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By Electronic Mail (*pubcom@finra.org*)
Marcia E. Asquith
Senior Vice President and Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 14-37 (Comprehensive Automated Risk Data System)

Dear Ms. Asquith:

Lincoln Financial Network ("LFN" or "Lincoln") appreciates the opportunity to submit this comment letter in response to the Financial Industry Regulatory Authority's ("FINRA") rule proposal to implement the Comprehensive Automated Risk Data System ("CARDS"), as outlined in Regulatory Notice 14-37. FINRA initially released CARDS as a concept proposal in Regulatory Notice 13-42 and Lincoln filed a March 2014 comment letter. Lincoln respectfully refers FINRA to that comment letter; as it also discusses issues which Lincoln believes still exist with the current version of the proposed rule. [1]

Lincoln Financial Network is the marketing name for Lincoln Financial Advisors Corp. ("LFA") and Lincoln Financial Securities Corp. ("LFS"), two broker-dealers and registered investment advisors affiliated with Lincoln Financial Group ("LFG"). [2] Currently, LFN maintains an affiliation with over 8,500 financial advisors, which include registered representatives, investment advisor representatives, insurance brokers and agents. LFN has an open architecture business model, allowing its financial advisors the ability to offer a variety of investment products, including securities (e.g., stocks, bonds, mutual funds, variable annuities), advisory services, and non-securities products (e.g., fixed annuities and life insurance, including insurance sold by insurance companies others than LFG).

[1] Comment Letter from Carrie L. Chelko, Chief Counsel, Lincoln Financial Network, addressed to Marcia E. Asquith, Office of the Corporate Secretary, FINRA (Mar. 21, 2014) [available at http://www.finra.org/Industry/Regulation/Notices/2013/P412658] (last visited Nov. 13, 2014).

[2] The affiliated companies of LFG act as issuers of insurance, annuities, retirement plans and individual account products and services. The affiliates include, but are not limited to the Lincoln National Life Insurance Company ("LNL"); Lincoln Life and Annuity Company of New York ("LLANY") and Lincoln Financial Distributors ("LFD"), Lincoln's wholesaling arm, a broker-dealer registered with the SEC and a member of FINRA.

I. FINRA Proposed Rule 4540

On September 30, 2014, FINRA published Regulatory Notice 14-37 and FINRA's proposed rule 4540. Under this proposed rule, FINRA would automatically collect account activity and suitability profile information of investors who maintain accounts with FINRA member firms. The information that FINRA proposes to collect, on a regular basis, involves significant amounts of private consumer information, including the following:

- Account number
- Securities transactions information, including purchases, sales and dividend reinvestments;
- ACAT (automated customer account transfer) data to show transfer of securities, positions, and accounts between member firms;
- Journal entries or transfers of securities and positions between accounts at the same firm;
- Account deposits and withdrawals;
- Margin balances and margin calls;
- Stock records and holdings;
- Personal profile information of investors or other authorized persons on an account ("personal customer information") including:
  - net worth
  - investment objectives
  - risk tolerance
  - investment time horizon
  - birth year
  - citizenship
  - country of residence
  - whether the customer is a politically exposed person
  - employer information
  - account type (i.e., individual, corporate, partnership, trust)
- Information on the registered representative servicing the account, including compensation and CRD number.

Proposed rule 4540 indicates that CARDS would be implemented in two phases. “Phase 1” would require carrying or clearing firms (i.e., firms that carry customer or non-customer accounts or clear transactions) to periodically submit in an automated, standardized format specific information that is part of the firms’ books and records relating to securities accounts for which they clear. “Phase 2” would require introducing broker-dealers, like LFN's broker-dealers, to submit personal customer information (as identified above), directly to FINRA through regular data feeds. This type of personal customer information is private information that was entrusted only to member firms and financial advisors by their customers. Due to significant adverse feedback by member firms, FINRA has elected to exclude gathering three pieces of personally identifiable information (“PII”) for customers (customer name, address, and tax identification number). However, proposed rule 4540 still requires many other elements of unique and highly sensitive personal customer information to be regularly submitted to FINRA, without specific authorization of the customer.

FINRA's stated purpose for the rule proposal is to identify risks, assist firms with their compliance and supervisory programs, and assist FINRA in assessing business conduct patterns and trends in the industry. While FINRA has appeared to engage the broker-dealer community for feedback, and has made minor changes to its original concept proposal (like excluding the three pieces of customer's PII), Lincoln respectfully suggests that these changes are not enough and FINRA has failed to address all of the concerns that Lincoln and FINRA's member firms have voiced in their respective comment letters. FINRA has also yet to address the concerns of private investors that they are acquiring significant amounts of personal customer information without express authorization of each of those customers.

II. Cost-Benefit Analysis

As Lincoln articulated previously, rulemaking, “whether by an SRO or the Commission itself, should be the product of a careful and balanced assessment of the potential consequences that could arise.” Daniel Gallagher, Commission, U.S. Secs. & Exch. Comm’n, Market 2012: Time for a Fresh Look at Equity Market Structure and Self-Regulation, Address Before SIFMA’s 15th Annual Market Structure Conference (Oct. 4, 2012), *available at* http://www.sec.gov/news/speech/2012/spch100412dmg.htm (last visited November 18, 2014). Commissioner Gallagher conveyed that a thorough analysis of both the benefits and costs needs to be undertaken, including how affected parties are impacted and whether alternative solutions are available. Id.

Unfortunately, FINRA's rule proposal is premature, as FINRA has yet to conduct a formal, thorough and complete Cost-Benefit Analysis. Instead, FINRA has conducted only an Interim Economic Impact Assessment, which is insufficient at best. FINRA member firms and the public deserve an opportunity to review a complete and final cost-benefit analysis of CARDS prior to proposed rule 4540 being filed with the SEC. Based on what has been shared by FINRA thus far, it is clear to Lincoln that the costs far outweigh the anticipated benefits. This reasoning is discussed in more detail below.

A. Exorbitant Costs

CARDS comes at a great cost[3] to investors, clearing firms and introducing broker-dealers. First, FINRA will experience significant costs associated with building, maintaining and utilizing this technology platform. This will include technology costs to ensure that the infrastructure and programs are operational. FINRA will also need to employ significant information security analysts and other data analysts and staff to help interpret the data, as well

[3] This particular section speaks only to the monetary costs and not the costs involving the loss of civil liberties and fourth amendment rights against search and seizure. Those additional costs involving constitutional protections are discussed in Section II.C.

as additional regulatory analysts to coordinate follow-up inquiries to member firms. FINRA has been silent on how it intends to pay for these additional costs. As such, member firms can only presume that these substantial costs will be passed on to them through increased member firm surcharges and/or increased enforcement actions/regulatory settlements.

Second, both clearing firms and introducing firms will incur costs to ensure that the new CARDS data can be gathered, standardized, organized, maintained and then transmitted to FINRA. Additional infrastructure and systems will be necessary to accomplish these efforts. It is reasonable to presume that costs incurred by clearing firms will be passed along to introducing broker-dealers.

Third, introducing broker-dealers will also necessarily incur their own costs, in addition to those costs that may be absorbed from the clearing firms. Phase 2 of the CARDS implementation requires transmission of all of the personal customer information to FINRA. As such, introducing broker-dealers also need to gather, standardize, organize, maintain and transmit this data to FINRA, either directly or through a third-party. All parties, including FINRA, will have ongoing costs, in addition to infrastructure and start-up costs, of maintaining the systems, and human resources and operational processes.

Fourth, the costs associated with the effort to "standardize" the data types in a uniform format which is acceptable to FINRA will be significant. Currently, each member firm determines how a customer's investment profile and objectives are defined. That is, one member firm may define "moderate growth" or "speculation" investment objectives differently than another member firm. Each firm chooses how these profile data points are defined using their own risk-based processes that are unique to each individual broker-dealer. FINRA has not created an industry standard of uniform or consistent definitions. Yet, without standardized investment objectives that are consistent across all member firms, FINRA will have challenges in interpreting all of the CARDS data it expects to receive.

In Regulatory Notice 14-37 (Section G), FINRA specified that firms will have the ability to report specified data elements (including suitability information) in free format text fields. This begs the question of how FINRA will have the ability to analyze the massive quantities of information it is obtaining from thousands of member firms if each firm has the ability to submit the data in free format text fields. Thus, FINRA may ultimately decide to take the logical next step and prescribe standardized data points for all member firms to implement.

If LFN's broker-dealers were to "standardize" the data in a manner acceptable to FINRA, Lincoln would need to (1) update all of its proprietary customer forms, (2) reprogram its systems and customer database and (3) contact all of its customers, in writing, to obtain updated information in the "standardized" or uniform format. Lincoln estimates that the cost of this effort alone would meaningfully exceed one million dollars and would include a combination of start-up costs and recurring annual costs. The cost estimate includes, but is not limited to, items such as the following:

- Updating forms,
- Reprogramming customer databases,
- Printing/mailing updated documents to customers,
- Training financial advisors and customer support staff on the new processes, definitions and forms,
- Hiring additional staff to process paperwork,
- Building/maintaining infrastructure,
- Monitoring information transmission,
- Developing new policies and procedures regarding information transmissions,
- Obtaining historical data, and
- Transmitting data and electronic feeds.

With all of these system and documentary changes, there will be a notable impact on financial advisors and the clients that they service. Unfortunately, a cost that cannot be quantified is this impact on financial advisors' and the customers' experiences, as advisors will need to spend time with customers, explaining why additional, standardized information is being required by FINRA.

Finally, while the costs of developing a CARDS compliant program will likely be immense, the costs associated with utilizing the data could be much higher. LFN's broker-dealers have robust technology tools for supervision and surveillance. The current technology assists LFN's broker-dealers in evaluating trends and sales practice issues. This is a reasonable technology solution designed to achieve compliance with securities rules and regulations. However, FINRA intends to use CARDS to analyze and identify the same issues. Going forward, CARDS may now be the new standard for determining whether a supervisory and surveillance system is considered appropriate or reasonably designed to achieve compliance with securities rules and regulations. As a result, LFN's broker-dealers, and other member firms, may need to develop a duplicative or mirroring surveillance system which applies the same FINRA analytics, metrics and algorithms used with CARDS. A mirroring internal system is the only way to ensure that transactions are scrutinized using the same analytical approach as FINRA and that potential red flags or anomalies can be detected and remediated, even if the other technology system would not have detected the red flag or anomaly. The costs to develop a duplicate CARDS system to be used internally by the firm are simply not quantifiable at this time. Alternatively, member firms may determine that the ongoing costs of maintaining two surveillance systems are prohibitive and be left with no choice but to shut down their current surveillance systems, which would cause an adverse balance sheet impact due to the costs incurred in purchasing or developing such systems being written off.

B. <u>Privacy & Information Security</u>

Under proposed rule 4540, FINRA would be the data warehouse to significant amounts of personal customer information of the entire investment community. And, despite the fact that FINRA has excluded three pieces of PII from this rule, this sensitive information may still be warehoused with FINRA in other ways, such as electronic blue sheets, rule 8210 inquiry productions, OATS data feeds, TRACE data feeds and 4530 filings. As such, "re-identification" or manipulating data to reengineer the missing PII is a very real risk. Many member firms and trade associations, including LFN, raised concerns of privacy, data security and re-identification risk in their original comment letters to the CARDS concept proposal. FINRA has not satisfactorily responded to these concerns. For example, FINRA has not articulated how customers will be informed of this data warehouse and who will be responsible in the event of a data breach. Indeed, many member firms and trade associations have proposed that FINRA indemnify member firms in the event of a breach.

While FINRA has articulated some of their anticipated information security protocols, including the control access, they have yet to respond sufficiently to the significant privacy and data security concerns. Rather, FINRA seems to imply that its security protocols are adequate and that any security concerns are secondary to FINRA's need for obtaining this information. In other words, FINRA has apparently concluded that the benefits of the rule outweigh the cyber security risks or that there is no re-identification risk.

With the proposed implementation of CARDS, two additional opportunities for a potential data intrusion would be introduced: (1) the data feed between the introducing firm and the clearing firm and (2) the data feed between the introducing firm/clearing firm and FINRA. With this proposal, one organization (FINRA) would create and maintain a central repository containing sensitive personal and financial information regarding every investment by its member firms' customers. Cybercriminals are ingenious in their methods for obtaining non-public, personally identifiable information, even without social security numbers. While some of the risks are reduced by FINRA's recent changes, FINRA would still be the target of data intrusion attempts, which, if successful, could have potentially devastating consequences.

In the event of an intrusion or privacy breach, it is unclear under CARDS who bears the liability – introducing/clearing firms for submitting information to FINRA or FINRA, if the intrusion occurred after the data was received by FINRA. Is FINRA prepared to indemnify introducing/clearing firms if a breach occurs in either situation since FINRA (under CARDS) would be providing a mandate that the firms submit this confidential information? The Regulatory Notice provides limited information regarding the steps FINRA would take to ensure the protection of any customer non-public personal information. Lincoln encourages FINRA to provide further, specific information surrounding the information security precautions that will be implemented to prevent the unauthorized disclosure or use of a customer's non-public personal information and who would be liable for such a breach if one occurs. Lincoln commends FINRA for its recent steps to limit the type of customer information it receives. FINRA should continue evaluating the type of data it seeks, not only by working with member firms, but also conducting focus groups with the investing public to obtain customer feedback and views.

Finally, the Regulatory Notice is silent on who may be able to obtain access to the CARDS data once it is transmitted to FINRA. As a result, Lincoln has a number of questions about whether FINRA intends to maintain the confidentiality of the data or whether it intends to share the information with third-parties, which could include private litigants and other regulators. LFN encourages FINRA to be transparent about whether this data is confidential or whether third-parties and private litigants could obtain access to this data through subpoenas, FOIA requests or other regulatory mechanisms.

C. Investors' Constitutional Rights

The implementation of CARDS also presents a troubling and serious threat to investors' civil liberties and constitutional rights. The Fourth Amendment to the United States Constitution guarantees "[t]he right of people to be secure in their persons, houses, papers and effects, against unreasonable searches and seizures."[4] Recognized by the United States Supreme Court as the "right to be let alone," Americans widely consider the Fourth Amendment to be both comprehensive, highly valued[5] and the principal constitutional protection against government intrusion. The issue of what is covered under the Fourth Amendment and what is a realistic level of privacy has received significant attention recently in the wake of several scandals by the National Security Administration (NSA) and its brethren. In June 2014, the Supreme Court unanimously held in Riley v. California[6] that the digital content of cell phones does not fall within the search-incident-to-arrest exception to the Fourth Amendment's prohibition against unreasonable searches. Further, in United States v. Warshak[7], the Sixth Circuit found that email users have an expectation of privacy in emails saved by their internet service providers.

In the wake of these recent rulings, it is unfathomable that FINRA believes it is entitled to gather significant amounts of personal customer information (i.e., net worth, age, investment objectives, risk tolerance, transaction history, cash balances, journaling activity, etc.) without obtaining the customer's consent to provide this information. Here, customers have an expectation of privacy with respect to the information they entrust to their investment firms and financial advisors and LFN have an obligation to protect it at all costs.

In addition, the American Civil Liberties Union ("ACLU") filed a comment letter to the original concept proposal - Regulatory Notice 13-42. In its comment letter, the ACLU expressed concern over the concept proposal in that FINRA should not be monitoring the financial pursuits and personal information of private consumers and argued that "ordinary individual investors should be able to conduct their financial business without unwarranted government intrusion and

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[4] U.S. CONST. amend. IV.

[5] See Olmstead v. United States, 277 U.S. 438, 478 (1928) (Brandeis, J., dissenting), *overruled by* Katz v. United States, 389 U.S. 347 (1967), *and* Berger v. New York, 388 U.S. 41 (1967).

[6] 134 S. Ct. 2473 (2014). Riley was decided together with United States v. Wurie, another case involving the warrantless search of a cell phone incident to arrest.

[7] 631 F.3d 266 (6th Cir. 2010).

fear of identity theft.[8] In addition to the intrusion on individual civil liberties, there is also a potential for a consumer to decide not to invest due to fear of identity theft which would only add to the deprivation of rights that CARDS would initiate.

D. Increased Regulatory Burden

FINRA has announced to the investment community, through speeches, conferences and regulatory notices, that CARDS would reduce burdens on firms by eliminating intermittent information requests from FINRA and increasing the efficiency of the examination process. LFN is concerned that, based on the frequency and volume of data feeds to FINRA, the opposite will likely occur (i.e., this proposal could mean a greater regulatory burden, resulting in more time-consuming and inefficient interactions with FINRA).

During a member firm's cycle examination, FINRA routinely issues information requests that seek customer and transactional data similar to information introducing/clearing firms would be required to furnish to FINRA through CARDS. While it is time-consuming to gather this information during the examinations, at least the requests are commonly limited in scope to certain financial advisors or time periods. These limitations are generally developed by FINRA using a "risk based" analysis. Once FINRA receives the information, examiners conduct their own post-transaction suitability review. Unfortunately, an examiner's post-transaction review may be based upon facts and circumstances which are not available in "real time" to the financial advisors, supervisory principals and member firms. FINRA's suitability conclusions could potentially use 20/20 hindsight and market information that was not available when a supervisory principal approved a transaction.

With this context in mind, LFN is concerned that CARDS could create a more acute disconnect than that described above concerning cycle examinations and actually increase the volume of subsequent inquiries. Member firms are required under Rule 2111 to conduct a suitability review of all recommended securities transactions and investment strategies.[9] In order to make a suitability determination regarding recommended sales and investment strategies, member firms rely upon the totality of the facts and circumstances ascertained through the

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[8] Comment Letter from Laura W. Murphy, Director and Christopher Calabrese, Legislative Counsel, American Civil Liberties Union addressed to Marcia E. Asquith, Office of the Corporate Secretary, FINRA (Mar. 21, 2014) [available at http://www.finra.org/Industry/Regulation/Notices/2013/P412658] (last visited Nov. 18, 2014).

[9] Rule 2111 (a) specifically provides: "A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."

required due diligence process. That determination is made at a point in time. The suitability review includes the information in the customer's profile, as well as other relevant information.

Some, but certainly not all, of the information relied upon by member firms to make suitability determinations will be captured by the CARDS data points. Indeed, the data points will be less complete than the information FINRA examiners have at their disposal during a cycle examination. Therefore, these data points are clearly not going to tell the whole story and could lead to misplaced concerns or the lack of concern where concern is actually warranted. Such false positives could include a situation where FINRA obtains data that indicates a 75-year-old customer with a moderate risk tolerance has his entire account invested in a single security. FINRA may see this transaction as unsuitable and over-concentrated because FINRA does not have access to the customer's other account information or investments, especially those maintained at other member firms or held direct with fund companies. The data that FINRA will be receiving (although extremely burdensome and potentially violative of the customers' Fourth Amendment rights) will not be enough to allow FINRA to examine the individual in an objective manner.

Because of the sterile and incomplete nature of the information contained in the data points, there is a very high likelihood that FINRA will need to make frequent, burdensome and costly subsequent inquiries with member firms, but on a much broader landscape than in a cycle examination, as the information submitted through CARDS will not be limited in time and scope. Alternatively, without the information requests, any conclusions reached by FINRA will be second guessing member firms' decisions based upon incomplete information. Thus, the very "threat" that FINRA is attempting to restrict or prevent (such as an unsuitable transaction) is not a true threat at all.

Under this new regulatory regime, FINRA will no longer receive data that is the result of a risk-based information request. Rather the new data feeds are going to be "all transactions," so there will be little (if any) ability to discern which pieces of the data feeds might be more problematic because there is no "risk based" analysis before obtaining or analyzing the data. As noted above, the subsequent inquiries will likely be voluminous and costly. Those costs will likely also result in increased costs to the consumer. Such subsequent inquiries will also cause more of a strain on supervisory principals and registered representatives, as they will need to spend time to explain the facts and circumstances in a post-transaction timeframe.

Due to the massive amount of data that FINRA would receive under CARDS, it will be extremely difficult to ascertain what data merits further scrutiny. When too much information is presented, everything can begin to look like a "red flag." While FINRA has indicated that it is their belief that CARDS will result in less regulatory burden, Lincoln believes that the opposite is the case. If FINRA sees anything that looks suspicious, FINRA will likely conduct a subsequent inquiry. CARDS will not permit FINRA to have any effective "policing power" due to the false positives (as addressed previously) and the necessity for FINRA to make subsequent inquiries to gather additional data once they identify something that appears suspicious. The goal of FINRA should be to prevent consumers from being subjected to unsuitable or inappropriate sales practices. Instead, CARDS will only provide FINRA with post-transaction review capabilities on transactions that may have happened weeks or months earlier. At that point, any harm will have occurred. Instead, FINRA should focus on refining the examination process to ensure that it is in a position to gather transactional information and dialogue with firms on all factors used by supervisors to approve transactions as suitable.

E. Scope of Data Collection

Lincoln believes that FINRA should specifically and more fully explain the need for each data category of information required by the proposed rule and explain whether the reporting to CARDS of information regarding institutional account sales activity is necessary - as CARDS appears to focus on retail sales practices concerns. If the anticipated use of information obtained from CARDS is to make suitability inquiries more efficient, Lincoln believes the reporting of institutional sales information would be superfluous. Tracking and identifying transaction activity to identify trends by investment product, firm and office would not require the extensive amount of information and data required by the rule as currently proposed. FINRA could obtain the same results by adding a small number of data categories to CAT or the other alternative solutions discussed in the next subsection.

F. Alternative Solutions

While FINRA indicates that it is "committed to a thorough analysis of existing as well as any future reporting requirements," it does not appear that FINRA has analyzed whether other reporting systems can be utilized or augmented so as to eliminate the need for CARDS. For example, OATS, TRACE and LOPER already provide real-time reporting data on equity, fixed income, and options transactions to FINRA. It would seem more reasonable and efficient for FINRA to analyze the transactional information available through these data feeds as a means to identify market trends, red flags and trading patterns. Then, if additional customer, financial advisor or commission data is needed, a Rule 8210 request can be used to gather the supplemental information. Alternatively, a "blue sheet" like request could be submitted to member firms for customer or commission information after OATS, TRACE and LOPER reporting is analyzed. Given that current transactional feeds already exist and additional reporting mechanisms like Consolidated Audit Trail are being implemented, FINRA should evaluate alternative solutions, like enhancing its current OATS, TRACE or LOPER reporting, to eliminate duplication and additional burdens.

III. Conclusion

Lincoln is supportive of FINRA's objective to more efficiently and effectively supervise member firms and protect the investing public. However, the proposed CARDS rule is not the solution to this objective, as it comes with unacceptable burdens, risks and costs. This objective can be attained through other, less burdensome, risky and expensive alternatives. Lincoln looks forward to a continuing dialogue with FINRA in the hopes that FINRA can identify alternative, less costly solutions and alternatives that do not adversely impact the constitutional rights of the investing public. If you have any questions, please do not hesitate to contact me at 484.583.1413 or carrie.chelko@lfg.com.

Respectfully Submitted,

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Lincoln Financial Network