such “possession or control” to occur.

### *The Potentially Overbroad Nature of the Commission’s Definition*

As noted above, the Commission states that the term “digital asset” refers to an asset that is issued and/or transferred using distributed ledger technology, including, but not limited to, so-called “virtual currencies,” “coins,” and “tokens.” While it is one thing to refer to a security as “digital” based on the technology chosen by an issuer to maintain that security on its books and records, it is another to also define a security as a “digital asset security” merely because ownership of the security might be transferred using distributed ledger or blockchain technology. The mere fact that a security tangentially interacts with blockchain technology as a record-keeping methodology should not necessarily result in that security being deemed a “digital asset security” for purposes of the Statement.

For example, with the emerging application of distributed ledger technology to the capital markets, certain issuers have arranged for a courtesy copy of their stockholder register to be made visible on a public or private blockchain.<sup>5</sup> This courtesy copy is intended to provide features investors may find useful to enhance transparency without impacting the conventional structure of uncertificated securities as handled every day by the current market system. These courtesy copies are provided as a convenience and with no controlling effect for corporate or securities law purposes. Thus, unlike digital asset securities, traditional securities for which the transfer agent maintains a non-controlling, courtesy “carbon copy” of its official (off chain) stockholder record do not involve the issuance and transfer of securities on the blockchain.

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<sup>5</sup> These courtesy copies have been pseudonymized and typically include the digital wallet address of each holder of record transacting in the security, the security position information of such holder of record, and the entire history of debits and credits of transactions in the security, but do not include any personally identifiable information.

In these situations, the security itself is uncertificated (*i.e.*, not certificated or otherwise “reified” in paper or any other physical medium) with ownership recorded in standard technology book-entry format, even though the transfer agent and/or a trading platform uses blockchain technology or digital assets in various ways to facilitate the trading and settlement of that uncertificated security. The mere fact that the security interacts with the blockchain at various points in time during the trading and settlement process should not require that an uncertificated security be deemed a “digital asset security” for purposes of the Statement.

The Commission should clarify that traditionally represented book-entry securities that have non-controlling blockchain components are not “digital asset securities” for purposes of the Statement since these traditionally represented securities do not present new risks to investors.

*How Applicable State Law (the UCC) Provides for “Possession or Control” to Occur*

The impact of the control provisions of Article 8 of the UCC on the Commission’s definition of digital asset security is unclear. Under state law, unless a paper certificate has been created by the issuer to represent a security, the security will be considered uncertificated<sup>6</sup> under the UCC regardless of its characterization under federal law. Under the UCC, “control” of an uncertificated security is only obtained when either: (1) the uncertificated security is “delivered” to the purchaser, or (2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.<sup>7</sup> An uncertificated security will be considered “delivered” for state law purposes only when either: (1) the issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or (2) another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

While we recognize that the Commission may determine that it cannot take a position on the proper application of the UCC to digital asset securities, we believe that the Commission should confirm that it does not object to the approach set out in the UCC (as described above) for establishing control of a digital asset security for UCC purposes. The digital asset security created by the issuer cannot be a “certificated security” under state law. Accordingly, state law should treat the transfer of a digital asset security created by an issuer from one

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<sup>6</sup> U.C.C. § 8-102 (AM. LAW INST. & UNIF. LAW COMM’N 2018) (definitions of “certificated security” and “uncertificated security.”) *See also id.* at Official Comment 16.

<sup>7</sup> *Id.* at § 8-106(c).



blockchain address to another blockchain address as an “instruction” by the owner of the related uncertificated security to the issuer (or its transfer agent) to re-register ownership of the uncertificated security to the person who is identified by the issuer (or its transfer agent) as controlling the receiving blockchain address. This is supported by the definition of “instruction” in Section 8-102 (“a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed”) as well as Comment 1 to Section 8-305 (“Thus, [an] instruction may be in the form of a writing signed by the registered owner *or in any other form agreed upon by the issuer and the registered owner*. Allowing non-written forms of instructions will permit the development and employment of means of transmitting instructions electronically.” (Emphasis added.))

In our view, the method of establishing control over a digital asset security under the UCC is consistent with the Commission’s definition of digital asset security and we are not aware of another relevant approach to obtaining control that would meet the requirements of state law. We request that the Commission confirm that it does not object to this approach.

### **3. Use of Third-Party Custody Providers.**

While the Statement addresses the ability of a broker-dealer to self-custody digital asset securities, it does not address whether broker-dealers can satisfy Rule 15c3-3(b) by maintaining digital asset securities at a good control location, such as a bank, transfer agent, or clearing agency, which is generally the means by which a broker-dealer demonstrates custody over traditionally represented book-entry securities. For example, a broker-dealer that establishes control over digital asset securities at a control location identified in paragraph (c) of Rule 15c3-3 (*e.g.*, at a bank under paragraph (c)(5) of Rule 15c3-3), rather than itself custodying digital asset securities, should not need to be a special purpose broker-dealer and could therefore engage in both a traditional and digital asset securities business.

Market participants would also benefit from additional clarity as to what the Commission might deem “good control locations” for digital asset securities. Subsequent guidance should include specific criteria for digital wallets (*e.g.*, cloud based vs. on-premises and hot / warm / cold storage mechanisms). The Commission should also clarify which types of regulated digital asset entities, such as federally chartered digital banks or state-chartered digital trust companies, can be deemed to be qualified custodians for purposes of the Investment Advisers Act of 1940.

Additionally, the Statement’s view that custody of digital asset securities must be kept separate from non-security digital assets raises the question of whether

third-party regulated custodians are precluded from offering solutions for both digital asset security and non-security digital assets. Market participants, including potential digital asset security issuers and service providers, will require further guidance so they can assess whether they will feasibly and efficiently be able to operate in this space.

#### **4. Not Technology Neutral.**

In the Statement, the Commission is imposing a bifurcated regulatory structure on broker-dealers, and potentially significantly limiting a broker-dealer's business model, based solely on an issuer's choice of technology representing its securities and regardless of whether a broker-dealer can meet the current regulatory requirements related to the custody of traditional book-entry securities. The Chamber believes that it is critical for the Commission to remain technology-neutral across all capital markets regulation, which is contradicted by this bifurcated structure.<sup>8</sup>

#### **5. Lack of Customary Industry Input.**

The Commission is implementing the temporary safe harbor without soliciting prior public comment or providing a cost/benefit analysis around the enumerated requirements, instead conditioning effectiveness on the passage of 60 days from the date of publication in the Federal Register. While we believe that the Statement is an important step towards providing much needed market clarity, we are concerned by the Commission's statement that it will limit its consideration of public comments provided with respect to the Statement to future rulemaking efforts only and that the temporary safe harbor will become effective in its current form regardless of the feedback provided by the public in response to the issues raised by the temporary safe harbor.

The Commission has utilized a "statement" approach in the digital asset space for some time now – setting out its views by speech, guidance, or statement without seeking prior industry feedback on the specific issue. A formal notice and comment rulemaking or even a consultation prior to issuing a final statement or guidance would be a more effective means of incorporating industry feedback.

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<sup>8</sup> We also note that, during Mr. Gary Gensler's nomination hearing before the Senate Committee on Banking, Housing, and Urban Affairs, Senator Bill Hagerty (R-TN) asked for Mr. Gensler to share his perspective on the SEC's role under his leadership if confirmed and how he will approach digital assets. Mr. Gensler responded as follows: "it's always important to update our market oversight to new technologies, but I believe that for most to be technology neutral." He went on to state that it would be "important to stay true to principals of investor protection and capital formation but at the same time be technology neutral." *Nomination Hearing: Hearing before the S. Comm. on Banking, Housing, and Urban Affairs*, 117<sup>th</sup> Cong. (Mar. 2, 2021) (statement of Gary Gensler, Nominee, Sec. and Exch. Comm'n).



## **6. Transition upon Expiration.**

To the extent that a broker-dealer undertakes to satisfy the requirements of the temporary safe harbor, the Statement provides no clarification regarding the implications for such broker-dealer once the five-year period for the temporary safe harbor expires. It will be difficult to justify a business decision to invest in a separate broker-dealer entity that meets all the requirements of the Statement without knowing if the business will need to cease operations in five years.

## **7. Qualified Custodian.**

While the temporary safe harbor provides some guidelines for a broker-dealer seeking to self-custody digital asset securities, it does not provide any assurance that a registered investment adviser could treat such broker-dealer to be a “qualified custodian” for purposes of the Investment Advisers Act of 1940. The Commission should provide clarity on the point.

## **8. Guidance regarding Recordkeeping and Rulemaking.**

In the Statement, the Commission makes clear that the temporary safe harbor is expressly limited to Rule 15c3-3(b) and does not address broker-dealer recordkeeping and reporting rules maintained elsewhere in the rules and regulations. Given the Joint Statement’s discussion of recordkeeping and reporting in the context of digital asset securities, we believe that the Commission should also address these points to ensure all parties meet expectations.

## **9. Margin and Rehypothecation.**

Notably missing from the Statement is guidance as to whether special purpose broker-dealers may extend margin credit on digital asset securities and if these assets may be rehypothecated. To the extent these activities are permissible, firms will also need to know whether the same requirements and thresholds that are applicable to traditional securities would apply to digital asset securities.

## **10. Staking Requirements.**

The Statement is also silent on the topic of staking. Additional guidance should clarify whether digital asset securities may be used for staking purposes. If these activities are permissible, special purpose broker-dealers will need to understand the extent to which they may facilitate customer participation in proof of stake (“POS”) validation programs, what limitations may apply, and relevant disclosures they will need to make.

## **11. Imposed Conditions Create Unnecessary Risk.**

Several of the conditions set forth in the temporary safe harbor create potential significant risk and liability for broker-dealers seeking to custody digital asset securities as we discuss below. We reiterate again our concern that the Commission is regulating based solely on the basis of the technology that the issuer has chosen to represent ownership of securities and that the imposition of these additional obligations may make it cost prohibitive for a broker-dealer to custody digital asset securities versus traditional securities.

The Commission's bifurcated structure fails to consider the risks that may potentially result if broker-dealers are forced to separately operate (and manage the risks associated with) a digital asset securities business. Relevant market, credit, liquidity, operational, and regulatory risks could be better mitigated if broker-dealers are instead required to implement effective and sophisticated risk and control frameworks for these businesses that are integrated with their enterprise-wide risk management programs. This would enable broker-dealers to benefit from converged and streamlined ERM methodologies and processes applied consistently across holistic organizations.

## **II. Commission Assertions**

In the Statement, the Commission asserts several problematic positions as justification for enacting a bifurcated regulatory structure for broker-dealers seeking to custody digital asset securities:

- A broker-dealer can operate successfully if its business is limited to operating in the digital asset securities space should they seek to self-custody digital asset securities;
- Digital asset securities trade and settle in a manner that creates a higher risk to investors than with respect to traditionally represented securities;
- Digital asset securities impose more investor risk than traditional securities; and
- Broker-dealers can operate successfully with self-custodied digital asset securities without also custodying non-security digital assets.

We believe each of these assertions is problematic in part or in whole, as discussed below, which materially impacts the basis for, and the viability of, the temporary safe harbor.

**Assumption 1: A broker-dealer can operate successfully if its business is limited to operating in the digital asset securities space should it seek to self-custody digital asset securities.**

The Commission suggests that a broker-dealer could shield traditional securities customers, counterparties, and market participants from the risks and consequences of digital asset security fraud, theft, or loss by limiting its business exclusively to dealing in, effecting transactions in, maintaining custody of, and/or operating an alternative trading system for digital asset securities only.

The Commission has provided no reasonable basis or clear benefit to investors for the creation of a bifurcated regulatory structure for the custody of traditional book-entry securities versus digital asset securities. Digital asset securities do not pose an inherently greater risk to investors based solely on the use of blockchain technology as opposed to more traditional book-entry methods of recording security ownership, such as using spreadsheets or other means.

Creating a separate regime based on this problematic assertion creates the potential for digital asset securities to appear riskier than they actually are and creates greater hurdles than necessary for the development of this technology. As a result, while we appreciate the Commission's movement towards regulatory clarity for digital asset securities, we believe that the creation of a bifurcated regulatory system will be detrimental to the growth of the industry and to the competitiveness of the United States in the digital asset security space globally.

Currently, many of the broker-dealers operating in the digital asset security space also operate in the traditional book-entry securities space and have notable experience complying with existing broker dealer regulations. For example, a broker-dealer may be approved to facilitate primary offerings of unregistered securities, as well as secondary trading of unregistered securities, including securities maintained using blockchain technology. In many cases, the issuer will choose to issue its securities in a traditional book-entry manner at the time of issuance and will only create digital asset securities at such time as those securities become eligible for secondary trading under Rule 144 (*i.e.*, generally twelve months from the date of issuance). Only at that time will the broker-dealer seek to self-custody digital asset securities on behalf of investors seeking liquidity.

The temporary safe harbor would create a significant hardship for existing or future broker-dealers operating under this model; first, to satisfy a separate set of conditions of the temporary safe harbor when operating two separate broker-dealers instead of one; and, second, with the resultant cost and operational difficulty that are not supported by a corresponding degree of additional investor protection.

**Assumption 2: Digital asset securities trade and settle in a manner that creates a higher risk to investors than with respect to traditionally represented securities.**

The Commission states that the risks associated with digital assets, including digital asset securities, are due in part to differences in the clearance and settlement of traditional securities and digital asset securities. It also states that traditional securities transactions generally are processed and settled through clearing agencies, depositories, clearing banks, transfer agents, and issuers.

We disagree with this assertion and believe that there is nothing inherent in a digital asset security or the related technology that increases risk with respect to the clearance and settlement process. For instance, if registered clearing agencies and transfer agents employed blockchain technology or had approval to hold or maintain digital asset securities on blockchains, the existing structures (*e.g.*, the Depository Trust Company, custodians, registered transfer agents) for clearance and settlement could apply. However, given the lack of registered clearing agencies and the limited number of registered transfer agents and broker-dealers providing services for digital asset securities, digital asset securities are by definition primarily outside the structures of those regulated entities at this point in time.

We also note that not all securities clear and settle through clearinghouses and central depositories today. Certain unregistered securities in uncertificated form are held directly with the issuer, and primary offerings and secondary trading of these securities often do not clear and settle through a clearing agency. To the extent an issuer wants to issue an uncertificated security, whether as a traditional or digital book-entry representation, and understands the implications that may result for the liquidity of the security, there is nothing under current regulations or based on technology that should prevent this.

In addition, although a range of public market intermediaries are considering ways to build blockchain technology into their processes to increase efficiency and decrease trading costs and timing, the majority of broker-dealers currently permissioned by FINRA to provide primary offering and secondary trading services for digital asset securities are operating almost without exception in the private unregistered securities space. As discussed above, these types of securities, whether issued traditionally or through the use of a digital asset security, do not clear or settle through either clearinghouses or central depositories. Instead, the broker-dealer generally handles all aspects of transaction settlement directly and the issuer generally acts as its own record-keeper for purposes of maintaining its capitalization table or uses a third-party service provider such as a law firm or capitalization management service to provide that service. We believe that the use of blockchain technology with respect to these types of transactions actually provides greater investor protection than the current more manual processes due to the ability of an issuer to automate primary investment and secondary

trading parameters and the ability of broker-dealers to more fully automate robust KYC and AML processes into transactions that take place on their platforms.

We expect that central clearinghouses and the netting provided by such structures will remain important to the functioning of the market in those types of securities that clear through central clearinghouses today. However, we also believe that the existing clearing agencies could adopt new blockchain technology and that new clearing agencies could be registered to enter the space and provide the same or potentially more efficient similar functions on a blockchain.

It has also been demonstrated that blockchain technology is one method of reducing settlement time from T+2 to real time settlement, which could make the clearance and settlement process for securities transactions match the economic realities of trading. In this sense, the clearance and settlement of digital asset securities is indeed different, and, in some ways, potentially more advantageous as compared to the current standard. Accordingly, the Commission's implication that delivery versus payment ("DVP") settlement for digital asset securities is somehow inferior or imposes more risk than the process that currently exists for traditional securities must also find balance against the benefits. We do, however, recognize that reducing settlement time will have broader implications to the securities ecosystem and will need to be further studied before any wholesale implementation.

**Assumption 3: Digital asset securities impose more investor risk than traditional securities.**

The Commission indicates its belief that digital asset securities present a greater risk of harm to investors, noting that the broker-dealer could more easily be victimized by fraud or theft, could lose a "private key" necessary to transfer a client's digital assets, or could transfer a client's digital assets to an unintended address without the ability to reverse a fraudulent or mistaken transaction.

We disagree with the Commission's position. Digital asset securities intentionally created in connection with the issuance of debt or equity by a traditional issuer may differ significantly from non-security digital assets and "inadvertent" digital asset securities (*i.e.*, those not intended by their issuer to be treated as "securities") when it comes to risk of theft or loss of keys. In fact, these "intended" digital asset securities are created using technology (*e.g.*, ERC20, ERC1404, and Tezos) fully capable of allowing an issuer to freeze, revoke, and reassign any digital asset security issued making theft or loss of keys or digital asset securities sent to the wrong address as easily correctable as with traditional securities. We note, however, that as is the case with traditional securities, it is impossible to guarantee that all digital asset security transactions will be impervious to fraud or bad actors.

While the reasoning below illustrates that the technical features of digital asset securities do not substantially increase the risk to investors from a broker-dealer's potential failure, we also note that regulators, courts, lawyers, and the industry have developed long-standing procedures to protect investors against a broker-dealer's failure, which procedures would apply to traditional book-entry securities and "intended" digital asset securities alike.

### *Blockchain's Recordkeeping Role*

Blockchain technology enables broker-dealers to fully comply with their recordkeeping and reporting requirements by allowing firms to evidence the existence and ownership of digital asset securities through the audit process. In addition, the smart contracts that automate transactions on a blockchain for digital asset securities allow for a blockchain to behave like a traditional security register recording transfers of ownership.<sup>9</sup> As a result, this technology benefits from enhanced auditability and real time information potentially available to the Commission, making the use of blockchain technology a far superior option for complying with recordkeeping and reporting obligations under the securities laws.

The Chamber believes that the use of blockchain technology by transfer agents and broker-dealers provides the following benefits for the custody of digital asset securities:

- Blockchain technology enables multiple entities in a financial ecosystem to enhance data sharing for efficiency and transparency purposes.
- Current processes and technology offer very little in the way of transparency to regulators or auditors. Regulators can dramatically improve oversight of markets thanks to technology that makes all transactions that occur on a blockchain transparent.
- Securities can be recorded by the issuer (or its transfer agent) in the name of the ultimate beneficial owner (vs. in street name), improving shareholder engagement, proxy voting, and reducing costly errors (e.g., the Dole Foods case where the number of securities claimed to be owned exceeded the known quantity of securities outstanding). For example, a smart contract can be coded to allow for a broker-dealer (or any other entity) to provide custody of a digital asset security (i.e., be responsible for the process of managing transfers of the security) but still tie ownership of the digital asset security to the actual beneficial owner of the security.
- Blockchain technology provides improved securities servicing (e.g., digital asset security transfer agents and custodians can provide dividend

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<sup>9</sup> Smart contracts are comprised of computer code that, upon the occurrence of a specified condition or conditions, is capable of running automatically according to prespecified functions. The code can be stored and processed on a distributed ledger and would write any resulting change into the distributed ledger. CHAMBER OF DIGITAL COMMERCE, SMART CONTRACTS: IS THE LAW READY (2018), <https://digitalchamber.s3.amazonaws.com/Smart-Contracts-Whitepaper-WEB.pdf>.



payments more efficiently and quickly than under the traditional system), thus increasing cost efficiency and investor protection.

- Blockchain technology offers programmatically enforced compliance with securities regulations through smart contracts, which can establish parameters for required investor qualifications, such as accredited investor or qualified client status and KYC/AML compliance.
- Blockchain technology provides for future innovation fully supported by a digital framework that enables automation that allows for real time transactions, settlement, and pricing. This level of automation would not only reduce human error, it also supports the important goal of true market efficiency.

### Blockchain as the Source of Truth

Blockchains have characteristics that make them particularly well suited to serving as the source of truth, including the following:

- tamper resistance;
- resilience to outage and unauthorized or malicious attacks;
- ability to combine digital asset transactions with settlement;
- ability to trace digital asset security provenance;
- accessibility;
- increased transparency and accountability between parties, including regulators and auditors without compromising privacy;
- speed and accuracy;
- cryptographic verification of identities and transactions; and
- scalability.

The characteristics set out above allow issuers, investors, intermediaries, regulators and other stakeholders to track ownership of a digital asset security on a blockchain from its issuance through each subsequent transfer. Each time one of the preceding actions occurs and a block is mined (*i.e.*, the transactions are confirmed), those blocks are propagated to every node on the network and, as a result, every node on the network has that single source of truth (*i.e.*, a copy of an immutable record). The single source of truth would show not only that ownership of a digital asset security has transferred from one holder to another, but how many units were transferred, the amount and type of payment received in return (if payment is made on-chain via digital assets such as stablecoins or cryptocurrencies, as opposed to payment via fiat currency off-chain), and when the transaction occurred. This source of truth functionality and the concomitant tracking ability allows firms to evidence the existence and ownership of digital asset securities through the audit process, as discussed above. By permitting special purpose broker-dealers to custody digital asset securities, the Commission has necessarily recognized blockchain as a source of truth.

Given the Commission’s recognition of blockchains as a source of truth for record-keeping purposes, it should expressly permit broker-dealers and other registrants to maintain books and records on blockchains for regulatory purposes. Books and records requirements are a cornerstone of the Commission’s regulatory regime. Accurate books and records, among other things, help ensure that investors’ assets are properly custodied; allow the parties to a securities transaction to track that transaction from order entry, to execution, and then to settlement; and assist the Commission and other regulators in the examination of registered entities.

The Commission’s record retention rules focus on auditability and immutability. For example, Rule 17Ad-7,<sup>10</sup> which governs record retention by transfer agents, requires that the transfer agent’s electronic storage media:

“Ensure the security and integrity of the records by means of manual and automated controls that assure the authenticity and quality of the electronic facsimile, detect attempts to alter or remove the records, and provide means to recover altered, damaged, or lost records resulting from any cause.”

The Commission takes a narrower, stricter approach with respect to electronic storage of broker-dealer records. Under paragraph (f) of Rule 17a-4, a broker-dealer storing records electronically must use an electronic storage medium that is non-rewriteable and non-erasable.

The Commission’s various books and records rules also require broker-dealers and other registrants to provide the Commission’s staff, and the staffs of other regulators, with prompt access to the registrants’ books and records. Those books and records, moreover, must be indexed and serialized.

Blockchain-based books and records are auditable in the truest sense of the word. Each entry is visible on the relevant blockchain but pseudonymized to protect privacy. Finally, blockchain-based books and records will allow regulators immediate access to registrants’ records. Regulators could maintain a node on the relevant blockchain.

Given that a blockchain can serve as the sole source of record, requiring a broker-dealer or other registrant to maintain non-blockchain copies of records for regulatory purposes is unnecessarily redundant, burdensome, and costly.

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<sup>10</sup> 17 C.F.R. § 240.17Ad-7.

**Assumption 4: Broker-dealers can operate successfully with self-custodied digital asset securities without also custodying non-security digital assets.**

The Statement raises the question of whether broker-dealers complying with the terms of the temporary safe harbor should also be allowed to self-custody non-security digital assets (*e.g.*, U.S. CBDC, ETH, or certain stablecoins). We strongly support allowing broker-dealers to self-custody these non-security digital assets to promote more efficient settlement processes around the secondary trading of digital asset securities. It will be very difficult for broker-dealers to interact with on-chain securities to the extent they are not allowed to hold non-security digital assets to facilitate settlement in those securities. In fact, certain blockchains require transaction fees or “gas” to be paid in non-security digital assets (generally, ETH). Without that ability, broker-dealers may not be able to process transactions necessary to custody or clear transactions for clients. Also, as noted above, blockchain technology has the potential to reduce settlement time from T+2 to real or near-real time settlement, which could allow the clearance and settlement process for securities transactions to match the economic realities of trading, a framework that we believe may have significant advantages. This framework depends, however, on the use of non-security digital assets. Providing broker-dealers the ability to integrate digital settlement payment alternatives for digital asset securities transactions benefits T+1 or even instantaneous settlement on a broker-dealer’s associated alternative trading system. Allowing capital that is typically tied up in the current T+2 settlement process to be re-allocated across the economy provides greater utility, liquidity, and efficiency.

Precluding broker-dealers from custodying non-security digital assets will impinge the ability of firms to settle trades in digital asset securities and make it more costly for them to interact with digital asset securities on-chain. This shortcoming highlights how the Statement fails to account for the conventions, characteristics, and operational nuances of the digital asset markets.

**Comments on Specific Requirements of the Temporary Safe Harbor**

1. The Commission mandates that broker-dealers seeking to custody digital asset securities establish, maintain, and enforce reasonably designed written policies and procedures covering a range of issues, including the following:
  - a. conduct and document an analysis of whether a digital asset is a security offered and sold pursuant to an effective registration statement or an available exemption from registration, and whether the broker-dealer has fulfilled its requirements to comply with the federal securities laws with respect to effecting transactions in that digital asset security, before undertaking to effect transactions in and maintain custody of such asset. Such policies and procedures should provide a reasonable level of assurance that any digital

assets transacted in or held in custody by the broker-dealer are in fact digital asset securities.

It is not practicable or necessary under current circumstances to require a broker-dealer to conduct an analysis of whether a digital asset is a “security”. Virtually all activity by registered broker-dealers involves “intended” digital asset securities – that is, digital asset securities issued by an issuer and intended to be treated as a security under the Federal securities laws (rather than digital assets the Commission deems constitute “investment contracts”). For these “intended” digital asset securities, no special analysis is needed.

Moreover, the Commission has yet to provide specific rules setting forth when a digital asset constitutes an “investment contract”, making it difficult for a broker-dealer to make that determination, should this be relevant. As a result, broker-dealers have no reasonable basis or ability to make that determination with respect to digital assets that are not “intended” digital asset securities.

To date, the guidance provided by the Commission or its staff on this topic is comprised of the following:

- A Report of Investigation. The DAO Report;<sup>11</sup>
- A non-binding speech - Remarks by William Hinman regarding Digital Asset Transactions: When *Howey* Met Gary (Plastic), made at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018);<sup>12</sup>
- A non-binding publication published by FinHub - Framework for “Investment Contract” Analysis of Digital Assets dated April 3, 2019 issued by the Strategic Hub for Innovation and Financial Technology (“FinHub”);<sup>13</sup>
- The non-binding SEC – FINRA Joint Staff Statement; and
- A range of enforcement actions and no action letters that provide limited guidance on how to determine whether a digital asset is a security or non-security digital asset.<sup>14</sup>

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<sup>11</sup> Report of Investigation Pursuant to Section 21(a) of the Sec. Exch. Act of 1934: The DAO (Exch. Act Rel. No. 81207) (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf> (“The DAO Report”).

<sup>12</sup> William Hinman, Director, Sec. and Exch. Comm’n, Speech at the Yahoo Finance All Markets Summit: Crypto, Digital Asset Transactions: When *Howey* Met Gary (Plastic) (June 14, 2018), <https://www.sec.gov/news/speech/speech-hinman-061418>.

<sup>13</sup> Sec. and Exch. Comm’n Div. of Corp. Fin, Framework for “Investment Contract” Analysis of Digital Assets (Apr. 3, 2019), <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>.

<sup>14</sup> See, e.g., TurnKey Jet, Inc. - Response of the Division of Corporation Finance (Apr. 3, 2019), <https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm>; Pocketful of Quarters, Inc. – Response of the Division of Corporation Finance (July 25, 2019), <https://www.sec.gov/corpfin/pocketful-quarters-inc-072519-2a1>; SEC v. Telegram Group Inc., No. 1:19-cv-09439 (S.D.N.Y. Oct. 11, 2019), <https://www.sec.gov/litigation/complaints/2019/comp-pr2019-212.pdf>; and SEC v. Ripple Labs, Inc., No. 1:20-cv-10832 (S.D.N.Y. Dec. 22, 2020), <https://www.sec.gov/litigation/complaints/2020/comp-pr2020-338.pdf>.

While some of these statements purport to be “guidance” in this area, none offer a specific framework for determining with reasonable certainty whether a digital asset at any moment in time is in fact a security, nor are they binding statements, other than those specific to a particular platform like the DAO Report, Turnkey Jet, and Pocketful of Quarters.<sup>15</sup> Indeed, the fact that XRP had been issued and outstanding for 8 years and was treated as a currency by another U.S. government agency, and yet is now considered to be a security by the Commission, is a clear example of the difficulty that issuers and market intermediaries have in reasonably assessing how the Commission will treat a given digital asset, now or in the future.<sup>16</sup>

In addition, Commissioner Hester Peirce publicly proposed a three-year safe harbor that would “provide network developers with a three-year grace period within which to facilitate participation in and the development of a functional or decentralized network, exempted from the registration provisions of the federal securities laws, so long as the conditions are met. This objective is accomplished by exempting: (1) the offer and sale of digital assets from the provisions of the Securities Act of 1933, other than the antifraud provisions, (2) the digital assets from registration under the Securities Exchange Act of 1934, and (3) persons engaged in certain digital asset transactions from the definitions of “exchange,” “broker,” and “dealer” under the 1934 Act.”<sup>17</sup> Commissioner Peirce’s proposed safe harbor has still not been taken up formally by the Commission.

In our view, the Commission has yet to provide a clear and specific framework that would allow issuers and market intermediaries to properly analyze when a digital asset that is not an “intended” digital asset security should be deemed to be a security and vice versa. Until such binding rules are promulgated, it is problematic to require that a broker-dealer seeking to custody digital asset securities or to settle transactions utilizing a non-security digital asset take on that burden and associated risk.

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<sup>15</sup> See, e.g., Chamber of Dig. Commerce, *New SEC Framework Signals the SEC is Open to Recognizing that Tokens Are Not Securities, But Does Little to Advance Clarity* (May 1, 2019), <https://digitalchamber.org/sec-framework/> (stating that “By developing a list of over 60 criteria for analysis, the SEC staff has ensured that every token platform will trigger at least one of those criteria, if not more, thus expanding any analysis significantly.” It goes on to state that “with little explanation of which factors carry more weight and which carry less, or how those are measured, participants in token systems (and legal counsel for those participants) have an even more challenging task of determining when the relevant token reasonably may be considered a security. Thus, while the insight into the various factors that may cause a token to be viewed as a security is interesting, the sheer number of those factors without meaningful guidance as to how those will be weighted and assessed, potentially creates more ambiguity, rather than less.”)

<sup>16</sup> See *Ripple Labs, Inc.*, No. 1:20-cv-10832 (S.D.N.Y. Dec. 22, 2020), <https://www.sec.gov/litigation/complaints/2020/comp-pr2020-338.pdf>.

<sup>17</sup> Hester Peirce, Commissioner, Sec. and Exch. Comm’n, *Speech at International Blockchain Congress: Running on Empty: A Proposal to Fill the Gap between Regulation and Decentralization* (Feb. 6, 2020), <https://www.sec.gov/news/speech/peirce-remarks-blockress-2020-02-06>.

We also raise the following points when imposing this obligation on broker-dealers seeking to custody digital asset securities:

- The issuer and its legal counsel are best placed to determine whether a digital asset is a security, as opposed to a third-party broker-dealer.
- If it should fall to the broker-dealer to ensure the status of a digital asset, we believe that guidelines and a safe harbor would need to be issued by the Commission to protect the broker-dealer from potential enforcement action.
- The Statement fails to identify the benefit provided to investors from the broker-dealer assuming this obligation.
- The Statement fails to provide an analysis of the costs associated with satisfying this condition.
- The Statement fails to address the possibility of various broker-dealers reaching a different conclusion with respect to the status of a specific digital asset.

The Commission must address these concerns to provide a level of certainty for broker-dealers seeking to self-custody digital asset securities.

b. conduct and document an assessment of the characteristics of a digital asset security's distributed ledger technology and associated network prior to undertaking to maintain custody of the digital asset security and at reasonable intervals thereafter.

The Chamber generally supports this requirement to the extent that it does not impose obligations in excess of those currently applicable to a broker-dealer requiring that it evaluate the technology associated with its custody platforms. We also note the inefficiency of requiring each special purpose broker-dealer to conduct a review of a digital asset security's distributed ledger technology and associated network and request that the Commission make clear that special purpose broker-dealers are permitted to rely on a reasonably determined third party assessment of that technology. This is particularly important for the Ethereum network, which is by far the most commonly used blockchain with respect to digital asset securities. It would be extremely inefficient if each special purpose broker-dealer had to conduct a redundant examination of the suitability of the Ethereum blockchain for maintaining digital asset securities.



c. for safekeeping and demonstrating the broker-dealer has exclusive possession or control over digital asset securities that are consistent with industry best practices to protect against the theft, loss, and unauthorized and accidental use of the private keys necessary to access and transfer the digital asset securities the broker-dealer holds in custody.

The Chamber questions the feasibility of a broker-dealer complying with this requirement inasmuch as it is not clear to us whether “industry best practices” yet exist that provide the required framework for evaluation. The digital asset security industry has had difficulty developing any such best practices absent clear guidance on this and the other numerous issues raised in this letter. While the Statement offers a path forward, best practices will only arise as digital asset securities are more widely used, which will occur only as the Commission offers concrete guidance allowing for their use. The Chamber is closely monitoring developments in this space with a goal to identifying best practices as they are developed by our Members. In the meantime, the Commission should modify this requirement to make clear that a special purpose broker-dealer could adopt processes and procedures reasonably designed to demonstrate that it has exclusive possession and control over the digital asset securities that it is custodying.

We also note that the Chamber is in the process of publishing a separate work that provides recommended best practices for proving that an entity holds assets sufficient to support customer liabilities.

d. to address specific events, including: (1) specifically identify, in advance, the steps it intends to take in the wake of certain events that could affect the firm’s custody of the digital asset securities, including blockchain malfunctions, 51% attacks, hard forks, or airdrops; (2) allow the broker-dealer to comply with a court-ordered freeze or seizure; and (3) allow the transfer of the digital asset securities held by the broker-dealer to another special purpose broker-dealer, a trustee, receiver, liquidator, a person performing a similar function, or another appropriate person, in the event the broker-dealer can no longer continue as a going concern and self-liquidates or is subject to a formal bankruptcy, receivership, liquidation, or similar proceeding.

Digital asset securities differ significantly from non-security digital assets when it comes to risk of attack, theft, or loss of keys. For example, digital asset security creation utilizes technology that is fully capable of allowing an issuer to freeze, revoke, and reassign any digital asset security issued in a way that makes theft or loss of keys or anything sent to the wrong address as easily correctable as with traditionally represented securities. This technology also allows for corrections, compliance with court-ordered freezes, or transfer of wallets on a broker-dealer insolvency. To that end, it is unclear to us what benefit is provided to investors of requiring that a broker-dealer

adopt specific processes and procedures other than those currently applicable to registered broker-dealers to address such events.

2. The Commission also proposes written disclosures to prospective customers about the risks of investing in or holding digital asset securities. It further notes that digital asset securities may not be “securities” as defined in SIPA - and in particular, digital asset securities that are “investment contracts” under the *Howey* test but are not registered with the Commission are excluded from SIPA’s definition of “securities” - and thus the protections afforded to securities customers under SIPA may not apply with respect to those securities.

While it is not unreasonable for the Commission to require that broker-dealers provide customer disclosures highlighting the risks and rewards of digital asset securities, we question the idea that such a disclosure must include language “*explaining that digital asset securities may not be “securities” as defined in SIPA.*” This would imply that the intended digital asset securities that special purpose broker-dealers will trade and/or custody for their customers (upon which they must undertake specific analyses to classify as “digital asset securities”) may, at some point in the future, not be deemed securities after all. This is inconsistent with the Statement’s primary premise: that special purpose broker-dealers may ONLY engage in digital asset securities business, further demonstrating that the temporary safe harbor requires revision.

In its discussion of this point, the Commission also notes that the potential liabilities caused by the theft or loss of non-securities property from a broker-dealer, including non-security digital assets, could cause the broker-dealer to incur substantial losses or even fail, impacting customers and other creditors. As a consequence, the broker-dealer may need to be liquidated in a proceeding under SIPA with SIPA protection not extending to all assets that may be held at a broker-dealer.

As discussed above, digital asset securities do not pose an inherently greater risk to investors based solely on the use of blockchain technology as opposed to more traditional book-entry methods of recording security ownership. As a result, the Chamber disagrees with requiring a broker-dealer to provide the proposed written disclosures since the requirement reinforces the false narrative that digital asset securities are in fact riskier. We also disagree with the requirement regarding SIPA risk since the same concern expressed by the Commission also applies to traditional securities that are “investment contracts” and not subject to SIPA protection.

3. The Commission proposes that broker-dealers enter into a written agreement with each customer that sets forth the terms and conditions with respect to receiving, purchasing, holding, safekeeping, selling, transferring, exchanging, custodizing, liquidating, and otherwise transacting in digital asset securities on behalf of the customer.

To the extent that the Commission is not imposing additional obligations on a broker-dealer custodial digital asset securities compared to a broker-dealer custodial traditional securities, and that the term “written agreement” contemplates the language typically included in a broker-dealer’s Terms of Service, the Chamber is generally supportive of this requirement.

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The Chamber greatly appreciates the opportunity to comment on the Statement and appreciates the Commission’s consideration of the above comments and concerns.

Please feel free to contact us with any questions regarding our comments.

Very Truly Yours,



Amy Davine Kim  
Chief Policy Officer