FINRA Seeks Comment on Blockchain

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On Jan. 18, 2017, the Financial Industry Regulatory Authority (FINRA) became the latest organization to weigh in on distributed ledger technology (DLT), also known as blockchain. Recognizing the growing interest and potential benefits surrounding the implementation of DLT, FINRA published a report examining the impact of blockchain on the financial services industry.

Blockchain is essentially an online database that is stored in a distributed, peer-to-peer fashion that employs cryptography, which ensures that only users with a unique, private key can edit the parts of the blockchain that they own while also ensuring that each user's copy of the blockchain is kept in sync. DLT can be used to store any kind of digital information, and it serves as the foundation for the virtual currency Bitcoin. In the financial services industry, DLT has the potential to be a cost-saving, efficiency-gaining technology. By providing an immutable record of transactions and party identities, DLT could speed up transactions, cut operations costs, secure infrastructure and help prevent fraud. The emerging technology also could be adapted to carry out processes such as the clearing and settlement of securities.

While DLT's development and implementation across industries are evolving at different rates, a recent World Economic Forum report predicts that, by 2025, 10 percent of GDP will be stored on blockchains or blockchain-related technology, and finds that over the past three years the financial services industry has invested more than $1.4 billion in DLT. One such example of this investment is the Hyperledger Project, which is an open source industry blockchain collaboration that includes members such as J.P. Morgan, IBM, Intel, the London Stock Exchange Group and R3, which is a financial

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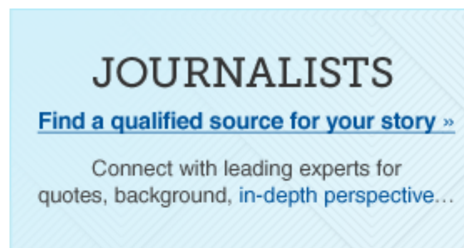
innovation firm that leads a consortium partnership with more than 75 financial institutions focused on designing and delivering DLT to the global financial markets. Even the Big Four accounting firms are developing and implementing various forms of DLT.

As with any new technology, businesses are concerned with not only costs and benefits but also regulatory compliance. According to FINRA, there are several regulatory issues financial service institutions should consider while exploring DLT, including customer data privacy, record keeping, know your customer, and anti-money laundering. More specifically, FINRA recommends that firms participating in a DLT network evaluate and update their procedures and security measures to ensure compliance with customer data privacy rules. FINRA also cautions firms to consider the impact of initiating and controlling customer funds or holding private keys to customers' cryptosecurities, which could impact compliance with regulations pertaining to the custody and security of customers' funds and securities. Broker-dealers should consider whether use of a DLT network would satisfy recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4 as well as FINRA Rule 4511. The FINRA report also covers a laundry list of factors to consider in analyzing whether a DLT network will satisfy know your customer and anti-money laundering obligations.

FINRA is encouraging all interested parties to provide comments on all aspects of the report by March 31, 2017. Information on how to comment is provided at the end of the report.



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