To Whom It May Concern:

CARDS has been proposed as a system for collecting and analyzing large quantities of data in order to perform broad based surveillance of the industry. This seems to be a reasonable and appropriate approach to regulating a diverse and complex collection of firms, lines of business, and investor clientèle. However, as I have thought more about the breadth and depth of the information FINRA proposes to collect, I believe the proposal substantially infringes on civil liberties and our fundamental right to privacy. Notwithstanding FINRA's decision not to collect PII, the routine and ongoing collection of even anonymous data is troubling.

Consider, for example, if our banking regulators proposed to collect bank account numbers, transaction data such as deposits, check and wire disbursements, transfers, and payments, and current assets in each customer's account. Even without PII, AML investigations could surely be automated and streamlined, bringing efficiencies to regulators and banks alike. Consumers would view this as an invasion of privacy and the proposal would never be implemented. This is not so different from the circumstances and the data set FINRA proposes to collect, and end investors have uncharacteristically objected in large numbers.

If our intelligence agencies collected and consolidated reams of data about phone calls placed and received, email and text messages sent and received, and money transfers between accounts (even without any PII), it is certain that our ability to combat terrorism would be greatly improved. Rather than sending subpoenas to individual firms, waiting for responses, collecting data in non-standard formats, and then analyzing it, investigations would be swift. Criminals could be identified and prosecuted in a fraction of the time it takes today. Almost nobody in our nation is willing to allow their data to be collected in furtherance of a project such as this, despite the obvious benefits. This hypothetical is not far from what Edward Snowden claims our government did (or continues to do). This revelation was met with near universal disapproval from our nation's politicians and citizens.

In theory, CARDS would reduce the information gap between member firms' full understanding of their business and FINRA's partial view and understanding. However, it would do so at tremendous cost to the end investor. While FINRA would directly or indirectly levy its costs on member firms, these costs ultimately flow down to investors. The system also has great potential to create false positives, spur more Rule 8210 requests, and I believe, ultimately drive up costs and not reduce them.

Unannounced Pilot

I was very disturbed when I learned that that FINRA was already collecting data about introducing firms from some of the larger clearing firms in what was described as a “pilot”. To date, all of the releases from FINRA have presented CARDS as a “Rule Proposal to implement” or a “concept proposal”. The language of the Regulatory Notices all present CARDS as a hypothetical, and leave the membership with the inaccurate impression that FINRA has not yet decided to implement the system. It would be better if FINRA were upfront with the member firms, and the Notices would present the system in its current form and seek input for modifications. Alternatively, the “pilot” should be discontinued until such time as public comment has been received and reviewed.

PII Collection

The collection of PII has been a major source of concern to both investors and the industry. While I applaud FINRA's decision not to request PII, this decision presents new challenges for the membership. For example, if FINRA flags activity for review, I can envision a Rule 8210 request to identify the name, DOB, SSN, etc. of all beneficial owners of the account(s) in question, along with all other account(s) in which they have any interest or control, and so on. The end result may be that the activity does not warrant further scrutiny, but I foresee numerous requests of this nature that take more time and resources away from compliance departments industrywide.

Data File Conformity

I have spent over 12 years working directly with the standard data files provided by five large clearing firms, FINRA, DTCC, and DST. While these files can be theoretically “plugged in” to an analysis tool, I have found dozens of nuances that FINRA will have to handle without the benefit that firsthand knowledge of the “right” data that offers. With the knowledge of the “right” data, one can much more easily find erroneous data and rectify the problem. Identifying and pairing off trades that have been canceled and/or corrected is extremely difficult, as many clearing firms do not uniformly follow their own stated process for pairing trades. Given my firsthand experience with this issue, I am concerned that this will lead to many false positives.

Potential For Incorrect Data

Does the absence of a record segment mean that the underlying information is unchanged, or does it mean that those fields were changed to blank values? This varies between data providers and file types. Standardizing this process is not the type of adaptation the industry could easily adopt in order to ease FINRA's process for ingesting files.

At least one large mutual fund company issues account numbers that are unique only when combined with the fund number. The fund number is not provided on any DTCC file, which is the primary data source for the industry. Again, imposing a uniform standard for account numbering would be a tremendous undertaking.

Clearing and introducing firms have various ways to report multiple execution average price trades, and they also vary across file offerings, executions through or away, and for other reasons. For example, one of our clearing firms reports averaged price trades on one file, but another file reports individual prints, even though the customer account reflects the average price. In previous examinations, FINRA has flagged false positives because the examiner believed one execution was the entire trade.

Data aggregation firms have tried for many years to collect and analyze data on behalf of their client broker-dealers. While these systems do a good job, every firm I know that uses these products spends significant time each day to manually reconcile and “scrub” the data. FINRA's approach of a binary accept/reject feedback system raises concerns that bad data will end up in FINRA's database and could spur unnecessary inquiries. The proposal does not discuss this possibility.

Mitigation of Risk

CARDS is being promoted as a tool to mitigate risk by identifying areas of risk more quickly. In order for this to be a reality, FINRA would have to employ experts who could spot the next crisis before profit-motivated broker-dealers, economists, analysts, and professional traders (in addition to collecting all of the data as proposed). CDOs, CDO squareds, CDS, and other esoteric instruments that fueled the crisis would be unlikely to appear in security master data. Even if they did, the information necessary to understand their construction and elements of risk cannot be input into a field for easy analysis. I cannot fathom how CARDS, if it existed in its proposed final form before the 2008 financial crisis, would have somehow detected and stopped the meltdown.

Another concept discussed in the Regulatory Notices published by FINRA is that CARDS could identify problematic branch offices. The only way this is possible is to associate a rep number to a branch office, yet the existing data does not allow for this. Doing so would impose more costs on clearing firms to capture the information and on introducing firms to provide and maintain the registration data on an ongoing basis. Clearing firms may collect an individual CRD Number associated with a rep/FA number, but often it is not required. In any case, the CRD Number is not validated. Team/split numbers do not capture all associated persons' CRD Numbers, and modifying systems to accept additional data would be another new cost and new and ongoing burden.

High profile private placement frauds were a major risk area to some firms in the recent past. Given that these investments are not publicly traded and do not lend themselves to algorithmic analysis, I cannot understand how CARDS would prevent the same issue in the future. The only data available is the financial statements, which firms could not readily provide in any machine readable format.

CARDS Suggests to Replace Compliance Oversight

RN 14-37 lists an objective of CARDS as the ability to “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”. False positives will drive up costs and sap firms' resources and abilities to identify and respond to actual suitability issues. This risk far outweighs any potential benefit this type of surveillance could offer. FINRA will not be able to collect and sufficiently analyze whether an investment is unsuitable, and if it can, it would seem that firms' compliance departments are redundant and thus unnecessary. This would only be theoretically possible if FINRA forced all firms to standardize their investor profile elements and to affirm changes to suitability definitions with every investor. The costs to firms (borne by investors) for this effort would be tremendous, and would take resources away from helping and protecting investors.

Small and Mid-Size Firm Impact

FINRA proposes in RN 14-37 to minimize the impact on smaller firms. The very vague proposal suggests substituting direct data transmission from firms to FINRA for a two step process. Firms would instead submit data to the clearing firms, who would submit it to FINRA. This introduces an additional point of failure, and does nothing to reduce the burden on smaller firms. It imposes new costs on firms to collect data “in their possession” for submission to their clearing firms. The phrase “in their possession” suggests to me that the information is in paper files or static images, and would require enormous resources to input this data into a new system. The burden would be disproportionately high, especially given the lower systemic risk posed by smaller firms.

Redundant Data

While the CARDS proposal notes that redundant systems would be eliminated after implementation, this has not been the case in the past. The BORAM was implemented despite the availability of much of the information on CRD or other sources available to FINRA. More recently, the introduction of the FOCUS SSOI created numerous pieces of redundant and/or overlapping data already that is already submitted on the FOCUS, yet no changes were made. FOCUS itself also requires provision of number of registered persons, and other information already known to FINRA. After CARDS RN 14-37 was published that promised a reduction in duplicative systems, RN 14-43 announced a new requirement, the FOCUS SIS. It contains additional redundant and/or overlapping data points, but no provisions were made to reduce the burden on firms. Even within CARDS, RN 14-37 states that the data requirements for CARDS will include both (1) a stock record and (2) a separate requirement to aggregate the stock record by security. If FINRA is proposing to perform advanced data analysis on the data collected, why can it not do arithmetic analysis to compute totals?

Other Data Sources

The Regulatory Notices suggest that FINRA has given much thought to reducing burdens on firms. However, there is more work to be done. For example, collecting ACATS data from each individual member firm or clearing firm is unnecessarily burdensome and costly. NSCC has an excellent reputation as an industry utility, and already possesses 100% of the ACATS data FINRA could even theoretically seek. Has FINRA approached NSCC about getting this data directly from the source?

Costs

FINRA questions the notion that all costs will ultimately be borne by investors. There is no other possible outcome – investors pay the industry, whether through fees, commissions, or service charges. While no investor will receive a CARDS invoice, firms will be forced to increase costs, reduce service staffing, or impose higher account size minimums. Similarly, clearing firms will pass along the costs of CARDS in various ways, even if not through a direct assessment. Clearing firms know that the burden of changing providers allows them to impose new costs on firms that will ultimately flow down to the end investor.

FINRA estimates developing CARDS will take 3 years and $8-12 million. For-profit firms have spent well over 10 years tackling these same challenges, and still do not have it solved. I believe this project would take no less than 5 years, assuming FINRA mandates that firms standardize data. Based on my knowledge of technology spending at clearing firms, I estimate the direct cost to FINRA at no less than $25 million. I cannot begin to estimate the cost to member firms, as the proposal does not have sufficient information.

In theory, CARDS seems like a good idea. However, its practical application (as proposed) will force firms' compliance departments to be reactive rather than proactive. Resources will be diverted in order to translate data or answer questions for FINRA, and sales practice oversight will suffer. The only ways for firms to recover the burden of these costs will result in harm to investors: client service could decrease, commissions and fees could increase, firms may exit the business, or rule violations may go undetected. Small and mid-sized firms simply to not have large profit margins that allow for absorption of new expenses without corresponding reductions elsewhere.

The time and expense FINRA proposes to expend on this project would be better spent on investor education. If investors were better informed, they would be better able to detect and report irregularities than FINRA's data analysis.

Thank you for the opportunity to comment.

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