



March 31, 2023

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

**Re: Proposed Regulation Best Execution, File No. S7-32-22, Rel. No. 34-96496, 88 FR 5440 (January 27, 2023)**

Dear Ms. Countryman:

Coinbase Global, Inc. (“Coinbase”) appreciates the opportunity to comment on the U.S. Securities and Exchange Commission’s (“SEC” or “Commission”) proposed Regulation Best Execution (“Reg Best Ex”). According to the Commission, Reg Best Ex is designed to supplement the existing regulatory framework concerning a broker-dealer’s duty of best execution with a new Commission-crafted standard. The new standard would require detailed policies and procedures for all broker-dealers, and require more detailed policies and procedures for broker-dealers engaging in certain “conflicted” transactions with retail customers. It also would impose related review, reporting, and documentation requirements.<sup>1</sup> The Commission indicates that proposed Reg Best Ex would apply to all securities, including the subset of digital assets properly considered digital asset securities.<sup>2</sup>

Coinbase is the only U.S. public company that operates a digital asset trading platform, and currently does not list digital asset securities, although we would like to participate in such a market when workable rules are created. As a public company, we understand the value of market oversight through clear and properly promulgated regulation. In the absence of regulatory clarity from the Commission regarding digital asset securities, we have developed a rigorous process for analyzing each digital asset proposed for listing before offering it on our platform to avoid listing securities. We have also petitioned the SEC for rulemaking to govern the regulation of securities that are offered and traded via digitally-native methods, including

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<sup>1</sup> Regulation Best Execution, Exchange Act Release No. 96496, 88 FR 5440 (Jan. 27, 2023) (“Proposing Release”).

<sup>2</sup> In its release, the Commission uses the terms “digital asset securities” and “crypto asset securities” interchangeably. We do the same in our comment.

potential rules to identify which digital assets are securities.<sup>3</sup> We believe that tailored regulation for digital asset securities is essential to encouraging capital formation, protecting customers and investors, and facilitating the wider adoption of digital asset technology. In this regard, our comments below are directed solely to the application of proposed Reg Best Ex to the handling of customer orders involving digital asset securities.

Given the lack of even basic rules, let alone a framework, for digital asset securities, we believe attempting to apply the prescriptive requirements of the proposed Reg Best Ex to digital asset securities is premature. Without a developed set of practices, it is difficult to determine which practice would qualify as best fitting customers' needs and therefore whether the proposed requirements would meet the Commission's stated goals. Additionally, the Commission discusses in the Proposing Release that it lacks information about how the digital asset market functions.<sup>4</sup> That admission should cause the Commission to reconsider application of Reg Best Ex to digital asset securities markets. The Commission has a statutory obligation to conduct an accurate analysis of the costs and benefits of adopting the rule as applied to digital asset securities, and must do so *before* releasing its proposal, but it has not been done here. We therefore believe, if the SEC chooses to adopt the proposed rule, that it should exempt digital asset securities from its application until the market has adequately developed and the SEC has gathered the necessary data to determine the effects of applying the rule.

### **Best Execution**

A broker-dealer's duty of best execution when handling a customer's order (or the order of a customer of another broker-dealer) arises out of agency law and also applies when a broker-dealer is acting in a principal capacity with respect to a customer order.<sup>5</sup> The duty, which is currently encapsulated in self-regulatory organization rules,<sup>6</sup> requires a broker-dealer, when acting on behalf of a customer, to exercise reasonable diligence to ascertain the best market for the security and buy or sell in such market, so that the resultant price for the customer is as favorable as possible under the prevailing market conditions. FINRA has recognized a non-exhaustive list of factors relevant to the analysis of best execution, including the (i) size of an order, (ii) trading characteristics of the security involved, (iii) availability of accurate information affecting choices as to the most favorable market center for execution and the availability of technological aids to process such information, and (iv) cost and difficulty associated with achieving an execution in a particular market center. Other factors include price, the opportunity for price improvement, the likelihood of a full or partial execution, the speed of execution, transaction costs, and customer needs and expectations.<sup>7</sup>

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<sup>3</sup> Letter to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, from Paul Grewal, Chief Legal Officer, Coinbase Global, Inc. (July 21, 2022) ("Petition for Digital Asset Securities Regulation"), available at <https://www.sec.gov/rules/petitions/2022/petn4-789.pdf>. Full comment file available at <https://www.sec.gov/comments/4-789/4-789.htm>.

<sup>4</sup> Proposing Release at 5448, 5518.

<sup>5</sup> FINRA Reg Notice 15-46, Guidance on Best Execution in Equity, Options and Fixed Income Markets (Nov. 20, 2015) ("Reg Notice 15-46").

<sup>6</sup> See, e.g., FINRA Rule 5310.

<sup>7</sup> FINRA Reg Notice 15-46.

Best execution analyses may vary for different securities or for similar securities that have different trading characteristics. For example, regulators have noted that some fixed income securities may trade frequently, be highly liquid and have transparent and accessible quotations. Other fixed income securities do not have public quotations or pricing information and may trade infrequently.<sup>8</sup> For these and other securities with limited quotation and pricing information, broker-dealers are expected to have policies and procedures in place to help determine the best interdealer market for such securities.<sup>9</sup> While some assets, such as NMS stocks, have fairly uniform features and trading characteristics that makes the “best execution” determination easier to apply broadly, the best execution analysis for other securities is more fact- and circumstance-based. The way in which a broker-dealer may best meet its customer’s needs can depend heavily on the specific characteristics of the market in which the broker-dealer is trading.

### **Proposed Regulation Best Execution**

Reg Best Ex would establish an SEC best execution rule that is significantly more prescriptive than existing best execution standards. The proposal would call for broker-dealer policies and procedures (i) identifying material potential liquidity sources, incorporating such sources into the broker-dealer’s order handling practices and ensuring that the broker-dealer can access such liquidity sources, and (ii) addressing how the broker-dealer will determine the best market for customer orders, including by accessing timely information with respect to displayed prices and opportunities for price improvement (including midpoint pricing opportunities and order exposure opportunities). Broker-dealers also would be required to determine the number and sequencing of markets to be assessed, balancing the likelihood of obtaining better prices with the risk that a delay would result in a worse price. In addition, for retail customer orders that present “conflicts of interest” (which, the Commission asserts, would include orders involving payment for order flow, internalization and affiliate transactions) a broker-dealer’s policies and procedures must include a plan for complying with the duty of best execution given such conflicts, including how it will assess a broader range of markets than it would for non-conflicted transactions. Broker-dealers would be required to review execution quality at least quarterly, including comparing it with execution quality that might have been obtained from other markets, and to revise their best execution policies and procedures accordingly. Broker-dealers would need to assess the effectiveness of their policies at least annually, and present an assessment report to their board of directors (or other governing body).

### **Proposed Applicability of Reg Best Ex to Digital Asset Securities**

#### ***Crypto Asset Securities Markets are Different from Traditional Securities Markets and Require Different Rules***

It is additionally hard to know *how* Reg Best Ex would apply in digital asset markets because (1) not all digital assets are securities and (2) the Commission has not provided guidance on how to determine if a digital asset is a security. Setting aside the merits of applying Proposed Reg Best Ex to customer orders in traditional stocks, the rule, as proposed, should not be applied to

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

transactions involving crypto asset securities. A fully developed crypto asset securities market in the U.S. does not yet exist. The Commission has yet to approve a national stock exchange to trade in crypto asset securities—nor is such a registration currently possible under existing rules and processes—and admits that no special purpose broker dealers are approved to custody and therefore execute crypto asset transactions on behalf of clients. This is not for lack of effort by crypto market participants—we (and, we understand, other market participants) have tried to engage with the Commission on registration topics. To date, those discussions have not borne fruit. According to the Commission, “only a limited amount of crypto asset security volume is executed on trading venues under the Commission’s ATS framework.” For this limited market activity, there is no regulatorily required market data and public reporting infrastructure noted above with respect to traditional stocks: there is no consolidated quotation tape, nor is there a consolidated source of transaction information. Nor are there uniform reports of execution quality or order routing determinations. These do not exist because the market is not yet sufficiently developed to need them.

It is also unclear whether a crypto asset securities market would ultimately develop the same structure as existing traditional securities markets, leaving open the question of whether the proposed rule would fit a market even after it developed. Innovations like the consolidated tape were developed to meet the specific demands of an increasingly fragmented market relying on a specific set of technological capabilities. Whether similar problems will emerge if a digital asset securities market is allowed to develop in the U.S. is currently unknown. But it is unlikely that the exact same solution will be needed given differences in the markets and technology, including the efficiencies gained from near-instant settlement and fully transparent transaction data facilitated by blockchain technology.

Applying the proposed rule to crypto asset securities would result in a mismatch between regulatory requirements and market realities. The Commission has acknowledged, commendably, that it needs a better understanding of the crypto asset securities markets. Specifically, the Commission notes in the Proposing Release that it has “limited information about the order handling and best execution practices of broker-dealers that engage in transactions for or with customers in crypto asset securities.”<sup>10</sup> Similarly, the Commission states that it “does not have a complete understanding of market participants’ current practices with respect to order handling and best execution for crypto asset securities, including the extent to which current practices in the market for crypto asset securities are consistent with FINRA Rule 5310.”<sup>11</sup> Again, this is understandable given the lack of such a market today, but counsels caution.

Absent a better understanding of market practices and a more developed crypto asset securities market, it is premature to apply a prescriptive set of requirements for broker-dealers. And applying rules designed for a different market with different practices is unlikely to have the customer-protecting results the Commission seeks in proposing the new rule. While the Proposing Release asks a number of questions regarding these practices, we believe that the Commission and the investing public would be much better served if the Commission were to

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<sup>10</sup> Proposing Release at 5448.

<sup>11</sup> *Id.* at 5518.

start by engaging in outreach designed to ensure it fully understands the digital asset market. The Commission historically has used the tools at its disposal—such as publishing concept releases, sponsoring roundtables, or issuing requests for comment—to help it understand other complicated or novel issues before engaging in rulemaking.<sup>12</sup> This has been true even in areas where the SEC has a long history of expertise and involvement, such as equity market structure, when those areas have undergone recent, dramatic change and evolution.<sup>13</sup> The same approach is even more appropriate here.

***The Commission Has Not Adequately Informed Itself, the Public, or Congress of the Economic Consequences of the Rule’s Application to Crypto Asset Securities***

Beyond the problems presented by the substance of the proposed rule, there are significant questions about whether the rule *can* be applied to digital asset securities at this time, based on the Commission’s statements in the Proposing Release. The Commission does not appear to have “apprise[d] itself—and hence the public and the Congress—of the economic consequences” of applying the proposed rule to crypto asset securities.<sup>14</sup> The Commission “has a unique [statutory] obligation to consider the effect of a new rule upon ‘efficiency, competition, and capital formation.’”<sup>15</sup> The fact that the Commission does not seem to have considered these effects likely would prevent it at this time from extending the proposal to crypto asset securities.

In order to “accurately assess” the economic impact of the proposed rule on efficiency, competition, and capital formation, the Commission must first “assess the baseline level” of efficiency, competition, and capital formation.<sup>16</sup> The Commission must then assess the likely economic impact of the proposal, including by quantifying the expected costs and benefits.<sup>17</sup> Commenters, in turn, must then have an opportunity to review and comment on the Commission’s assessment.<sup>18</sup> The Commission has not done these assessments with respect to crypto asset securities. The Commission, instead, has outlined the information that it currently lacks, and would need, to perform its statutory duties. The Commission admits that it “lacks data on broker-dealer routing behavior, the frequency of crypto asset securities trading in both non-conflicted and conflicted transactions, and many of the details of trading protocols and digital asset securities trading platforms.”<sup>19</sup> The Commission also notes that it has limited information about the pervasiveness of payment for order flow in the crypto asset securities market.<sup>20</sup> Based on these observations, it seems the Commission has neither gathered the information nor conducted the analysis necessary to extend its proposal to crypto asset securities.

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<sup>12</sup> See, e.g., SEC, Concept Release on Equity Market Structure (Jan. 14, 2010) (“Concept Release”); Regulation NMS, 69 Fed. Reg. 77,424 (Dec. 27, 2004).

<sup>13</sup> See, e.g., Concept Release.

<sup>14</sup> *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

<sup>15</sup> *Id.*, quoting *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

<sup>16</sup> *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010).

<sup>17</sup> E.g., *Bus. Roundtable*, 647 F.3d at 1150.

<sup>18</sup> E.g., *Chamber of Commerce v. SEC*, 443 F.3d 890, 899 (D.C. Cir. 2006).

<sup>19</sup> Proposing Release at 5528.

<sup>20</sup> *Id.*

The Commission should not—and, under the APA, cannot—apply a consequential new rule to crypto asset securities before performing the proper analysis. The Commission states, for example, that the market for digital asset securities may be similar to the market for non-NMS stock equity securities, but the Commission does not provide its reasoning or any data to support that assertion. Furthermore, the Commission acknowledges that there is “no exact comparison.”

Extending Reg. Best Ex to crypto asset securities would also be inconsistent with the Commission’s guidance for its own analysis. In 2012, in response to a loss in court due to the insufficiency of the economic analysis accompanying a rule the SEC had adopted, the SEC’s Office of the General Counsel and Division of Risk, Strategy, and Financial Innovation<sup>21</sup> made the following determination:

*It is widely recognized that the basic elements of a good regulatory economic analysis are: (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 alternatives identified by the analysis.<sup>22</sup>*

The analysis in the Proposing Release does not meet that standard with regard to crypto asset securities.

Without publishing a complete economic analysis, the Commission has not given the public an opportunity to meaningfully comment on the proposed rule, including on its likelihood of achieving its intended purpose, and the accuracy of the Commission’s assessment of costs and benefits. Where, as here, the Commission’s analysis is incomplete in the proposing stage, the public will have no opportunity to comment, and to correct or affirm assumptions or calculations made in reaching the Commission’s conclusions. The appropriate remedy is to reconsider this proposal and, if appropriate, re-propose in the proper context a new proposal concerning crypto asset securities.

### **Alternative Path Forward**

The Commission has noted that it lacks information about the operation of crypto asset securities markets. We recommend that, as a starting point, the Commission should review and respond to Coinbase’s Petition for Digital Asset Securities Regulation.<sup>23</sup> In that document, we outlined a number of ways in which digital asset markets have developed differently from traditional markets, and highlighted the areas in which new rulemaking is needed. This information may provide a foundation from which the Commission can build a concept of “best execution” for crypto asset securities.

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<sup>21</sup> This division has since been renamed the Division of Economic and Risk Analysis. See <https://www.sec.gov/news/press-release/2013-2013-104htm>.

<sup>22</sup> Memorandum from the Division of Risk, Strategy, and Financial Innovation and the Office of the General Counsel, Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012) at 21, available at [https://www.sec.gov/divisions/riskfin/rsfi\\_guidance\\_econ\\_analy\\_seculemaking.pdf](https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_seculemaking.pdf).

<sup>23</sup> Petition for Digital Asset Securities Regulation.

Additionally, we recommend the following steps that the Commission has often taken in addressing a new or developing area.

First, the Commission should issue a concept release (as it did when first proposing Regulation NMS) to obtain more information on the operation of digital asset securities markets—the type of information the Commission needs to conduct a proper economic analysis. This approach would allow the Commission to engage in dialogue with the public to better understand this nascent class of securities *prior* to proposing or applying an incongruent ruleset. It would also provide the SEC with key information necessary to assess the need for and appropriate contours of a best execution rule in this context. The SEC could combine the concept release with roundtables or other public forums to generate discussion and gain even more insight into order handling in this securities class. As discussed above, the SEC has embraced a similar approach to develop its understanding before engaging in rulemaking in other contexts.

Second, with the above feedback from market participants and the public, and in the context of considering Coinbase’s Petition for Digital Asset Securities Regulation, the Commission should develop needed updates to several aspects of existing regulation that are poorly suited to the structure of digital asset securities. To date, only five offerings of digital asset securities have been registered under the Securities Act of 1933, and only five classes of digital asset securities have been registered under the Exchange Act.<sup>24</sup> Further, no broker-dealer has been granted the ability to custody and transact in digital asset securities by FINRA.<sup>25</sup> The Proposing Release states there is only a limited amount of digital asset security volume under the Commission’s ATS framework.<sup>26</sup> As we have stated elsewhere, the lack of clear and workable regulations has hindered the development of a digital asset securities market. A fully informed rulemaking process in this area will allow the Commission and its staff to develop an understanding of the markets for these securities. Until then, attempting to establish a set of execution principles for digital asset securities trading is premature and unlikely to achieve its regulatory goals.

Third, we recommend that the Commission allow the nascent digital asset securities market to develop more fully before determining what should be considered “best execution” for its broker-dealers. There is no need to rush through adopting a new rule now. We understand that the Commission is concerned about the extent to which customers of brokers-dealers currently offering services in digital asset securities receive protections under the federal securities laws, including the duty of best execution.<sup>27</sup> But, as an initial matter, we are unaware of any broker-dealers providing such services, except for a small handful who participate through a direct distribution or by using the three-step non-custodial process laid out in the September 2020 no action letter for secondary trading.<sup>28</sup> Moreover, to the extent that these services exist

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<sup>24</sup> Proposing Release at 5449 n.96.

<sup>25</sup> *Id.* The Special Purpose Broker-Dealer guidance is set to expire in April 2026. See SEC Statement, Custody of Digital Asset Securities by Special Purpose Broker-Dealers (Dec. 23, 2020) available at <https://www.sec.gov/rules/policy/2020/34-90788.pdf>.

<sup>26</sup> Proposing Release at 5448-49, 5518 n.515.

<sup>27</sup> *Id.* at 5449.

<sup>28</sup> SEC No-Action Letter, ATS Role in the Settlement of Digital Asset Security Trades (Sept. 25, 2020), available at <https://www.sec.gov/divisions/marketreg/mr-noaction/2020/finra-ats-role-in-settlement-of-digital-asset-security-trades-09252020.pdf>.

Vanessa A. Countryman

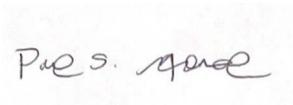
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and expand, investors are not unprotected. For the last half century, all investors have relied on the protections of FINRA's own Best Execution rule, Rule 5310, which will continue to apply. The FINRA rule takes into account specific facts and circumstances, and is much less prescriptive than proposed Reg Best Ex. Therefore, application of Rule 5310 should be the preferred approach for assessing best execution in this context until the SEC is better able to assess the costs and benefits of applying proposed Reg Best Ex to digital asset securities, or determines to craft a more appropriately tailored best execution rule for such securities.

Again, Coinbase appreciates the opportunity to comment on proposed Reg Best Ex and would be pleased to discuss our comments further with the Commission and its staff.

Very truly yours,

A handwritten signature in black ink, appearing to read "Paul S. Grewal", is written over a light blue rectangular background.

Paul S. Grewal  
Chief Legal Officer

cc: The Hon. Gary Gensler, Chair  
The Hon. Hester M. Peirce, Commissioner  
The Hon. Caroline A. Crenshaw, Commissioner  
The Hon. Mark T. Uyeda, Commissioner  
The Hon. Jaime E. Lizárraga, Commissioner