



March 21, 2014

**By Electronic Mail ([pubcom@finra.org](mailto:pubcom@finra.org))**

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

**Re: Regulatory Notice 13-42, FINRA Requests Comment on a Concept Proposal to Develop the Comprehensive Automated Risk Data System (“CARDS”)**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to comment on the concept proposal by the Financial Industry Regulatory Authority (“FINRA”) to develop the CARDS system. SIFMA understands and fully supports FINRA’s efforts to use new technology innovations to make it a more efficient and effective regulator, to better protect investors, and to ease regulatory and compliance burdens on FINRA members. For the reasons discussed in greater detail below, and without further analysis, study, disclosure and review, SIFMA cannot support the CARDS proposal.

Without more information about required data elements, data standardization, other technical details regarding the reporting platform, transmission methods, an analysis of other current and proposed reporting requirements, and an explanation of how the data will be stored, protected and used, SIFMA cannot conduct the necessary fulsome cost and benefit analysis of the proposal to conclude that the proposal should be supported. Nevertheless, SIFMA provides its initial general comments on the proposal and its responses to the specific questions contained in the proposal.

Moreover, because the proposal involves significant and controversial issues, if FINRA determines to move forward with the proposal, SIFMA urges FINRA to work closely with the industry to address the technical, compliance and legal questions prior to the proposal being published for comment as a proposed rule.

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<sup>1</sup> SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, please visit [www.sifma.org](http://www.sifma.org).

## I. OVERVIEW

FINRA's concept proposal calls for the development of a new program, CARDS, to collect on a standardized, automated and regular basis, information relating to account ownership, account activity and security identification. Initially, FINRA proposes to collect specific retail customer information which, at a minimum, would include account type and category (e.g., retirement, brokerage, cash, margin, options, discretionary, day trading); customer investment profile information (e.g., investment objective, date of birth); an identifier for beneficial owners or control persons; servicing registered persons and locations (e.g., registered person CRD number and branch CRD number); details of account activity (e.g., purchase and sale transactions, event dates); additions/withdrawals, securities and account transfers; margin and balances; and description of securities (e.g., CUSIP, symbol, description, ISIN, SEDOL). Under FINRA's proposal this information would be collected from clearing and self-clearing firms. Introducing brokers would be required to provide the specified information to their clearing firm(s) for further transmission to FINRA. FINRA would use the information to run analytics to identify potential "red flags" of sales practice misconduct and to identify potential business conduct problems with member firms, branches and registered representatives. FINRA believes that CARDS would reduce regulatory costs and burdens by reducing requests for information and making the examination process more efficient.

## II. EXECUTIVE SUMMARY

In this section SIFMA summarizes some of its general comments on the CARDS proposal. A detailed discussion of each of these issues is included in the various sections of this comment letter. In addition, SIFMA has included in this comment letter responses to the specific questions that FINRA raises in Regulatory Notice 13-42.<sup>2</sup>

- **Process for Vetting CARDS:** It is not clear in Regulatory Notice 13-42 whether FINRA intends to promulgate CARDS in accordance with established rulemaking procedures. SIFMA strongly urges FINRA to follow the normal notice-and-comment rulemaking process in adopting CARDS.
- **Duplicative, Superfluous Reporting:** SIFMA believes that before FINRA considers the implementation of a new, significant and costly reporting regime, FINRA should perform an extensive and detailed review and analysis of all currently required reporting to FINRA, other self-regulatory organizations ("SROs") and the SEC to determine whether and how much of the information believed necessary to meet the intended purposes of CARDS is already being collected through one or more existing reporting systems.

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<sup>2</sup> This executive summary does not include a summary of SIFMA's responses to FINRA's specific questions raised in Regulatory Notice 13-42. See **Section IV** of this comment letter for a detailed discussion of SIFMA's responses.

- **CARDS v. CAT:** CARDS, as envisioned in Regulatory Notice 13-42, could overlap with the Consolidated Audit Trail (“CAT”). FINRA does not clearly articulate a rationale for having CARDS as a separate collection mechanism and repository of information.
- **Costs Associated with CARDS:** SIFMA is very concerned about the likely significant technology and compliance costs of implementing CARDS – both from a start-up perspective and on an on-going basis. CARDS would require firms to develop new systems and/or dramatically modify existing systems to collect data elements that they do not have currently, create storage capacity to store vast amounts of new data, develop methods to standardize data format, transmit vast amounts of data to FINRA, and save the data for an unspecified period of time.
- **Data Security Concerns:** Perhaps more daunting than the potential technological challenges of implementing FINRA’s undefined reporting requirements is protecting the sensitive information outlined in the proposal. SIFMA believes that FINRA does not sufficiently address the data security concerns associated with CARDS, especially in light of broad governmental policy objectives related to the security of financial data.
- **Privacy Concerns:** CARDS raises serious issues under foreign and state privacy laws, regardless if CARDS collects or stores personally identifiable information (“PII”). The information that will be requested through CARDS is a roadmap to an individual’s financial life and virtually all investors’ information will be housed in one place. The fact that FINRA has now asserted that it will not be collecting certain PII from member firms directly through CARDS, does not establish that FINRA will not find other means of linking the information it does not collect to information it may obtain from other sources (such as CAT, once it has been fully implemented), in an effort to “household” accounts and link customers within and across broker-dealers. Just because these linkages are developed internally within the CARDS system, it does not reduce the dangers of a data breach even if it does reduce the number of “pipelines” over which the data is transmitted.
- **Data Standardization:** SIFMA is concerned about issues associated with data quality and data standardization. Currently, there is no uniform regulatory standard for the format of and approach to information that must be gathered regarding issues such as account objectives and risk tolerance.
- **Clearing Firm Concerns:** The concept proposal suggests that clearing firms will be simply a conduit for the submission of data on behalf of the introducing brokers but does not provide sufficient details for firms to understand the actual technical requirements of such a role. Much of the information that will be required to flow through these systems to FINRA is not presently on the books and records of clearing firms as it is unrelated to the information necessary for clearing firms to

perform the generally ministerial functions they have agreed to perform under their clearing agreements with their introducing brokers. If CARDS is adopted and retains the conceptual approach that the customer information will be gathered by, and transmitted to FINRA by, clearing firms, it must be made clear, and not merely suggested, that clearing firms are simply conduits for passing the information from introducing brokers to FINRA and have absolutely no responsibility to review the information or to detect potential sales practice, suitability issues, and/or rule violations.

### **III. GENERAL COMMENTS**

#### **A. Process for Vetting CARDS**

In Regulatory Notice 13-42, FINRA solicits comment on a *concept proposal* to develop CARDS. SIFMA commends FINRA for approaching the CARDS proposal through the initial issuance of a concept proposal rather than rushing head first into a full Regulatory Notice. Given the significant issues raised by the CARDS proposal, SIFMA believes that if FINRA, after reviewing the comments, is still determined to proceed further with CARDS, FINRA should follow a thorough and formal vetting process that permits all interested parties sufficient time to consider and comment on a formal CARDS proposal. At a minimum, SIFMA believes that, after considering the comments received on Regulatory Notice 13-42, FINRA should issue another Regulatory Notice soliciting comments on a more fully developed CARDS proposal and ultimately should file the CARDS proposal with the Securities and Exchange Commission under Section 19 of the Securities Exchange Act of 1934 (the “Exchange Act”).<sup>3</sup>

#### **B. Duplicative, Superfluous Reporting**

*Before* FINRA considers the implementation of a new, significant and costly reporting regime, FINRA should perform an extensive and detailed review and analysis of all currently required reporting to FINRA, other SROs and the SEC to determine whether and how much of the information believed necessary to meet the intended purposes of CARDS is already being collected through one or more existing reporting systems. Additionally, FINRA should not require firms to submit data through CARDS that firms are not otherwise required to obtain or possess for a given customer account under other FINRA rules. SIFMA also recommends that FINRA conduct a careful assessment to determine whether information being collected is actually and effectively being used for its intended purposes or could be

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<sup>3</sup> See § 19(b) of the Exchange Act (providing that “no proposed rule change shall take effect unless approved by the Commission” or an exception applies). SIFMA believes that the proposed CARDS system entails a significant expansion in the scope of data that member firms will have to collect and, therefore, is not a mere policy, practice, or interpretation of an existing FINRA rule, and it is not solely concerned with the administration of FINRA as a self-regulatory organization. See generally 17 C.F.R. § 240.19b-4 (2014) and SEC Form 19b-4.

used more efficiently and productively. Further, this assessment should be produced to the SEC for its review.

While FINRA has committed that CARDS would eventually replace the use of existing data systems and feeds, such as INSITE, and that it would conduct a thorough analysis to avoid duplicative reporting, to ensure that FINRA's data collection needs are met in a manner that maximizes efficiency and minimizes costs this assessment should be done *prior* to the design or implementation of CARDS. This analysis should be comprehensive, identifying opportunities to eliminate duplicative reporting which may occur through INSITE, TRACE, OATS, RTRS, Large Option Position Reporting, Blue Sheet Reporting, CAT and other facilities.

### **C. Significant Costs**

SIFMA is very concerned about the likely significant technology and compliance costs of implementing CARDS – both from a start-up perspective and on an on-going basis. CARDS would require clearing firms to develop new systems and/or dramatically modify existing systems to collect data elements that they do not have currently, create storage capacity to store vast amounts of new data, develop methods to standardize data format, transmit vast amounts of data to FINRA, and save the data for an unspecified period of time. The development, implementation and testing of these systems would entail costs for hardware, software development, and associated personnel time which would almost certainly run into tens of thousands of personnel hours per member firm. It is also likely many firms would have to turn to outside vendors to assist in this process. FINRA's CARDS proposal comes at the same time that firms are spending significant resources to meet the development and implementation requirements of other regulatory initiatives such as CAT and Large Trader Reporting ("LTR") and rules and regulations that have been adopted or amended to comply with Dodd-Frank. Such a large burden would almost certainly lead to significant increased expenditures.

Once the necessary CARDS systems are developed, they would need to be maintained which would primarily entail personnel costs, but also will include hardware and software costs. Clearing firms also would likely face significant personnel time spent interacting with introducing brokers regarding receipt of the required information in the correct format and on a timely basis. These efforts inevitably will create new overhead for member firms (both clearing firms and introducing brokers) and the costs ultimately will be borne by the investing public.

While we appreciate that one of the possible benefits is that member firms would see more focused examinations, SIFMA believes it is unlikely firms' overall burden in responding to regulatory inquiries would be reduced. CARDS might lead to marginally reduced initial examination requests and the possible identification of potential sales practice "red flags", but the most likely outcome of CARDS is that the vast amount of data being collected without associated context would give rise to many more perceived issues and "red herrings" (*i.e.*, false positives, mismatched records, and data standardization anomalies) that will have

to be investigated with member firms.<sup>4</sup> Thus, we predict a significant increase in time spent by member firms responding to regulatory inquiries premised on FINRA's automated, quantitative analysis of the data. Coincident with this, we also anticipate a significant drain on FINRA's resources following down "rabbit holes" built from massive amounts of data that lead to nothing in the end. Whether the time spent by FINRA, in preparing, and by member firms, in responding to, CARDS-based inquiries would be well spent would depend heavily on the quality of the data and FINRA's ability to digest and appropriately analyze the significant amount of information it receives. While FINRA has expressed a belief, based on an extremely limited proof of concept, that CARDS will lead to more focused and, thereby, limited examinations of member firms, any limits in FINRA's ability to properly analyze the data will result in an opposite effect, leading to unfocused preliminary inquiries and innumerable efforts to understand the data in advance of regularly scheduled examinations; or, preliminary "focused" examinations that are driven by nothing more than erroneous presumptions based on faulty or misunderstood data and/or analysis.

Moreover, it reasonably follows that adoption of the CARDS proposal would also lead to a new area of FINRA regulatory review involving industry-wide sweeps and direct member firm examinations regarding the accuracy and timeliness of CARDS reporting. As with OATS, this would be an expensive and resource draining compliance program for both FINRA and its members.

We believe it is necessary to determine that CARDS would actually result in material benefits for FINRA, member firms, and the investing public before imposing these very significant costs on the industry, especially FINRA's clearing firm members.

#### **D. Privacy/Cyber-Security**

Perhaps more daunting than the potential technological challenges of implementing FINRA's undefined reporting requirements is protecting the sensitive information outlined in the proposal. To the extent the required information includes any individual elements of PII, or could lead to the discovery of PII, there are risks inherent throughout the reporting process. For instance, the data must be encrypted and transmitted from the introducing broker to the clearing firm; encrypted and transmitted from the clearing firm to FINRA; and ultimately, encrypted, stored and maintained by FINRA. Requiring the transmission of PII through multiple channels only increases the likelihood of such data being compromised.

In its Request for Comment, FINRA stated that as it developed CARDS it would consider ways to gather account identifying information without collecting account names or other PII. On March 4, 2014, after considering strong and pervasive comments regarding

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<sup>4</sup> For example, firms' suitability determinations may be based on additional extraneous factors, including individual interactions between clients and associated persons that cannot be fully captured by a CARDS-type system.

privacy concerns<sup>5</sup>, FINRA announced that based on the comments and discussions with industry participants, it had determined that the CARDS proposal would not require the submission of information that would identify to FINRA the individual account owner, particularly, account name, account address or tax identification number. While this is a move in the right direction, it does not completely address the significant privacy and cyber-security concerns raised by the proposal. Collected in this vast pool of sensitive information will be a complete picture of an individuals' financial life: their holdings, investments, investment strategies, and employment information. FINRA has stated that it will need to link individual accounts across broker-dealers and further has not mitigated the risk that the collected information could be linked to other information that could lead to the discovery of PII.

Further, it is unclear to SIFMA how FINRA would guarantee the safeguarding of such information or which parties will be liable in the event of a breach and whether FINRA will indemnify firms if the breach occurs at FINRA. And nothing in the concept proposal will alleviate the public concerns that "big brother" is watching and that personal privacy is further compromised.

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<sup>5</sup> See, e.g., Comment Letter from John Terry, President, High Street Securities (Dec. 23, 2013); Comment Letter from Jim Biddle, President and CEO, The Securities Center, Inc. (Dec. 24, 2013); Comment Letter from Steven J. Weaver, Associate Vice President, Morgan Stanley Wealth Management, LLC, (Dec. 26, 2013); Comment Letter from Kemp Richardson, J.K.R. & Co. (Dec. 26, 2013); Comment Letter from G.T. Stafford (Jan. 3, 2014); Comment Letter from Calvin Williams (Jan. 3, 2014); Comment Letter from David B. Paul (Jan. 3, 2014); Comment Letter from Jay Hickman (Jan. 3, 2014); Comment Letter from Joe Purcella (Jan. 3, 2014); Comment Letter from Leila McGehe (Jan. 3, 2014); Comment Letter from Ronald Blake (Jan. 3, 2014); Comment Letter from Stephanie Oates (Jan. 3, 2014); Comment Letter from Paul Meehl, (Jan. 3, 2014); Comment Letter from Alan Higgins (Jan. 3, 2014); Comment Letter from John Plumberg (Jan. 3, 2014); Comment Letter from Gary A. Besley (Jan. 3, 2014); Comment Letter from Al Dorvinen (Jan. 4, 2014); Comments Letter from Robert Meitzen (Jan. 4, 2014); Comment Letter from Don Brock (Jan. 4, 2014); Comment Letter from Robert L. Weiss (Jan. 4, 2014); Comment Letter from Samuel J. Orr (Jan. 5, 2014); Comment Letter from Kathy Love (Jan. 6, 2014); Comment Letter from Sandy Pappalardo, Chief Operating Officer, Pupuva Financial Services, Inc., (Jan. 8, 2014); Comment Letter from Herbert Diamant, President, Diamant Investment Corp., (Jan. 17, 2014); Comment Letter from David Tilkin, The Tilkin Group (Jan. 17 2014); Comment Letter from Robert Granucci (Jan. 18 2014); Comment Letter from Erich Sokolower, Marketing Director, Repex & Co. (Jan. 24 2014); Comment Letter from Stephen Cartwright, President, Sweeney Cartwright & Co. (Jan. 24 2014); Comment Letter from Ed McCabe, Managing Partner, ARC Consulting Systems LLC (Jan. 30 2014); Comment Letter from Justin Pogue (Feb. 5 2014); Comment Letter from Noemi Schaefer, Chief Compliance Officer, Shay Financial Services, Inc. (Feb. 11 2014); Comment Letter from Nicholas C. Cochran, Vice President, American Investors Co. (Feb. 11, 2014); Comment Letter from Gina M. Menne, Oakbridge Financial Securities, Inc. (Feb. 13 2014); Comment Letter from Steven Larson, CEO, Oakbridge Financial Services (Feb. 13, 2014); Comment Letter from Paul Knese, (Feb. 19 2014); Comment Letter from James Alger, President, Delta Trust Investments, Inc. (Feb. 20 2014); Comment Letter from Terri Startare, Elish & Elish Brokerage (Feb. 21 2014); Comment Letter from Rod Lueck, Techmate (Feb. 21, 2014); Comment Letter from J. Robert Burgoyne, True Blade Systems, Inc. (Feb. 21 2014); Comment Letter from Caroline Austin (Feb. 21 2014); Comment Letter from Michael Finnan, President and CEO, Morgan Wilshire (Feb. 21 2014); Comment Letter from Samuel J. Flaherty, CFP, Flaherty Financial Services, LLC (Feb. 26 2014); and Comment Letter of Chris Melton, Executive Vice President, Coastal Securities (Feb. 27 2014).

CARDS, as currently proposed, would require firms to standardize, integrate and pool a number of different sensitive data types together into one master set, and then transmit this data to a clearing firm, who will in turn transmit the data to FINRA. This creates no fewer than five opportunities for data breach (if one assumes the unlikely scenario that only one server is used for each transmission): data could be compromised at an introducing broker; in transmission from introducing to clearing; at the clearing firm; in transmission from clearing to FINRA; or, at FINRA itself. As such, further consideration must be given to the heightened measures necessary to safeguard this data given the tremendous value that master trading/customer files could present to a successful hacker.

As Robert Mueller, then Director of the FBI, stated, “I am convinced that there are only two types of companies: those that have been hacked and those that will be.”<sup>6</sup> A glance at news articles for the past twelve months offers countless cautionary tales: from a Russian teenager successfully intercepting the credit card information and pin numbers of over 100 million Target and Neiman Marcus customers late in 2013, to threats of cyber terrorism and corporate espionage from nation states such as China. Similarly, the NSA leaks scandal has invigorated public debate regarding the proper balance between government interests (be it national security or investor protection) and fundamental principles of privacy in the U.S.<sup>7</sup> The Snowden scandal also serves as a cogent reminder that an organization that collects and maintains uniquely sensitive and personal information has a heightened burden to ensure that data remains protected from both external sources (*e.g.*, hackers, foreign governments), and internal sources (*e.g.*, FINRA staff persons or contracted vendors with access to data).

Whether it is an independent hacker, a foreign government, or a FINRA staff person or vendor, the list of possible harms that could result from a breach, given the breadth of data covered by CARDS, is only limited by the imagination.

Before going forward with a formal proposal, FINRA should address (1) how the data would be protected, both in the various stages of transmission, as well as while housed at FINRA;<sup>8</sup> (2) who would be responsible to customers and/or the markets when a breach

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<sup>6</sup> Robert S. Muller, III, Director, Federal Bureau of Investigation, Speech at RSA Cyber Security Conference (Mar. 1, 2012).

<sup>7</sup> Notably, data collection efforts under CARDS must be narrowly tailored to avoid capturing data for international customers, as laws governing privacy issues abroad tend to be dramatically more stringent than those in the U.S. These foreign rules may require that firms withhold private customer information absent a specific, targeted demand from a regulator for specific customer information.

<sup>8</sup> The principal guidance FINRA has offered to its members related to the requisite data security measures that must be taken, if any, in fulfilling regulatory mandates relates to Rule 8210 responses. In 2010, FINRA amended Rule 8210 to require information provided in electronic format on a portable media device (CD-ROM, DVD or portable hard drive) to be encrypted in order to protect it from access by an unauthorized person. In Regulatory Notice 10-59 FINRA noted that information provided pursuant to Rule 8210 might include a person’s first and last name in combination with a SSN, driver’s license number, or financial account number. See <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122487.pdf> [last visited on March 14, 2014].



occurs; (3) whether FINRA is prepared to indemnify introducing brokers and clearing firms for the release of customer data to FINRA; (4) whether customers would be permitted to opt out (*i.e.*, refuse to allow their information to be provided to FINRA via CARDS) and, if so, what logistics are required to facilitate an opt-out process; (5) what disclosures and/or protections would be offered to customers whose data is maintained by CARDS; and (6) who would have access to the information and how would such access be granted in the first instances, and supervised/re-evaluated on a going forward basis. FINRA also needs to address how long this information would be maintained and who else, apart from FINRA staff with a “need to know,” would have access to it. FINRA should also disclose, prior to implementation, the identity of its systems’ administrators; its policies and procedures for the protection and use of the data; if it plans to use third-party vendors; and, the risk controls that would be used by the administrator. Additionally, FINRA must address how the costs of remediation of a data breach would be allocated if a breach occurs.

FINRA should also address the applicability of state and federal data privacy laws to the data collected via CARDS. This should include an explanation as to whether FINRA, as a Delaware incorporated entity, is subject to state privacy laws directed at corporations, and how FINRA would respond to requests for information from private and/or public litigants, as FINRA would become a known repository of an inordinate amount of detailed, personal, financial information. The requested information is a roadmap to an individual’s financial life and virtually all investors’ information will be housed in one place. The fact that FINRA has now asserted that it will not be collecting certain PII from member firms directly through CARDS, does not establish that FINRA will not find other means of linking the information it does not collect to information it may obtain from other sources (such as CAT, once it has been fully implemented), in an effort to “household” accounts and link customers within and across broker-dealers. Just because these linkages are developed internally within the CARDS system, it does not reduce the dangers of a data breach even if it does reduce the number of “pipelines” over which the data is transmitted.

Any rule implementing CARDS should also clearly articulate which entity (introducing broker, clearing firm, or FINRA) bears responsibility to notify individuals of a data breach, when one occurs. Laws require that customers be notified of a breach of any system containing personal information. Under CARDS, would FINRA be obligated to notify customers of a breach, or will FINRA seek to transfer the obligation back to its member firms? It is unclear whether FINRA would be able to transfer that obligation if FINRA is deemed to own or license the information held within the CARDS system. If FINRA plans to take the position that it does not own the information held within CARDS, then would FINRA permit member firms to have oversight and governance over FINRA’s storage and handling of the data maintained in CARDS so that firms may ensure they are meeting their legal obligations?

This is a matter of significant concern. Both the SEC and FINRA have identified cyber-security as a priority for their 2014 examination program and FINRA is currently conducting a sweep of its members regarding the same. FINRA, however, is not subject to

Regulation S-P.<sup>9</sup> FINRA, therefore, needs to explain how this information would be protected and under what standards.

We expect most investors in today's environment are very sensitive regarding who has their most sensitive information, who has access to it and how it is being used. It is conceivable that due to such concerns investors would move their accounts to registered investment advisers where their most sensitive information would not be subjected to such heightened exposure. In this regard, FINRA's proposed program is anti-competitive to the detriment of its own members. Further, any migration of clients and FINRA licensed professionals to the fee-only advisory service model could result in less regulatory oversight over activities of interest to FINRA.

#### **E. Data Quality and Data Standardization**

SIFMA is also concerned about issues associated with data quality and data standardization. Currently, there is no uniform regulatory standard for the format of and approach to information that must be gathered regarding issues such as account objectives and risk tolerance. For example, one firm might have three levels of risk tolerance whereas another might have five. We question whether FINRA will seek to dictate the standard for investment objectives and customer risk tolerance levels, and if so, whether it is appropriate for FINRA to do so.

To the extent FINRA goes forward with CARDS, it will need to address with specificity the data to be collected and the proper definition and format for that data. Stringent standardization requirements will impose significant costs on the industry, particularly if members are required to collect and maintain know-your-customer ("KYC") information different from the KYC information that existing forms and systems are designed to capture and maintain.

#### **F. Clearing Firm Responsibility**

The concept proposal suggests that clearing firms will be simply a conduit for the submission of data on behalf of the introducing brokers. The proposal, however, does not provide sufficient detail for firms to understand the specific technical requirements of such a role. Clearing firms need greater specificity in order to understand and analyze the feasibility of and costs associated with such a role.

The proposal also does not allay concerns that regulators and investors will have an expectation that clearing firms have some responsibility to review and analyze the information that passes through clearing firm systems on its way to FINRA. Much of the information that the concept proposal envisions as required to flow through clearing firm systems on its way to FINRA is not presently maintained on the books and records of clearing

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<sup>9</sup> See 17 C.F.R. Prt. 248 (2014).

firms. Clearing firms do not maintain such information because clearing firms do not need the information to perform the ministerial functions relating to custody, clearance and settlement that they have agreed to perform pursuant to clearing agreements with introducing brokers. For instance, because clearing firms do not generally deal directly with introduced customers, and do not make recommendations on specific investments, the regulatory responsibility to assess whether or not a recommended transaction is consistent with the investment objective of a customer is imposed upon the introducing broker, who deals directly with that customer. Further, the requirement to collect, retain, and monitor the information necessary to make such decisions (the “know your customer” information) is typically allocated to introducing brokers under FINRA Rule 4311.

While the concept proposal does state that clearing firms will not be responsible for the “accuracy or completeness” of the information introducing brokers submit to clearing firms for transmission to FINRA, it is silent as to any other regulatory expectations of a clearing firm’s responsibilities with respect to such data. The simple receipt and transmission of information that clearing firms do not presently hold, and are not required to retain, review or use, exposes clearing firms to potential regulatory and litigation risk.

If CARDS is adopted and retains the conceptual approach that clearing firms will gather customer information from introducing brokers and transmit such data to FINRA, the CARDS final rule(s) must explicitly state that (1) introducing brokers have the affirmative obligation to provide the required data to clearing firms; (2) clearing firms are simply conduits for passing the information from introducing brokers to FINRA, with no responsibility to review the information; (3) clearing firms will not be required to confirm that introducing brokers have made complete submissions of CARDS related data or to otherwise track and monitor that all introducing brokers on a clearing firm’s platform have made required CARDS related data submissions; and (4) clearing firms are not expected to review for or otherwise detect potential sales practice concerns, suitability issues, and/or other rule violations simply because the introducing broker data relative to such transactions passed through the clearing firm’s systems on its way to FINRA. Clearing firms also should not be required to retain the introducing broker data that has been submitted through CARDS if such data is not normally maintained as “books and records” of the clearing firm.

These limits on responsibility need to be clearly defined so that they can be understood and interpreted correctly by regulators, arbitrators and the investing public.

#### **IV. RESPONSES TO SPECIFIC QUESTIONS IN REGULATORY NOTICE 13-42**

- 1. Are there alternative methods for FINRA to achieve its goals as articulated? If so, what are those alternatives and why might they be better suited? Are there other information collection methods FINRA should consider either as an alternative, or as a supplement, to CARDS?**

First and foremost, as discussed above, SIFMA recommends that FINRA conduct an assessment to eliminate duplicative, un-productive and burdensome reporting. FINRA should also increase its cooperation and coordination with the SEC and other SROs to address duplicative and inconsistent reporting regimes. Today, clearing firms face numerous data collection, maintenance, and reporting requirements including OATS, INSITE, equities and fixed income trade reporting, short interest reporting, large trade reporting, large option position reporting and blue sheets, among others; plus CAT is on the horizon. Each of these regimes has its own standards for data retention and the manner and format of reporting. These multiple reporting regimes present an opportunity for consolidation.

Admittedly, FINRA only controls certain of these reporting regimes and cannot dictate cooperation, coordination or consolidation. Notwithstanding, FINRA should proactively initiate discussions with other regulators regarding opportunities to streamline broker-dealers' obligations. FINRA also has the opportunity to create a model for how such consolidation can be achieved by weaving any proposed CARDS requirements into existing reporting requirements.

Serious consideration should be given to combining proposed CARDS reporting requirements with CAT to make development less costly and more efficient.

- 2. What would be the primary sources of economic impact, including the potential costs and benefits, to clearing, self-clearing and introducing firms in developing, implementing and maintaining the systems that would be necessary to comply with the reporting requirements of CARDS? What systems would potentially have to be modified and what would be the anticipated costs? Would the primary sources of economic impact differ based on the size of the firm or differences in the business model?**

Without more information about required data elements, data standardization, other technical details regarding the reporting platform, transmission methods, an analysis of other current and proposed reporting requirements and an explanation of how the data will be stored, protected and used, SIFMA cannot conduct the necessary analysis to adequately respond to this question. As noted above, we believe that FINRA should not require firms, whether introducing or clearing firms, to provide data through CARDS that firms are not otherwise required to obtain or possess under other FINRA rules with respect to customer accounts. For example, FINRA should not require self-directed firms that are not required to gather data to comply with FINRA's suitability rule (*e.g.*, investment objective) to collect such information solely for the purpose of reporting through CARDS. In addition, FINRA

should not require firms to report customer profile information if such firms are not using the information to service customer accounts. Certain firms may have customer investment profile information in their possession because it has been collected through a new account application but may not use the information to recommend securities transactions to a customer if the customer has not elected to receive advice. Requiring firms to provide information through CARDS that they do not currently have or are not using would not further FINRA's regulatory objective of identifying red flags of sales practice misconduct. Moreover, it is possible that collecting such data from firms could result in "false positives" if FINRA were to run the data through analytics tools designed to identify patterns of sales practice misconduct in a firm's customer accounts or to identify trends across the industry. Collecting such data from firms would impose undue costs on firms without any corresponding regulatory benefit for FINRA or such firms.

With respect to clearing firms, we suspect the primary economic impact of CARDS would be the imposition of substantial costs for developing and maintaining new systems to collect and store the required data, as well as to transmit the data to FINRA. The technological and personnel-related costs associated with providing the information to FINRA will be sizable and persistent. Introducing brokers will incur similar costs associated with gathering and transmitting the required data to their clearing firms.

Additional costs also would be incurred in responding to the new sweeps and examination modules that will be put in place as part of FINRA's CARDS reporting compliance program. We would expect this program to be as active and robust as FINRA's current OATS compliance program.

Further, we believe it is unlikely firms will see reduced regulatory costs as suggested in the concept proposal. Instead, both clearing firms and introducing brokers can expect to incur increased costs associated with responding to a heightened number of regulatory inquiries triggered by CARDS analytics. The quantitative data FINRA receives via CARDS will be insufficient on its own to enable FINRA to reach informed decisions regarding wrongdoing, and insufficient to eliminate false positives. As such, the most likely outcome is that FINRA will need to make additional inquiries of clearing firms and/or introducing brokers to follow-up on all potential issues identified by CARDS analytics.

**3. In addition to systems modifications, what other potential changes to firms' infrastructure would be necessary? For example, would firms need to hire additional personnel either on a temporary or full-time basis to implement CARDS?**

Implementation would require a substantial commitment of personnel to design, implement and test system modifications; following implementation, permanent personnel would be necessary to support data systems and to resolve bugs or data reconciliation issues on a going forward basis. Each firm is singularly situated in terms of personnel availability, so it is difficult to make a general statement regarding the extent to which any specific firm would need to hire supplemental personnel. We, however, would expect that the

implementation of CARDS would entail thousands of hours of personnel time at each clearing firm and introducing broker. Accordingly, it is virtually certain that some firms will need to hire or contract for additional personnel. If the CARDS implementation were to overlap with the implementation of CAT, then these personnel needs would be compounded.

We also believe CARDS would require an increase in legal costs (whether through in-house or outside counsel) for advice regarding the implementation of CARDS and the possible need to restructure the terms of introducing-clearing firm relationships. Advice may also be required regarding a firm's potential liability to its clients regarding data security and privacy issues in the event of a breach in the transfer of sensitive information from introducing broker to clearing firm to FINRA.

Furthermore, as noted above, we believe the implementation of CARDS would lead to an increase in regulatory inquiries. If so, firms will incur additional personnel costs to respond to these additional inquiries.

Finally, firms may also incur increased costs associated with the protection of sensitive customer data, particularly clearing firms that do not ordinarily possess such data.

**4. To what extent do firms believe that they would rely upon third parties to fulfill their reporting obligations? Should FINRA specify supervisory obligations for firms that enter into agreements with third parties to fulfill the firms' reporting requirements related to CARDS? How could FINRA use CARDS to reduce firm use of personnel or third parties to fulfill examination and reporting requirements?**

In many instances, firms are able to contract with third-party service providers to perform certain activities and functions related to their business operations and regulatory responsibilities. FINRA has provided guidance regarding member firms' responsibilities when outsourcing functions to third-party service providers.<sup>10</sup> FINRA consistently maintains that the member firm remains liable for compliance with federal securities laws and regulations and FINRA and Municipal Securities Rulemaking Board rules. Given the personal and sensitive nature of the information proposed to be submitted, firms may choose not to rely on third-party service providers.

Firms that choose to enter into agreements with third-party service providers are subject to the existing guidance under NASD Notice To Members 05-48 and related interpretive guidance which firms have relied upon for years.<sup>11</sup> Disrupting this established

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<sup>10</sup> See, e.g., NASD Notice to Members 05-48, *Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers* (July 2005) (available at <http://www.finra.org/Industry/Regulation/Notices/2005/P014736>) [last visited March 14, 2014].

<sup>11</sup> See generally *id* and NASD Notice to Members 05-28 and NASD Interpretive Letter dated Aug. 15, 2006 (available at <http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P017175>) [last March 14, 2014].

framework through specific supervisory obligations to third-party providers for CARDS may disrupt firms' current processes and impose additional costs. As such, FINRA should not impose any additional restrictions or requirements specific to CARDS without a clear justification for doing so.

SIFMA does not believe that CARDS would reduce use of personnel or third parties to fulfill existing examination and reporting requirements. As discussed in greater detail above, at the outset, the development and implementation of a uniform reporting system is expected to require an *increase* in IT, operations, legal and compliance resources, and once fully implemented, dedicated resources would be required to oversee compliance with the collection and reporting requirements.

It is unclear whether CARDS would have a positive impact on member firms' examination requirements. FINRA has not stated, or suggested, that following the implementation of CARDS it would conduct fewer examinations. We expect that in addition to responding to exam inquiries and inquiries triggered by CARDS analytics, firms will also be required to respond to inquiries regarding the timeliness or sufficiency of data submitted via CARDS.

- 5. To what extent do introducing firms currently maintain customer profile and suitability information with their clearing firms? If introducing firms maintain such information with the clearing firm, to what extent do introducing firms use the clearing firms' data fields in providing the information to the clearing firms? If the clearing firms' data fields are not used, how do introducing firms provide the information to their clearing firms? What would be the potential costs to introducing firms in providing the data elements required by CARDS to their clearing firms? If the data is not currently maintained in a standardized form, how much effort would be required to standardize the data to ensure comparability? Although CARDS contemplates the transmission of information from clearing firms to FINRA, would introducing firms find it more efficient and cost effective to transmit the specified information (or portions thereof) directly to FINRA?**

Introducing brokers routinely engage in activities for which no clearing services are required and as such frequently maintain substantial amounts of client profile and transactional data outside of the facilities of clearing firms. These types of clients and activity would include direct participation programs, non-listed REITs, most offerings under Regulation D, and direct-to-fund mutual funds. Since clearing firms do not have visibility into this activity and do not provide clearance or custody services in support of this business, it is not possible for SIFMA and clearing firms to estimate the amount of this activity or the potential costs to introducing and clearing firms to collect, maintain and standardize this data. Further, even if the frequency, nature and volume of such transactions of data were known, SIFMA would still be unable to estimate costs without more information about required data elements, data standardization, other technical details regarding the reporting platform,

transmission methods, an analysis of other current and proposed reporting requirements and an explanation of how the data will be stored, protected and used, SIFMA cannot conduct the necessary analysis to adequately respond to this question. *See* response to question 2.

- 6. The information provided to FINRA would include, at a minimum, account, account activity and security identification information. Is this information collected and maintained for all types of customers and products? To what extent is this information currently maintained in an automated format? To what extent is the information stored at clearing and self-clearing firms versus service bureaus?**

The burden posed by CARDS is tremendous. Although most account activity and security information is stored electronically, the most material issue is that such is frequently not stored in a uniform manner across firms or even within the various systems of individual firms. Data contained within a firm's independent internal systems would need to be standardized and then integrated across the various systems (requiring connectivity between those systems). Depending on variables such as client type, business unit and product type, the number of internal systems at any one introducing broker can quickly exceed several dozen. Even at firms with less systems, the standardization and integration of such systems would be a substantial project, and of course, much more so as the number of systems climbs. In addition, once standardized and integrated across internal systems, this data would then need to be standardized and transmitted to a clearing broker, who would in turn transmit the data to FINRA.

There are also issues associated with security identification information. The concept proposal also requires the provision of security identification information, such as CUSIP, symbol, description, name, ISIN, SEDOL. While certain of this information may be included within the trade data transmitted to the clearing firm, much of it is not maintained by either the clearing firm or the introducing broker in the ordinary course of business: instead, it is sourced from a service bureau. Furthermore, this information is not maintained for all types of customers or products, and to the extent it is maintained, as noted above, its location within a trading record and/or a firm's systems will vary.

Given the multiple-system aspect of firm operations, the scope of products and customer type that may be subjected to CARDS should be limited because, each additional variable creates an exponential effect on the burden associated with standardizing and integrating systems. Given the stated purpose of identifying potential sales practice violations, we would suggest limiting the scope of collection to equity and fixed income transactions in retail accounts (*i.e.*, non-institutional, accounts held by investors with a net worth of \$2 million or less excluding primary residence).



7. **FINRA expects that as applicable securities laws and FINRA rules evolve and are amended to include additional books and records requirements, it would revise CARDS' data specification elements to include that information. FINRA is contemplating assessing whether revisions to the data elements would be necessary on a 12 to 18 month cycle. What would be the feasibility of a 12 to 18 month cycle and what could impact that feasibility? What could be the potential economic impact of a 12 to 18 month revision cycle?**

It is impossible to comment on the feasibility or economic impact of a 12 to 18 month cycle without knowing the significance of the corresponding additional books and records requirement. The range of conceivable options is simply too broad. However, we are confident that each round of incremental enhancements would come at significant cost. Any system enhancement requires a planning and design stage, followed by a creation stage, a testing stage, and finally, an implementation and integration stage. At any given stage an unanticipated glitch could require reversion to a prior stage. System enhancement projects routinely take 12 to 18 months, if not more. As such, a revision cycle of 12 to 18 months would likely mean that as soon as a firm comes into compliance with the last round of standards, they would be called upon to implement the next round of enhancements. Furthermore, it is not necessarily appropriate that every record maintained by a member firm under its books and records requirements also be included in the CARDS regime. Any rule implementing a CARDS regime should contain detailed parameters regarding the types of books and records rules that may later be added to the regime and naming the persons or persons who will determine whether a new books and record requirement should be integrated into the CARDS regime at the next enhancement cycle. Any such addition should be held open to public comment, or involve industry representation among the decision makers.

8. **FINRA is considering submissions of the required information to FINRA on a regular schedule (such as weekly or daily) in a format that would permit FINRA to run analytics for a particular day during the period being reported. Should FINRA require a longer or shorter period of time for submission of the information to FINRA? Given the proposed purpose for collecting the information, what would be an appropriate schedule for submission of the information to FINRA? What would be the costs and benefits of a longer versus a shorter reporting schedule for submission of the information to FINRA? What would be the costs and benefits of requiring different submission schedules depending on the information to be provided to FINRA? For example, what would be the costs and benefits if FINRA were to require monthly submission of account information, but daily submission of account activity information?**

Daily reporting across all data types, on a trade date plus one basis for transaction activity, and only providing account data updates when an account has activity is preferable. First, it provides operational consistency. Second, it eliminates or reduces the costs for data storage, forward processing and related costs that may otherwise be incurred by firms. Alternatively, reporting could be tied to customer statement production rules and cycle.

- 9. FINRA is considering a phased approach to implementing CARDS. It envisions that the first phase of CARDS would focus on business conduct for retail accounts. What are the ways in which the first phase could be structured to best achieve the goal of focusing it on business conduct for retail accounts?**

Given SIFMA's strong reservations about the CARDS proposal, it would be premature to comment on a phased-in approach at this time.

- 10. For purposes of the initial phase of CARDS, would firms be able to clearly distinguish between retail customers and others? What systems changes, if any, would be necessary to allow firms to limit the submission of information to retail account activity? What would be the economic impact on firms, including the costs and benefits of limiting the initial phase of CARDS to the submission of information relating to retail account activity only? Is it easier or harder to limit reporting to retail account activity? What other types of account activity should or should not be included in an initial phase of implementation? How should historical information versus new accounts be treated under a phased approach?**

While we would encourage FINRA to limit the scope of CARDS, should it determine to implement CARDS, it is important to note that FINRA has not provided a definition of "retail" and there is no industry-wide, agreed-upon definition of "retail" customer. Even individual firms which draw high-level distinctions between different business units based upon the typical clientele of that business unit nonetheless allow for myriad exceptions. For example, the "typical" customer of a private banking business unit may have \$10 million plus liquid net worth and invest exclusively through third-party money managers, notwithstanding that that unit may also provide brokerage services to family members of a "typical" account holder, and those persons may have considerably less means. Similarly, while the typical client of a traditional wire house may be a so-called "mom-and-pop" investor, there is nothing prohibiting a corporation or high-net worth individual from using the services of that brokerage house as well. Parsing existing accounts into "retail" and "non-retail" buckets would be a considerable undertaking that would likely require guidance as to the parameters for defining a "retail" account, followed by an account-by-account analysis of whether an account meets the criteria. Therefore, FINRA would need to issue guidance including information relating to treatment of accounts held in the name of a corporation, a trust, a joint account, and IRA accounts, among others. Any phased-in approach would have to allow at least a year, if not more, to allow firms to contact customers to properly document accounts. FINRA also would need to establish a process for firms to seek and obtain guidance regarding what will likely be many unique situations not covered by general guidance promulgated with the rule.

Limitations on inclusion would be addressed best at a system level, which would require FINRA to work with its members to understand their systems, and how those systems are correlated to different internal business units or trading types, if at all (*e.g.*, account

numbers may contain a pre-fix to indicate that an account was originated in a retail branch account profile system).

**11. Following FINRA's analyses of the datasets firms provide, would it be beneficial for firms to receive the data with performance benchmarks? If so, should FINRA make that data available directly or through vendors or clearing firms?**

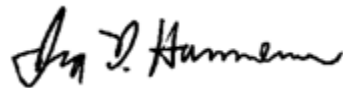
If FINRA imposes a CARDS Reporting Compliance program, then it must provide performance benchmarks. Again, this program would be costly, and if any benefits are derived from the proposal, the compliance program will more than offset them.

**V. CONCLUSION**

SIFMA thanks FINRA for issuing its request for comment and meeting with SIFMA regarding the proposal. We look forward to a continuing dialogue and working together to an appropriate resolution.

If you have any questions or require further information, please contact Kevin Zambrowicz, Associate General Counsel & Managing Director, SIFMA, at (202) 962-7386 ([kzambrowicz@sifma.org](mailto:kzambrowicz@sifma.org)), or our outside counsel Michael Wolk at (202) 736-8807 ([mwolk@sidley.com](mailto:mwolk@sidley.com)) or Timothy Nagy at (202) 736-8054 ([tnagy@sidley.com](mailto:tnagy@sidley.com)).

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