
Broker-Dealer Crypto Asset Activities and Best Practices

The Financial Industry Regulatory Authority (“FINRA”) recently released an update to its guidance regarding crypto asset activities, which included a non-exhaustive list of potential areas of concern to FINRA.¹ The publication is based on information collected by FINRA through its ongoing regulatory operations and member firms’ responses to prior regulatory notices² and a crypto asset questionnaire.³ We summarize below key areas for consideration and provide recommendations for firms to consider in light of FINRA’s evolving regulatory initiatives with respect to crypto asset-related activities of member firms and their associated persons.

Background

Over the past several years, FINRA has undertaken a focused effort to identify and act upon regulatory challenges presented by the crypto asset activities⁴ of FINRA member firms. FINRA defines crypto assets or digital assets as “assets that are issued or transferred using distributed ledger or blockchain technology,” which include “so-called virtual currencies, coins, and tokens.”⁵ Some, but not all, digital assets qualify as “securities” under the federal securities laws.

Based on FINRA’s observation of member firms’ engagement in crypto asset-related activities that could run afoul of FINRA rules, FINRA provided a non-exhaustive list of potential concerns involving such activities, including potential violations of:

- FINRA Rule 2210 (Communications with the Public) in connection with crypto asset-related communications, including misrepresentations overstating the extent to which protections provided by FINRA rules or federal securities laws apply to crypto asset-related activities;
- FINRA Rule 3110 (Supervision) in relation to failing to meet reasonable due diligence requirements on crypto asset private placements, and ineffective monitoring of crypto asset activities; and

¹ FINRA Provides Update on Member Firms’ Crypto Asset Activities (“FINRA Crypto Asset Activities Update”), <https://www.finra.org/rules-guidance/guidance/crypto-assets-update>.

² Beginning in 2018, FINRA has encouraged member firms to promptly notify their Risk Monitoring Analyst (“RMA”) if the member firm, or its associated persons, parent companies or affiliates, engage in, or plan to engage in, activities in relation to crypto assets. See Regulatory Notices 18-20 (FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets); 19-24 (FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets); 20-23 (FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets); and 21-25 (FINRA Continues to Encourage Firms to Notify FINRA if They Engage in Activities Related to Digital Assets).

³ FINRA selected almost 600 member firms to receive the questionnaire based on FINRA’s prior knowledge of a firm’s potential engagement in crypto activities.

⁴ Based on FINRA’s engagement with member firms, it provides a list of themes related to crypto asset activities being conducted by member firms and their associated persons. The list includes activities related to private placements, custody, facilitation of customer crypto asset transactions through affiliates or third parties, and blockchain and distributed ledger technology initiatives. Please refer to the update for the comprehensive list.

⁵ FINRA Crypto Asset Activities Update, *supra* note 1.

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- FINRA Rule 3310 (Anti-Money Laundering Compliance Program) in relation to failures by firms to establish AML programs reasonably designed to detect and report suspicious attempted or completed transactions in crypto assets by, at, or through broker-dealers.

Additionally, FINRA's list includes instances where FINRA has issued disciplinary actions relating to violations of the following FINRA Rules:

- FINRA Rules 3270 (Outside Business Activities of Registered Persons), 3280 (Private Securities Transactions of an Associated Person), and 3110 for failures related to disclosure of outside business activities ("OBA") or approval and supervision of private securities transactions ("PST") involving crypto assets;
- FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) for (i) member firms or associated persons negligently causing the dissemination of promotional materials with material misstatements and omissions relating to the member firm's crypto asset business; (ii) associated persons facilitating money movements and crypto asset-related activities with knowledge that the funds were proceeds of illegal activities and part of money laundering activities; and (iii) associated persons providing false responses relating to crypto asset-related OBAs or PSTs on member firms' annual compliance questionnaires; and
- FINRA Rule 8210 (Provisions of Information and Testimony and Inspection and Copying of Books) for associated persons failing to provide records on crypto asset-related OBAs and PSTs, provide relevant records in a timely manner, or appear for related testimony.

FINRA emphasizes that their update is primarily for member firms' consideration in developing or modifying relevant policies or procedures to comply with related regulatory obligations, and the update does not create new requirements, or relieve firms of existing legal or regulatory obligations, nor constitute a binding interpretation of existing obligations.

Recommendations

Broker-dealers should strongly consider developing or modifying relevant policies and procedures to appropriately reflect the significant growth in crypto asset-related activities and the complexities relating to this asset class. This would include a review and evaluation of supervisory programs and controls relating to AML compliance, communications with the public, manipulative trading, due diligence on crypto asset securities, and associated persons' involvement in crypto asset-related OBAs and PSTs.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Frank Weigand (Partner) at 212.701.3890 or fweigand@cahill.com; or Paul Joseph (P.J.) Austin (Associate) at 212.701.3214 or paustin@cahill.com; or email publicationscommittee@cahill.com.

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