



# TEMPLUM MARKETS

October 23<sup>rd</sup>, 2018

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

Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, CD 20006-1506

Re: Financial Technology Innovation

Dear Ms. Mitchell:

Templum Markets, LLC ("Templum") writes this letter in response to the Financial Industry Regulatory Authority's ("FINRA") request for comments in its July 30, 2018 Special Notice regarding Financial Technology Innovation (the "Special Notice"). Templum appreciates FINRA's invitation for comments and believes the request is particularly timely as financial technology ("FinTech") and blockchain technology continue to attract significant interest in the financial services industry. We support FINRA's efforts to promote a constructive dialogue on how to most effectively regulate FinTech and the implications of the use of blockchain by securities market industry.

## **I. Background**

### **A. About Templum**

Templum is a registered broker-dealer with the U.S. Securities and Exchange Commission (the "SEC") and is a member of FINRA. Templum operates an alternative trading system for the sale of unregistered digital assets that are securities (the "Platform"). Templum operates two businesses through the Platform: (i) a mechanism by which firms may display non-binding indications of interest related to unregistered securities (the "Quotation Bureau"); and (ii) a mechanism by which firms may facilitate purchases and sales ("Transactions") of the securities listed on the Platform (the "Trading Platform"). Templum uses blockchain technology as a ledger to record and effect Transactions on its Trading Platform.

### **B. The Report**

In the Special Notice, FINRA identified the great potential for FinTech and the important steps that FINRA has taken to better understand the industry and regulate it in a way that both supports market efficiency and protects consumers. We commend FINRA for maintaining an open dialogue with its members to better understand the industry and ensure that it is providing tailored regulatory oversight that meets the industry's diverse and evolving needs. We encourage FINRA to continue this work by growing their staff focused on FinTech and blockchain technology, and by continuing to engage with the SEC and industry organizations

including the Securities Industry Financial Markets Association regarding when digital assets are securities.

## II. Comments

### A. Regulatory Sandbox

To continue engaging the industry in a constructive dialogue, we recommend that FINRA create a FinTech innovation office and create a regulatory sandbox. Both an innovation office and regulatory sandbox will benefit both FINRA as well as market participants. FinTech presents unique regulatory challenges, from tracking digital asset ownership to facilitating proper clearance and settlement. As a result, the industry needs tailored regulation and rulemaking in order to protect investors and to meet the needs of businesses that are active in the space. An innovation office and regulatory sandbox would help continue the dialogue that FINRA has begun through informational releases and conferences, and engage the industry in with the goal of developing tailored regulation.

We urge FINRA to develop a regulatory sandbox for its regulation of the issuance, purchase, sale, clearance, and settlement of digital assets that are securities. Like the frameworks used in Canada,<sup>1</sup> Australia,<sup>2</sup> Singapore,<sup>3</sup> and the United Kingdom,<sup>4</sup> a regulatory sandbox would help facilitate a constructive dialogue between FinTech companies and FINRA. A regulatory sandbox is a construct in which firms are permitted to experiment and grow without excessive regulation so long as their operations remain within enumerated boundaries. A regulatory sandbox will allow the FINRA to develop a supervisory model for these innovative forms of securities as the technology evolves. Such a system will also foster innovation by allowing early stage companies, the principal drivers behind technological advancement in FinTech, to grow without having to go through a full registration process. We urge FINRA to consider joining international efforts to establish a global regulatory sandbox on these issues, such as the Global Financial Innovation Network, to ensure that the dialogue between FINRA and U.S. based FinTech companies can have early and meaningful impact on international regulatory thinking around developments that will be of increasing economic significance to the U.S.

### B. FinTech Innovation Office

We believe that both FINRA and the FinTech industry would benefit from the creation of an office of FinTech innovation modeled after the Commodity Futures Trading Commission's ("CFTC") LabCFTC. On May 17, 2017, the CFTC announced the release of their LabCFTC, a FinTech initiative designed to promote innovation in a sandbox-like environment. The agency uses LabCFTC to provide a platform to facilitate collaboration between FinTech companies and the CFTC to help develop a regulatory framework that works with the FinTech industry to support responsible innovation. The CFTC notes that the goal of the initiative is to "promote

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<sup>1</sup> OSC Launchpad, Ontario Securities Commission, available at: <http://www.osc.gov.on.ca/en/osclaunchpad.htm>.

<sup>2</sup> Australia's FinTech Priorities, Australian Government: The Treasury, available at: <https://fintech.treasury.gov.au/australias-fintech-priorities/>.

<sup>3</sup> Monetary Authority of Singapore, FinTech Regulatory Sandbox Guidelines (June 6, 2016), available at: <http://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/Consultation%20Paper%20on%20FinTech%20Regulatory%20Sandbox%20Guidelines.pdf>.

<sup>4</sup> Richard B. Levin and Bobby Wenner, A Potentially Promising Approach to Regulation of FinTech or Should the U.S. Adopt a Regulatory Sandbox? (Jan. 2017), available at: <http://sftp.polsinelli.com/publications/fintech/resources/FinTechWhitePaper0117.pdf>.

FinTech innovation and fair competition by making the CFTC more accessible to FinTech innovators and serving as a platform to inform the CFTC's understanding of new technologies." The CFTC facilitates research aimed at supporting innovation and to monitor industry trends to ensure that regulation suits the development of the industry.

Templum encourages FINRA to create a FinTech Innovation Office that will help provide needed guidance to the industry with respect to the regulation of digital assets. The FinTech Innovation Office will also create a collaborative environment that will help FINRA to develop regulations that both achieve its regulatory mandate and support responsible innovation in FinTech.

B. Digital Asset Trading Should be Integrated into Exam Modules

As the use of blockchain technology in the financial services industry has continued to grow, so too has the trading of digital assets that are securities. We believe that digital assets that are securities present unique regulatory challenges that must not only be addressed by tailored regulation, but also through the development of best trading practices for the industry. To do this, we believe FINRA should integrate the trading of digital assets that are securities into its exam modules where applicable for individuals who intend to engage in such activity. FINRA currently has specialized exam modules for specific trading topics, such as the Series 26 Investment Company and Variable Contracts Products Principal Exam and the Series 31 Futures Managed Funds Exam. Similar to these financial products, we believe digital assets that are securities require specialized knowledge to be traded in a compliant manner. Such knowledge includes an understanding of blockchain technology, its uses and potential risks, as well as appropriate regulatory frameworks for different types of digital assets. FinTech remains a relatively new segment of financial services industry, but it is being adopted at a rapid pace. As a result, it is critical that FINRA members and their registered representatives and associated persons understand the risks and challenges associated with the technology. We believe adding information regarding the sale and secondary trading of digital assets that are securities to FINRA's training modules would help to protect the public and promote market integrity.

C. Post Trade Reporting

Templum encourage FINRA and the SEC to treat all digital assets that are sold in a public or private offering as securities, including that transactions in such securities be reported to FINRA for surveillance purposes. We believe that the FinTech industry would benefit from FINRA requiring post trade reporting for all transactions in digital assets that are securities. Such post trade reporting would be conducted by broker-dealers, in a manner that is equivalent to trade reporting in traditional securities through TRACE or an equivalent system.

Blockchain technology lends itself to traceability and auditability through the use of a distributed ledger. We believe that FINRA should leverage the benefits of this technology to track the trading in digital assets that are securities. To do so, FINRA should require members to report all trades in digital assets that are securities through traditional systems such as TRACE, or allow broker-dealers and trading platforms to provide FINRA with access to their blockchain. Allowing trading platforms to provide FINRA with access to their blockchain could likely provide a more streamlined, automated reporting process by leveraging the benefits of distributed ledger technology, including its immutability and ease of auditing.

#### D. Clearance, Settlement, and Custody

Regulation of digital assets that are securities has focused heavily on the determination of whether a particular asset is a security. We firmly agree with SEC Chairman Jay Clayton that most, if not all, digital assets that have been offered to the public to raise capital through initial coin offerings (“ICOs”) and other means are securities, and should have been offered pursuant to a registration with the SEC or an exemption from registration. As a result, trading in digital assets must be facilitated in compliance with securities laws, including post-trade activities such as clearance, settlement, and custody. We believe that FINRA is in a unique position to help provide guidance to the FinTech industry with respect to the clearance, settlement, and custody of digital assets that are securities.

##### *i. Impact of blockchain technology on regulatory oversight of clearing, settlement and custody functions*

Entities that act as “clearing agencies” for securities are required to register with the SEC or be granted exemption from registration. Registered clearing agencies traditionally include entities acting as central counterparty (“CCP”), central securities depository (“CSD”) and/or settlement systems for physical, immobilized, and dematerialized securities.

Clearing agencies provide important services to broker-dealers that are regulated by FINRA. The functions performed by clearing agencies play assist in reducing systemic risk in traditional and evolving markets, ensuring finality of transfers and legal certainty regarding rights to securities as they are transferred and held by market participants. For example, clearing agencies that act as CCPs can compare and confirm trade data submitted by participants (or reporting to participants the results of trade comparisons submitted by the exchanges), act as the common counterparty and/or guarantee the completion of the trade if either side defaults or goes out of business, and prepare instructions for their participants regarding their settlement obligations. Clearing agencies that act as a CSD and settlement system perform the valuable function of organizing the transfer of assets and rights so that transactions, pledges, margin calls and collateral obligations can be settled with high efficiency and legal certainty.

Clearing agencies perform key functions in the financial services industry, and it is likely that these functions will be impacted by the advent of blockchain technology. For the efficiency and safety of U.S. securities markets and market participants, it is critical that these clearing agencies operate in a regulatory environment that is tailored to their unique needs and changing role. It is not yet certain how the development of blockchain-based trading platforms and digital assets that are securities will impact the functions traditionally performed by clearing agencies and the regulatory oversight of such functions. For example, because blockchain technology allows parties to transact directly with each other through a network by leveraging its distributed nature, blockchain platforms may reduce or eliminate the need for certain clearing agency functions, or they may perform these functions in innovative ways. Regardless of how the evolving technology effects the operation of clearing agencies, their essential functions should continue to be provided under the SEC’s and FINRA’s oversight as regulated entities.

The SEC has stated its view in multiple releases that clearing agencies that may be required to register or seek exemption can include not only entities that have traditionally registered as clearing agencies (CCPs, CSDs and settlement systems), but also entities that provide non-traditional, innovative, or ancillary services (such as collateral management activities, trade matching services, and compression services). Consistent with this view and the broad relevant statutory definitions, it is possible that blockchain technology platforms could

be considered to be clearing agencies if they perform certain functions. Other types of financial institutions can provide the same or similar services as a clearing agency under other forms of regulatory oversight such as broker-dealer registration, to the extent that they offer such services as part of 'customary' brokerage or banking activity. It is not yet clear how clearing, settlement, and custody functions that may be performed in connection with evolving blockchain technology platforms will fit within this regulatory framework for oversight of clearing, settlement, and custody functions.

We encourage FINRA to work with the SEC to provide clear guidance to the industry regarding the appropriate regulatory oversight of clearing, settlement, and custody functions as they evolve in the context of blockchain and digital assets, including providing needed clarity regarding the oversight of such functions through clearing agencies or registered broker-dealers.

*ii. Interaction of blockchain technology and digital assets with services of registered clearing agencies*

The services of existing clearing agencies that perform a valuable function in the financial services industry are also being impacted by the advent of blockchain technology.

Clearing agencies such as The Depository Trust Company ("DTC") and other registered clearing agencies are relied upon to facilitate the efficient trading of physical, immobilized, and dematerialized securities by ensuring timely and final settlement and provide risk management functions, such as central counterparty services. A wide range of security types may be made eligible for processing by SEC registered clearing agencies such as DTC, in accordance with the rules of the clearing agency and relevant statutory and regulatory requirements. Currently, however, digital assets that are not registered with the SEC are ineligible for book entry delivery through DTC (for example) and therefore cannot benefit from the efficiency, risk-reduction and other benefits provided by these clearing agencies to the market.

As noted above, blockchain technology may eliminate the need for some traditional functions provided by registered clearing agencies. It may be beneficial, however, to the market to explore ways in which registered clearing agencies and blockchain technology providers could interact. For example, we believe that FINRA should encourage and work with the SEC to evaluate the use of blockchain technology for securities that are not DTC eligible. Leveraging blockchain will allow parties to streamline transactions and reduce friction, benefitting FINRA members that interact rely on the DTC, while promoting market efficiency. FINRA should also work with the SEC and DTC to explore how digital assets that are securities could be made DTC eligible securities and whether doing so would have additional market benefits.

*iii. Custody*

Section 15(c)(3) of the Exchange Act and Rule 15c3-3 (the "Customer Protection Rule"), are designed to protect customer funds with two main requirements: possession or control of securities, and reserve formula. The requirements have the objectives of establishing guidelines to calculate customer assets to be segregated, methods to segregate and practices to prevent broker-dealers from using segregated customer assets to finance their proprietary activities, satisfying deliveries and covering customer short transactions. Specifically, the rule requires that customer funds involved in an applicable securities transaction be held at a bank as defined in the Exchange Act. The Customer Protection Rule also requires a broker-dealer to maintain physical possession or control over customers' fully paid and excess margin securities. Physical possession or control generally means that the broker-dealer must hold securities in

one of several locations specified in the rule and that they be held free of liens or any other interest that could be exercised by a third-party to secure an obligation of the broker-dealer. The application of the rule is unclear in a world of digital assets that are securities and blockchain technology. It is unclear if digital assets that are unregistered securities must be held in compliance with the Customer Protection Rule.

We believe blockchain technology has the potential to reshape how banks act as custodians, particularly with respect to digital assets that are securities. Blockchain has the ability to hold digital assets that are securities and record their transfer. We encourage FINRA to engage with the SEC to examine the custody rule and the Customer Protection Rule in light of blockchain technology. As trading in digital assets that are securities becomes more commonplace, this will be an issue that needs to be addressed for an increasing number of FINRA's members. By allowing issuers or trading platforms to use blockchain technology in lieu of banks as custodians, securities trading could be streamlined and transaction costs could be reduced, producing savings for investors. Such efficiencies created by blockchain have great potential when used on a large scale. To facilitate this, traditional rules and regulations need to be modernized to embrace blockchain technology.

#### E. Transfer Agents

Blockchain and digital assets represent a fundamental change in the financial services industry and could make traditional aspects of the industry obsolete. One area of the securities laws that can be improved and modernized through the introduction of blockchain is the role of transfer agents. Section 17A(c) of the Exchange Act requires that transfer agents be registered with the SEC, or if the transfer agent is a bank, with a bank regulatory agency. FINRA registered broker-dealers often work with registered transfer agents to facilitate the recording of share ownership and bookkeeping.

A blockchain technology platform could be required to register as a transfer agent if it monitors the issuance of securities or registers the transfers of securities. While it is unlikely a blockchain technology platform would countersign securities, platforms operating their own blockchain to track the issuance and trading of digital assets could be deemed to be monitoring the issuance of securities with a view of preventing unauthorized issuance (i.e., a registrar, registering the transferring of such securities). Other blockchain platforms could be deemed to be registering the transfer of securities, exchanging or converting securities, or transferring record ownership of securities by a bookkeeping or ledger entry without physical issuance of securities certifications.

The SEC released a concept release regarding transfer agents in 2015, noting the potential value of blockchain technology in streamlining the industry. We encourage FINRA to work with the SEC and FINRA members to determine when a blockchain technology platform must register as a transfer agent and to provide guidance to issuers of digital assets as to when they must use a transfer agent.

### **III. Conclusion**

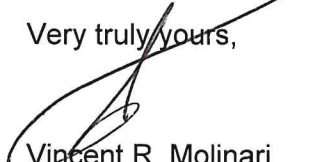
Templum commends FINRA for soliciting comments from the industry on the growth of the FinTech industry. The development of a regulatory sandbox, the creation of a FinTech Innovation Office, and the creation of licensing and educational programs for FINRA members with respect to FinTech, are consistent with FINRA's mission as an SRO. We believe blockchain technology is an incredibly powerful tool that will promote much needed innovations in the financial services industry. However, the current securities laws, and FINRA rules are ill-

suiting to blockchain technology and the regulation of digital assets as securities. We believe the securities laws and FINRA's rules need to be modernized to meet the developing needs of the industry.

We welcome the opportunity to tell you more about Templum, its business model and the firm's use of blockchain technology and to discuss these issues with you to support facilitate further guidance from FINRA and other regulatory agencies.

Should you are to discuss this letter or any other matter, please do not hesitate to call myself or Templum's counsel, Richard B. Levin, of Polsinelli PC at 303-583-8261.

Very truly yours,



Vincent R. Molinari  
Chief Executive Officer