

MEMO# 35333

June 1, 2023

Your Comments Requested by COB June 7 - ICI Draft Letter on Rule 3b-16 Definition of an "Exchange" Reopening Release

[35333]

June 01, 2023

TO: Equity Markets Advisory Committee
ETF (Exchange-Traded Funds) Committee
Fixed-Income Advisory Committee RE: Your Comments Requested by COB June 7 - ICI Draft Letter on Rule 3b-16 Definition of an "Exchange" Reopening Release

ICI is circulating the draft comment letter regarding the Securities and Exchange Commission's (the "Commission" or SEC) supplemental information and reopening of the comment period for its proposal that would, among other things, amend Rule 3b-16 under the Securities Exchange Act of 1934, which defines certain terms used in the statutory definition of "exchange."^[1] While the Reopening Release primarily focuses on how proposed amended Rule 3b-16 ("Proposed Rule 3b-16") would apply to crypto asset securities and blockchain trading systems, it also provides supplemental commentary on Proposed Rule 3b-16's application to order management systems, order execution systems, and order execution management systems (collectively referred to as OEMSs) and ETF portals. OEMSs and ETF portals are the focus of ICI's letter.

Comments are due to the SEC by Tuesday, June 13. To ensure that we have sufficient time to incorporate or address any further member comments and views before the 13th, please provide me with any feedback or comments by email at kevin.ercoline@ici.org no later than COB Wednesday, June 7.

Overall, ICI agrees with the Commission's statements in the Reopening Release suggesting that OEMSs and ETF portals do not generally have the characteristics of an exchange and do not otherwise fall within the regulatory intent of Proposed Rule 3b-16. As stated in our comment letter filed in response to the Original Proposal, we do not believe the SEC intended OEMSs and ETF portals generally to meet the definition of "exchange," although Proposed Rule 3b-16's broad and ambiguous language created uncertainty regarding whether such systems could be deemed exchanges.^[2] While we support the Commission further revising Proposed Rule 3b-16 to incorporate the language it requests comment on in

the Reopening Release, we continue to believe that the market would benefit from the regulatory certainty provided by the Commission explicitly clarifying that OEMSs that perform specified functions commonly utilized by advisers to manage orders and ETF portals would not be "exchanges."

Section I of our letter recommends that the SEC provide explicit clarification, by adopting clearer language in Proposed Rule 3b-16 and by offering explicit statements and guidance, that OEMSs with certain characteristics are not "exchanges" under any final Rule 3b-16. In Section I, we first provide background information about how advisers currently use OEMSs. Second, we recommend that the SEC adopt many of the changes to Proposed Rule 3b-16 on which the SEC requests comment in the Reopening Release. Third, in response to comments by the SEC regarding OEMSs, we emphasize prior guidance from the SEC that a system automating management of customer orders and facilitating internal agency cross-trades as part of that automated management is not an "exchange." Finally, we further recommend that the Commission provide certainty to market participants by providing a list of non-exclusive examples of functions that would not cause an OEMS to meet the definition of an exchange under any final Rule 3b-16, similar to the list the SEC compiled in 1998 for the Regulation ATS Adopting Release.^[3]

Section II of our letter similarly recommends that the SEC explicitly clarify that ETF portals are not "exchanges" under any final Rule 3b-16. In Section II, we first provide background on how ETF portals operate and the functions they help facilitate. Second, we explain why ETF portals are not, and should not be deemed, "exchanges" under any final Rule 3b-16. Finally, for the avoidance of doubt, we request that the Commission explicitly clarify that an ETF portal is not an "exchange" under any final Rule 3b-16.

Kevin Ercoline
Assistant General Counsel

Sarah A. Bessin
Deputy General Counsel - Markets, SMAs & CITs

Notes

^[1] Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange," Exchange Act Release No. 97309 (April 14, 2023), 88 Fed. Reg. 29448 (May 5, 2023), available at <https://www.govinfo.gov/content/pkg/FR-2023-05-05/pdf/2023-08544.pdf> ("Reopening Release"). See also Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, Exchange Act Release No. 94062 (Jan. 26, 2022), 87 Fed. Reg. 15496 (Mar. 18, 2022), available at <https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-01975.pdf> ("Original Proposal").

^[2] Letter from Sarah A. Bessin, Associate General Counsel, and Nhan Nguyen, Assistant General Counsel, ICI, to Vanessa A. Countryman, Secretary, SEC, on the Original Proposal at 2-3 (April 18, 2022), available at <https://www.sec.gov/comments/s7-02-22/s70222-20124231-280809.pdf> ("Prior Letter").

[3] See Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 40760 (Dec. 8, 1998), 63 Fed. Reg. 70844, 70854-56 (Dec. 22, 1998), available at <https://www.govinfo.gov/content/pkg/FR-1998-12-22/pdf/98-33299.pdf> ("Regulation ATS Adopting Release").

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