

March 31, 2023
Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

**Re: Proposed Regulation Best Execution
File Number S7-32-22; RIN 3235-AN24**

Dear Ms. Countryman:

The Crypto Council for Innovation (**CCI**)¹ appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's (the **Commission's**) proposed Regulation Best Execution (the **Proposed Rule**). CCI commends the Commission on its continued efforts to modernize and advance the regulation of the securities markets. However, while we applaud the Commission for beginning to consider how its rules could apply to crypto assets that are securities (**Crypto Securities**), we are concerned that the Commission is doing so in a haphazard, one-off manner that could have potential negative, unexamined, or unclear effects on crypto markets. In particular:

- *First*, the Proposed Rule puts the proverbial “cart before the horse.” While duties of best execution are of critical importance, the Commission should first focus on facilitating registration for broker-dealers, alternative trading systems (**ATs**), and national security exchanges that wish to transact in Crypto Securities, allowing a robust, regulated market to develop. Then, with that experience and market structure in place, the Commission could consider how best execution rules should apply to that market.
- *Second*, to the extent the Proposed Rule would apply to Crypto Securities, the Commission has failed to provide a sufficient economic analysis, as required under the Administrative Procedure Act (the **APA**).

I. The Commission Should First Focus on Facilitating Registration for Broker-Dealers, ATs, and Exchanges that wish to transact in Crypto Securities Before Considering How Best Execution Rules Should Apply to that Market.

¹ CCI is an alliance of crypto industry leaders with a mission to communicate the opportunities presented by crypto and demonstrate its transformational promise. CCI members span the crypto ecosystem and include some of the leading global companies and investors operating in the industry. CCI members share the goal of encouraging the responsible global regulation of crypto to unlock economic potential, improve lives, foster financial inclusion, protect national security, and disrupt illicit activity. CCI believes that achieving these goals requires informed, evidence-based policy decisions realized through collaborative engagement.

CCI supports the development of a robust, regulated market for Crypto Securities.² As the Commission itself acknowledges, few regulated broker-dealers actually transact in Crypto Securities.³ But this is primarily because the Commission and its staff have not addressed regulatory challenges to the development of secondary markets for Crypto Securities. The challenges to applying the traditional securities market regulatory structure to registering and operating as a broker-dealer, ATS, or national securities exchange that facilitates trading in Crypto Securities are well known in the industry—and to the Commission.⁴ Indeed, industry participants have publicly enumerated areas where the Commission’s existing rules and systems are inconsistent and unworkable for Crypto Securities and asked the Commission to engage in rulemaking⁵—but it has not yet done so.

Against this backdrop, the Proposed Rule is quite premature and has little relevance in today’s Crypto Securities market. While duties of best execution are incredibly important in the established securities markets, initiating rulemaking involving Crypto Securities with best execution puts the “cart before the horse.”

In practice, through its interpretation of the manner in which regulations would apply to broker-dealers engaging with Crypto Securities, the Commission (either directly or through FINRA) has thus far significantly limited the extent to which broker-dealers can

² The predicate question of *which* specific crypto assets are securities is beyond the scope of the Proposed Rule, and thus this comment letter. However, the fact that the Proposed Rule primarily concerns *secondary* market transactions means that the question of whether a particular secondary market transaction in a crypto asset involves a security is more complex.

This is because even where the *initial* sale of an asset is an investment contract (and thus a security), it does not automatically follow that subsequent, secondary sales of that same asset also involve a securities transaction. See, e.g., *Minute Entry for Proceedings Held Before Judge Paul J. Barbadoro re: Motion to Limit the Commission’s Remedies, SEC v. LBRY, Inc.*, Case No. 1:21-CV-00260 (D.N.H. Jan. 30, 2023) (Judge Barbadoro clarifying that his November 7, 2022 order granting summary judgment to the Commission and finding that defendant LBRY had offered its digital asset, LBC, as a security, applied only to primary sales of the token, not secondary market sales); *SEC v. Ripple Labs Inc. et al.*, Case No. 1:20-CV-10832, Pl. SEC’s Reply Mem. of Law in Further Supp. of its Mot. for Sum. J. at 5 (Doc. No. 730) (S.D.N.Y. Dec. 2, 2022) (the Commission conceding that its claims in the *Ripple* litigation do not apply to secondary market transactions); *Hocking v. Dubois*, 885 F.2d 1449, 1462 (9th Cir. 1989) (en banc) (finding that in the case of a secondary market sale, rather than a primary sale by a promoter, an analysis of how the asset was promoted and what was represented to the buyer is necessary to determine whether the secondary sale constituted an investment contract). Given this uncertainty, the Commission should also focus on providing additional clarity as to when a secondary sale of a crypto asset involves a security before promulgating best execution requirements for such sales.

³ See Proposed Rule at 38, 292 (pointing out that “there are currently no special purpose broker-dealers authorized to maintain custody of [Crypto Securities]” and acknowledging that “[t]he Commission lacks knowledge on the prevalence of broker-dealer activity in [the Crypto Security] market”).

⁴ CCI notes that the Proposed Rule, by its express terms, would not apply to investment advisers, who have their own best execution obligations. See Proposed Rule at 431, 433 (citing the Exchange Act, not the Advisers Act, as the statutory authority for the Proposed Rule and applying it to only “a broker or dealer, or a natural person who is an associated person of a broker or dealer”). However, CCI believes the Commission should further clarify that the Proposed Rule, to the extent it is adopted, has no direct or indirect applicability to investment advisers.

⁵ See, e.g., Coinbase, Petition for Rulemaking – Digital Asset Securities Regulation (July 21, 2022) <https://www.sec.gov/rules/petitions/2022/petr4-789.pdf>.

facilitate transactions in Crypto Securities.⁶ Due to these limitations, the handful of Crypto Securities that do exist and are traded through broker-dealers, to our knowledge, are uniformly traded through a closed-system and only on one market—typically a single ATS.⁷ The Proposed Rule would require broker-dealers facilitating transactions in securities to seek to execute customer securities transactions in the market that may be reasonably likely to provide the most favorable prices for customer orders. But the existing market structure for Crypto Securities (as a result of requirements imposed by the Commission) is that there is typically *only one* market where each Crypto Security trades. As a result, a requirement that a broker-dealer identify material potential liquidity sources or conduct any sort of best execution review would not be meaningful or relevant, until such point as the Commission permits the development of a more robust market with multiple venues wherein Crypto Securities are traded. The Proposed Rule contemplates the regulation of a Crypto Securities market which has a plethora of trading venues, yet this market simply does not exist.

The Commission’s approach to analyzing best execution in the Crypto Securities markets is untimely and counterproductive. By its own admission, the Commission “does not have a complete understanding” of how “order handling and best execution” of Crypto Securities currently work.⁸ Given the Commission’s lack of understanding, it is perhaps unsurprising that the Proposed Rule prescribes rules for the best execution of Crypto Security transactions that are nonsensical in light of the current market structure.

The Commission’s proposed application of the Proposed Rule attempts to shoehorn regulations designed for well-established, inter-connected, and complex traditional securities markets onto emergent Crypto Securities markets that the Commission, by its own admission, does not understand. Rather than prescribing best execution obligations for Crypto Securities in such a haphazard way, the Commission should first focus on facilitating the registration of and developing the appropriate regulatory structure for

⁶ See, e.g., SEC Division of Trading and Markets and FINRA Office of General Counsel, *Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities*, July 8, 2019, <https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities> (expressing the view that it may not be possible for broker-dealers to maintain custody of Crypto Securities in compliance with the Rule 15c3-3); SEC, *Letter to FINRA re: ATS Role in the Settlement of Digital Asset Security Trades*, Sept. 25, 2020, <https://www.sec.gov/divisions/marketreg/mr-noaction/2020/finra-ats-role-in-settlement-of-digital-asset-security-trades-09252020.pdf> (letter taking no-action position on broker-dealer custody of Crypto Securities solely where firms utilize a complex workaround dubbed the “Three-Step Process,” involving an arrangement where securities are custodied with a third-party, non-broker-dealer); SEC, *Custody of Digital Asset Securities by Special Purpose Broker-Dealers*, Dec. 23, 2021, <https://www.sec.gov/rules/policy/2020/34-90788.pdf> (providing that the Commission would not take enforcement action against a broker-dealer for custodizing Crypto Assets if, among other things, the broker-dealer neither engages in business involving traditional securities, or non-security digital assets—a solution no firms appear to have determined to be feasible).

⁷ For example, entities such as Securitize Markets, LLC, a registered broker-dealer and member of FINRA/SIPC, offers consumers the ability to purchase and sell certain Crypto Securities on the secondary market. See Securitize, *Welcome to Securitize Markets: Secondary Market*, <https://securitize.io/invest/secondary-market> (last accessed: Mar. 12, 2023). Our understanding is that, based on restrictions imposed by the Commission and FINRA staff, Crypto Securities traded on these and similar platforms such as Oasis Pro Markets, LLC, Figure Securities, Inc., and Templum Markets LLC, trade exclusively on those platforms, rather than being available for trading on multiple marketplaces.

⁸ Proposed Rule at 290-91.

broker-dealers, ATSS, and exchanges that wish to transact in Crypto Securities, allowing a robust, regulated market to develop. Then, with that experience and market structure in place, the Commission could consider how best execution rules should apply to that market.

Further, we note that taking this phased approach to a best execution rule would not leave customers unprotected in the meantime. Even if the Proposed Rule does not capture Crypto Securities, common law best execution obligations would still apply,⁹ and since broker-dealers transacting in such assets with customers would be members of FINRA, FINRA Rule 5310, which applies a similar best execution standard, would also apply.

II. The SEC's Economic Analysis Does Not Satisfy the APA.

As the Commission is aware, under the APA, it has “a ‘statutory obligation to determine *as best it can* the economic implications’” of a proposed rule.¹⁰ To satisfy this obligation, the Commission is required to “examine[] the relevant data and articulate[] a satisfactory explanation for its action including a rational connection between the *facts found* and the choices made.”¹¹ Under the Exchange Act, the Commission is required to consider whether a proposed rule will promote efficiency, competition, and capital formation.”¹² “Failure to ‘*apprise itself*—and hence the public and the Congress—of the economic consequences of a proposed regulation’ makes promulgation of the rule arbitrary and capricious and not in accordance with the law.”¹³

Indeed, the Commission has recognized that there are specific fundamental requirements of economic analysis required for rulemaking to be consistent with law: (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main

⁹ See, e.g., *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 270 (3d Cir.), cert. denied, 525 U.S. 811 (1998).

¹⁰ *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (emphasis added) (quoting *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005)). See also 15 U.S.C. § 78c(f) (the Commission must consider the effect of a new rule on “efficiency, competition, and capital formation”). In addition to the statutory requirements and case law interpretations thereof, the Commission’s own established standards require the same. See SEC, Division of Risk, Strategy, and Financial Innovation and Office of General Counsel, Current Guidance on Economic Analysis in SEC Rulemaking (Mar. 16, 2012) available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_seculemaking.pdf (SEC Rulemaking Economic Analysis Guidance).

Even if the Commission did not have an obligation to conduct an economic analysis with respect to the Proposed Rule, it still chose to include a 200+ page economic analysis. Because the Commission is relying on this analysis in promulgating the rule, “a flaw in that analysis can render the regulation arbitrary and capricious.” *Council of Parent Attys. and Advocates, Inc. v. DeVos*, 365 F. Supp. 3d 28, 54 n. 11 (citing *Nat’l Ass’n of Home Builders v. EPA*, 682 F.3d 1032, 1039-40 (D.C. Cir. 2012)).

¹¹ *Bus. Roundtable*, 647 F. 3d at 1148 (emphasis added) (quoting *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

¹² See Securities Exchange Act of 1934, § 3(f).

¹³ *Id.* (emphasis added).

alternatives identified by the analysis.¹⁴ And yet, with regard to the Commission’s view that the Proposed Rule applies to Crypto Securities, the Commission’s economic analysis provided *none* of these four. Rather, the mere three pages of discussion contain no analysis but rather a terse description of how the Commission believes the market operates, and statements about the Commission’s lack of information or understanding of the market. Courts have vacated Commission rulemaking efforts for insufficient economic analysis where the Commission at least *tried* to perform one¹⁵—here the Commission did not even bother.

Moreover, by failing to provide a sufficient economic analysis, the Commission has deprived the public of a meaningful opportunity to comment on the Proposed Rule—in violation of the APA¹⁶—since the public has no opportunity to challenge, refute, or supplement the economic rationale for the Proposed Rule as it relates to Crypto Securities.

Here, the Commission claims that the Proposed Rule would apply to transactions in Crypto Securities. Yet, it has made no attempt to “apprise itself,” seek out facts, or “determine as best it can” (or at all) the economic impact of the Proposed Rule as it pertains to Crypto Securities.

Not only has the Commission made no effort to understand the very Crypto Security market it is attempting to regulate, it has also made clear that it has no understanding of that market. In its purported economic analysis, the Commission admits that “[b]ecause transaction data and other information on the crypto asset securities market is limited, [it] does not have a complete understanding of market participants’ current practices with respect to order handling and best execution for Crypto Securities.”¹⁷ But the *very purpose* of applying the Proposed Rule to Crypto Securities is to regulate those very practices. As the APA requires, the Commission must work to understand the markets it regulates before proposing rules that would apply to them.

Ignorance of the facts upon which it bases its rulemaking does not excuse the Commission from its obligation to diligently seek out and analyze those facts. Although difficulty finding pertinent data may necessarily mean the Commission will be less precise in its economic analysis, it “does not excuse the Commission from its statutory obligation to determine *as best it can* the implications of the rule it has proposed.”¹⁸

¹⁴ See SEC Rulemaking Economic Analysis Guidance, *supra* note 9.

¹⁵ See, e.g., *Bus. Roundtable* (finding Commission’s purported economic analysis to be inadequate); *American Equity Investment Life Insurance Company v. SEC*, 613 F.3d 166 (D.C. Cir. 2010) (same); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005) (same).

¹⁶ See, e.g., *Appalachian Power Co. v EPA*, 251 F.3d 1026 (D.C. Cir. 2001) (remanding portion of agency rulemaking for failure to provide sufficient notice and opportunity to comment on an element of the rule); *Chamber of Commerce v. SEC*, 443 F.3d 890, 900 (D.C. Cir. 2006) (basis for agency decision making must be exposed to the public for informed comment).

¹⁷ Proposed Rule at 290-91.

¹⁸ *Chamber of Commerce*, 412 F.3d at 143.

Despite this requirement, there is no evidence in the Proposed Rule that the Commission has made any attempt to study the gaps in its knowledge as to the Crypto Security market. If the Commission believes it is not feasible for it to conduct this analysis at this time, because the market is largely unregulated and does not involve registered broker-dealers, the Commission should facilitate the development of a regulated market first. Once that exists, data will be available for the Commission to conduct this analysis and, if appropriate, adopt rules.

III. Conclusion

CCI and its members stand willing and ready to work with the Commission to hone regulations that will help develop a robust, responsible, and well-regulated market for Crypto Securities. While we support the Commission's efforts to develop such a market, for the reasons stated above we believe that: (i) the Commission should first focus on facilitating workable registration and regulation of broker-dealers, ATSS, and exchanges that wish to facilitate transactions in Crypto Securities, before considering how best execution rules should apply to that market, and (ii) the Proposed Rule, as applied to Crypto Securities, is premature as the Commission admits that it is not able to conduct a sufficient economic analysis, as required under the APA.

Thank you again for the opportunity to comment on the Proposed Rule.

Respectfully submitted,

/s/ Sheila Warren

Sheila Warren

Chief Executive Officer
Crypto Council for Innovation