

**VIA ELECTRONIC MAIL**

February 12, 2015

SEC Investor Advisory Committee c/o  
Brent J. Fields  
Secretary, Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

**Re: File No. 265-28 – Investor Advisory Committee Meeting**

Dear Chair Schacht and Members of the SEC Investor Advisory Committee:

Thank you for the invitation to be part of today's panel on FINRA's Comprehensive Automated Risk Data System (CARDS) proposal. The Financial Services Institute (FSI) welcomes the opportunity to share our members' perspective on the important investor protection goals of CARDS and how to overcome the implementation challenges associated with this proposal. In addition to my oral remarks this afternoon, I have attached our December 1, 2014 comment letter to FINRA in response to its request for comment on Regulatory Notice 14-37. The letter provides a more detailed discussion of FSI's views on specific aspects of CARDS.

Sincerely,



Robin Traxler  
Vice President, Regulatory Affairs

## VIA ELECTRONIC MAIL

December 1, 2014

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

**Re: Regulatory Notice 14-37: Request for Comment on a Rule Proposal to Implement the Comprehensive Automated Risk Data System**

Dear Ms. Asquith:

On September 30, 2014 the Financial Industry Regulatory Authority (FINRA) released Regulatory Notice 14-37 (Regulatory Notice),<sup>1</sup> seeking comment on a proposed rule to implement the Comprehensive Automated Risk Data System (CARDS). This Regulatory Notice amends a prior concept proposal to develop CARDS (Concept Release) in response to public comments.<sup>2</sup> The Concept Release introduced CARDS as a rules-based program allowing FINRA to collect member firms' data on a regular basis via clearing firms. FINRA solicited comments on the Concept Release and received hundreds of comment letters. The Financial Services Institute<sup>3</sup> (FSI) and many of our members commented on the Concept Release. FINRA has taken steps to listen to the industry's comments about CARDS, and has incorporated industry feedback to improve the concept, resulting in this Regulatory Notice.

In the Regulatory Notice, FINRA has provided firms more specific information on CARDS and provided more detail as to how FINRA intends to utilize the collected data. FINRA believes CARDS will improve its ability to identify and respond to high risk areas and suspicious activity by helping FINRA track product mixes, monitor for problem areas such as pump and dump schemes, suitability, churning, mutual fund switching and concentrations of high-risk securities, as well as other benefits such as understanding the overall risk profile of a firm and allowing FINRA to conduct more targeted sweeps, firm-wide initiatives, and examinations.

Protecting investors is of the utmost priority for FSI members, and FSI appreciates the opportunity to comment on the Regulatory Notice. Implemented effectively, CARDS could enhance FINRA's

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<sup>1</sup> Regulatory Notice 14-37, Comprehensive Automated Risk Data System (Sept. 2014), available at <http://www.finra.org/Industry/Regulation/Notices/2014/P600952>.

<sup>2</sup> Regulatory Notice 13-42, Comprehensive Automated Risk Data System (Dec. 2013), available at <http://www.finra.org/Industry/Regulation/Notices/2013/P412658>.

<sup>3</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor financial advisors. FSI has 100 Broker-Dealer member firms that have more than 138,000 affiliated financial advisors serving more than 14 million American households. FSI also has more than 35,000 Financial Advisor members.

ability to protect investors. FSI and its members are committed to ensuring that CARDS reaches its intended investor protection goals while allowing our members to effectively provide the objective financial guidance that is so valued by their clients. Because of our members' commitment to this effort, FSI formed a CARDS Task Force (Task Force), anticipating the need to have subject matter experts collaborate to provide constructive comments and feedback to FINRA.<sup>4</sup> The Task Force is composed of three members of FSI's Board of Directors who represent large, mid-size, and small firms as well as FSI's Compliance and Operations & Technology Councils. The Task Force supports the investor protection purpose of CARDS and this comment letter is the result of the Task Force's work to formulate recommendations to improve and refine CARDS so it can best reach its goals, benefitting FINRA, industry participants, and investors.

#### Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their financial advisors. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64 percent of all practicing financial advisers – operate in the IBD channel.<sup>5</sup> These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.<sup>6</sup> Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is

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<sup>4</sup> FSI Announces Formation of FINRA CARDS Task Force, October 2, 2014 available at <http://www.financialservices.org/content.aspx?id=5513> and “FSI sets up task force to influence CARDS development,” InvestmentNews, October 2, 2014 available at <http://www.investmentnews.com/article/20141002/FREE/141009976/fsi-sets-up-task-force-to-influence-cards-development>.

<sup>5</sup> Cerulli Associates at <http://www.cerulli.com/>.

<sup>6</sup> These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisers.

committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

### Executive Summary

FSI supports FINRA's investor protection goals for CARDS. We commend FINRA for its effort to respond to the public comments to the Concept Release. FINRA has made several important enhancements to CARDS to ensure that investors are properly protected and resources are expended efficiently. However, FSI has several comments and suggestions for FINRA to consider in light of the specific information included in the Regulatory Notice. A summary of each of these topics is included below. A detailed discussion of each of these topics is included in the subsequent sections of this comment letter.

#### A. Direct Business Data

- **Significance for IBD Model:** FSI believes CARDS would be most effective if it includes direct business data in addition to brokerage business data. For firms with significant portions of direct business, CARDS will have an incomplete picture of a firm's business profile and its product mixes and concentrations.
- **Risk of False Positives:** Without the collection of direct business data FINRA will likely encounter a significant number of false positives.<sup>7</sup> Absent this data CARDS will collect incomplete and potentially misleading information regarding specific firms, financial advisors and branch offices.
- **Efficiency:** Adding the collection of direct business data at a later point in time could create inefficiencies. FSI recommends FINRA add this data to phase 2 of its CARDS' implementation. In the alternative, FINRA should provide firms with the specifications for the collection of direct business information prior to any rule filing so that they can plan for the development of necessary systems.

#### B. Collection and Use of Suitability Data

- **Necessity of Suitability Data:** FINRA's stated purpose for collecting suitability data is to allow it to identify customers that hold high risk products, branch offices with concentrations of those products, and financial advisors selling the products. However, it seems that FINRA can make each of these determinations based upon the product data collected by CARDS.
- **Unintended Impacts on Financial Advice:** One unintended consequence of requiring suitability data is that suitability reviews may become formulaic processes. This may detrimentally impact the nuanced nature of personal financial advice.
- **False Positives:** FSI member firms are concerned that an analysis of suitability data by FINRA will result in numerous "false positives" requiring FINRA and FSI member firms to expend significant resources to review and respond to these determinations.

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<sup>7</sup> False positive is defined as "relating to or being an individual or a test result that is erroneously classified in a positive category (as of diagnosis) because of imperfect testing methods or procedures." See <http://www.merriam-webster.com/medical/false-positive>.

### C. Regulatory Oversight

- **Sweeps:** In the event FINRA determines that a sweep is necessary despite the data it has obtained through CARDS, FSI requests that the sweep include a clear statement of why CARDS data is insufficient to resolve the inquiry.
- **Compliance and Supervisory Functions:** FSI applauds FINRA's commitment to assist, rather than duplicate, the compliance and supervisory efforts of member firms. FSI members and investors would benefit from utilizing CARDS to improve firms' supervisory functions.
- **Duplicative Data Systems:** FSI appreciates FINRA's commitment to eliminate duplicative data systems. FSI recommends that FINRA undertake a review of all existing data systems and prepare an explanation as to why FINRA believes these systems will still be necessary upon CARDS' implementation.
- **Books and Records Requirements:** FSI requests that FINRA review the various existing books and records requirements that overlap with CARDS requirements prior to the implementation of CARDS. FSI asks that FINRA work with the industry to recommend changes to the books and records rules that are a logical result of CARDS requirements.

### D. Data Protection and Privacy

- **Security Controls:** FSI applauds FINRA for committing to obtain Service Organization Controls (SOC) 2 and 3 reports prior to the CARDS implementation date. FSI suggests that FINRA also obtain these reports on an annual basis.
- **Access to Data:** FSI supports FINRA's commitment to limit access to raw CARDS data to a few select technical employees. FSI requests that FINRA detail which other entities may have access to CARDS data and how that data will be protected.
- **Data Breach Protocols:** FSI recommends that FINRA release a protocol document describing the procedures it will take upon a breach of CARDS, including the procedures for notifying investors as well as allowing firms to suspend CARDS submissions in the event of an ongoing breach.
- **Liability:** FSI members request clarification from FINRA regarding their liability to investors in the event of a CARDS breach. FSI also requests that FINRA agree to indemnify firms for costs or damages incurred as a result of a data breach occurring after firms have provided data to FINRA.
- **Data Incidents:** FSI recommends that FINRA develop a process to review data incidents to address vulnerabilities and ensure the security of personal investor data. FINRA should share this with the public so that all stakeholders can understand the full extent of FINRA's comprehensive security program.

### E. Technology Issues

- **Testing Environment:** FSI requests that FINRA provide greater detail and specifics on the CARDS testing environment (CTE) and the onboarding process.
- **Amendments to Data Specifications:** Firms are interested in learning if FINRA has developed any plans to review the CARDS data specifications on a regular basis following implementation. If so, firms would like FINRA to detail the process for amending these specifications following CARDS implementation.

- **Pre-submission Validation**: FSI requests further clarification with regard to the extent to which the CTE is used as pre-submission validation and whether the feedback files that firms receive from the CTE can be relied upon prior to sending data to the production environment.
- **New Systems**: Firms will be required to create new systems and procedures to effectively oversee the feedback process and meet the regulatory obligations and seven business day repair period. Based upon the volume of errors, the complexity of the errors, and the ability for clearing firms and introducing firms to efficiently match data, these systems will require their own upfront and maintenance costs.
- **Appeal Process**: FSI requests that FINRA develop an appeal process for CARDS data feedback and error determinations to permit firms to dispute the validation results.
- **Data Matching**: Firms expect significant costs associated with matching the required data records for suitability to the data records that their clearing firms will be submitting.

#### F. Costs and Benefits

- **Continuing Engagement**: FSI looks forward to working with FINRA and its Office of the Chief Economist to collect and analyze data and other information related to the costs, benefits, and challenges related to CARDS implementation. As more details regarding CARDS implementation are released, firms will have the ability to provide more definitive cost estimates and other projections related to CARDS implementation.
- **Small Firm Impact**: Initial and on-going maintenance costs will be significant, particularly for smaller firms.
- **Retrospective Review**: FSI recommends that FINRA commit to a structured retrospective rule review that provides commenters with data and other information related to CARDS implementation.

#### Comments

FSI and its members have a great appreciation for the immense value data and technology can bring to the industry, regulators, and investors. New technologies continue to play an enormously important and transformative role in nearly every industry. The effective use of new technologies is particularly essential in the financial services industry and the IBD community in particular. FSI members have been effectively using technology to enhance their ability to conduct remote supervision, build robust compliance efforts, and provide innovative services to investors. Technology has also changed the way that clients and advisors communicate about investing, whether by reviewing performance metrics and portfolio composition on a tablet or conducting meetings through videoconferences. The adoption of social media platforms and the emergence of “robo-advisors”<sup>8</sup> will continue to change the way that clients receive financial advice and how advisors deliver value to their existing clients as well as the next generation of investors. As the industry and investors change, regulators must adapt as well and adopt new tools and technologies to better protect investors and conduct more targeted and efficient examinations and industry surveillance. FINRA has developed CARDS as one of those tools that will allow them

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<sup>8</sup> See Eric Rasmussen, *The Rise of the Robo Advisors*, Financial Advisor Magazine, available at <http://www.famag.com/news/the-rise-of-the-robo-advisors-17370.html>.

to leverage the power of technology to be a more effective and efficient regulator.<sup>9</sup> FSI members support FINRA's investor protection goals, and are interested in providing essential input and suggestions for FINRA to create a system that will allow it to achieve its vision. It is in the best interest of investors and the industry to leverage emerging technologies to gather and analyze data in order to better inform regulators of emerging risks, trends, and potential fraud.

We provide our comments and suggestions in the sections below.

## **DIRECT BUSINESS DATA**

### **1. Overview**

As we discussed in our previous comment letter, while several FSI member firms are self-clearing, most conduct transactions on a fully disclosed basis with a clearing firm. In this arrangement, FSI members act as the introducing broker-dealer, which "introduces" client accounts and transactions to a clearing firm that is a Depository Trust & Clearing Corporation (DTCC) member for purposes of clearance, settlement, and custody.<sup>10</sup> These transactions will take place through the clearing firm's brokerage platform after the broker-dealer and financial advisor conduct the required pre-trade suitability, Know Your Customer (KYC), anti-money laundering (AML) and other compliance reviews. Upon entering the transaction via the clearing firm's brokerage platform, an automated processing system captures and transmits the order, books the transaction in the customer's account, and settles the transaction. The clearing firm also makes payments to the broker-dealer, maintains consolidated position information, and generates statements and tax forms for the client.

In addition to utilizing a clearing firm's brokerage platform for trading, many firms and advisors directly process transactions with product providers, typically mutual fund companies, variable annuity providers, or alternative investment sponsors. For many IBD firms, this non-brokerage business represents a very significant part of their business model.

Commonly referred to as "direct business," transactions are often conducted through the so-called "check and app" process. Upon following the pre-transaction suitability requirements of Rule 2111, a client completes and signs an application form and provides a check to his or her financial advisor. The financial advisor forwards these materials to the broker-dealer home office or Office of Supervisory Jurisdiction (OSJ) to conduct principal review, KYC, and AML processes before forwarding these materials to the product provider. Upon reviewing the application, the product provider makes the investment, sends the commissions to the broker-dealer, and generates statements, tax reports, and other documents which it sends directly to the client. This transaction data does not flow through clearing firms' brokerage platforms, and therefore will not be collected in CARDS under the current proposal. Although introducing broker-dealers do retain the required books and records for these transactions, including documentation with respect to suitability, KYC, and AML, this information does not flow through the clearing firm platform.

The initial phase of CARDS as proposed in the Regulatory Notice will exclude the collection of direct business data.<sup>11</sup> FINRA has also indicated that later phases of CARDS may collect this direct

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<sup>9</sup> See Remarks by Richard Ketchum, October 28, 2013, available at <http://www.finra.org/newsroom/speeches/ketchum/p373689>.

<sup>10</sup> See Henry Minnerop, *Clearing Arrangements*, 58 Bus. Law. 917 (May 2003).

<sup>11</sup> Regulatory Notice 14-37, at 11.

business information pursuant to a separate request for comment and rulemaking.<sup>12</sup> We appreciate that FINRA has been mindful of the importance of direct business data while acknowledging concerns that collecting direct business data presents challenges. FSI's previous comment letter reviewed the challenges and costs involved with standardizing direct business data and the difficulty firms would have collecting this information.<sup>13</sup> However, now having the benefit of the detail in the Regulatory Notice and supplementary documents provided by FINRA, FSI believes that CARDS will only be successful if direct business data is collected. FSI recommends that FINRA include direct business data in phase 2 or, in the alternative, provide the specifications for the collection of direct business data prior to any rule filing so that firms can plan the development of necessary systems. Excluding direct business data without providing specifications for its later inclusion in CARDS may introduce additional costs and challenges when FINRA decides to conduct a separate rulemaking to propose a system for transmitting direct business to CARDS.

The exclusion of this data could also undermine FINRA's goal with regard to CARDS by not providing FINRA the necessary data to effectively and efficiently identify risks and trends in the industry. Absent direct business data CARDS will not truly be comprehensive. Furthermore, for firms with significant portions of direct business, it may increase the prominence of false positives, creating inefficiencies and increased costs to both FINRA and member firms responding to inquiries and sweep letters that originate due to the incomplete data set that CARDS in its proposed form will collect. We expand on these concerns below:

## **2. Importance Of Direct Business Data to CARDS Goals**

FINRA intends to utilize CARDS to significantly enhance its ability to collect data, conduct robust analyses, and improve its effectiveness as a regulator. FINRA listed the following examples of uses of CARDS data to enhance its investor protection capabilities:

- Understand the business profile of a firm and incorporate that understanding into FINRA's examination, surveillance, cycle planning, and risk assessment functions;
- Track product mix across firms and in branches of each firm, including changes to that mix;
- Understand, on an ongoing basis, where firms consistently sell products that present higher risk to customers and, when compared to risk tolerance profiles, appear to be unsuitable for those clients;
- Identify patterns of transactions that indicate bad behavior on the part of a particular broker-dealer branch office, or registered representative, and monitor more effectively for problem areas such as pump and dump schemes, suitability, churning, mutual fund switching, and concentrations of high-risk securities; and
- Understand the overall risk profile of a firm, including where a firm is taking on too much market risk in its proprietary trading or other risk-taking activities; and identify potentially suspicious activity in accounts that may call into question the adequacy of a firm's anti-money laundering program.<sup>14</sup>

FSI fears that each of the above listed goals will be severely undermined if FINRA does not collect both brokerage and direct business data. Without direct business data CARDS will present

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<sup>12</sup> *Id.*

<sup>13</sup> See Letter by David T. Bellaire, Executive Vice President & General Counsel, FSI, to Marcia E. Asquith, Office of the Corporate Secretary, FINRA, March 20, 2014, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p473379.pdf>

<sup>14</sup> Regulatory Notice 14-37, at 3



an incomplete picture of a firm's business profile, its product mix and concentrations. The exclusion of direct business data may also result in a significant number of false positives because CARDS will collect incomplete and potentially misleading data regarding specific financial advisors and branch offices.

For example, CARDS would identify a firm as having a high volume of their overall business in certain types of products custodied at their clearing firm, when in fact these products are merely a fraction of the firm's overall business. Furthermore, without direct business data CARDS may identify that an individual branch office has an overconcentration in a specific product type. In reality, the direct investments being sold by that office may balance out the perception created by CARDS data. To the extent FINRA may identify individual client holdings of a specific financial advisor or branch office, for example in preparation for an examination, investors who engage in aggressive hedging strategies by purchasing options and other investment contracts may appear to be invested in strategies and products that are contrary to their stated investment objective. However, an analysis of their direct business investments, which CARDS will not collect under the current proposal, would provide a more complete picture of their overall investing strategy.

Similarly, as FINRA tries to identify trends and other "macro" issues within the securities markets, CARDS will only be collecting a portion of data and this will severely impact its overall effectiveness to spot trends and address risks at firms and in the markets. More likely, the absence of this data will result in a high percentage of false positives, increasing the burden placed upon IBD firms and FINRA, and ultimately increasing the costs to investors. For CARDS to achieve its goals FINRA will likely need to collect and consolidate multi-custodial client account data from firms and product providers.

### **3. Potential Redundant Efforts And Costs**

The Regulatory Notice states that direct business data will be exempted from the required data submission of CARDS in this initial stage.<sup>15</sup> FINRA has, however, announced that at a later phase this product information could be collected. In the event that CARDS is expanded to collect direct business data, FINRA has announced that this would require another request for comment and additional rulemaking.<sup>16</sup> FINRA has decided to bifurcate the collection of brokerage and direct business data to reduce the implementation strain. This decision, however, may in fact increase the overall costs of implementing CARDS. By implementing CARDS in multiple phases, firms will build a system based on current FINRA requirements and then be faced later with additional and likely redundant costs as they build systems to accommodate transmission of direct business data. In the initial phases, firms will be preparing systems that may not be compatible with the methods that FINRA will use to add direct business data to CARDS.

FSI recommends adding this data to phase 2 or at least providing the specifications for the collection of direct business information prior to any rule filing so that firms can plan the development of necessary systems. Providing the specifications for the collection of direct business data will allow firms to more accurately respond to the data specifications, submission mechanics, and specific questions related to implementation costs. Major clearing and settlement participants, such as the National Securities Clearing Corporation (NSCC), will be vital in determining the scope

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<sup>15</sup> Regulatory Notice 14-37, at 11.

<sup>16</sup> *Id.*

of the costs involved and whether other changes with respect to data standardization will need to be implemented. One suggestion for FINRA to consider is commissioning a report to determine whether having the initial phase of CARDS exclude direct business data is cost-effective compared to alternative approaches. A useful illustration of this analysis is the Boston Consulting Group (BCG) report commissioned by the Depository Trust and Clearing Corporation that focuses on the costs and benefits of shortening the settlement cycle.<sup>17</sup> Such a study may help elucidate whether requesting comment on full implementation with the inclusion of direct business data instead of pursuing CARDS in multiple stages is the more efficient path forward.

In sum, collecting all available data from broker-dealers, clearing firms, and product providers will provide FINRA the data it needs to achieve its goals. FSI member firms welcome the opportunity to provide comment on a complete CARDS proposal, and are eager to constructively engage with FINRA in a discussion of the best methods for collecting direct business data.

## COLLECTION AND USE OF SUITABILITY DATA

### 1. Overview

FINRA stated in the Regulatory Notice that “CARDS would provide a more holistic view of customer accounts, thereby allowing FINRA to better pinpoint where suitability risks might exist by identifying groups of customers holding high-risk products, branch offices with concentrations of such products and registered representatives selling those products.”<sup>18</sup> FINRA has also stated that CARDS would allow FINRA to detect instances where firms consistently sell products that present higher risk to customers and appear to be unsuitable for those customers.<sup>19</sup>

FSI member firms have concerns about the possible use of suitability data provided through CARDS. FSI requests that FINRA consider the extent to which they need suitability data to achieve their stated goals for CARDS. One unintended consequence of requiring such information is that suitability reviews may become formulaic processes that will ultimately have a chilling effect on the personal nature of financial advice. Additionally, FSI members anticipate both FINRA and the firms needing to devote significant time and resources to responding to “false positives” that will not further investor protection. Lastly, FSI members are concerned that because FINRA collects the data, they may create an expectation that they will in fact utilize the data to conduct individual reviews.

### 2. Necessity of Suitability Data

FINRA’s stated purpose for collecting suitability data is to allow it to identify customers that hold high risk products, branch offices with concentrations of those products, and financial advisors

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<sup>17</sup> Boston Consulting Group, *Cost Benefit Analysis of Shortening the Settlement Cycle*, (October 2012), available at [http://www.dtcc.com/~media/Files/Downloads/WhitePapers/CBA\\_BCG\\_Shortening\\_the\\_Settlement\\_Cycle\\_October2012.ashx](http://www.dtcc.com/~media/Files/Downloads/WhitePapers/CBA_BCG_Shortening_the_Settlement_Cycle_October2012.ashx). The report reviews available models and data with respect to shortening the settlement cycle from T+3 to T+2, T+3 to T+1, and T+2 to T+1. A similar analysis could potentially be useful for FINRA in determining the best course of action with regard to developing CARDS. The BCG study analyzed whether moving from the current T+3 settlement period for equities to T+2 as an intermediate step was cost effective versus the benefits of moving directly to T+1. FINRA is in a similar situation with regard to CARDS.

<sup>18</sup> Regulatory Notice 14-37, at 17.

<sup>19</sup> Remarks of Susan Axelrod, Oct. 29, 2014, available at <http://www.finra.org/Newsroom/Speeches/Axelrod/P601434>.

selling those products. However, it seems that FINRA could make each of these determinations solely based on the product data collected through CARDS. Upon identifying a representative with a large concentration of a high-risk product, FINRA may undertake an analysis of the suitability of the product for particular clients. Such a review is better suited to be performed by examiners during an examination rather than by an automated system that will not have all the relevant data points, will not contain additional contextual information about the client's overall financial situation and will not be privy to the initial suitability determination made by the financial advisor and the broker-dealer.

Furthermore, as member firms begin to contemplate the technological implications of building systems in light of CARDS requirements, they have noted an additional concern regarding the utility of data submitted in free text format. Firms record suitability information in different manners and use different terminology in describing suitability factors. FSI members believe this reality will pose significant challenges to FINRA in attempting to run analytics on this data. In fact, FSI believes the costs in inputting, storing and transmitting the suitability data FINRA currently contemplates collecting through CARDS might outweigh the benefits FINRA envisions.

As such, should FINRA request suitability information via CARDS, FSI requests that FINRA consider amending the required account profile information to only collect the birth year, net worth and investment time horizon data elements. Items such as investment objective and risk tolerance are likely to be recorded in a variety of formats by broker-dealers. Attempting to interpret an individual firm's classification and then standardize it across all firms is, at best, a difficult task that may result in frequent incorrect classifications. Elements such as birth year, net worth and investment time horizon are more easily quantifiable and can be expected to result in few, if any, misunderstandings. FSI believes limiting the requested data to these elements may reduce the frequency of "false positives" while not compromising the functions of CARDS.

Lastly, if FINRA does indeed collect suitability information, we suggest it be used in a more limited and focused manner. FINRA could utilize the data by identifying trades or transactions for an examiner to review with the firm during their on-site examination. Reviewing the information in person with firms and financial advisors will allow for FINRA to examine the issue with the added context of the various factors not included in CARDS data that contributed to the investment decision. This will allow for a more efficient use of both firm and FINRA resources and ensure that these resources remain focused on protecting investors to the greatest extent possible.

### **3. Suitability Review Procedures**

FSI members believe it is important for FINRA to understand the inherent nuances of suitability information. The non-formulaic nature of a suitability review is essential to achieve investors' investment objectives. An effective analysis of suitability data involves the examination of the information provided to the financial advisor by the client. As the data is subsequently passed along to the Registered Principal and ultimately to the broker-dealer home office, important details are lost, challenging the ability to make an accurate suitability determination.

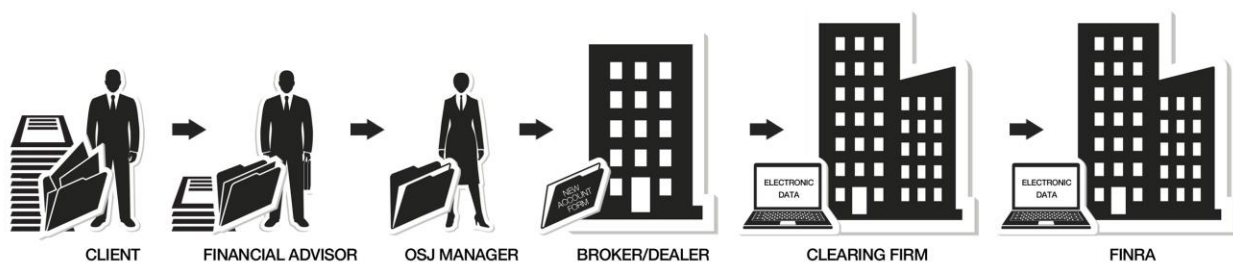
To provide greater context for this concern we believe it is helpful to discuss the various steps in a suitability review conducted by FSI member firms. In a typical product sale, the customer possesses all of the information relevant to their financial condition. Such information includes all of their bank and brokerage account balances as well as details for all assets not held at a financial institution. Additionally, the customer is aware of personal developments or considerations which

may impact their finances. Examples of these considerations may include a pending divorce, a dependent with special needs whose health is deteriorating, anticipated inheritances, or upcoming major expenses, amongst many other considerations that may impact their finances and investment goals. While the client may share a lot of this information with the financial advisor, the advisor may not have a complete picture of the client's financial condition even after exercising reasonable diligence. The financial advisor documents the information shared by the client in the client file or record keeping system and on the New Account Form which is forwarded for review to the Registered Principal at the financial advisor's Office of Supervisory Jurisdiction (OSJ).

Upon receiving the New Account Form, the Registered Principal can then examine transactions for potential suitability issues. Oftentimes when suitability concerns are apparent the Registered Principal will have a conversation with the financial advisor to better understand the client's objectives for making the investment or liquidating the position. Sometimes the Registered Principal will even reach out to the client directly to better understand the factors that contributed to the transaction. In many instances the Registered Principal will instruct the financial advisor to include notes in the client file to reflect information known to the advisor that is not contained on the New Account Form. Alternatively, the Registered Principal may make handwritten notes in his or her own file or on other documentation for reference by the firm's home office. The Registered Principal will then make a suitability determination based on all this information, indicate his approval in the appropriate systems and forward the required forms and documentation to the broker-dealer's home office.

Typically, broker-dealers use exception reports to aid in reviewing the suitability determinations of their financial advisors and Registered Principals. Depending on the structure of a firm, the exception reports may be analyzed by the Compliance Department at the home office or by a Registered Principal at an OSJ pursuant to policies and procedures developed by the Compliance Department. These reports automatically identify exceptional occurrences in customer accounts to help compliance staff discover potential sales practices issues. Personnel reviewing these reports conduct independent analyses based on the report results in conjunction with the information in the client file. If additional information is necessary they will make the necessary requests of the Registered Principal and financial advisor. Upon completion of the review, the firm will either approve the processing of the transaction or reject it for further review.

The following visual illustrates the various steps discussed above. As depicted, FINRA will receive the suitability information through CARDS at a point several steps removed from the client and without any of the additional context available to the financial advisor and Registered Principal:



#### 4. Impact of CARDS on Independent Financial Advice

CARDS would require aspects of suitability data to be transmitted to FINRA. FINRA has stated publicly that it does not intend to utilize this information to conduct individual determinations. FSI applauds this approach because an analysis of this data would be incomplete without access to the entirety of a client's holdings, or understanding of the many personal factors that contribute to investment decisions.

FSI members are concerned that the presence of suitability data in CARDS could encourage FINRA or others to second guess the determinations made by the firm in its suitability reviews. In an effort to avoid future inquiries, some firms might establish suitability thresholds for products in order to meet FINRA expectations, ease the submission of this data through CARDS, and reduce the likelihood that FINRA will inquire about potential issues. Additionally, if a financial advisor anticipates added inquiries on a potential recommendation due to CARDS' limited view of clients' specific circumstances, the advisor will be incentivized to alter the recommendation to avoid such inquiries. In this case, the personal, nuanced nature of independent financial advice will be watered down, which unintentionally harms investors.

#### 5. False Positives

Furthermore, an analysis of suitability data by FINRA would result in numerous "false positives" requiring FINRA and firms to expend significant resources to review and respond to these determinations. FSI believes it is important to share with FINRA the experiences of member firms with internal systems utilized to monitor suitability. These systems often detect a significant number of false positives. In fact, one FSI member firm found that 96 percent of all transactions flagged for suitability review by an automated system in the last twelve months were false positives that were ultimately approved by the Registered Principal at the OSJ. Figure 1 details the rate of false positives flagged by the firm's internal system.

Figure 1

	Number	% of Total	% of Flagged
Total trades evaluated through internal system	6,861,487	100.00%	
Trades flagged for manual OSJ review	155,681	2.27%	100.00%
Rejected trades	6,316	0.09%	4.06%
Approved trades (False-positives)	149,365	2.18%	<b>95.94%</b>
# of human interactions for false positives	<b>475,217</b>		

To respond to these false positives, this FSI member firm estimates that it dedicated the equivalent of 8.3 full time employees over a twelve month period. As Figure 1 illustrates, the firm required on average, more than three human interactions to resolve each false positive.<sup>20</sup>

An analysis of the firm's data for transactions cleared by their clearing firm even more starkly details the amount of false positives that an automated suitability review system yields. Ninety nine percent of transactions flagged for review by the internal system were false positives. Figure 2 provides the data for transactions processed through the clearing broker.

Figure 2

	Number	% of Total	% of Flagged
Total trades evaluated through internal system	1,220,175	100.00%	
Trades flagged for manual OSJ review	18,020	1.48%	100.00%
Rejected trades	166	0.01%	0.92%
False positives	17,854	1.46%	<b>99.08%</b>
# of human interactions for false positives	<b>64,576</b>		

As demonstrated through this example, responding to false positives may have the detrimental impact of redirecting resources away from internal firm surveillance and other essential efforts while also increasing the regulatory burden on member firms without a corresponding benefit to investors. The likelihood of a high rate of false positives and the inefficient diversion of resources at both FINRA and member firms may threaten the investor protection benefits of CARDS. Therefore, FSI encourages FINRA to reconsider the collection of suitability data through CARDS.

## REGULATORY OVERSIGHT

### 1. Overview

FINRA stated in the Regulatory Notice that CARDS will contribute to a more targeted use of sweeps and more effective examinations and inquiries.<sup>21</sup> Additionally, FINRA reiterated that it does not intend to replace the functions currently being performed by broker-dealer compliance and supervisory programs.<sup>22</sup> In fact, FINRA stated it would provide firms with access to CARDS

<sup>20</sup> The Registered Principal needed to request more details from the advisor, the advisor responded to the request, the Principal then reviewed the information and provided a response to the advisor.

<sup>21</sup> Regulatory Notice 14-37, at 4 ("In addition, FINRA would analyze CARDS information before launching firm-wide sweeps or examining firms on-site, thereby potentially eliminating some sweeps, more effectively targeting the firms included in other sweeps...and streamlining reviews conducted as part of on-site visits to firms...").

<sup>22</sup> *Id.* at 13.

data “in a form that would facilitate and improve a firm compliance department’s capabilities.”<sup>23</sup> Additionally, FINRA committed to retiring two existing data reporting feeds, the Integrated National Surveillance and Information Technology Enhancements (INSITE) and the Automated Exam Program (AEP), which it believes will no longer be necessary following CARDS implementation.<sup>24</sup>

FSI applauds FINRA for its efforts to use CARDS as a tool to alleviate certain regulatory obligations and aid the compliance and supervisory programs at member firms. CARDS has the potential to reduce the burdens on broker-dealers in responding to numerous, data-driven regulatory inquiries. Furthermore, it presents the possibility for more efficient and effective examinations of firms. Nevertheless, FSI members believe there are additional opportunities for FINRA to eliminate duplicative requirements that would create unnecessary burdens. Specifically, FSI members believe that FINRA should commit to undertake several initiatives described below related to the role of CARDS in the broker-dealer regulatory regime.

## **2. Sweeps and Inquiries**

In the Regulatory Notice, FINRA stated that it believes CARDS would reduce burdens on firms by “eliminating intermittent, and sometimes frequent and extensive, information requests.”<sup>25</sup> Furthermore, FINRA committed to analyzing CARDS data before launching sweeps in order to more effectively target the firms subject to the sweeps. FINRA believes these streamlined and targeted examinations would reduce the resources required of firms to respond to sweeps.

FSI appreciates FINRA’s commitment to use CARDS data in lieu of launching sweeps and inquiries. Firms routinely devote significant resources to responding to these requests and we commend FINRA for its commitment to reduce these instances. Should FINRA determine a targeted sweep is necessary, FSI suggests that the sweep include a clear statement of why CARDS data is insufficient to resolve the inquiry. FSI suggests the statement include a discussion of what data FINRA possesses, what data it is seeking that it does not possess, and why it believes the additional data is necessary to resolve its inquiry. FSI also requests that FINRA consider the significant resources firms will be devoting to developing and maintaining CARDS-related systems when considering the frequency of and expected response times related to sweeps and other inquiries.

FSI also requests that FINRA undertake certain initiatives after CARDS implementation to allow for the industry to evaluate the reduction in regulatory burdens due to CARDS. Specifically, FINRA should consider publishing detailed statistics on the number and size of sweeps, the number of additional inquires resulting from CARDS outside of a targeted exam and any other information that may be useful in evaluating the increased investor protection and decreased regulatory burden due to CARDS. FINRA engages in statistical reporting of this sort through the monthly FINRA Dispute Resolution Statistics which can be used as a template for this reporting.<sup>26</sup> Furthermore, FINRA might also consider publishing statistics detailing the results of sweeps and inquiries made based on CARDS data, including amounts paid as restitutions, fines or other penalties.

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<sup>23</sup> *Id.* at 14.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 4.

<sup>26</sup> See <https://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/>.

FSI member firms are eager to work with FINRA to develop a system that will reduce resource burdens and improve the effectiveness of FINRA's investor protection efforts. Our members wish to have the opportunity to evaluate the impact of CARDS on the volume of regulatory inquiries from FINRA in order to assist FINRA in crafting an ideal analytical system. Providing the information described above will facilitate an effective retrospective rule review and allow firms to undertake the necessary evaluations and work with FINRA to continue to improve CARDS in the years following its initial deployment.<sup>27</sup>

### 3. Augmenting Broker-Dealer Compliance Efforts

In response to industry comments to the Concept Release, FINRA clarified in the Regulatory Notice, as well as in public statements, that it does not intend to supplant the compliance and supervisory programs administered by broker-dealers.<sup>28</sup> FINRA stated that it will not engage in a "transaction-by-transaction based exception program."<sup>29</sup> According to FINRA, firms will retain responsibility for "granular oversight" and to "prevent and detect problems with individual customers and transactions."<sup>30</sup> FINRA has further stated that "CARDS would also help firms better manage compliance, through more timely conversations with firms about issues we're spotting and data and tools that enhance firms' ability to identify and address problem producers and actions. The feedback and report card approach has worked well in FINRA's market regulation program and would be a valuable enhancement to FINRA's member regulation programs as well."<sup>31</sup>

#### i. Limitations on Use of CARDS Data

FSI applauds FINRA's commitment to assist the compliance and supervisory efforts of member firms rather than duplicate those efforts. FSI members currently conduct robust supervisory programs to protect investors and ensure compliance with federal and state securities laws and regulations. It is in the best interest of all firms, regulators and, most importantly, investors to ensure that broker-dealers continue to perform these essential functions. While FSI members appreciate FINRA's desire to ensure that these functions remain the responsibility of broker-dealers, concerns about the impact of CARDS on their compliance and supervisory functions remain.

In light of the amount of individual client data FINRA proposed to be analyzed by CARDS, FSI members worry that CARDS will ultimately be utilized as a tool to conduct granular reviews of individual transactions over a multi-year period. It is conceivable that in response to a high profile enforcement matter involving allegations of unsuitability, FINRA may receive external pressure to utilize CARDS information in contrast to its stated intent. In an effort to avoid the unnecessary duplication of firms' compliance efforts, FSI suggests FINRA consider adding the following section to the Supplementary Material of Proposed Rule 4542:

**.04 Limitations on Use of Information.** Through the regular transmittal of information specified in Rule 4542 FINRA seeks to enhance investor protection and help restore and maintain investor confidence by allowing FINRA to identify high-risk areas and suspicious

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<sup>27</sup> See COSTS AND BENEFITS Section beginning on page 27.

<sup>28</sup> Regulatory Notice 14-37, at 13; see also Remarks from Rick Ketchum, May 19, 2014, available at <http://www.finra.org/Newsroom/Speeches/Ketchum/P506341>.

<sup>29</sup> Regulatory Notice 14-37, at 13.

<sup>30</sup> *Id.*

<sup>31</sup> Remarks from Susan Axelrod, *supra* note 19.



activities. However, FINRA is not establishing a transaction-by-transaction based exception program. Information submitted pursuant to Rule 4542(a)(1)(D)(iv) and Rule 4542(b)(1) shall not be used by FINRA or any other person or entity in receipt of the information from FINRA, other than the transmitting member, to conduct individual suitability reviews of specific customer transactions except in the context of a targeted examination letter, or broker-dealer or branch office cycle examination.

FSI members believe the addition of this language will further clarify FINRA's intended use of the data while providing FINRA the necessary flexibility to enhance their investor protection capabilities.

ii. Sharing CARDS Data with Firms

FSI members are encouraged by FINRA's willingness to share CARDS data with firms.<sup>32</sup> In the Regulatory Notice FINRA specifically requested comments on what types of information would be most valuable to enhance compliance and supervisory programs at broker-dealers. FSI members are very intrigued by the possibility of utilizing CARDS to improve their supervisory functions. Our members see their internal compliance activities as an essential component of investor protections. Firms routinely invest additional resources in these areas to ensure that they fully comply with regulatory requirements and properly supervise sales activities.

If FINRA has developed a system by which it believes it has determined how best to analyze data in order to detect potential issues, FSI members believe that it is in the best interest of firms as well as investors to share the information so that they can incorporate the same analyses into their compliance and supervisory functions. If firms can identify and remedy issues earlier, this may result in FINRA being able to reallocate its own resources to focus on other issues. To the extent FINRA has a tool that may be useful in improving these efforts, FSI members are very eager to utilize it. Furthermore, the shared use of this data to improve firms' own compliance efforts would factor into a cost-benefit analysis were firms to enjoy cost savings in other areas by having access to the wealth of information provided by CARDS. As such, FSI members are interested in receiving the analyses of data generated by CARDS. Any data, analysis or performance benchmarks would prove helpful in improving supervision programs and allowing firms to undertake targeted reviews of certain activities.

Additionally, FSI members believe that if CARDS data is to be used by examiners in advance of an on-site examination, FINRA should provide the same data to the firm in advance of the examination. While firms recognize that they have in their possession all the data submitted to CARDS, FSI members believe it will be useful to understand how the data has been analyzed and interpreted in advance of an examination. This will improve the examination's efficiency by allowing firms to remedy any issues, anticipate follow-up questions, and prepare for the examination to the benefit of both the examiner and the firm.

#### **4. Duplicative Systems**

In the Concept Release, FINRA stated that it anticipated CARDS would replace the use of existing data systems and feeds. FINRA specifically noted that INSITE may be eliminated and stated that

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<sup>32</sup> Regulatory Notice 14-37, at 14.

it was committed to undertaking a “thorough analysis” of all current and future reporting requirements.<sup>33</sup>

In response, many commenters noted that much of the transaction data requested by CARDS is already transmitted to FINRA through feeds such as Order Audit Trail System (OATS), Trade Reporting and Compliance Engine (TRACE), Real-time Transaction Reporting System (RTRS) and others. Broker-dealers were confused as to why an additional reporting system was necessary and why more feeds were not considered for elimination. Additionally, many commenters raised concerns about potential overlap between CARDS and the Consolidated Audit Trail (CAT), which is currently being developed. Commenters noted that CAT will collect a significant amount of transaction data. As such, it was not clear to commenters why it was necessary to expend additional resources on developing CARDS when a large amount of resources was already being devoted to the development of CAT.

FINRA responded in the Regulatory Notice by stating its intent to retire INSITE as firms begin to submit CARDS information under phase 1. Furthermore, FINRA identified AEP as an additional data system that overlaps with CARDS and stated that it will retire this system as well. Beyond these two systems, FINRA stated that it did not believe that its current reporting feeds collected the same type of information that FINRA will collect with CARDS.<sup>34</sup>

With respect to CAT, FINRA stated that it believed there to be limited overlap between the two systems.<sup>35</sup> Specifically, CAT will not collect suitability information as well as margin requirements, position data and other pieces of information that FINRA believes are essential to its investor protection goals.

FSI appreciates FINRA’s commitment to eliminate duplicative data systems. While FSI members believe retiring INSITE and AEP is a good start, it is unclear why other systems were not also deemed ripe for elimination. Much of the transaction data FINRA is seeking through CARDS is already available to FINRA through OATS, TRACE, RTRS and other reporting tools. It would be helpful if FINRA explained why those data feeds cannot be built out to achieve the goals of CARDS. Furthermore, if CARDS is in fact the preferable alternative, it is unclear why these other transaction reporting systems are still scheduled to be operational. All the data reported to these feeds will also be included in CARDS submissions. FSI believes that FINRA should undertake a review of all existing systems and explain to the public why FINRA believes these other systems will still be necessary upon CARDS implementation.

Moreover, while FSI appreciates FINRA’s review of the potential overlap between CARDS and CAT, we believe that the differences between the two systems can be overcome. FSI suggests that as an alternative to CARDS, FINRA could expand the amount of information collected through CAT to include the data desired for CARDS. This way, FINRA will receive all of the data required by CARDS and firms will only be required to connect to one new reporting system as opposed to two. Requiring firms to build systems to support submission to both CARDS and CAT is duplicative. We believe it is worthwhile to investigate whether the CAT development process can be leveraged to provide FINRA with the additional information it desires without the need to develop an entirely new system.

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<sup>33</sup> Regulatory Notice 13-42, at 7.

<sup>34</sup> Regulatory Notice 14-37, at 14.

<sup>35</sup> *Id.*

## 5. Books and Records Requirements

Broker-dealers are already required to maintain much of the information requested by CARDS on their books and records pursuant to SEC Rules 17a-3 and 17a-4.<sup>36</sup> Required records include items such as all purchases and sales of securities, all receipts and disbursements of cash, all dividends and interest received and all securities borrowed, amongst many others. Additionally, broker-dealers are required to record personal information about customers such as date of birth, net worth, annual income and investment objective. FINRA proposes to require firms to create a second record containing this information, transmit it to CARDS and then store the transmitted record for three months.<sup>37</sup> Moreover, FINRA will now maintain a third copy of this information in CARDS.

FSI requests that FINRA review the various existing books and records requirements that overlap with CARDS requirements prior to the implementation of CARDS. Our members believe that CARDS adds duplicative recordkeeping requirements and may create unnecessary burdens. FSI asks that FINRA work with the industry to recommend changes to the books and records rules that are a logical result of CARDS requirements. FSI members do not question the necessity of maintaining this valuable information for inspection by regulators. We believe FINRA should commit to reviewing these requirements to identify areas for consolidation that would ease the burden on firms to maintain large recordkeeping systems, often at significant time and dollar costs.

## DATA PROTECTION AND PRIVACY CONCERNS

### 1. Overview

On March 4, 2014, prior to the closing of the public comment period, FINRA announced that in response to commenter concerns regarding investor privacy it would not collect personally identifiable information (PII) through CARDS.<sup>38</sup> In responding to the Concept Release, FSI voiced its appreciation for FINRA's decision not to collect information such as name, address, social security number or tax identification number.<sup>39</sup> However, FSI and other members of the industry noted that despite the removal of PII, CARDS still presented several concerns regarding data security and privacy.

In the Regulatory Notice, FINRA attempted to address many of these concerns. FINRA stated that due to the absence of PII, FINRA does not believe that the identities of account owners could be reasonably determined by a potential hacker.<sup>40</sup> Additionally, excluding PII will prevent accounts from being linked across broker-dealers. Furthermore, FINRA committed to limiting the access to "raw" CARDS data to a "few select full-time technical employees."<sup>41</sup> Lastly, FINRA committed in the Regulatory Notice to obtain SOC 2 and 3 reports prior to the implementation date for CARDS.<sup>42</sup> FSI appreciates each of these efforts to limit the privacy and security risks posed by

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<sup>36</sup> 17 C.F.R. §240.17a-3, 17a-4.

<sup>37</sup> Proposed FINRA Rule 4546(3).

<sup>38</sup> See Update Regarding Regulatory 13-42, available at <http://www.finra.org/Industry/Regulation/Notices/2013/P451243>.

<sup>39</sup> See FSI Letter, *supra* note 13.

<sup>40</sup> Regulatory Notice 14-37, at 6.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

CARDS to ordinary investors. Nevertheless, CARDS, as currently proposed, raises several concerns regarding data security and potential procedures in the event of a data breach.

## 2. Security Controls

In the Concept Release, FINRA did not address what security controls would be in place to protect the customer information housed and analyzed by CARDS. In response, various industry members and the general public noted the need for FINRA to develop comprehensive information security controls for CARDS. Specifically, commenters noted that it was vitally important for FINRA to share with member firms any security controls to allow them to assess the safekeeping of their customers' data.<sup>43</sup>

In response to these comments, FINRA stated in the Regulatory Notice that it would obtain SOC 2 and 3 reports prior to the CARDS implementation date. According to FINRA, these reports will demonstrate the integrity of its security controls.<sup>44</sup> FINRA also stated that it would apply its existing security controls that are based on industry best practices to CARDS. Lastly, FINRA stated that it believed the risk of a data breach to be low since CARDS will not collect PII and as such the investor protection benefits "significantly outweigh the remote risk of a security breach."<sup>45</sup>

FSI applauds FINRA for committing to obtain SOC 2 and 3 reports prior to the CARDS implementation date. FSI previously suggested that FINRA be subject to Statements on Standards for Attestation Engagements No. 16 (SSAE-16).<sup>46</sup> We noted that such an audit would hold FINRA to the same standards as other private sector data centers. Furthermore, FSI stated that subjecting CARDS to these audits would allow FINRA to be more accountable to its member firms and their customers. FSI believes that obtaining SOC 2 and 3 reports will achieve the same goals as an SSAE-16 audit and commends FINRA for this commitment.

FSI suggests that FINRA obtain these reports on an annual basis and not simply prior to the CARDS implementation date. Obtaining these reports annually will ensure that FINRA retains the ability to update its security controls to meet the evolving challenges of cyber threats. Furthermore, FSI requests that FINRA provide to members the SOC 2 and 3 report results so members may evaluate the security of their customers' data. Reports should include any details on

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<sup>43</sup> See e.g. Letter from Ira D. Hammerman, Executive Vice President & General Counsel, SIFMA, to Marcia E. Asquith, Corporate Secretary, FINRA (March 21, 2014), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p473353.pdf> [hereinafter SIFMA Letter]; Letter from Eric Arnold & Cliff Kirsch, on behalf of the Committee of Annuity Insurers, to Marcia E. Asquith, Corporate Secretary, FINRA, (March 21, 2014), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p472298.pdf> [hereinafter Committee of Annuity Insurers Letter]; Letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA (March 21, 2014), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p473399.pdf> [hereinafter Wells Fargo Letter]; Letter from Richard Foster, Vice President & Senior Counsel, Financial Services Roundtable, to Marcia E. Asquith, Corporate Secretary, FINRA, (March 21, 2014), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p473352.pdf> [hereinafter FSR Letter]; Letter from Judy Werner, Executive Director, National Society of Compliance Professionals, to Marcia E. Asquith, Corporate Secretary, FINRA, (March 21, 2014), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p473398.pdf> [hereinafter NSCP Letter].

<sup>44</sup> Regulatory Notice 14-37, at 6.

<sup>45</sup> *Id.*

<sup>46</sup> See FSI Letter, *supra* note 13.

how FINRA will update their controls to address any deficiencies identified in the audits. FINRA should also provide a disclosure to investors explaining that their private information will be housed in a system subject to these two audits.

Additionally, FSI suggests that CARDS data should be subject to destruction on a routine schedule, in accordance with the retention requirements of the SEC Books and Records rules, with the schedule disclosed to members. CARDS will house a vast amount of sensitive, financial information. While such information is also maintained on the books of member firms, this information is often routinely destroyed following the conclusion of the mandated time frame for maintaining the particular record. Such a practice mitigates the potential damage should a system be hacked, including risk to investors of having their information stolen or otherwise compromised. FSI suggests that FINRA subject CARDS data to similar destruction schedules. We believe that developing a destruction schedule does not detract from the laudable investor protection benefits to be provided by CARDS. Subjecting CARDS data to destruction pursuant to the books and records retention requirements ensures that FINRA has ample time to utilize CARDS data while not exposing investors to unnecessary risks.

### **3. Access to Data by Others**

While FINRA stated its commitment to information security in the initial concept release, it did not detail who would have access to CARDS data. In response, commenters requested that FINRA detail which individuals within FINRA, which third parties and which agencies would have access to CARDS data.<sup>47</sup> Such disclosures are essential for understanding the security protections that will be afforded to CARDS data. Furthermore, it will provide both firms and investors with an understanding of the entire universe of entities that will have access to their personal financial information. In the Regulatory Notice, FINRA stated that access to raw CARDS data would be limited to “a few select full-time technical employees.”<sup>48</sup> Furthermore, FINRA committed to tracking and monitoring the access of these individuals to CARDS data.

FSI is grateful for FINRA’s commitment to limit access to raw CARDS data, and encourages FINRA to ensure that it maintains active and robust oversight of such access. Nevertheless, FSI is concerned about the potential for others beyond these few select employees to access CARDS data. This concern is especially important to investors. As the number of individuals with access to CARDS data grows, the risk of a breach or perhaps disclosure of such information exponentially increases.

As such, FSI requests that FINRA detail which other entities may have access to CARDS data and how that data will be protected in subsequent transmissions and upon being shared. FINRA has yet to categorically state whether any third party vendors will be used and if so, whether they will have access to CARDS data. If such third parties can access CARDS data, FSI believes it is an essential component of a robust information security program to detail how FINRA will oversee the activities of third parties and ensure that data remains secure.

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<sup>47</sup> See e.g. SIFMA Letter, *supra* note 43; Letter from Laura W. Murphy, Director, & Christopher Calabrese, Legislative Counsel, ACLU, to Marcia E. Asquith, Corporate Secretary, FINRA, (March 21, 2014), available at <http://www.finra.org/web/groups/industry/@ip/@req/@notice/documents/noticecomments/p473391.pdf> [hereinafter ACLU Letter].

<sup>48</sup> Regulatory Notice 14-37, at 6.

Additionally, FSI believes it is important for FINRA to disclose whether it will share CARDS data with government agencies or other federal and state regulators.<sup>49</sup> Sharing such data with an additional agency increases the data's vulnerability to attack. While FINRA stated that CARDS data would be encrypted in transit and after receipt, FINRA has not yet outlined the protections for data that is shared with other agencies, the minimum data protection measures such agencies must certify are in place, and how FINRA will respond to indications that these protections have broken down. As such, FSI requests FINRA detail how data will be protected in transmission to these other agencies and how FINRA will ensure that the data is secure while in their possession. These additional recipients of CARDS data should be required to formally assure firms that they intend to effectively protect this information while it is in their possession. Additionally, FSI requests that FINRA disclose whether these other agencies will be required to destroy CARDS data in their possession and how FINRA intends to ensure that these agencies do not re-transmit CARDS data to unauthorized parties. This information is essential to not only understand how CARDS data may be utilized, but also to evaluate the protection of personal investor information that is to be housed in CARDS.

#### 4. Data Breach Protocols

In the Concept Release, FINRA did not directly address its procedures for handling a breach of CARDS. In response, commenters noted that it was essential for FINRA to develop and publish such procedures. Specifically, commenters noted that it would be helpful to know who bears responsibility to notify customers in the event of a breach of CARDS data.<sup>50</sup>

In response, FINRA stated in the Regulatory Notice its opinion that the risk of a breach of CARDS is low due to the limited utility of CARDS data.<sup>51</sup> FINRA contended that the absence of PII, the inability to move customer cash or securities and FINRA's information security protocols contributed to this limited usefulness. FINRA further stated that it is "committed to the highest level of security" for investor information to be housed in CARDS.<sup>52</sup>

FSI appreciates FINRA's decision not to collect PII through CARDS and its commitment to the highest quality information security protocols. Nevertheless, FSI wishes to stress that despite FINRA's perceptions concerning the utility of CARDS data, the potential for a breach of CARDS still exists. CARDS is an attractive target for hackers as it will be a single system that contains details of all investors' holdings. Furthermore, hackers may be able to use CARDS data in conjunction with data obtained from a breach of a different system. While we appreciate FINRA's commitment to secure the information, in the current cyber environment the potential for a breach always exists.<sup>53</sup>

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<sup>49</sup> See Letter from Andrea Seidt, NASAA President, to Marcia E. Asquith, Office of the Corporate Secretary, FINRA, March 21, 2014, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p473396.pdf>.

<sup>50</sup> See e.g. SIFMA Letter, *supra* note 43; Wells Fargo Letter, *supra* note 43; NSCP Letter, *supra* note 43.

<sup>51</sup> Regulatory Notice 14-37, at 6.

<sup>52</sup> *Id.*

<sup>53</sup> See e.g. Deirdre Fernandes, "Former Homeland Security Chief Warns of Cyber Threat," Boston Globe (Nov. 5, 2014), available at <http://www.bostonglobe.com/business/2014/11/05/former-homeland-security-chief-speaks-warns-growing-cyber-threat/vFSp00f3upMfb8HGg0kHyH/story.html> (quoting former U.S. Homeland Security Secretary Michael Chertoff on the growing rate of cyber threats).

In light of FSI's belief that CARDS could be breached, we request that FINRA release a protocol document describing the procedures it would take upon a breach of the system.<sup>54</sup> Specifically, FSI members are still unclear as to whether FINRA will notify investors of a breach of CARDS or whether the firms will be required to notify their customers. Regardless of whether the hacked data would be useful, any breach of the system where customer data is revealed should be disclosed to investors. It is not unprecedented for a public company to disclose a data breach, even where the data seized by the attack is of limited usefulness and does not result in harm to individual victims.<sup>55</sup> FSI believes that it is contradictory to FINRA's investor protection goals to not provide for the notification of a breach of CARDS to investors. Absent prompt notification of any breach, investors will lose confidence in both their advisors and their regulators.

Additionally, the protocol should allow firms to temporarily suspend CARDS transmissions in instances where there is an ongoing breach, or where the vulnerability has not been repaired. Requiring firms to continue to transmit data, when FINRA is aware that CARDS has been breached would be contrary to the goal of investor protection. Should FINRA have reason to believe the system is not secure, FSI believes that it is imperative to limit the harm to investors by suspending CARDS data transmissions. Upon repairing an identified vulnerability in the system, FINRA should test the repairs prior to requiring firms to start transmitting data.

## 5. Liability

An additional issue commenters discussed in relation to the Concept Release concerned liability in the event of a breach of the CARDS system. Commenters encouraged FINRA to clearly state who would bear the liability for a CARDS data breach. Commenters, including FSI, also requested that FINRA indemnify members for any damage awards resulting from a CARDS data breach.<sup>56</sup> Additionally, FSI requested that FINRA consider the reputational harm that firms and advisors will suffer should CARDS be breached.<sup>57</sup>

In addition to stating in the Regulatory Notice that FINRA believes the security risk to be low, FINRA also stated that it "is compliant with relevant data security and privacy laws and regulations."<sup>58</sup> While FSI appreciates this commitment, it is still unclear whether FINRA is acknowledging that it will be the owner of data transmitted to CARDS and as such will be liable to investors whose information is compromised.

Any breach of the CARDS system will pose significant litigation and reputational risk to both FINRA and member firms. FSI members request clarification from FINRA specifying that only FINRA, and not FINRA member firms, will be liable to investors in the event of a CARDS breach. Furthermore, as FINRA is solely in control of its information security controls, FINRA should agree to indemnify firms for any costs or damages incurred as a result of a CARDS data breach occurring after firms have provided the data to FINRA.

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<sup>54</sup> The protocol document could be similar in nature to the disclosures broker-dealers are required to make to their customers concerning their business continuity plans pursuant to FINRA Rule 4370(e).

<sup>55</sup> See Hugh Son, "JPMorgan Employee Password Was Key in Hack Hitting 76 Million Homes," BLOOMBERG (Oct. 2, 2014), available at <http://www.bloomberg.com/news/2014-10-02/jpmorgan-says-data-breach-affected-76-million-households.html>.

<sup>56</sup> See e.g. FSI Letter, *supra* note 13; SIFMA Letter, *supra* note 43; NSCP Letter, *supra* note 43.

<sup>57</sup> See FSI Letter, *supra* note 13.

<sup>58</sup> Regulatory Notice 14-37, at 6.

## 6. Data Incidents

Lastly, FSI requests that FINRA include in its information security protocols a process for reviewing data incidents to determine what corrective actions are required to reduce the likelihood of reoccurrence. FSI believes that an essential component of a comprehensive security program is a process to review a system breach to determine corrective actions. Hopefully, CARDS lacks any vulnerability, but it is within the realm of possibility that the system will be breached in some manner. It is important for investors and firms to know that FINRA has a process in place to address any exploited vulnerabilities and ensure that personal investor data will be secured. As such, FSI would appreciate FINRA developing such a process and sharing it with the public so that all stakeholders can understand the full extent of FINRA's comprehensive security program.

## TECHNOLOGY ISSUES

### 1. Overview

In conjunction with the publication of the Regulatory Notice, FINRA released three supplemental documents addressing many of the technical specifications surrounding CARDS.<sup>59</sup> These documents, titled the Data Dictionary, Submission Mechanics Overview and Data Scenarios Document, sought to "provide firms with the operational and technical requirements for submitting CARDS information to FINRA."<sup>60</sup> FSI appreciates FINRA sharing this important information with firms at this early stage in the development process. A complete understanding of the technical requirements associated with the reporting program is essential for FSI member firms to be able to analyze the operational and budgetary impacts of CARDS.

FSI members have reviewed these supplemental documents in addition to the several statements on technological issues included in the Regulatory Notice. While FSI members are pleased to see that FINRA intends to conduct an onboarding and testing process in an attempt to ensure successful implementation of CARDS, firms are interested in learning more specifics regarding the timing and activities to be conducted in the test environment. Additionally, FSI members would appreciate FINRA disclosing whether it intends to evaluate the data dictionary on a prescribed schedule as well as the intended process for editing the document subsequent to CARDS implementation. Finally, FSI has questions regarding the outlined validation process FINRA describes in the Submission Mechanics Overview and requests additional information regarding pre-validation procedures.

### 2. Onboarding and Testing

In the Regulatory Notice, FINRA revealed that prior to CARDS implementation it would provide "an independent environment for testing."<sup>61</sup> Before being able to submit data to CARDS, firms would be required to successfully transmit data to the CARDS test environment. The CARDS test environment would process all submissions in the same way that CARDS will upon implementation.<sup>62</sup>

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<sup>59</sup> See <http://www.finra.org/Industry/Compliance/RegulatoryFilings/CARDS/index.htm>.

<sup>60</sup> Regulatory Notice 14-37, at 8.

<sup>61</sup> *Id.* at 12.

<sup>62</sup> *Id.*



FSI member firms are pleased to hear that FINRA will be administering a testing environment prior to CARDS implementation. Firms agree that this is an essential step to ensure proper development of CARDS. Our members request that FINRA provide more specifics on the test environment. The information firms would find helpful includes:

- (1) When will the test environment be open for submissions;
- (2) Will actual client data need to be included or will it be test data;
- (3) Will there be FINRA personnel available to work with firms to troubleshoot and address transmission and validation issues both during the onboarding period and once CARDS is implemented;
- (4) What will be deemed a successful testing experience; and
- (5) What will the repercussions be if a firm has not successfully transmitted information to the test environment prior to the CARDS implementation date.

Additionally, introducing brokers would appreciate FINRA specifying whether they will be able to submit to the testing environment after CARDS is operational but before the phase 2 implementation date, or if the testing environment will close prior to the phase 1 implementation date.

FSI wishes to reiterate that it appreciates FINRA's willingness to provide the industry with the technical specifications for CARDS well in advance of implementation. We request that FINRA continue to provide firms with some of the more specific technical information mentioned so they can begin to more fully assess the impact of this project from an operational as well as a budgetary standpoint. Firm budget and project development cycles often require new systems or projects to be planned for well in advance of implementation.

### **3. Updates to Data Dictionary**

FSI member firms are grateful to FINRA for providing a comprehensive data dictionary. The document has proved useful in allowing firms to better understand what data is required by CARDS and in what format it would need to be provided. Furthermore, it has allowed firms to already begin to consider the ways in which they will need to modify or develop systems to compile and store the requested information in a format that is compliant with CARDS specifications.

The data dictionary has also raised several concerns amongst FSI members, particularly as they anticipate that the dictionary will be modified after the implementation of CARDS. Firms are interested in learning if FINRA has developed any plans to review the CARDS data specifications following implementation and evaluate the data elements and formats in order to potentially make changes. If so, firms would like additional information on how often FINRA anticipates undertaking such reviews. Member firms currently anticipate devoting significant resources to developing and maintaining systems to transmit data to CARDS. Any changes to that system may be, depending on the change, difficult or costly to implement. As such, FSI member firms request that FINRA consider the implications of retrofitting systems when evaluating the efficacy of the items in the data dictionary.

Additionally, FSI member firms are also interested in what the process will be to publicize and deploy the edited data specifications. Firms would like additional information on whether FINRA will seek firm input in evaluating the data elements and formats. Furthermore, they wonder what the process will be to communicate edits to the data specifications to the industry. Also of concern

is the amount of notice FINRA will provide firms in advance of changing the data specifications and the timeframe following such an announcement for continuing to submit records pursuant to the previous data dictionary. These details will prove helpful in allowing firms to assess the complete impact of CARDS on their businesses and understand what resources will be required, both in the short term and the long term.

#### 4. Validation Process

The Rule Proposal indicated that FINRA would perform automated validations on submitted data and provide results to member firms.<sup>63</sup> If the automated validations result in errors, member firms would be required to correct the errors within seven business days after receipt of the validation results from FINRA.<sup>64</sup> As a general matter, FSI believes that this is too short a period to respond to errors. FSI requests that FINRA extend the amount of time that firms have to submit repairs to 15 business days after receipt of validation results. In addition, FSI member firms have a number of questions with regard to the proposed validation process. These are discussed in the sections that follow below.

##### i. Pre-Submission Validation

FINRA's CARDS Draft Submission Mechanics Overview provides a high-level outline with respect to the mechanics for submitting data through CARDS. In the document, FINRA describes a process to submit data to the CTE and then later to the CARDS Production Environment.<sup>65</sup> Firms who will be required to submit data to CARDS have an interest in receiving pre-submission validation in order to avoid the costs likely to incur if they must later repair records and files that are submitted to the Production Environment. The Regulatory Notice is unclear as to whether the CTE is a one-time "independent system for testing"<sup>66</sup> the submission systems that firms create to submit data to CARDS, or is a pre-submission validation system that firms can utilize on an on-going basis. FSI requests further clarification with regard to the extent to which the CTE is used as pre-submission validation and whether the feedback files that firms receive from the CTE can be relied upon prior to sending data to the production environment.

The pre-submission validation process also leads to questions with regard to the timing of file and records submissions and repairs. CARDS as outlined will be collecting data on a monthly basis. However, a potential issue could occur in the instance where a firm submits the data for pre-submission validation and receives an error or series of errors. Firms that find themselves in this situation would be forced to choose between submitting the data to the production environment with the errors, or identifying and repairing these errors. Since the time and resources involved in repairing a high volume of errors could be substantial, firms may require contravening the requirements related to monthly submission to the Production Environment. More detail would be helpful regarding how this situation should be addressed by firms.

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<sup>63</sup> *Id.* at 12.

<sup>64</sup> *Id.*

<sup>65</sup> See Submission Mechanics Overview at 3.

<sup>66</sup> Regulatory Notice 14-37, at 12.

ii. Volume of Responses

Data files transmitted to CARDS will have an extraordinary number of records. Furthermore, there is currently a lack of certainty with regard to whether the systems maintained by FINRA, clearing firms, and introducing firms will encounter issues transmitting and matching data files and records. In the event that the data submission files contain an error, the potential volume of records that need to be identified, analyzed, and corrected will need to be resolved manually. As a result, firms will be required to create new systems and procedures to effectively meet the regulatory obligations and seven business day repair period. One of the systems firms will likely be required to create are tracking systems for the feedback files and errors. Based upon the volume of errors, the complexity of the errors, and the ability for clearing firms and introducing firms to efficiently match data, these systems will require their own upfront costs and on-going maintenance costs.

Firms will also likely need to hire additional staff solely to respond to issues related to CARDS data submission feedback. These additional employees will be tasked with monitoring feedback, identifying the potential source of errors, and remedying these errors in order to submit the corrected files or records within the required seven business days. Larger firms may benefit from economies of scale, as these firms already have large technology divisions and management structures that can more easily add employees or add these responsibilities to existing staff. However, larger firms will also have the largest volume of data to manually review and remedy. For smaller firms without robust technology divisions, the potential time and resources involved may require more than seven business days to address errors. Therefore, FSI recommends that FINRA extend the timeframe to repair data to 15 business days.

Firms are also unclear with respect to how useful the feedback files will be once they are received and firms begin the process of relying upon these files when correcting errors. As a result, FSI suggests that FINRA provide examples of feedback files that firms will receive if files or records have specific errors.

iii. Appeal Process

The Regulatory Notice does not provide a method for firms to contest the errors they may receive in their feedback files. CARDS will use an automated system for validating whether submitted files or records conform to submission requirements. Such systems may identify files or records as containing errors where no such error exists. Furthermore, CARDS' automated processes may be updated periodically by FINRA, and these updates may result in feedback errors that firms cannot appeal under the current proposal. Software updates notoriously introduce unintended bugs that disrupt systems that had previously worked as intended. Depending upon the number of changes to the Data Dictionary and other elements of the CARDS submission and automated validation criteria, the potential opportunities for validation errors related to issues with FINRA's own systems may be numerous. To address these potential issues, FSI requests that FINRA provide an outline of an appeal or escalation process for CARDS data errors.

iv. Costs Associated with Validation

As discussed above, the costs involved with monitoring, responding, and submitting corrections to the feedback files are unclear but are likely significant. Firms are likely to encounter upfront fees in creating new systems and procedures for monitoring, tracking, and repairing errors received through the CARDS feedback files. In addition, firms will need to hire employees to conduct on-

going maintenance of these systems and to troubleshoot any issues that arise. Finally, new employees will likely need to be hired to conduct the analysis, tracking, and repairing of errors that appear in the CARDS feedback files. Depending upon the volume of errors that the feedback files yield, these costs could be significant, especially for smaller firms. Third-party vendors and consultants will likely be required as part of the implementation and ongoing maintenance of these systems, adding to the upfront and ongoing costs. FSI urges FINRA to take these costs into account when conducting a robust cost-benefit analysis of CARDS and any retrospective review of the final system.

v. **Data Mapping Issues Related to Validation**

Firms expect significant costs associated with matching the required data records for suitability to the data records submitted by their clearing firms. At most IBDs, suitability data is not submitted to clearing firms, however, CARDS is requiring that the data housed at clearing firms related to specific accounts match to the suitability data maintained at introducing firms. This will require significant costs to ensure that the Select Account Profile Data elements map to the appropriate CARDS record layouts. In situations where the validation errors are related to a data mapping issue, firms will experience significant difficulty in determining whether the feedback error they receive from CARDS is related to an issue with their own data or the data that their clearing firm submitted for the same accounts. In situations where elements are missing, there may be a need for firms to create systems to interact with the data being submitted by their clearing firm, or to go back to financial advisors and have them provide data that may not be available today. FSI urges FINRA to explore these costs in more detail upon conducting a cost-benefit analysis of CARDS.

## **COSTS AND BENEFITS**

### **1. Overview**

FSI continues to support the adoption of a robust cost-benefit analysis for FINRA rulemaking. FINRA's adoption of its framework on economic impact assessment for proposed rulemaking is a significant development that we applaud and support. In addition to the publishing of this document, FINRA's interim economic impact assessment included in the Regulatory Notice is an important and well-developed step toward conducting a thorough assessment of the costs and benefits that firms can anticipate with the implementation of CARDS. FSI looks forward to working with FINRA and its Office of the Chief Economist to collect and analyze data and other information related to the costs, benefits, and challenges related to CARDS implementation. As more details regarding CARDS implementation are released, firms look forward to providing more definitive cost estimates and other projections related to CARDS implementation.

### **2. Cost Projections**

In the Regulatory Notice, FINRA anticipated the following costs: 1) building and maintaining an infrastructure to submit the required data; 2) transmission and reconciliation of data to FINRA by clearing firms; and 3) archiving and storing CARDS data transmitted as regulatory records. These costs include compiling, standardizing, and formatting data across multiple systems and conducting quality control, reconciliation, transmission, and storing of data.

In addition, fully-disclosed introducing firms, which make up the majority of FSI's membership, would incur costs associated with developing and maintaining systems and procedures if they decide to submit CARDS data directly to FINRA. Firms that use third-parties or rely on clearing firms to transmit Select Account Profile Data elements on their behalf will incur the costs billed to them for this service, as well as costs involved in validating the vendors submissions, which will ultimately be passed down to investors. FINRA has estimated that the costs to clearing and self-clearing firms range from approximately \$390,000 to \$8.33 million, with annual costs ranging from \$76,000 to \$2.44 million. FINRA also determined its own costs to develop CARDS technology systems and processes would range from \$8 to \$12 million over a three-year period. FSI appreciates the work FINRA has done to collect this information. FSI requests more information regarding these estimates, and looks forward to reviewing additional data on costs projections as FINRA makes it available. FSI also requests that FINRA provide information on the sizes of firms that were surveyed to provide these figures, as well as a breakdown of the types of costs that compose these projections.

FSI has collected information from member firms to conduct cost projections and other analysis with respect to CARDS. Firms have identified three categories of costs that firms will incur to meet the additional regulatory requirements related to CARDS: 1) Initial Project Costs; 2) Ongoing Maintenance Costs; and 3) Special Maintenance Inquiry Costs. These categories are summarized below:

i. Initial Project Costs

To meet FINRA's proposed requirements, firms will be required to create the systems and processing logic necessary to gather the Select Account Profile Data elements and map them to the appropriate CARDS record layouts. Additional application and database modifications will be necessary to ensure that all of the required data elements are collected. Where data elements are missing, firms will need to establish a system to contact financial advisors and have them gather and provide the data. In order to map broker-dealer databases to the required CARDS transmission formats, firms will be required to perform Extract, Transform, and Load (ETL) work to meet the submission requirements outlined by FINRA.<sup>67</sup> Firms will need to build job scheduling logic to ensure that the data delivered meets the required specifications, and exception handling logic will need to be developed to ensure that when there are errors, there is a mechanism to alert and track the issues in order to remediate them. FSI has received cost projections for this category that range from \$250,000 to over \$1 million per introducing firm.

ii. On-Going Maintenance Costs

Firms will likely be required to have staff at least partially dedicated to monitoring the CARDS job scheduling to make sure that CARDS files are submitted to the appropriate destination and that any remediation necessary is successfully addressed. This category of costs may also require the involvement of an application developer to address issues that require a more technical solution. Firms estimate that an information technology operator can be staffed at an average salary of \$60,000 per year, and an application developer at an average salary of \$80,000. Based upon the size of the firm, additional professionals in this category may need to be added to the staff which will further increase costs. Some firms, particularly smaller broker-dealers, will elect to contract with a third-party and be billed for these services. One FSI member firm

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<sup>67</sup> For a discussion of ETL, see Marc L. Songini, QuickStudy: ETL, Computerworld (Feb. 2, 2004); available at <http://www.computerworld.com/article/2575153/business-intelligence/quickstudy---etl.html>.

estimates that on-going costs, including special maintenance inquiry costs, will approach \$800,000 per year.

### iii. Special Maintenance Inquiry Costs

The volume of data that FINRA collects will likely lead to additional inquiries and sweeps. The lack of direct business data may increase the likelihood of firms having to explain the blind spots in the data that FINRA has collected through CARDS. Firms estimate that this will likely require at least half of a technical employee's time as well as a regulatory compliance staff member to manage these inquiries, and for larger firms may require dedicated teams of technology and compliance professionals.

## 3. Proposed Benefits

In the Regulatory Notice, FINRA described several projected benefits of CARDS: 1) increased investor protection through greater effectiveness of FINRA's surveillance and examination programs; 2) reduced regulatory costs and burdens on firms associated with providing information on an ad hoc basis in support of FINRA examinations; and 3) elimination of duplicative systems that provide information CARDS would cover. FINRA anticipates that CARDS would allow FINRA to quickly uncover potentially fraudulent and abusive behavior and provide a comprehensive view of firms and industry activity. This would allow FINRA to analyze firms, branch offices, and financial advisors, and compare activities against those of their peers. FINRA also believes that CARDS will enable FINRA to review firm data before examinations which will lead to more focused exams. FINRA believes that CARDS may eliminate the necessity for certain sweep initiatives and will allow FINRA to "pinpoint where suitability risks might exist by identifying groups of customers holding high-risk products, branch offices with concentrations of such products and registered representatives selling those products." FINRA expects that CARDS would replace existing reporting systems that already collect related information, such as INSITE and AEP.

FSI believes that these proposed benefits are laudable and important to ensure that regulators have all of the necessary tools they need to be effective. FSI believes that in order to achieve these goals, however, FINRA faces a significant number of challenges that may lead to a reduction in the feasibility of some of these proposed benefits. Specifically, as discussed previously, excluding direct business data at the outset is likely to lead to a significant number of false positives.

FINRA also faces challenges because of the immense amount of data that it intends to collect and analyze. While allowing suitability data to be submitted in flexible free text formats addresses the burdens associated with data standardization, it also significantly increases the costs of conducting analysis. FSI requests FINRA consider these challenges in assessing the costs and benefits of collecting suitability data.

## 4. Retrospective Rule Review

FSI requests that FINRA commit to a structured retrospective review of CARDS and its requirements. The retrospective review should include a publication of data and statistics related to CARDS to allow for commenters to effectively respond to questions regarding CARDS' effectiveness and whether the costs to comply with CARDS outweigh the benefits. Special

attention must also be paid to the effect of CARDS on smaller broker-dealers who do not have the same resources as larger firms to meet CARDS submission and technology requirements. FSI suggests that FINRA release data and a Regulatory Notice every three years to implement the retrospective rule review.

## 5. Implementation Period

FINRA anticipates that firms would be required to start submitting CARDS information to FINRA under phase 1 approximately nine months following SEC approval of CARDS requirements. Building systems to collect, transmit and store all the necessary data required for CARDS is a significant undertaking. Firms will need sufficient time to conceptualize, budget, build and test these systems. As such, FSI requests FINRA extend the phase 1 implementation date to 18 months from SEC approval of CARDS.

FINRA also anticipates that fully-disclosed introducing firms would begin submitting CARDS information to FINRA within 15 months of SEC approval. This implementation schedule is likely to create significant challenges for firms. Introducing firms will likely need to make significant changes to their systems in light of the submission requirements that will be imposed on clearing firms. As a result, introducing firms will only have 6 months to implement these changes after the clearing firms have finalized their own implementation of phase 1 requirements. FSI requests that FINRA provide introducing firms at least 12 months from the end of phase 1 for phase 2 implementation, as introducing firms will likely not be capable of doing much of the most resource intensive work required to implement the submission requirements until phase 1 is complete. This additional time will also provide firms the ability to develop cost projections and receive budget approval, which takes place on fixed schedules based upon an annual budgeting cycle.

## SPECIFIC REQUESTS FOR COMMENT

**Request 1: In proposing the rule to implement CARDS, FINRA has sought to incorporate the feedback received since issuing the concept proposal, discuss the details of its examination and surveillance objectives, and explain how the CARDS initiative and rule proposal strive to obtain data to achieve those objectives in a direct and efficient manner. FINRA welcomes comments on other approaches to achieve the CARDS objectives that would be similarly or more effective.**

Please refer to the Direct Business section on pages 6-9.

Additionally, FSI member firms wish to suggest that FINRA consider whether it could expand upon already existing data feeds and reporting systems instead of developing an entirely new system. Much of the transaction information to be collected by CARDS is currently reported through OATS, TRACE, RTRS and others. Additionally, CAT will collect a significant amount of transaction data once it is operational. FSI members believe it may be more cost effective for FINRA to build out already existing systems to achieve CARDS's purposes as opposed to developing an entirely new one. While FSI member firms appreciate FINRA's decision to retire INSITE and AEP, perhaps these two systems can be expanded to achieve the CARDS goals instead of retired in favor of a new system.

**Request 2: In addition to the economic impacts identified in the Interim Economic Impact Assessment, are there other significant sources of economic impacts associated with CARDS, including anticipated costs and benefits, to carrying or clearing firms, or introducing firms? What are these economic impacts and what factors or firm characteristics contribute to these impacts? What would be the magnitude of costs associated with developing, implementing and maintaining the systems and procedures to submit CARDS information under the proposed rule? What factors or business attributes contribute to the costs associated with the proposal, such as size of the firm or differences in business model?**

FSI member firms believe CARDS will result in three categories of costs: 1) Initial Project Costs; 2) Ongoing Maintenance Costs; and 3) Special Maintenance Inquiry Costs. Costs estimates for each of these categories varies by the business model and size of a firm. Firms have provided ranges of \$250,000 to \$1 million for the initial phases, and \$100,000 to \$800,000 to conduct on-going maintenance and inquiry response.

In considering the costs of CARDS, FSI member firms wish to note that the costs of complying with regulatory mandates are usually passed down to the customer. In developing CARDS it is important to assess the extent of the cost burden to ensure that investors do not experience an increase in the costs of financial services. These costs may exponentially increase when FINRA adds direct business data to CARDS. As such, FSI believes FINRA should determine whether it may be more cost effective to develop CARDS in one stage and collect all data, both brokerage and non-brokerage, to limit the cost impact for firms and investors.

FSI also believes FINRA should consider the possibility that increased costs and requirements associated with CARDS might have anti-competitive impacts. FINRA members may be encouraged to leave the broker-dealer business model and instead conduct business under the Investment Advisor regulatory regime. Additionally, it is possible that clients will choose to solely maintain fee-only accounts with registered investment advisers due to the data security concerns.

**Request 3: To what extent do fully-disclosed introducing firms anticipate using a third party to report the Select Account Profile Data Elements under phase 2? What would be the sources and magnitude of costs to introducing firms associated with providing these data elements to FINRA through a third party? What would be the costs associated with providing these data elements directly to FINRA? Do introducing firms currently store these data elements in standardized electronic form in their systems? If not, how costly would it be for introducing firms to standardize the required data in order to transmit it to FINRA directly or through a third party?**

FSI's membership is largely comprised of fully-disclosed introducing firms. While several firms have indicated that they intend to use a third party to report phase 2 data elements, most of our members are not able to make such a determination until they receive cost estimates from third party providers.

Many FSI member firms do currently store phase 2 elements in a standardized electronic format in their systems. Many firms use books and records vendors to provide the platforms to store this information. However, there are some FSI member firms that currently use imaging to store these data elements. In their systems, customer data is scanned onto their system and stored as individual image files. Converting their recordkeeping systems to allow for transmission to CARDS is a significant and costly endeavor. These firms have yet to determine a solution to this issue.



**Request 4: To what extent do carrying or clearing firms anticipate using a third party to report CARDS information under phase 1? What would be the sources and magnitude of costs to these carrying or clearing firms associated with providing the required information to FINRA through a third party? To what extent do clearing firms anticipate transmitting the Select Account Profile Data Elements on behalf of their introducing firms in phase 2? What would be the sources and magnitude of costs to clearing firms associated with transmitting these data elements on behalf of introducing firms?**

FSI's self-clearing members have not indicated that they intend to use a third party to report CARDS information. We do not have reason to believe that any of our self-clearing members will use a third party to transmit CARDS data.

**Request 5: What are the costs incurred by firms today in responding to FINRA sweeps and other initiatives designed to address emerging risks to investors? What are the sources of these costs? What factors or business attributes contribute to the costs?**

The main source of costs for responding to sweeps and other regulatory initiatives are personnel costs. Responding to these inquiries is a manual process performed by firm employees and, on occasion, outside counsel. Often firms have needed to add staff in order to have sufficient resources to respond to a sweep while still overseeing their compliance and supervisory programs. As such, the total cost for a sweep depends on the amount of employees required to respond to the sweep, the amount of time spent responding to the sweep and whether support from outside counsel is necessary. In responding to a sweep, firm personnel must research the request, compile the information requested, draft a letter or response document to be reviewed by senior staff and then submit the reply to FINRA.

FSI members hope that the introduction of CARDS will ultimately result in a reduction in the number and size of sweeps and other inquiries from regulators. FSI member firms, particularly small firms, might have difficulty affording the resources necessary to administer CARDS, respond to feedback and validation requests for CARDS submissions, and comply with frequent regulatory inquiries in a timely manner. FSI requests FINRA consider the resources firms will be required to devote to CARDS in considering whether to initiate a sweep or other inquiry.

Furthermore, as discussed above, FSI member firms request FINRA publish statistics on the amount and size of sweeps and other inquiries undertaken as a result of CARDS data and those that were necessary despite the CARDS data.

**Request 6: What economic impact, including costs and benefits would accrue to the investing public by this proposal? How do investors evaluate enhanced investor protection? What would be the magnitude and primary sources of costs associated with the proposed rule to investors? What factors or attributes would contribute to the costs borne by different segments of the public associated with the proposal?**

FSI member firms do not believe they are best situated to answer this question. As a general presumption, costs imposed on broker-dealers are ultimately passed down to investors. This is the case with regulatory costs imposed on all businesses across all industries. FSI's fully-disclosed introducing members anticipate their clearing firms passing the costs associated with CARDS down

to them. These firms will then end up passing the costs of phase 1 and phase 2 of CARDS onto investors.

FSI member firms do not believe they can properly assess the benefits that CARDS will provide to investors. FSI members are interested in understanding what metric FINRA will be using to assess the investor protection benefit of CARDS. As discussed above, FSI believes it may be worthwhile to publish data on the size of all arbitration awards, customer restitutions and fines imposed by FINRA based on data obtained from CARDS. This will allow firms to form a better understanding of the benefits of CARDS to investors.

**Request 7: The rule proposal would require the submission to FINRA of customer and non-customer account numbers. Should FINRA allow firms to submit unique identifiers rather than account numbers? What would be the costs and benefits of allowing firms to submit unique identifiers rather than account numbers?**

FSI believes submitting unique identifiers is an intriguing prospect worth considering. Unique identifiers may help better protect customer information as well as quell concerns regarding data mapping of CARDS data. However, in spite of these benefits, FSI member firms are concerned about the costs of creating unique identifiers. One FSI member firm anticipates that a project to create unique identifiers for each customer would cost around \$204,000. Broker-dealers would need to understand the appropriate mapping within each of their systems and then modify all impacted systems to carry the unique identifier. FSI members believe it is worthwhile for FINRA and the industry to explore the possibility of submitting unique identifiers and determining if the potential security benefits outweigh the costs.

**Request 8: Should FINRA consider an exception to the reporting requirements for firms that do not engage in any retail activity? Should FINRA consider an exception to the reporting requirements for firms that engage in limited retail activity? If so, what threshold should FINRA consider for limited retail activity and what is the basis for such threshold? What are the costs and benefits for any proposed threshold associated with limited retail activity?**

FSI member firms do not believe FINRA should limit CARDS to retail activity. Our members believe that in order for FINRA to have a complete picture of the securities markets it is imperative that it review data from institutional investors as well. A market conduct tool should not discriminate between retail and institutional activity. Institutional activity will be essential to ensuring FINRA can fulfill its stated goals for CARDS. FINRA needs institutional data to truly understand where the risks lie at a particular firm and where there are risks to the system as a whole.

While FSI is unclear as to the definition of "limited retail activity" we do not believe that FINRA should exempt any broker-dealer from submitting data to CARDS. It is essential for FINRA to have a complete picture of a firm's activities as well as the markets for particular securities in order to properly utilize CARDS and ensure investors are protected.

**Request 9: The rule proposal would require the transmission of information regarding money movements. What would be the costs and benefits of requiring firms to regularly transmit information relating to money movements?**

Tracking money movements is not necessarily a straightforward endeavor as sources of funds are not easily known based on information in the broker-dealer's possession. Many FSI members would rely on their clearing firms to transmit information on money movements to CARDS.

However, there is a possibility that some data on money movements will be solely in the possession of the introducing firm. Some firms engage in an electronic form of direct business, whereby they will either receive checks from a customer or receive authorization to automatically debit a customer's bank account. In these cases, building the infrastructure to transmit this data to CARDS will be significantly costly and unwieldy for introducing firms. This also raises questions concerning mapping this data to money movement data stored and maintained at clearing firms.

**Request 10: FINRA intends to retire INSITE and AEP as firms start submitting the information as part of CARDS. What would be the costs to firms associated with retiring their existing AEP and INSITE systems? What would be the magnitude of annual cost savings and the factors that contribute to these cost savings? Are there other collections of data that FINRA should consider retiring upon successful implementation of CARDS? What are those systems, and what would be the anticipated costs savings associated with retiring those systems?**

Please refer to subsection 4 of the Regulatory Oversight section on pages 16-18.

**Request 11: FINRA plans to provide feedback to firms based on FINRA's analyses of CARDS information. Further, FINRA plans to provide firms with access to their own data in a way that would facilitate their use as part of their compliance efforts. What information would be most beneficial to firms in meeting their compliance and supervisory obligations? What benefits might arise from sharing relevant data and analyses with firms?**

Please refer to subsection 3 of the Regulatory Oversight section on pages 15-16.

**Request 12: Some commenters have asserted that carrying or clearing firms would pass all costs associated with the proposal onto introducing firms. Other commenters have asserted that all costs would ultimately be borne by investors. Is there sufficient competition among carry or clearing firms to limit their ability to pass on costs? Is there sufficient competition among introducing firms to limit their ability to pass on costs? What evidence supports these comments?**

The majority of FSI fully-disclosed introducing firm members utilize one of two large clearing firms. In some cases, FSI members utilize both of these firms.

Small firms in particular may not be able to bear these costs and remain competitive. These firms may not be able to absorb the costs of CARDS to a similar extent as their larger competitors. FSI members also believe that some costs will be passed down to investors. This has the potential to negatively impact firms, financial advisors and most significantly, investors.

**Request 13: FINRA contemplates that the collection of information to be required by this proposal would enhance efficiency in other programs. In what other ways could FINRA use the information contemplated in this proposal to better protect investors and enhance market integrity? What would be the value of using the information collected in those ways?**

To the extent FINRA has a tool that may be useful in improving these efforts, FSI members are very eager to utilize it. FSI members believe that it is in the best interest of firms as well as investors to share CARDS information so that they can incorporate the same analyses into their compliance and supervisory functions. If firms can identify and remedy issues earlier, this may result in FINRA being able to reallocate its own resources to focus on other issues.

FSI member firms support FINRA's interest in utilizing CARDS to detect fraud, track product mixes and understand the overall business and risk profiles of firms. FSI member firms believe FINRA might consider utilizing CARDS to detect stock manipulation schemes, insider trading and other activities that can be measured by objective standards. We recommend requiring the transmission of institutional activity to support these efforts. FSI believes that utilizing CARDS to undertake objective analyses as opposed to nuanced, personal analyses will be the most efficient and effective use of FINRA's resources and will provide the greatest benefit to investors.

**Request 14: Do carrying or clearing firms believe that nine months following SEC approval of CARDS requirements would be a reasonable time period within which to start submitting CARDS information to FINRA under phase 1? Do fully-disclosed introducing firms believe that within 15 months of SEC approval of CARDS requirements would be a reasonable time period within which to start submitting CARDS information to FINRA under phase 2?**

Please refer to subsection 5 of the Costs and Benefits section on page 30.

Conclusion

We are committed to constructive engagement in the regulatory process. Through the efforts of FSI's CARDS Task Force we have provided these comments with the input of essential subject matter experts representing a wide variety of independent firms. We look forward to the opportunity to work with FINRA on this important regulatory initiative.

Thank you for your consideration of our comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" and a smaller "Bellaire" following.

David T. Bellaire, Esq.  
Executive Vice President & General Counsel