



**March 30<sup>th</sup>, 2017**

**To:** FINRA Leadership, [pubcom@finra.org](mailto:pubcom@finra.org)

**Re:** Report on Distributed Ledger Technology: Implications of Blockchain for the Securities Industry

To whom it may concern:

Neighborly Securities, (“Neighborly”) is writing in response to the Financial Industry Regulatory Authority’s (“FINRA”) report on distributed ledger technologies (“DLT”) and its solicitation for comments. We believe that a partnership between FINRA and its members on emerging innovations is vital to the effective enforcement of FINRA’s regulations in a changing technology environment, and we commend FINRA’s effort to engage the securities industry in a conversation.

### **1. Background**

Neighborly is a FINRA member firm with the mission of modernizing municipal finance. We hope to improve municipal issuers’ access to the capital markets and lower the cost of issuance so that communities can fund the projects that they care about, including university projects, parks, schools, water and sewage utilities, and affordable housing.

### **2. Reporting Requirements, Supervision and Surveillance**

FINRA’s report correctly identifies Reporting Requirements and market Surveillance as major opportunities for DLTs in Securities Operations. DLTs present many new opportunities for FINRA to gain a much deeper view into a consolidated audit trail and the process of executing and recording transactions. Conventional blockchain technology can be built to provide an unchangeable ledger that moves only forward in time. Security protocols can ensure that once a transaction has been committed to the ledger, it cannot be changed. Additionally, the transaction must be approved by the community at large (in the case of a public blockchain), by the permissioned actors in a network (in a private blockchain), or by particular Notaries with an approval and/or documentation role, in the case of a Corda network. This ensures that each transaction is reconciled among all relevant parties at the moment it is added to the ledger(s), which may in the future allow FINRA a more direct view into the activities of its members, allowing for more cost-effective enforcement. The increase in enforcement capability will also come with improvements in error-handling and cross-firm reconciliation.

### **3. Cryptocurrency Opportunities and Risks**

FINRA correctly identified in their report that cryptocurrencies and their underlying technology can be significantly impactful in the clearing process. Neighborly is excited about the idea that customers can themselves be self-clearing someday. If customer transactions were to directly clear using a transparent and well-regulated process, broker-dealers could improve recordkeeping, risk management and capital management.

However, Neighborly remains cognizant of the AML risks of people directly using non-BSA-regulated rails to participate in securities transactions. Many governments and other issuers are experimenting with issuing payment instruments and securities on DLTs, and Neighborly believes that a deep look at the AML aspects of transactions, especially on open networks like Bitcoin, deserves deeper research. Neighborly is currently studying this topic, and we look forward to discussions with regulators to advance the conversation. Neighborly is particularly interested in central bank efforts worldwide to bring DLTs / Blockchain-style clearing to traditionally issued government currency, which could address many of these issues.

Two other areas FINRA could study include:

- The enforceability of Ricardian Smart Contracts that embed legalese text into every transaction (and possibly other forms of smart contracts).
- Risks and costs associated with patents and IP restrictions to the the stability and safety of these markets.

#### **4. Distributed Ledger Technology and Municipal Finance**

Neighborly is focused on the potential applications of DLTs to municipal finance. The issuance and underwriting process for municipal securities is often done in negotiated deals with very little transparency. Neighborly believes that DLTs could be used to involve direct participants in the pricing decisions for municipal bonds, potentially dramatically increasing transparency in issuance. Neighborly believes that a more competitive and transparent underwriting and issuance process can lead to greater transparency and reduced costs in government borrowing.

Increased transparency and granularity of borrowing allows investors to analyze opportunities and deploy capital more efficiently, while at the same time opening up previously-obscured channels of funds for municipalities to meet their needs. Regulators and market participants would be able to more efficiently protect investors. Broker-dealers would be able to reduce the cost of underwriting, trading, clearing and settlement, while maintaining high-fidelity records of transactions, empowering more effective regulatory oversight. With improvements in underwriting, issuance, and trading, Neighborly hopes that one day this technology will improve public finance nationwide.

#### **5. Conclusion**

We applaud FINRA's research in this area and would be happy to discuss further. Neighborly is a FINRA-member brokerage with significant Fintech DNA in Silicon Valley and a mission dedicated to increasing transparency and access to public finance. We are very willing to share expertise with FINRA if doing so helps in any way.

Thank you,

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