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VIA ELECTRONIC MAIL (pubcom@finra.org)

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

**Re: Regulatory Notice 13-42, Comprehensive Automated Risk Data System
Comment Letter of Charles Schwab & Co., Inc.**

Dear Ms. Asquith:

Charles Schwab & Co., Inc. ("Schwab") appreciates the opportunity to comment on FINRA's concept proposal to develop the Comprehensive Automated Risk Data System (CARDS). We support FINRA's ongoing efforts to increase the effectiveness and efficiency of its national examination program and recognize the critical importance of that program to investor protection. At the same time, Schwab has concerns about the CARDS proposal given its potential negative impact on investors and member firms serving them. Based on those concerns, we oppose its implementation as outlined in FINRA Regulatory Notice 13-42 (the "Regulatory Notice").

Our concerns include the following:

- **Privacy and Fraud Risks.** The data requested in the CARDS proposal is highly confidential and sensitive both from an individual investor and member firm perspective. We have concerns about FINRA's ability to protect the data from risks of privacy breach and fraud.
- **Scope of Access to and Use of CARDS Data.** There are important unanswered questions regarding access to and use of CARDS by areas within FINRA, other SROs, governmental agencies and private third parties. Before moving forward, there needs to be full transparency regarding the possible scope of access to and use of CARDS and a full vetting of issues associated with all aspects of such access and use, including procedural protections and controls that protect customer and member firms' privacy and proprietary interests.
- **CARDS Use in the FINRA Examination Program.** The scope of CARDS is overly broad and disproportionate to FINRA's stated needs. Contrary to FINRA's assertions, Schwab believes CARDS will increase regulatory costs and burdens on member firms, and will not achieve improvements in the efficiency and effectiveness of FINRA's examination program.
- **Impact of CARDS on Self-Regulation.** There is a significant risk that the collection of the data described in the Regulatory Notice will fundamentally alter the nature of FINRA's oversight of member firms, registered representatives and customer activity that may undermine the effectiveness and efficiency of FINRA and member firm investor protection efforts.
- **Alternative Solutions to CARDS.** A more targeted use of existing data collection processes in support of the examination program could achieve the stated policy objectives without the significant risks and data production concerns associated with CARDS.

For these reasons, which are more fully described below, we urge FINRA to withdraw the CARDS proposal.

Privacy and Fraud Risks

The confidential, proprietary and personal nature of the information and the breadth and scope of the CARDS database raise major concerns regarding the potential for fraud, cyber security risks, and privacy protection.

The CARDS proposal contemplates standardized, automated and regular submission to FINRA of broad categories of account and account activity information for every retail customer of every clearing firm (on behalf of introducing firms) and self clearing firm regulated by FINRA. If implemented, FINRA would hold and control a centralized, dynamically updated repository of highly confidential, sensitive, private information that would include account identifiers, account types, investment profile information (such as investment objectives, dates of birth and employment information), investments, securities transactions, cashing and money movements, and borrowing activity of virtually every retail customer of every U.S. broker dealer.

In addition to the significant privacy and confidentiality interests of individual investors, data regarding brokerage accounts and account activity represent highly confidential proprietary business information of member firms. The data provides a road map of core components of each firm's business model, client base and sales activities that if inappropriately disclosed, shared or stolen, could cause significant harm to a member firm's business.

Subsequent to the issuance of the Regulatory Notice, FINRA announced that in response to feedback received, the CARDS proposal will not require the submission of information that would identify to FINRA the individual account owner - particularly, account name, account address or tax identification number. Implicit in this announcement is recognition that the collection of certain customer account information raises substantial privacy and fraud concerns that outweigh the regulatory benefit of collecting the information. While the reduction in scope is helpful, we believe that centralized collection of the additional account level data elements raise similar privacy concerns and fraud risks. Social engineering techniques commonly used by fraudsters could readily take advantage of access to CARDS data to target accounts holding particular securities or significant cash positions, or to support pump and dump, shadowing or other illicit activity. The inherent value of the data would make CARDS a target for fraud and a single breach could cause enormous harm to retail investors, member firms, and the markets.

Critical issues associated with the risk of privacy breach and fraud have not been addressed adequately in the CARDS proposal. The Regulatory Notice reflects FINRA's recognition of the value and sensitivity of the CARDS information and indicates that it will incorporate "current and effective information security efforts to protect this information." This approach is not sufficient. We believe the breadth, scope and sensitivity of the CARDS information will require the development of a new program of controls with SEC or other independent oversight designed to detect and prevent unauthorized use. If CARDS is implemented, investors should have the right to opt-out of the program to protect their privacy. FINRA should indemnify member firms for all costs and liability associated with privacy breach or fraud resulting from misappropriation of CARDS data, without charge back to the membership. Provisions for individual accountability and liability of FINRA employees involved in a misappropriation of CARDS data should be established. Even with such a program of controls, the risk of breach associated with the development of the database would remain, and outweigh the purported benefits of CARDS.

Scope of Access to and Use of CARDS Data

There are significant open issues associated with the access to and use of CARDS by areas within FINRA, other SROs, governmental agencies and private third parties.

It is not clear if FINRA intends to restrict access and use of CARDS to employees supporting the examination program. Given the sensitivity of the data, broader access to CARDS within FINRA raises additional questions and concerns. Does FINRA contemplate use of the data in FINRA enforcement

investigations or cases, in support of rulemaking or the issuance of Regulatory Notices, to drive investor bulletins or communications, or in support of any other aspect of FINRA's activities? If so, will member firms be notified when, why and how their submitted CARDS data are accessed and used? What assurances can FINRA provide that it will not seek to sell or market CARDS data elements? How will limitations on use of CARDS data within FINRA be controlled and enforced? All potential uses within FINRA need to be identified, considered and addressed. We believe it is critical to have full transparency regarding the possible scope of use of CARDS and a full vetting of issues associated with all aspects of such use.

FINRA also needs to address the issue of providing access to CARDS data to other SROs, the SEC, other state and federal agencies and private third parties. The potential access to and use of CARDS data by third parties expand and raise new concerns regarding privacy, data protection, use and misuse that need to be addressed. For example, other securities regulators may wish to incorporate CARDS in their regulatory examination and enforcement programs – the details, risks and controls associated with such use require transparency and analysis. Individual investors and member firms may have significant and differing concerns if CARDS information is made available to and used by federal agencies such as the I.R.S., Department of Justice or the N.S.A. The possibility of government and third-party use of CARDS and FINRA's authority to deny or limit requests by other agencies for access needs to be vetted fully. In all instances of third-party access to CARDS, procedural protections, including notice and an opportunity to challenge any such production, should be addressed.

CARDS Use in the FINRA Examination Program

The Regulatory Notice states that FINRA would use CARDS information “to run analytics that identify potential red flags for sales practice misconduct (e.g. churning, pump and dump schemes, markups, mutual fund switching), as well as help FINRA identify potential business conduct problems with member firms, branches and registered representatives.” Through CARDS, FINRA believes it will more effectively be able to identify sales practice misconduct, to compare conduct between firms, and to understand industry-wide trends. FINRA asserts that CARDS would increase efficiencies and effectiveness of its examination processes, and “would be expected to reduce present regulatory costs and burdens on firms by reducing the need for manual, partial, overlapping and one-time regulatory report generation for the information required to be reported to CARDS.”

In our view, the scope of CARDS as outlined in the Regulatory Notice is overly broad and disproportionate to FINRA's stated needs. Schwab believes CARDS will increase regulatory costs on member firms, and will not achieve the stated increases in efficiencies and effectiveness of FINRA's examination program.

We are not convinced that a comprehensive overview of sales practice and business practice misconduct derived from data analysis of CARDS is an achievable objective. Sales practice and business conduct (or misconduct) take place within each firm and are unique to each firm's business model. Firm policies and procedures, reasonably designed and tailored to each firm's business, vary across broker-dealers with different models, and provide critical context required to identify particular account activity as problematic. The differences in business models and policy and procedural controls render a comparison of CARDS data across firms to identify misconduct inherently ineffective, or at worst, misleading. As such, Schwab believes that FINRA will not likely be able to use the data within CARDS to make meaningful comparisons among firms or to identify trends of sales practice misconduct.

Because of inherent limits of the data, interpretation of results and identification of specific red flags would be highly susceptible to mistakes and false-positives. Although the CARDS data set is strikingly broad, certain critical information regarding customers (e.g. customer contact notes reflecting client feedback, preferences and conversations, information concerning related brokerage accounts, and banking, insurance or investments held outside the broker-dealer) will not be in the system. Without this information, FINRA examiners will in many instances interpret the data incorrectly, generating inquiries based on false-positives, and creating an inefficient use of both FINRA regulatory resources and the compliance, supervisory and business resources required to research, respond to and convince FINRA examiners that the red flag was not an indication of a violation.

Much of the data that would be collected in CARDS would be irrelevant to a sales practice analysis. For many firms, a majority of their customer account information will pertain to self-directed investors or clients of independent registered investment advisors who do not receive investment advice and guidance from the member firm. The overwhelming majority of account activity information, including cashiering transactions, will not involve transactions related to investment recommendations made by registered representatives of the firm.

The analytical program described in the Regulatory Notice suggests that CARDS would require development of a new FINRA surveillance program with a scope far beyond that of its current examination program. Significant costs associated with the development and implementation of the FINRA program would be borne by member firms. Additional investment in compliance and supervisory programs would be required to manage new inquiries resulting from CARDS seeking information and explanation for perceived red flags. Firm compliance, supervisory and business resources would need to be funded to research and respond to the anticipated increased flow of regulatory requests. These costs far outweigh any reduction in regulatory burdens associated with reduced exam production requests related to the availability of CARDS data and run the risk of diverting resources away from more effective investor protections efforts.

Impact of CARDS on Self-Regulation

Although FINRA asserts that CARDS “would not supplant the legal, compliance and supervisory programs firms administer,” we believe that the implementation of CARDS would have a transformative effect upon self-regulation and the respective roles of FINRA and firm compliance and supervisory programs.

With the establishment of a central database of all U.S. broker-dealer customer account and account activity, it is inevitable that FINRA will be deemed responsible for front line monitoring of CARDS for money laundering, sales practice violations, manipulation and fraud. As FINRA implements data analytics program to identify and surveil for these issues, FINRA’s perceived ability to identify possible violations of regulation indicated by the data will trigger accountability for detecting and preventing such violations. Such accountability would be highlighted by the public, Congress and the SEC when a major regulatory violation occurs. A failure to identify or promptly act upon an indication of violative activity that could have been detected in CARDS will be deemed a failure of regulation. FINRA will be held directly responsible for violative conduct that in hindsight could have been detected and prevented through analysis of CARDS.

This dynamic has the potential to force a transformation of FINRA oversight from examination of the systems of supervision and control of member firms to day-to-day supervision of registered representative and customer activity. If FINRA has the data, FINRA has a duty to monitor the database for indications of violations. Such activity would be duplicative of firm compliance and supervision efforts, and if not supplanting internal control efforts, would create significant redundancies with member firm compliance and supervision programs. That result would be both highly inefficient and ineffective. Day-to-day supervision and compliance efforts are appropriately the responsibility of member firm personnel who are accountable for designing and implementing controls that are tailored to the unique business model of each firm. Internal compliance and supervisory personnel have access to information, including relevant policies and procedures, and understanding of internal systems, business activities and personnel to identify and act upon red flags far more effectively than FINRA examiners data mining CARDS. FINRA does not have the level of access to and understanding of each firm’s business practices, systems, policies, procedures and personnel to support an expansion of its role to conduct day-to-day supervision of business and customer activity efficiently or effectively.

Schwab is also concerned that FINRA’s collection of so much client data unrelated to sales activity or member firm misconduct will lead to investigations into customer activities where there is no nexus, other than the placement of a transaction, to the member firm, its registrants or associated persons. Because FINRA is limited in its ability to take direct action against individual investors, data mining of customer activity may lead to more referrals to government agencies (e.g. the SEC, Department of Justice, State

Attorneys General), and even development of programmatic surveillance of customers on behalf of those agencies. Such a development would represent a significant expansion of FINRA's role in the regulation of the financial services marketplace raising significant jurisdictional, public policy, and legal questions that must be fully considered and addressed with the SEC, member firms and legislative and other public policy forums representing the interests of individual investors.

Alternative Solutions to CARDS

Schwab supports FINRA's goal to conduct more effective, targeted and less costly exams. However, FINRA's need to oversee compliant sales practices is unlike its role in cross-market trading surveillance and calls for a lower-cost technology solution which is more closely aligned to its examination program. We believe the data requests that are made at the outset of the regular examination cycle are sufficient for FINRA to achieve its stated goals.

For a potential alternative approach to CARDS, FINRA need look no further than its own Automated Exam Program ("AEP") currently in use within its financial and operational examination programs. Using AEP, FINRA could receive large and representative samples of standardized information against which it could run its sales practice data analyses. Security risks are mitigated relative to CARDS, in that there are many fewer data transfers between FINRA and the firms. Sales practice examiners could use the output to guide a more targeted and effective on-site review. Also, firms would be able to respond to FINRA questions about the data more efficiently within the examination context rather than on an ad-hoc basis, which requires a more formal written response. Inevitably, even the most well designed data analysis will produce a certain rate of false-positives which can be resolved readily during an on-site exam.

The Regulatory Notice states that "FINRA does not have a data-based method of assessing business conduct patterns and trends across the industry." In fact, FINRA already collects extensive information about a firm's business conduct and compiles detailed information about complaints, arbitrations, settlements, and regulatory orders against firms. Complaint data is trended industry-wide on a quarterly basis and can be leveraged for additional analysis.

Enhancement of AEP could be implemented much more quickly and cheaply than CARDS and maintained at a small fraction of the cost with far fewer risks. Schwab has customized its brokerage platform over many years in response to our clients' needs. We believe other clearing firms have done the same. Unlike order and trade data which is largely already standardized by virtue of industry protocol (i.e. FIX), we believe the data types specified in the Regulatory Notice will require extensive translation and standardization before they can be of any use and regularly transmitted to CARDS according to FINRA specifications. On a daily basis, large firms post millions of transactions in hundreds of unique categories to customer accounts. Under CARDS, clearing firms will be required to translate those custom transaction types into the schema specified by FINRA and keep duplicate records of each reportable transaction. A similar process will be required for account types, investment profiles, balances, and certain security identification information. Each time any change is made to the myriad up-stream systems feeding data to CARDS additional regression testing will be required to ensure that the accuracy of daily CARDS reporting is not negatively impacted. The cumulative burden of duplicate translation processing, storage, and ongoing testing and reconciliation will be substantial.

Schwab thanks FINRA for consideration of the points raised in this letter and welcomes any further discussions or questions. Please feel free to contact the undersigned to discuss them in more detail.

Very truly yours,

A handwritten signature in black ink, consisting of a large, stylized 'S' followed by a cursive 'C' and a long horizontal flourish.

Scott Cook
Senior Vice President Compliance and CCO
Charles Schwab & Co., Inc.