



November 30, 2018

VIA ELECTRONIC MAIL ([pubcom@finra.org](mailto:pubcom@finra.org))

Marcia E. Asquith  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority  
1735 K Street, NW  
Washington, DC 20006-1506

Re: Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry

Dear FINRA:

R3 appreciates the opportunity to provide comments on FINRA's September 2018 paper entitled "Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry" (the "paper"). As FINRA continues to work with the industry to proactively identify benefits or risks that new financial technologies ("FinTech") may present to investors, broker-dealers, and the securities industry, R3 welcomes the opportunity to provide any and all subject matter expertise that may be of assistance.

As background, R3 is an enterprise blockchain software firm working with a broad ecosystem of more than 200 members and partners across multiple industries from both the private and public sectors to develop on Corda, our open-source blockchain platform, and Corda Enterprise, a commercial version for enterprise usage. Our global team of over 180 professionals in 13 countries is supported by over 2,000 technology, financial, and legal experts drawn from our global member base.

Our Corda platform is already being used in industries from financial services to healthcare, shipping, insurance and more. It records, manages, and executes institutions' financial agreements in perfect synchrony with their peers, creating a world of frictionless commerce.

### **R3's Comments**

R3's comments on the paper focus on 1) AML and KYC issues; and 2) Security Tokens and Asset Backed Tokens. R3 would be more than happy to provide additional information on either of these topics or on other related topics of interest to FINRA.

#### ***1) AML and KYC***

The increased digitization of almost all banking activities has driven the need for fast, safer, and more efficient identity solutions. Meanwhile, global financial and law enforcement agencies

continue to implement increasingly strict and complex anti-money laundering (“AML”) and know your customer (“KYC”) rules and regulations. These rules and regulations focus particularly on correspondent banking, which enables business and remittance flows between countries. When combined with inconsistent AML/KYC regulatory standards, however, the global flow of funds can be slowed and subject to duplicative processes, creating major inefficiencies in the global financial system.

To effectively comply with their AML/KYC obligations, financial institutions must have a clear picture of their customer’s profile, identity, spending habits, and the kinds of transactions he/she engages. When this role is handled internally, a firm must dedicate a team of specialized experts to monitor and track customers’ behavior, which can be very costly as well as inefficient, diverting resources away from other lines of business.

Many financial institutions are spending incredible sums to ensure compliance with AML/KYC regulations. This trend, however, has led to many banks de-risking (i.e., terminating a banking relationship with a particular institution, country, or region). If implemented properly, FinTech can solve the global de-risking problem that has led to the significant number of globally unbanked citizens.

Technology must be coupled with regional AML/KYC standards in order to improve transaction traceability and identify potential suspicious activity; sensitive data must also be handled appropriately and protected. Blockchain technology can reintegrate excluded entities into the financial system, improve government oversight, and reduce the cost and inefficiency burden banks face today.

FinTech developments, like R3’s Corda products, promise to improve AML/KYC compliance without the need for extensive networks with central administrators. Distributed ledger technology (“DLT”), which is the technology underpinning blockchain-based systems, enables verifiable and immutable data, providing increased transparency to relevant participants. The more readily a bank in a well-developed country can access information on an end-user and the end-user’s bank in an underbanked or less developed region, the more comfortable the bank in the well-developed country will be with facilitating a transaction.

In stark contrast to the complex and duplicative KYC process that financial institutions are forced to endure today, R3’s Corda platform allows customers to create and manage their own identities, thus reducing duplication and costs by eliminating the need for each financial institution to individually attest and update KYC records. Corda also addresses concerns regarding data privacy and security that may arise when sharing identity data; Corda only shares data with those with need to see it.

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## **2) Security Tokens and Asset Backed Tokens**

The benefits of a decentralized issuance and transaction marketplace and smart securities contracts have clearly captured the attention of institutional players. This year has seen increased focus on security tokens, which offer the promise of spurring a new, lower friction method of asset and capital formation. These 'enterprise-ready tokens,' if developed appropriately, could automate or simplify much of the asset origination, issuance, execution, and secondary trading processes that make up so much of investment banking fees today. Issuers of securities everywhere see the value in a more efficient, effective connection to those looking to allocate capital, all in a safe, regulated and automated environment.

If bitcoin represented the first blockchain revolution and the emergence of enterprise blockchain platforms represented the second, the creation of a new global capital market powered by enterprise security tokens will usher in the third.

The first instances of these new enterprise token will likely focus on what is called asset-backed tokens. Put simply, the digital token represents an asset that is held 'somewhere else,' often at a regulated custodian. The token acts as a 'digital twin' and can be traded or exchanged freely on a blockchain with settlement finality, while the underlying asset remains blissfully in place at a custodian.

This interplay of a regulated custodian linked with an on-chain digital representation, while seemingly straightforward, unlocks new ways for markets to transact and expand. It offers a way for businesses to begin to iterate and implement enterprise-friendly yet novel digital assets, all from a strong foundation of an accepted regulatory base.

If tokens are to become credible and useful instruments in the institutional world, the quality and type of investor they are able to attract must also be considered. For example, when companies embark on a capital raise, whether it is a Reg D placement or full-blown IPO, they (and their investment bank partners) seek 'strong-hand' investors – those that aren't in it just for a quick profit. The same will apply in the future for companies issuing their debt or equity as tokens, and as such they will seek out platforms that give them access and distribution to a buy-side of proven investors.

R3 is uniquely positioned to facilitate the emerging 'token economy' in a secure and regulated manner. The same enterprise-ready focus that led to the design and capabilities of our Corda platform can be extended to bringing the best innovations of the 'wild west' of the token world to the enterprise.

Corda was designed from inception to solve the problem of how to represent real-world agreements on a blockchain in a canonical and enforceable way, and this approach can be directly applied to security token issuance. Financial agreements on Corda take the form of



smart contracts, linking business logic and data to associated legal prose in order to ensure that trades executed on the platform are rooted firmly in law.

Other key considerations for security token issuance, such as identity, security, data privacy and settlement finality, are already handled elegantly by Corda and have been key drivers in securing its position as the blockchain platform of choice in capital markets. Corda-based token examples actually emerged back in 2016, when we began a collaboration with Bank of Canada, Payments Canada and others under the name Project Jasper, where a token called CAD-COIN represented collateral held by the central bank. Since then, we have seen pilot and production examples from our partners, in particular from HQLAx in securities lending and Tradewind Markets in gold trading.

Connectivity with the established financial services community also differentiates Corda from any other platform in the space. R3 is already in talks with a number of major market infrastructure providers about creating regulated environments for security tokens, underpinned by Corda, and the 200+ member ecosystem includes most of the biggest names in financial services, giving token issuers access to a vast network of high quality investors. Corporates, banks, asset managers, and market infrastructure providers are also crowding in to provide a stable, regulated settlement asset on Corda. Corda's unique design supports delivery of digital security tokens against payment in digital cash instruments in a single, atomic transaction. This will reduce time, cost, and perhaps most importantly, risk in the emerging token-enabled credit market on Corda.

Platforms like Corda provide the catalyst and foundation to enable security tokens to become a new and potentially invaluable tool in the capital markets toolbox. Unregulated ICOs provided the inspiration for this next wave, yet the shift is already underway to make tokens enterprise-grade. The third blockchain revolution of digital assets will arguably be the most important and impactful to date.

## **Conclusion**

R3 appreciates the information provided in FINRA's paper and believes that RegTech tools, like blockchain technology, can assist the securities industry with its regulatory compliance obligations.

DLT could hold the key to reducing the KYC burden faced by banks, leading to improved regulatory oversight and, ultimately, increasing financial inclusion across the globe. Moreover, moving payment transfers onto a DLT platform could provide a holistic view of the payment system and deliver clear benefits to banks, regulators, and intelligence units tasked with identifying money launderers, terrorist financing, and other bad actors.

The role of DLT in security tokens and asset backed tokens will be determined by providers' ability to manage issuance, identity, security, data privacy and protection, as well as settlement finality and a myriad of additional regulatory factors. Proper consideration of these factors can unlock a great deal of potential and efficiency in the security markets and capital formation more broadly.

We would welcome the opportunity to continue our engagement with FINRA on the issues discussed in the paper as well as other issues related to RegTech and FinTech, particularly the application of DLT in the securities industry.

Respectfully yours,

A handwritten signature in dark ink, appearing to be 'Charley Cooper', with a long horizontal flourish extending to the right.

Charley Cooper  
Managing Director, External Affairs