

SEC Order Granting Temporary Conditional Exemptive Relief for Trading of Tokenized NMS Stock on Tokenized Securities Venues “Innovation Exemption”

FAQs on the Innovation Exemption and Considerations for Issuers

4-927 Order Granting Temporary Conditional Exemptive Relief, Pursuant to Section 36(a)(1) of the Securities Exchange Act of 1934, from the Definition of “Exchange” in Section 3(a)(1) of the Exchange Act for the Use of Certain Distributed Ledger Trading Venues for Tokenized NMS Stocks and from the Definition of “Dealer” in Section 3(a)(5) of the Exchange Act for Certain Liquidity Providers for Tokenized NMS Stocks, and Request for Comment

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**Provided for Informational Purposes as Excerpts from the
*SEC’s Highlights of the Order Granting Exemption Relief***

“The order facilitates the permissioned trading of tokenized NMS stock using innovative AMMs and liquidity pools (together referred to as “AMM Liquidity Pools”) on public, permissionless blockchain by exempting TSVs from the definition of “exchange” in the Exchange Act (“TSV Exemption”). A TSV is an organization, association, or group of persons that brings together buyers and sellers in tokenized NMS stock by: (1) providing one or more AMM Liquidity Pool(s) for permissioned participants to interact and agree to terms of a trade and (2) setting standards for persons to access trading on such AMM Liquidity Pool(s). Tokenized NMS stock means an NMS stock that is (1) a security tokenized by, or on behalf of, the issuer of the underlying NMS stock; or (2) a security tokenized by a third party that is unaffiliated with the issuer of the underlying NMS stock. “Tokenized NMS stock” does not include securities where a third party issues a crypto asset representing its own security that provides synthetic exposure to an underlying security, such as a tokenized linked security or a tokenized security-based swap.

The order also exempts from the definition of “dealer” in the Exchange Act any liquidity provider in an AMM Liquidity Pool that supplies liquidity in the form of tokenized NMS stock using proprietary capital, as well as engaging in additional dealer activities, such as quoting pricing to customers or entering into agreements to provide committed capital (“Covered Firm”), subject to conditions (“Covered Firm Exemption”). Among other things, for the exemption to be available, a liquidity provider’s securities activities

must be limited to activities related to the trading of tokenized NMS stock in an AMM Liquidity Pool operating pursuant to the TSV Exemption.

The exemptions are subject to conditions that are carefully scoped to ensure that they further the goals of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation, which include, among others, the following conditions:

- Tokenized NMS stock traded on a TSV is subject to limits on the number of symbols and volume traded;
- A TSV must verify that the tokenized NMS stock made available for trading on the TSV provides holders the same rights and privileges as does traditional NMS stock of an equivalent class;
- Before making available for trading tokenized NMS stock that is tokenized by an unaffiliated third party, the TSV must provide written notice and an opportunity to object to the issuer of the underlying NMS stock;
- Smart contracts used by a TSV must be auditable, public, and deployed on a public, permissionless distributed ledger; and
- A TSV must provide public notice about its operations, trading activities, and the trading activities of its affiliates on the TSV.”

Considerations for Issuers on the SEC's Innovation Exemption

On September 17th, the SEC released the Innovation Exemption: a temporary order granting conditional exemptive relief to Tokenized Securities Venues (“TSV”) to trade tokenized versions of U.S. public company stock in an environment that sits outside of the National Market System (aka Regulation NMS), which governs all US equities trading today, while the SEC considers the need for additional action to facilitate onchain trading.

Specifically, the Innovation Exemption provides as follows:

A framework for trading tokenized equities: The order permits TSVs to trade certain categories of tokenized equities (subject to issuer opt-outs and other restrictions, described below). The order states “TSVs can trade tokenized NMS stocks that are tokenized by, or on behalf of, the issuer of the underlying NMS stock or a security tokenized by a third party that is unaffiliated with the issuer of the underlying NMS stock.” Eligible tokenized stocks must be a full digital representation of the underlying stock and provide holders with equivalent shareholder rights, including voting, dividends, and liquidation rights. Synthetic products that provide economic exposure without ownership of the underlying stock are not eligible under the exemption. Under the terms of the Exemption, tokenized securities traded on TSVs are to be traded in pairs against stablecoins, cryptocurrencies, or tokenized money market funds, but not cash. TSVs can begin operating as quickly as 30 days after filing public notice with the SEC.

A TSV may trade a **tokenized security upon written notice to its issuer, unless the issuer opts-out**: Before a TSV may trade stock tokenized by an unaffiliated third party, it must provide written notice to the issuer and wait at least 30 calendar days. Issuers can opt-out, and we have provided additional information about the opt-out process in the section below.

Volume and scope limitations: Tokenized NMS stocks traded on a TSV are subject to limits on both the number of symbols and the volume traded which constrains the overall scope of the exemption. A TSV may trade up to 75 Tier 1 symbols (S&P 500, Russell 1000, and certain eligible ETPs), each capped at 0.25% of prior-month average daily volume, and up to 250 Tier 2 symbols (other eligible NMS stocks), each capped at 2.5% of prior-month average daily volume, with affiliated TSVs aggregating their activity toward these limits. Note that these volume caps are imposed on a per-TSV basis and each TSV may choose which symbols to trade.

No requirement of interoperability: Although the Innovation Exemption imposes volume caps on the tokenized securities that TSVs may trade, it does not require that tokens traded be interoperable with one another across TSVs or with the broader securities market. Thus, a TSV could be the predominant or even exclusive venue in which a tokenized security trades. Indeed, a TSV could design a token such that it is only able to trade on the TSVs own platform and will not be eligible to trade anywhere else. If this is the case, the TSV is required to disclose this limitation publicly, but it is not required to address it in any manner.

How do the national market system rules work today, and what do they deliver for investors and issuers in terms of price transparency?

National market system rules normal require securities markets to display, in real time, the best bids and offers for all securities they trade, and to report that data without delay to a centralized securities information processor (SIP). The SIP aggregates the best bids and offers across all connected markets and publishes the National Best Bid and Offer (NBBO), the single best bid and offer for a security across all U.S. equities markets at any given time during the trading day. Markets must also report trade execution data to the SIP in near real time.

Together, this system enables issuers, broker-dealers, and investors to compare which markets can offer the best available prices at any given time, and to better understand market behavior, what is driving it, and what may happen going forward. These rules deliver price transparency across many individual markets. They are essential to ensuring

investors and their brokers have ready access to the information needed to obtain best execution at any given time.

What does it mean if a trading venue does not display its best prices, report them to the SIP, or do so in near real time?

The Innovation Exemption does not require TSVs to display their best prices, report them to the consolidated tape or publish trade execution data until 10 minutes after trades occur, unlike traditional equity markets. This effectively creates a shadow market for equity securities that can become disconnected from the broader market in both pricing and price transparency. Issuers, investors, and broker-dealers participating in TSVs will lack the information available elsewhere to understand, at any point in time, how TSV prices compare to prices for the same securities in the broader market. It will also impair their ability to understand what has just happened in the markets, or what is likely to happen next, with respect to the prices of those securities.

Where these rules do not apply, investors will not know, or will not know in a timely manner, or without undue effort or expense, whether the prices they receive on a TSV are better, worse, or the same as what is available elsewhere. Investors may not appreciate that the stock ticker they see on their television screens or devices may be inconsistent with the prices they actually receive when buying or selling on a TSV.

The above impairs an issuer's ability to maintain a complete, accurate, and contemporaneous understanding of the price and trading behavior of its own securities. In addition, to the extent investors are confused or receive poor outcomes on a TSV where the issuer authorized its stock to trade, investors may assign blame to the issuer.

The following questions can help an issuer conduct diligence on a TSV before deciding whether to consent or object.

- Whether and how does the TSV intend to address the risk of price dislocations on its market?
- How will it communicate those risks to investors and mitigate their impact?
- Whether and how will the TSV provide timely, actionable market data so issuers, investors, and market participants can understand what is happening on the venue, what is driving that behavior, and what is likely to occur next?

What Issuers Will Need to Consider Now

There is no immediate action required, however it is important for issuers to understand the notification and consent/opt-out process, so they are prepared to respond if a qualifying TSV seeks to tokenize their shares.

Written notification: If a qualifying TSV wants to tokenize a company's shares, the TSV must provide written notification and an opportunity for the issuer to object.

The Order states "Issuer Notice must be sent to the physical or email address for the issuer's principal executive offices listed on the cover page of the issuer's Exchange Act reports. Issuer Notice must include the TSV's current and accurate contact information for the issuer to provide any notice of its objection."

Companies should confirm that this information is current and that the relevant physical mailboxes are actively monitored. Issuers should also understand that because the Innovation Exemption is effective immediately, issuers may begin receiving written notifications from TSVs or prospective TSVs at any time.

Object/Opt-Out: After receiving notice, an issuer will have 30 calendar days to evaluate the proposal and submit an objection. Any objection must be delivered directly to the venue that provided the notice.

If an issuer objects within the 30-day period, the venue may not make the tokenized stock available for trading under the exemption. If no objection is received within the 30-day period, the venue may proceed, subject to the conditions of the exemption.

Nasdaq *cannot* submit or process objections on behalf of issuers.

Notifications and Opt-Outs are on a Per-TSV Basis: Issuers should be aware that any notice it receives for a TSV to trade its securities is effective only for that TSV. Likewise, any opt-out that an issuer communicates is effective only for the particular TSV that issued the notice.

The Innovation Exemption does not provide for a blanket opt-out that is applicable to any and all TSVs that wish to trade tokenized versions of an issuer's securities.

Nasdaq's Perspective

Tokenization of real-world assets, including US equities, is advancing from concept to commercial reality, an evolution that holds real promise for how capital markets operate.

As the SEC and other government leaders drive these market innovations forward, we are strongly advocating for corporate issuers to remain at the center of the tokenization of their equities in a manner that preserves issuer control, existing regulatory frameworks, and the underlying rights associated with company shares. Importantly, we have long

advocated that issuers stay active participants in decisions that affect how their shares are represented and traded.

We were pleased to see that the SEC included the concept of negative consent for issuers, and support its request for public comment to help inform further considerations.

While we laud steps to bring America's capital markets into the digital age, the Innovation Exemption introduces new considerations for corporate issuers. Specifically, issuers should consider how TSVs trading tokenized versions of U.S. public company stock in environments *outside* the National Market System have the potential to undermine transparent price discovery, fair access to market data, and the safeguards that Regulation NMS provides to investors in existing securities markets.

In our view, experimentation should not fragment liquidity, weaken the link between trading interest and the public price of a company's shares, or create a parallel market structure without the safeguards needed to operate responsibly at scale. Given these risks we believe issuers must be cautious about their participation in this initiative, as the consequences for liquidity, price discovery, and long-term shareholder value may not become apparent until well after the experiment is underway.

As an issuer ourselves, having carefully reviewed and weighed these current considerations of the Innovation Exemption, we intend for Nasdaq, Inc. (Nasdaq: NDAQ) to opt out of TSVs.