



## Consumer Federation of America

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  
Comprehensive Automated Risk Data System

Dear Ms. Asquith:

I am writing on behalf of the Consumer Federation of America (CFA)<sup>1</sup> to express our strong support for FINRA's proposed rule to implement the Comprehensive Automated Risk Data System (CARDS). With this proposal, FINRA seeks to bring its broker-dealer oversight and examination program into the 21st Century, utilizing modern data analysis techniques to uncover potential fraud and abuse more quickly and efficiently. By collecting data in a standardized format and on a regular basis across all firms that are subject to CARDS, this new system should make it easier for FINRA to identify patterns of conduct that indicate possible abuses and target its oversight resources accordingly. It would in our view be irresponsible for FINRA not to move forward with this sort of modernization of its oversight program.

CARDS offers potential benefits to both compliant firms and investors. Once firms have made the necessary investment to implement CARDS, it should reduce compliant firms' costs and burdens associated with the current paper-based, man-hours-intensive examination system. In addition, firms will have access to CARDS data for their own compliance efforts, allowing those firms that wish to take advantage of this opportunity to deal quickly with compliance problems before an enforcement action by FINRA becomes necessary. This should be particularly beneficial for smaller firms that cannot afford the investment in in-house automated compliance systems commonly employed today by large firms. Most importantly, however, by dramatically increasing the likelihood that certain types of abusive conduct will be quickly caught and punished, either by the firms themselves or by FINRA, CARDS has the potential not just to detect but to deter wrongdoing that in the past might have slipped through the cracks. The benefits to investors of an effective deterrence program, while unquantifiable, are potentially enormous.

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<sup>1</sup> CFA is a non-profit association of approximately 280 national, state, and local pro-consumer organizations. It was formed in 1967 to represent the consumer interest through research, advocacy and education.

While CARDS offers enormous potential benefits, those benefits do not come without costs. In crafting this proposal, FINRA has shown itself to be extremely sensitive to those costs. For example, the regulatory proposal put forward in this latest release includes a number of modifications made in response to feedback FINRA has received both through the formal comment process and through its outreach to firms and other interested parties. CFA is generally supportive of changes to the regulatory proposal made in response to industry concerns over implementation costs and burdens. These include: the decision to implement CARDS in phases, starting first with the information that already resides at clearing and carrying firms; providing introducing firms with the option of submitting data to FINRA directly or by entering into an agreement with a third party; and allowing firms to report certain types of data, including suitability information and product and security descriptions, in free format text fields.

We are concerned, however, by the proposal to exempt from the CARDS reporting requirements transaction information for products that “are not held, or custodied at, or executed through, a clearing firm, such as variable annuities, private placements, direct participation programs (DPPs), private investments in public equity (PIPEs), non-traded real estate investment trusts, unregistered securities, precious metals and direct mutual funds, other than NSCC Network Level 3 mutual funds.” This list includes some of the very investment products most commonly associated with fraudulent and abusive sales practices. Failing to include information on these products within the CARDS reporting system is thus troubling in its own right. Moreover, recognizing that transactions in these products are likely to be subject to less regulatory scrutiny, unscrupulous broker-dealers are likely to tailor their conduct accordingly, magnifying risks to unsuspecting investors.

FINRA indicates in the rule proposal that it expects that “the collection of this information may be part of a later phase of CARDS, which would be subject to additional rulemaking.” While we recognize that there are additional costs associated with collecting and reporting this information, we believe the risks to investors from excluding this information are far greater. We therefore strongly urge FINRA to move forward without further delay with rulemaking to plug what could otherwise be a very significant gap in the protections afforded by CARDS. In the interim, it will be incumbent on FINRA to strengthen its non-CARDS-related oversight efforts with regard to those investment products and practices that will not be subject to automated reporting requirements.

Despite FINRA’s careful attention to industry’s legitimate concerns about the potential costs of implementing CARDS, industry opposition continues unabated. It is evident from the volume of opposition form letters that have been submitted, for example, that the broker-dealer trade associations are pulling out all the stops in an effort to stymie this regulatory effort. However, the arguments put forward in these letters are almost entirely specious and ignore the details of the CARDS proposal, the significant changes FINRA has already made in response to industry comment, and the process used to arrive at the proposed regulatory approach. The following section of the letter briefly addresses the main arguments made by industry opponents to CARDS and why those arguments should not be allowed to impede progress on this important investor protection rulemaking.

## **Concerns over Customer Privacy and Information Security**

The broker-dealer community's first attack on CARDS was based on the argument that it would put customer account information at risk. CFA takes threats to consumers' online privacy and information security very seriously. However, industry opposition to CARDS on this basis rings hollow. FINRA took a crucial step to reduce threats to privacy and information security when it decided not to collect investors' personally identifiable information through CARDS, and it has committed to adopting the highest possible data security standards. Moreover, the CARDS database will not include access to, or the ability to transact in, customer accounts. To the degree that certain information reported to CARDS, such as account numbers, could conceivably be reverse engineered to allow a hacker to identify customer holdings, FINRA officials have suggested that they would be willing to work with firms to ensure that information can be submitted in a way that doesn't carry that risk.<sup>2</sup>

Yet industry commenters continue to suggest that the database will be attractive to hackers. While we cannot conclude with absolutely certainty that the CARDS database will be entirely immune to hacker attacks, the firms' own systems would seem to be far more attractive targets. After all, many of the same firms that have raised the privacy/security issue with regard to CARDS maintain extensive electronic customer account databases, offer investors account access online and through mobile phone apps, and require customers to opt out of, rather than opt into, sharing of their sensitive financial data. If these risks to customer privacy and security can be justified on the grounds that they promote convenience for customers and operational efficiencies for firms, the far less severe investor privacy and security risks associated with CARDS can certainly be justified in order to promote the broader goal of improved investor protection.

### **The Risk of "False Positives"**

Having successfully lobbied FINRA to limit its collection of customers' personally identifiable information, industry opponents now argue that the lack of a complete picture of client holdings and activities will result in "false positives" that will create unnecessary work for firms and their compliance departments. It is certainly true that a certain number of false positives will be inevitable under CARDS, just as it is inevitable that a certain percentage of frauds will continue to go undetected once CARDS is implemented. However, it is patently absurd to suggest that efforts to detect wrong-doing will be less efficient under CARDS. What industry appears to be suggesting is that the cost and inconvenience to firms from the occasional false positive should outweigh the harm to investors from the all too common failure under the current system to detect wrong-doing until after investors have suffered devastating losses. We disagree.

### **Duplication of Existing Efforts**

Another common theme of industry opposition letters is that CARDS unnecessarily duplicates other data reporting obligations, in particular the consolidated audit trail or CAT. If evidence were needed that the bulk of comment letters were written without the benefit of a

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<sup>2</sup> For example, firms could use dummy account numbers when submitting information to CARDS.

review of the regulatory release, this argument supplies it. The regulatory notice clearly explains the differences in the data collected through CAT and CARDS. It states, for example, that: “Unlike CARDS, CAT will not contain information regarding customer risk tolerance, investment objectives, money movements, margin requirements and position data that FINRA uses to conduct its reviews. This distinction is a core feature of CARDS and emphasizes FINRA’s investor protection mission.” The regulatory notice further explains that FINRA staff has carefully analyzed the two systems and found that “there was limited overlap. Any transaction information proposed to be collected by CARDS that would also have to be collected by CAT would require significant additional information such as commissions and fees and final settled moneys that CAT would not collect.”

Finally, the rule proposal makes clear that FINRA is committed to eliminating duplication where it finds it. To that end, FINRA has already indicated that it will retire data collection efforts under its Integrated National Surveillance and Information Technology Enhancements program (INCITE) and the Automated Exam Program (AEP) once CARDS is up and running. While it is reasonable for firms to seek to reduce unnecessary duplication of efforts, the rule proposal makes clear that FINRA has been sensitive to this concern in developing the CARDS proposal and that industry’s objections to CARDS on this basis are unjustified.

### **Insufficient Information about Costs and Benefits**

As has become standard for any rulemaking to improve investor protection, industry opponents seek to attack CARDS on the grounds that FINRA has not sufficiently analyzed the potential costs and benefits. In fact, however, FINRA’s approach to economic analysis of this rule proposal goes above and beyond what anyone could reasonably demand of regulations to improve investor protection. FINRA actively sought input on the potential costs associated with CARDS through its concept release. It conducted a pilot project with six firms, got feedback on data specifications from a sounding board of 11 firms of various types that would be affected by CARDS, conducted direct outreach to stakeholders, and modified its proposed approach based on the comments it received during that process. Moreover, the current modified rule proposal provides additional details on its interim economic impact assessment and provides an additional opportunity for comment.

Regulatory economic analysis is a speculative exercise. Benefits in the form of fraud prevented or abusive conduct deterred are impossible to quantify. It is reasonable to conclude, however, that CARDS will render certain types of broker-dealer misconduct obsolete. Churning accounts should be easily detected under CARDS, as should pump and dump schemes, and the mass recommendations of the same investment product or product set to all customers without regard to suitability. Other types of suitability violations may require more extensive investigation, but CARDS should be extremely useful in flagging warning signs of a problem, such as a high volume of sales of high-risk, high-commission products by a particular broker, branch office, or firm. This is enough, in and of itself, to justify the costs associated with CARDS. However, FINRA’s interim economic impact analysis also demonstrates the potential for CARDS to reduce regulatory costs and burdens on firms associated with providing information on an ad hoc basis in support of FINRA examinations.

## Conclusion

No one has more enthusiastically embraced the potentially transformative impact of technological advances than the financial sector. Securities firms have invested countless millions to upgrade their technology in order to improve the efficiency of their operations and to enhance the convenience of their services for customers. Now that FINRA proposes to harness technological advances to improve the efficiency and effectiveness of its oversight program, however, some in the industry are digging in their heels. But FINRA cannot reasonably be expected to oversee a highly automated 21st Century securities business with an antiquated paper-based, in-person inspection system. CARDS has the potential to put FINRA on an equal technological footing with the firms it oversees. It is an investment that is well worth making. We urge you to move forward expeditiously with this rulemaking project.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Barbara Roper", with a horizontal line extending to the right.

Barbara Roper  
Director of Investor Protection