MEMORANDUM

To: Crypto Task Force Meeting Log
From: Crypto Task Force Staff
Re: Meeting with Representatives of Kiln and FS Vector, LLC

On May 8, 2025, Crypto Task Force Staff met with representatives from Kiln and FS Vector, LLC.

The topic discussed was approaches to addressing issues related to regulation of crypto assets. Kiln and FS Vector, LLC representatives provided the attached documents, which were discussed during the meeting.

Kiln proposed agenda for SEC CFT Meeting:

- Recognition of Staking as a Technological Infrastructure Function
- Role of Third-Party Staking Service Providers
- Decentralization & Functional Utility vs Speculative Characteristics
- Distinguishing Functional Utility in Liquid Staking from Investment Contracts
- Views on Maximal Extractable Value
- Views on Crypto Lending
- Addressing Fraud and Manipulation in cases where a Surveillance-Sharing Agreement does not Exist

April, 2 2025

Crypto Task Force
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: There Must Be Some Way Out of Here

Dear Task Force Members:

Kiln USA Inc (**Kiln**) appreciates the opportunity to respond to the U.S. Securities and Exchange Commission's (the **SEC** or **Commission**) Crypto Task Force (**Crypto Task Force**) February 21, 2025 request for information on crypto policy matters and to assist the Crypto Task Force in its goal of providing clarity on the application of the U.S. federal securities laws to the crypto asset market. As the leading non-custodial provider of enterprise-grade staking services, Kiln is uniquely positioned to respond to Commissioner Peirce's recent request for information, "There Must Be Some Way Out of Here" (**RFI**).[1]

Kiln provides technology services which facilitate digital asset owner's ability to act as validators on all major Proof-of-Stake (**PoS**) blockchains, thereby securing the networks on which they participate and earning programmatical blockchain rewards on their digital assets for their efforts. Kiln technology further supports the validation of over 4.3% of the ETH staked on the Ethereum network on a multi-client, multi-cloud, and multi-region infrastructure. Kiln also provides a validator-agnostic suite of products for fully automated deployment of validators and reporting and rewards management, which streamlines stakings operations for custodians, wallets, and exchanges across providers.

Our responses to Cmr. Pierce's questions contained in the RFI are below.

RESPONSES TO RFI QUESTIONS

Question 3: Certain crypto assets are used in a variety of functions inherent to the operation of a blockchain network, such as mining or staking as part of a consensus mechanism or securing the network, validating transactions or other related activities on the network, and paying transaction or other fees on the network. These technology functions may be conducted directly or indirectly, such as through third-party service providers. What types of technology functions are inherent to the operation of a blockchain network? Should the Commission address the status of technology functions under the federal securities laws and, if so, what issues should be addressed?

Response:

[1] *See* "There Must Be Some Way Out of Here", Statement by Commissioner Hester M. Peirce, Feb. 21, 2025, *available at https://www.sec.gov/newsroom/speeches-statements/peirce-statement-rfi-022125.*

Consistent with the SEC Division of Corporation's recent statement on certain proof-of-work mining activities,[2] we believe that activity related to or involving the functions of PoS blockchains generally does not involve the offer and sale of securities within the meaning of Section 2(a)(1) of the Securities Act of 1933 (the "**Securities Act**") and Section 3(a)(10) of the Securities Exchange Act of 1934 (the "**Exchange Act**"). We would encourage the SEC or its staff to release further guidance providing for the same.

The **types of technology functions that are inherent to the operation of a blockchain network** include:

- **Consensus Mechanisms** – Blockchains rely on consensus mechanisms to ensure that the ledger is the same for all network participants. These consensus mechanisms in turn incentivize the correct validation of transactions and thereby secure the network. In PoS blockchains, staking participants (validators or delegators) commit (or "stake") tokens to earn the right to be automatically selected by the blockchain network to propose a new block. If the validator proposes a block incorrectly, other validators will point this out, and the validator that proposed the incorrect block could lose some of its "stake." This economic mechanism, together with the confirmation of blocks by other validators, protects the network from bad actors and thus eliminates the need for designated trusted intermediaries to verify network transactions. PoS consensus mechanisms achieve this decentralized network security without the astronomical energy consumption required for Proof-of-Work consensus mechanisms, making PoS a critical component of Web3 infrastructure.
- **Validation & Block Production** – Blockchains are essentially P2P networks enabling users to interact without needing a centralised intermediary. They require a distributed group of users to operate computers (i.e. "nodes") which run the software necessary for the system to operate. For PoS consensus mechanisms, nodes act as "validators" of recorded and new information. Validators process transactions, propose new blocks, and verify the legitimacy of transactions in accordance with network rules. This ensures the trustless and decentralized nature of blockchain technology. Infrastructure providers like Kiln play a key role in facilitating this validation process by offering staking infrastructure in a non-custodial and non-discretionary manner, reducing operational complexity while allowing users to retain control of their assets and participate in validation directly.
- **Block Creation Fee Payments** – Most PoS blockchain automatically emit rewards to validators for proposing a block that is accepted by the validator group. In addition, many networks require users to pay fees (often in native tokens) to compensate validators for including their transactions in a block. These fees are inherently not discretionary or profit-based but are instead set by protocol mechanisms (e.g., Ethereum's EIP-1559 fee markets). Their function is infrastructural, akin to bandwidth or computing fees.
- **Smart Contract Execution** – Some blockchain networks, such as Ethereum, support decentralized applications **(**"dApps") and smart contracts. Smart contracts allow on-chain

[2] See Statement by SEC Division of Corporation Finance, "Statement on Certain Proof-of-Work Mining Activities" (Mar. 20, 2025), available at: https://www.sec.gov/newsroom/speeches-statements/statement-certain-proof-work-mining-activities-032025.

programmability and automation, further reinforcing blockchain networks as technology platforms.

- **Staking & Delegation** – PoS blockchains enable token holders to either validate directly or delegate their assets to third-party non-custodial service providers, like Kiln, who provide the technical infrastructure for validation. These mechanisms allow broad participation in securing the network. Importantly, staking does not involve the transfer of ownership or control of assets, capital formation, discretionary investment management, or redistribution of profits in the manner typically associated with investment contracts under *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). Rewards are automatically emitted by the applicable network to incentivize participants to the blockchain's security.

Given the technological and economic importance of the above blockchain functions, Kiln believes that the SEC should provide regulatory clarity while recognizing the fundamental differences between blockchain infrastructure operations and traditional securities transactions.

- **Recognition of Staking as a Technological Infrastructure Function** – Staking services form a core layer of PoS blockchains, ensuring security and network liveness. Staking participants—whether validators or those delegating to them—receive protocol-defined rewards for their role in maintaining consensus. These rewards are not generated through managerial effort or entrepreneurial discretion and therefore fall outside the scope of the investment contract analysis established under *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

  Specifically, the *Howey* test requires:

  1. An investment of money;
  2. In a common enterprise;
  3. With an expectation of profits;
  4. Derived from the efforts of others.

  Participants in PoS validation commit tokens not in expectation of profits from others' efforts, but as part of a protocol-defined mechanism to achieve consensus. Validators perform a rule-bound, automatic function that is inseparable from the infrastructure of the network itself.

  Similarly, staking infrastructure services do not resemble the kinds of instruments the Supreme Court has treated as securities under the *Reves v. Ernst & Young*, 494 U.S. 56 (1990) framework. Under *Reves*, courts assess whether a note (or similar instrument) has a "family resemblance" to traditional securities by examining its purpose, expectations of the parties, and whether an alternative regulatory scheme exists. Here, infrastructure services do not fit that profile: they do not raise capital, do not resemble debt-like obligations, and function within a technical, not financial, regulatory perimeter.

  Kiln encourages the Commission to adopt functional, technology-neutral criteria to distinguish core infrastructure activities from financial services.

The SEC should clarify that the act of participating in a blockchain's consensus mechanism by validating transactions in return for fees paid by other users or rewards which are automatically emitted by the blockchain does not fall within the ambit of the federal securities laws. While such participants receive payments for their contributions which make the business of staking profitable, such payments are better characterized as service fees rather than profits due to the managerial efforts of a third party. To earn rewards, a validator must "stake" (or risk) their own assets to "prove" they intend to comply with the rules of the protocol. Upon their successful compliance with such rules, rewards are emitted directly to them. At no point does the participant rely on the managerial efforts of any third party, and as such the receipt of fees and block rewards should not be characterized as involving a securities transaction.

- **Third-Party Service Provider Role** – Many blockchain participants utilize non-custodial or delegated staking services such as those offered by Kiln which facilitate participants' access to consensus mechanisms of blockchain networks. Staking services such as Kiln's provide technological infrastructure, playing a similar role to that of cloud computing services in traditional finance. The provision of technological infrastructure that eases access to such consensus mechanisms in a reliable manner is a ministerial service, rather than the essential managerial efforts which can implicate the federal securities laws. Moreover, the participants' expectation of profits primarily comes from the consensus mechanism of the applicable blockchain network, which emits rewards and causes the payment of transaction fees which have value due to the utility of the network. Many customers also believe that their staked assets and accrued rewards will appreciate in price; however, such appreciation results from broad and decentralized market forces. These rewards are not shares of the staking service providers' profits or the capital appreciation of an investment into the staking service provider. These service providers do not manage investments or offer return guarantees. In short, the provision of staking services is not the offer or sale of securities in an enterprise: instead, staking service providers' technical infrastructure performs ministerial network functions on behalf of customers in exchange for payment for their services.

  Accordingly, Kiln believes the Commission should issue guidance clarifying that third-party staking providers, when operating in a non-custodial, non-discretionary, and protocol-conformant manner, are not engaged in the issuance, offer, or sale of securities.

- **Decentralization & Functional Utility** – Many blockchain networks operate autonomously through decentralized protocol governance. The native tokens in these systems typically serve functional purposes—for example, staking, governance participation, fee payment, or resource allocation. These tokens may enable network participation, but they do not inherently confer investment interests or profit expectations. While there may be a speculative market for these utility tokens, the law has long recognized that potential for speculation on an asset should not necessarily result in that asset being characterized as a security. For example, there are secondary markets for season tickets to professional sports events that remain unregulated by the SEC. The SEC should consider when the decentralized nature and primary utility of these types of tokens

substantially outweigh any potentially speculative purpose and release appropriate guidance that allows technological innovation to flourish.

A regulatory framework that brings clarity should recognize that many crypto assets serve as inputs to technical systems, not as proxies for investor claims or financial returns. Misclassifying these functional assets as securities could undermine core network participation, reduce economic security, and disincentivize responsible infrastructure provisioning in the United States.

Question 4: **Users of liquid staking applications receive a so-called "liquid staking token." This token represents their staked crypto asset, and the token can be used in other activities, all while continuing to participate in the proof-of-stake protocol. Should the Commission address the status of liquid staking tokens under the federal securities laws, and, if so, what issues should it address?**

Response:
Liquid staking is a technological solution that provides liquidity and increased efficiency for participants in PoS blockchain networks, without sacrificing security and participation in network protocols. Liquid staking addresses one of the main issues often associated with staking models - that once tokens are staked, they are locked up and can't be used until the "unbonding" period expires. It allows token holders to deploy their tokens via a liquid staking protocol to receive a receipt token or Liquid Staking Token ("**LST**") to evidence ownership of their staked assets (and rewards). This enables the LST holder to retain liquidity and still accrue staking rewards while the underlying assets remain staked, so the LST can be deployed in other activities.

LSTs serve a critical function in PoS ecosystems by addressing the liquidity constraints of traditional staking while preserving network security and decentralization and efficiency. PoS blockchains' consensus mechanisms rely on validators "staking" the native token of the network, during which time such assets remain non-transferable. LSTs enable participation in PoS consensus mechanisms which maintain control over a transferable receipt of ownership of the underlying staked assets. These receipt tokens increase flexibility for network participants, allowing them to engage in on-chain activities without forfeiting staking rewards or weakening the underlying protocol's integrity.
Key aspects of LSTs include:

- **Representation of Staked Assets** – LSTs are simply programmable representations of assets which customers of liquid staking protocols receive in return for staking their assets through the liquid staking protocol. LSTs can be redeemed for the staked assets and associated rewards, yet unlike the underlying staked assets retain utility. This represents an important technological innovation which allows users to contribute to the security and consensus mechanism of such proof of stake networks while effectively retaining the ability to use the assets.
- Because they are redeemable for the staked asset and associated rewards, LSTs have no speculative purpose beyond the inherent properties of the underlying staked assets. LSTs do not have embedded leverage and do not offer derivative or synthetic exposures. The SEC should recognize LSTs as an important technological innovation and clarify that

under the circumstances described above, LSTs do not fall within the ambit of the federal securities laws.

- **Use in DeFi and Other Applications** – LSTs can be utilized in DeFi applications in a manner that expands their utility within and across blockchain ecosystems.
- **Continued Participation in PoS Consensus** – PoS blockchains' level of decentralization and security is directly tied to the volume of staked assets and number of participants in the consensus mechanism. By providing continued utility to holders of staked assets, LSTs incentivize additional participation. The SEC should provide regulatory clarity that enables networks to achieve greater security at lower costs.

The SEC should ensure that any characterization of LSTs aligns with its technological function. Specifically, the SEC should acknowledge the following:

- **Distinguishing Functional Utility from Investment Contracts:**

  LSTs primarily serve as a means of retaining utility of staked assets rather than as an investment contract. Unlike securities, LSTs derive their value from a combination of protocol-governed staking reward schedules, user value derived from personal utilization of the LSTs, and broader market forces which affect the price of the underlying asset.

  From both a functional and legal standpoint, LSTs are not speculative or synthetic financial instruments. They are fully collateralized, redeemable on a 1:1 basis (subject to protocol-defined unbonding conditions), and governed by smart contract logic. LSTs do not grant rights to future profits managed by third parties, nor are they subject to discretionary management or pooling of investor funds.

  Instead, LSTs function analogously to traditional documents of title—such as warehouse receipts or bills of lading—in that they represent and track ownership of an asset while that asset remains locked or performing another technical function. Just as a warehouse receipt allows transfer of title to grain in storage without physical delivery, an LST enables transfer of ownership of a staked token without requiring the token to be unstaked. This feature is central to understanding their nature: they are records of control, not investment instruments.

  Kiln believes that the legal status of LSTs under U.S. securities laws should be assessed by reference to well-established frameworks, including the *Howey* and *Reves* tests.

  Under *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the Supreme Court defined an "investment contract" as involving:

  1. An investment of money,
  2. In a common enterprise,
  3. With an expectation of profits,
  4. Derived from the efforts of others.

  In the case of LSTs, even if one assumes prongs (1) and (2) are satisfied, there is no reasonable expectation of profits derived from the managerial or entrepreneurial efforts of others. Rewards are protocol-determined and algorithmically distributed, not earned or optimized through the managerial actions of a third party. The "profits" associated with

LSTs are simply a pass-through of staking rewards that would accrue to the underlying asset regardless of whether an LST exists.

The *Reves v. Ernst & Young*, 494 U.S. 56 (1990) "family resemblance" test—used to evaluate whether an instrument is a security in the form of a note—also supports the conclusion that LSTs are not securities. LSTs do not function as debt instruments, are not issued for capital raising purposes, and do not promise repayment or yield. Their structure, purpose, and use distinguish them from the types of notes and financial claims traditionally regulated under the securities laws.

In Kiln's view, the Commission should consider the following functional and structural features when evaluating whether LSTs fall within the scope of federal securities laws:

- **Redemption and Collateralization**: LSTs are typically backed 1:1 by the underlying staked asset, which remains immutably locked in the protocol. This collateralized design differentiates LSTs from synthetic derivatives and obviates the need for hedging or complex financial structuring.

- **Protocol-Governed and Non-Discretionary**: LST issuance, redemption, and reward accrual are automated via smart contracts. There is no human decision-making involved in yield generation or distribution, and therefore, no managerial effort that would implicate securities law under *Howey*.

- **Custodial vs Non-Custodial Design**: Many LST systems operate in a decentralized and non-custodial manner, where users interact directly with self-executing smart contracts. No central entity takes possession or exercises control over the user's assets. The regulatory framework should recognize the difference between custodial LST models (where a user relinquishes control and/or ownership of the staked asset to a centralized entity in order to obtain an LST) and non-custodial LST models (where users retain control over their funds through a sequence of self-directed, on-chain transactions rather than relinquishing control to a centralized intermediary).
- **Functional Utility vs Investment Intent**: The purpose of LSTs is to unlock liquidity and composability for staked assets—not to attract outside capital or deliver excess returns. This **technological utility** should be a key factor in assessing regulatory treatment, especially in light of increasing integration between staking and decentralized financial infrastructure.

- **Market Impact on Staking Participation and Network Security** – Overly broad application of securities laws to LSTs could have unintended consequences, including:
    - Reduced staking participation, undermining PoS blockchain security;
    - Centralization of staking within custodial institutions, reducing transparency and user control; and
    - Constraints on DeFi composability and innovation, weakening the utility and competitiveness of U.S.-based blockchain services.

To avoid these risks, Kiln supports a principles-based approach and recommends that the Commission:

- Clarify that LSTs, when fully backed, non-custodial, and protocol-governed, should not be considered securities or derivatives;
- Recognize that LSTs function similarly to legally recognized documents of title, and should be treated accordingly, where the underlying token is not a security;
- Tailor regulatory considerations to reflect structural differences between custodial and non-custodial staking protocols;
- Prioritize technology neutrality and outcome-focused regulation, rather than prescriptive classification based on superficial features like transferability or programmability.

Kiln supports regulatory efforts that provide clarity while allowing staking and liquid staking to continue contributing to securing blockchain networks and improving capital efficiency. We applaud the SEC for its effort to engage with industry stakeholders to develop tailored regulatory digital asset framework, and hope that it recognizes the protocol-driven and decentralized nature of LSTs, ensuring that regulation fosters innovation while maintaining investor protection.

Question 20: How should Commission registrants assess Maximal Extractable Value ("MEV") when they consider building or transacting in these environments? How best should Commission registrants delineate between the different types of MEV occurring on chain? In what ways is the market addressing the MEV in which MEV extractors order or re-order transactions to engage in front running, back running, or so-called "sandwich attacks"?

Response:
Maximal Extractable Value ("MEV") refers to the potential value that can arise as a byproduct of transaction ordering and inclusion decisions made during block construction within a blockchain network. MEV is not an action in itself, but rather the outcome of upstream activities that support the network's consensus process, such as arbitrage routing, liquidation execution, or transaction batching. MEV is an inherent feature of public blockchain architecture, emerging from the market microstructure that governs transaction execution. It refers to the additional value that can be derived from optimizing the ordering, inclusion, or exclusion of transactions within a given block. MEV is not an action in itself, but the outcome of upstream activities that support the block production and consensus process. There is no fixed or baseline transaction order in public blockchains. Instead, agents involved in block construction—such as searchers, block builders, and validators—access a pool of pending transactions and optimize block content based on competitive fee dynamics or other strategies. While some forms of MEV may diminish user experience, most MEV-related activity contributes positively to blockchain ecosystems by supporting network security, price discovery, and efficient execution. As such, MEV should be viewed as a neutral mechanism whose impact depends on the implementation and context. MEV is especially relevant in PoS and other blockchain protocols where transaction ordering can significantly impact the value extracted by validators or other participants, such as miners or block proposers.

When Commission registrants assess MEV, several key factors should be considered:

- **Identification of Transaction Ordering Manipulation** – Registrants should assess the potential for MEV to affect user outcomes. However, it is important to distinguish

between participants in the MEV supply chain. Validators, particularly in networks like Ethereum that implement proposer-builder separation ("**PBS**"), do not have visibility into or discretion over individual transactions within a block at the time of proposal. Rather, transaction ordering is executed upstream by searchers and block builders who compete to construct optimized blocks. While certain MEV strategies such as sandwich attacks may negatively impact users, many forms of MEV—such as arbitrage or liquidation facilitation—contribute positively to price discovery and network efficiency. Registrants should adopt a nuanced approach that recognizes the difference between harmful and benign MEV and that its mitigation is best addressed through application-level safeguards and market design rather than validator-level surveillance obligations (which would be ineffective and impossible to meet).

- **Technical Analysis of Blockchain Protocols** – Each blockchain has its own approach to consensus and transaction ordering. Registrants should conduct thorough technical assessments to understand how MEV may arise in different networks and consider how this could affect their operations and compliance obligations.
- **Transparency and Market Integrity** – While MEV is an inherent feature of public blockchain systems, registrants should consider whether their activities, or the tools and infrastructure they rely on, could contribute to forms of MEV that materially disadvantage users. In practice, this means assessing whether they are engaging in, facilitating, or benefiting from transaction flow arrangements that systematically prioritize one party's execution to the detriment of others without user consent or mitigation tools (e.g., slippage protection, OFAs, or protected mempools). Importantly, the presence of MEV alone should not be viewed as a per se violation of market integrity—many forms of MEV (e.g., arbitrage, liquidation execution) are market-stabilizing. As such, registrants should focus on implementing best practices to avoid toxic MEV (e.g., selecting ethical relayers, supporting open order flow auctions, or offering user opt-outs), rather than attempting to eliminate MEV entirely. These safeguards align with industry-led frameworks and are more technically and legally feasible than attempting to monitor or prevent MEV at the validator level.

MEV is Not Inherently Abusive

MEV is a neutral concept describing economic opportunities within transaction ordering. In many cases, MEV:

- Aids price discovery by aligning prices across decentralized and centralized exchanges;
- Enables more efficient market execution, particularly for liquidations and arbitrage trading; and,
- Strengthens network security, as MEV incentives encourage active validator participation, reducing centralization risks.

In contrast, certain forms of MEV, such as sandwich attacks, time-bandit attacks, or unethical order flow practices, can create negative externalities for users.

Regulatory frameworks should distinguish between non-toxic, efficiency-enhancing MEV and malicious or exploitative MEV, and not assume all MEV is equivalent to front-running in traditional finance

The Role of Validators Searchers, and Block Builders

MEV extraction is not directly controlled by validators but rather emerges from the interaction between searchers, block builders, and relayers. Specifically:

- Searchers identify MEV opportunities and submit transaction bundles to block builders;
- Block builders optimize block construction to maximize value while ensuring efficient execution; and,
- Validators (proposers) operate under Ethereum's PBS model, where they blindly sign block headers without knowledge of individual transactions inside the block.

Due to this separation, validators do not actively engage in transaction ordering and should not be considered as directly responsible for MEV-related activities.

Delineating Different Types of MEV

For effective regulatory oversight, a taxonomy of MEV activities is crucial. Commission registrants should categorize MEV based on impact on transaction order fairness and market integrity:

- Non-Toxic MEV (Efficiency-Enhancing)
    - DEX Arbitrage: Ensures token prices remain aligned across different platforms.
    - Liquidation Execution: Helps stabilize DeFi lending markets by executing liquidations quickly.
    - Gas Optimization & Latency Reduction: Improves transaction efficiency without disadvantaging users.
- Toxic MEV (Market-Abusive)
    - Sandwich Attacks: Manipulating transaction order to front-run a user’s trade and extract additional value.
    - Time-Bandit Attacks: Reorganizing past blocks to capture missed MEV, undermining blockchain finality.
    - Dark Pool Exploitation: Leveraging private mempools to gain an unfair advantage over public transactions.

Market Responses to MEV Challenges

The blockchain industry is actively addressing MEV-related risks through technical innovations and governance improvements:

- **PBS**
    - Implemented on Ethereum, PBS ensures that validators cannot manipulate transaction ordering, reducing potential conflicts of interest.
- **MEV-Boost and Ethical Relayers**
    - MEV-Boost, developed by Flashbots, decentralizes block production and prevents validators from engaging in MEV extraction.
    - Ethical relayers restrict access to searchers who adhere to fair market principles, reducing the likelihood of sandwich attacks.
- **Fair Ordering Protocols and Private Mempools**

    - Some decentralized exchanges (DEXs) and wallet providers are implementing private or protected mempools to prevent MEV attacks.
    - Order Flow Auctions (OFA) create a competitive market for transaction inclusion, reducing the risk of manipulation.
- **Decentralized MEV Mitigation**
    - Emerging solutions such as inclusion lists (Vitalik Buterin's proposal) and batch auctions aim to limit adversarial MEV while preserving beneficial forms of transaction optimization.

Importantly, MEV does not arise in centralized, off-chain environments such as centralized exchanges ("CEXs"), where transaction ordering occurs within closed systems controlled by the exchange operator. As such, MEV is not relevant or applicable in the context of CEX operations, and monitoring for MEV-related risks is only meaningful in public, permissionless blockchain networks where block construction is decentralized.

Kiln recognizes that MEV is an inherent challenge in blockchain environments, particularly in relation to transaction ordering. We believe that addressing MEV requires a combination of technical innovation and transparent protocols. Registrants should be diligent in assessing how MEV might impact their operations and take proactive steps to ensure they are not contributing to unfair market practices. As blockchain technology evolves, we are committed to supporting a balanced approach to MEV that fosters innovation while supporting market integrity and allowing blockchain networks to continue evolving in a transparent, efficient, and decentralized manner.

Question 33: How should the Commission approach various crypto lending concepts in a way that doesn't stifle the potential opportunities they provide?

Response:
Kiln appreciates the opportunity to engage in the ongoing conversation about the regulatory approach to crypto lending. We recognize the importance of fostering innovation within the blockchain ecosystem, including the growing sector of decentralized and crypto-backed lending, while ensuring appropriate safeguards for consumers and investors. We understand that crypto lending presents both significant opportunities and potential risks, and we believe the Commission's approach to crypto lending should strike a careful balance between protecting consumers while not stifling innovation.

Opportunities of Crypto Lending
Crypto lending represents a rapidly growing sector within the blockchain ecosystem, offering various benefits for both borrowers and lenders, including:

- **Access to Liquidity** – Crypto lending platforms enable individuals and institutions to unlock liquidity from their digital assets without needing to sell them, allowing them to retain exposure to their positions while accessing funds for other uses.
- **Yield Generation** – Lenders can earn interest on their assets when those assets are lent out through lending platforms.
- **Inclusiveness** – Many crypto lending platforms operate in the DeFi space, offering permissionless and open-access financial services that allow global participation without relying on traditional intermediaries, enhancing the inclusivity of the financial ecosystem.
- **Efficient Capital Allocation** – By enabling crypto assets to be utilized in lending markets, the sector facilitates more efficient capital flows and the provision of credit in a decentralized context.
- **Transparency –** Crypto lending protocols can operate in a fully on-chain, automated, and publicly auditable manner. This structure can reduce reliance on intermediaries and provide greater transparency into how funds are managed, including collateralization levels and liquidation logic. By contrast, centralized lending arrangements may present different risk profiles due to their reliance on internal controls and off-chain risk management practices. Recent events in the market have highlighted the importance of transparency in lending practices, particularly where insufficient disclosures or misaligned incentives have contributed to failures.

Regulatory Considerations for Crypto Lending
While crypto lending introduces innovative opportunities, it also presents unique challenges from a regulatory perspective. The Commission should approach this sector with a focus on clarity, consistency, and flexibility, particularly as it evolves alongside technological advancements. Key considerations include:

- **Clear Classification of Lending Models** – The SEC should develop a framework that distinguishes between different types of crypto lending models, such as collateralized lending, peer-to-peer lending, and decentralized lending protocols. For instance, in collateralized lending, the lender accepts crypto assets as collateral and earns interest,

while in other models, such as DeFi lending, the lending mechanisms are typically governed by smart contracts and decentralized governance systems. Each model may warrant different regulatory treatment based on its structure and function.

- **Consumer Protection** – While fostering innovation, it is crucial for the SEC to ensure that appropriate consumer protection measures are in place. This includes requiring transparency in lending terms, risk disclosures, and ensuring that users are fully aware of the risks associated with crypto lending, including the potential for loss of collateral in cases of market volatility.
- **Market Integrity** – It is vital to ensure that lending platforms operate with high standards of market integrity, preventing manipulation or fraud while also preventing financial risks from propagating across the broader market. This may include ensuring that platforms adhere to anti-money laundering and know-your-customer regulations where applicable.
- **Stability of Collateral Assets** – The SEC should evaluate how platforms assess and manage the stability of collateral assets in crypto lending markets. Given the volatile nature of digital assets, clear guidelines on how collateral is valued and liquidated in the event of default will help mitigate systemic risks.

Flexible and Proactive Regulatory Approach
Kiln believes that the Commission should take a flexible and proactive approach to regulating crypto lending, focusing on these key principles:

- **Regulatory Clarity Without Overregulation** – The Commission should provide clear guidelines that enable innovation in the crypto lending space while ensuring that platforms comply with key legal requirements, such as registration and licensing requirements, when appropriate.
- **Support for DeFi Lending** – Decentralized lending platforms, such as those found in the DeFi space, operate without a central intermediary and are governed by smart contracts. The SEC should consider these platforms separately from traditional centralized lending platforms, as they may require different regulatory frameworks to foster innovation while maintaining appropriate safeguards.
- **Collaboration with Industry Stakeholders** – It is essential that the Commission works closely with all stakeholders to develop a regulatory framework that considers the technical nature of crypto lending and its broader implications for the financial system.

RFI 34/Crypto Lending:

Question 34: Participation in traditional securities lending programs, such as fully paid securities lending programs offered by broker-dealers, generally does not represent a new securities transaction or implicate Investment Company Act registration requirements. How are crypto lending programs similar to or different from traditional securities lending programs?

Response:
Both traditional securities lending and crypto lending programs facilitate the temporary transfer of assets in exchange for compensation, but they differ in several key aspects due to the distinct

nature of the assets involved, their regulation, and the broader financial environment in which they operate. Below is a comparison of the two:

Similarities

- **Collateralization** – Both securities lending and crypto lending typically involve the lending of assets against collateral to mitigate risk. In traditional securities lending, a borrower typically provides cash or securities as collateral, while in crypto lending, digital assets (such as stablecoins or cryptocurrencies) are commonly used as collateral to secure the loan.
- **Interest/Fees** – Both programs provide an opportunity for lenders to earn income, with interest rates or fees based on the supply and demand for the assets being lent. In securities lending, the borrower typically pays a fee to the lender, while in crypto lending, the fee is typically paid in the form of interest on the borrowed crypto or stablecoins.
- **Short-Term Nature** – Both types of lending arrangements often involve short-term transactions, where the borrower is expected to return the loaned assets within a specified period, and the lender may reclaim their assets at the end of the lending period.
- **Asset Type and Nature** – The most fundamental difference between crypto lending and traditional securities lending lies in the nature of the assets involved. In traditional securities lending, the assets, such as stocks or bonds, benefit from well-established and clear legal frameworks, including those under the Exchange Act. In contrast, crypto lending deals with digital assets whose regulatory status remains unclear, including as to fundamental questions around if such assets constitute securities or commodities. The unique characteristics of digital assets, such as decentralized control and programmability, also distinguish crypto lending from its traditional counterpart.
- **Collateral Risk** – In both traditional securities lending and crypto lending, borrowers post collateral which may be highly volatile. However, crypto lending platforms have introduced innovative risk management mechanisms enabled through blockchain technology such as liquidation procedures of over-collateralized loans which rely on the nearly instantaneous verification of the value of collateral falling below a certain threshold. Unlike traditional lending markets, crypto lending procedures execute autonomously on a continuous basis and market participants can independently verify their efficacy due to the open-source nature of the underlying software code.
- **Platform Structure and Regulation** – Traditional securities lending is often facilitated through broker-dealers, custodians, and other regulated entities that are subject to well-defined regulations, including the Investment Company Act, among others. Crypto lending platforms, on the other hand, are often decentralized and operate autonomously and programmatically. While some crypto lending platforms are registered entities, decentralized finance (DeFi) platforms that employ decentralized governance and rely on autonomous smart contracts do not benefit from a tailored regulatory framework. The lack of uniform regulation for crypto lending presents unique challenges and requires tailored approaches to ensure that market integrity is maintained.
- **Role of Intermediaries** – In traditional securities lending, intermediaries such as clearinghouses and brokers play an essential role in facilitating the lending process, managing collateral, and ensuring that the transactions comply with regulations. In crypto lending, decentralized platforms may bypass intermediaries by relying on

blockchain-based smart contracts. By removing intermediaries and the transaction costs they impose, crypto lending returns value to both lenders and borrowers. Further, despite the lack of regulatory clarity, market participants can become comfortable with the risks posed by crypto lending platforms by independently verifying that the smart contract code will autonomously execute transactions as intended. Therefore, the risks posed by crypto lending – namely, operational, security, and technology risks – call for a different regulatory focus than that of traditional securities lending.

Unique Characteristics

While there are similarities between crypto lending and traditional securities lending, the SEC should consider the unique characteristics of crypto lending, particularly the decentralized nature of many platforms, Kiln believes that the SEC should:

- **Tailor Regulations to Digital Assets** – Given the distinct features of digital assets, a one-size-fits-all regulatory approach may not be suitable. The Commission should consider creating guidelines specific to crypto lending that address the unique risk mitigation strategies that DeFi offers to lenders and borrowers alike and the opportunity that blockchain technology offers to regulators to monitor market and credit risks in real time.
- **Distinguish Between DeFi and Centralized Platforms** – Crypto lending models vary significantly depending on whether they are centralized or decentralized. The SEC should apply different regulatory frameworks depending on the structure of the lending platform, recognizing the unique features of decentralized models.
- **Ensure Consumer Protection** – Regardless of whether crypto lending is centralized or decentralized, consumer protection must remain a priority. This includes transparency in lending terms, proper risk disclosures, and mechanisms to address disputes or defaults in lending agreements.
- **Monitor Systemic Risks** – As the crypto lending market grows, the SEC should be vigilant about potential systemic risks, including liquidity issues or market instability, particularly in the case of rapid asset devaluation or disruptions within decentralized platforms. Of course, systemic risks are not unique to decentralized financial activity; moreover, the Commission should take the opportunity to develop regulatory frameworks that leverage unique visibility into such risks as they develop.

Kiln recognizes the growing importance of both crypto and traditional securities lending in the broader financial ecosystem. While there are similarities between these two lending models, there are also significant differences that warrant careful regulatory consideration. Kiln supports the SEC's efforts to develop a tailored regulatory approach to crypto lending, one that fosters innovation while ensuring proper protections for investors, consumers, and the financial markets.

Question 35:
If the listing exchange does not have an SSA with a regulated market and no regulated market for the crypto asset underlying an ETP exists, could the listing exchange address concerns regarding fraud and manipulation based on the size and liquidity of the underlying spot market? What would be an appropriate measure of size and liquidity that

would address these concerns? Are there more appropriate ways to address concerns regarding fraud and manipulation?

Response:

Addressing Listing Applications for Crypto Asset-Based ETPs
The Commission's mandate to prevent fraudulent and manipulative acts and practices is critical, especially as the crypto market expands. In reviewing listing applications for crypto asset-based ETPs, Kiln agrees that the Commission should take a nuanced approach that considers both the size and structure of the underlying crypto markets and the safeguards in place to ensure transparency and fairness.

Surveillance-Sharing Agreement (SSA) and Its Role
An SSA with a regulated market is typically a key factor in preventing fraud and manipulation by ensuring that exchange listing processes are closely connected to transparent and well-regulated spot markets. However, as the crypto asset market is evolving, Kiln acknowledges that the Commission may encounter instances where no SSA exists or where the underlying crypto asset market is not directly linked to a regulated market. In these cases, the Commission should acknowledge that an SSA is not the exclusive manner for a crypto asset-based ETP to satisfy compliance with the federal securities laws and explore alternative approaches that evaluate the size and liquidity of the underlying spot market to ensure that adequate safeguards are in place. These alternative approaches should be grounded in objective measures rather than ambiguous standards.

Addressing Fraud and Manipulation Without an SSA
If a listing exchange does not have an SSA with a regulated market, and no regulated market for the crypto asset underlying an ETP exists, the SEC could use several objectives to assess the risk of fraud and manipulation:

- **Size and Liquidity of the Spot Market** – The size and liquidity of the underlying spot market are critical indicators of its resilience to market manipulation. A highly liquid and sizable market with broad participation is less susceptible to manipulation because it would be harder for any single actor to control the market. A low level of market concentration among participants would also reduce the likelihood of coordinated manipulation.
- **Measures of Size and Liquidity** – To assess size and liquidity, the SEC could consider several factors:
    - **Market Capitalization** – The total market capitalization of the crypto asset can provide an indication of the asset's significance and the depth of its market. A higher market cap generally correlates with more participants and a more stable trading environment.
    - **Trading Volume** – Daily trading volume across different exchanges provides insight into how actively a crypto asset is traded, which is directly related to liquidity. High trading volume suggests that price movements are less likely to be manipulated.

- **Geographic Distribution of Spot Markets** – A diverse and geographically distributed set of trading venues for the crypto asset can reduce the risk of localized manipulation and foster more reliable price discovery.
- **Number of Active Wallets** – The number of active wallets holding the asset can indicate the degree of decentralization and adoption, further contributing to the asset's resilience against manipulation.
- **Price Divergence and Convergence** – The Commission should also monitor the frequency and size of price divergences across different spot markets. Regular and rapid convergence of prices across markets can signal healthy arbitrage opportunities, which help ensure that prices do not deviate significantly from their fair value due to manipulation.
- **Price Discovery Mechanisms** – Effective price discovery is essential for preventing manipulation. If the exchange listing the crypto asset-based ETP cannot rely on an SSA, it could consider implementing mechanisms to monitor and address price manipulations across a diverse set of spot markets. The Commission should ensure that exchanges have robust surveillance mechanisms to detect unusual patterns of price movements or transaction activity.

Incorporating Staking into ETPs

Kiln encourages the Commission to support the inclusion of staking as a feature in crypto asset-based ETPs. Staking is a fundamental component of Proof-of-Stake networks that enhances network security and aligns investor incentives with the technical design of the asset.

Staking is anti-dilutive in nature: rewards generated by the protocol offset fees and can increase the net asset value per share. For instance, a token share starting at 0.10 could increase to 0.11 through protocol rewards, preserving value for investors in a manner akin to securities lending in traditional ETPs.

Engaging reputable non-custodial validators can mitigate slashing risk, ensuring consumer protection through best practices and operational safeguards. Moreover, liquidity constraints from unbonding periods can be addressed through structural mechanisms:

- Partial staking: Limiting staking to a portion (e.g., 60%) of the ETP's assets to maintain liquid reserves for T+1 redemptions.
- LSTbased / tokenised models: Holding liquid staking tokens (LSTs) or token representing the staked assets or validator, allows full staking exposure with immediate liquidity, resolving redemption and tax timing issues.

Regulatory Treatment of Staking in ETPs

Kiln believes that staking does not constitute a securities transaction when conducted within an ETP structure that:

- Does not involve discretionary investment management;
- Involves protocol-determined, algorithmic reward issuance; and,
- Does not rely on the entrepreneurial or managerial efforts of others.

Rewards accrued from staking should be understood as protocol fees, not profits from a business venture. In this context, staking aligns more with infrastructure participation than with capital formation. As such, we encourage the Commission to clarify that staking, when conducted in a rule-based and non-discretionary manner, does not implicate the federal securities laws.

Crypto Asset-Based ETPs Already Referenced in Registered Funds

For crypto asset-based ETPs investing in assets already referenced in crypto asset-based exchange-traded funds (ETFs) registered under the Investment Company Act, the SEC should consider the following:

- **Convergence of Regulatory Standards** – The Commission could assess whether the existing regulatory framework governing ETFs in the traditional securities space provides sufficient consumer protection and market integrity when applied to crypto assets. If an asset is already widely traded and referenced in other registered crypto ETPs, the Commission should consider lowering regulatory burdens, assuming that the listing exchange is adhering to transparent and rigorous compliance standards.
- **Diversification and Risk Exposure** – The Commission should evaluate the underlying crypto asset's risk exposure and how the ETP's investment structure helps mitigate concentrated risks. In some cases, the diversification of the underlying assets or the use of hedging strategies could contribute to a more stable offering.

Factors to Consider in an SSA for Crypto Asset-Based ETPs

If an exchange listing an ETP on a crypto asset does not have an SSA in place, the Commission should consider several factors when evaluating the effectiveness of any alternative safeguards:

- **Transparency and Reporting Requirements** – The Commission should require exchanges to establish transparent reporting and surveillance practices for crypto asset-based ETPs. Exchanges should provide regular updates on trading volumes, pricing information, and other key metrics that could help prevent manipulation and protect investors.
- **Market Access and Participation** – Exchanges should be assessed on their ability to ensure fair access to crypto markets for a broad range of participants. This may include ensuring that liquidity providers and market makers participate in a manner that does not distort pricing.
- **Collaboration with Other Market Participants** – Exchanges should be encouraged to collaborate with other participants in the crypto ecosystem, such as liquidity providers and external auditors, to further ensure market integrity.

Additional Considerations in Evaluating SSA Effectiveness

In evaluating the sufficiency of an SSA between an exchange seeking to list a crypto asset-based ETP and a spot market for the underlying asset, the Commission should consider both the functional effectiveness of the SSA and the extent to which the agreement ensures that the exchange can monitor for, and respond to, potential fraud or manipulation in the relevant market. In Kiln's view, a robust SSA need not replicate the precise contours of traditional equity or commodity market arrangements but should be fit-for-purpose given the structural and jurisdictional realities of crypto markets.

The following factors may serve as relevant guideposts in the Commission's evaluation:

- **Granularity and Timeliness of Data Access** – The SSA should provide the exchange with real-time or near-real-time access to trade and order book data on the spot market for the underlying asset. This includes access to both executed trade data and unexecuted order flows, which are critical for monitoring spoofing, layering, or wash trading activity.

- **Regulatory and Jurisdictional Context of the Spot Market** – Where possible, the spot market should be subject to regulatory oversight that provides for transparency, recordkeeping, and cooperation with foreign or U.S. authorities. However, in cases where the spot market is not within the regulatory perimeter of a national securities exchange or futures market, the Commission should evaluate whether the SSA includes contractual commitments that replicate key elements of oversight (e.g., data integrity, response time to inquiries, preservation of records).

- **Market Coverage and Representativeness** – The SSA should relate to a spot market that accounts for a significant share of price discovery and trading volume for the crypto asset underlying the ETP. An SSA with a marginal or low-volume trading venue may have limited surveillance value and should be assessed accordingly.

- **Interoperability with Exchange Surveillance Protocols** – The exchange must be able to integrate the data received under the SSA into its existing market surveillance systems. The utility of an SSA increases where data can be programmatically reviewed, correlated with trading patterns on the ETP market, and used to flag cross-market misconduct.

- **Incident Response Procedures and Escalation Rights** – The SSA should include mechanisms for real-time escalation, including rights for the exchange to request further information or assistance in the event of suspected manipulation. Response timelines and contact protocols should be documented and enforceable.

Weighing Pricing Information in the ETP Listing Process

The SEC should closely evaluate the reliability, frequency, and dissemination of pricing information for the crypto assets underlying ETPs. Key factors to consider include:

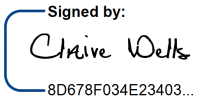
- **Price Data Quality** – The Commission should examine whether the data provided by exchanges is reliable and free from manipulation. Ensuring that pricing information is derived from a wide range of sources, and not overly reliant on a single exchange or venue, is essential.
- **Frequency of Pricing Updates** – The Commission should assess how frequently pricing data is updated and disseminated to ensure that investors can rely on real-time, accurate prices to make informed decisions.
- **Dissemination to Market Participants** – The Commission should evaluate how widely and transparently pricing data is shared with market participants to ensure fair and efficient price discovery.

Kiln recognizes the importance of addressing concerns around fraud and manipulation in crypto asset-based ETPs. We believe that the Commission should adopt a flexible and dynamic approach that allows for innovation while ensuring that adequate safeguards are in place to protect investors and maintain market integrity. By carefully weighing factors such as market

liquidity, price discovery, and surveillance practices, the Commission can facilitate the continued growth of the crypto asset market without compromising investor protections.

Kiln welcomes the SEC's engagement on these matters and looks forward to contributing to a regulatory framework that fosters innovation while ensuring consumer protection and market integrity.

Sincerely,



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