



July 1, 2014

By 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, FINRA Concept Proposal to Develop the Comprehensive Automated Risk Data System (“CARDS”) – SIFMA’s Supplemental Comments on FINRA’s Proposal**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to provide further comments on the concept proposal by the Financial Industry Regulatory Authority (“FINRA”) to develop the CARDS concept. SIFMA previously filed a comment letter on the concept proposal that discusses a range of significant concerns that SIFMA has with the CARDS concept.²

SIFMA appreciates that FINRA already has modified its proposal by (1) removing personally identifiable information (“PII”) from the CARDS concept proposal; (2) not requiring linking of accounts within CARDS (at least initially); (3) promising to implement CARDS in phases; (4) not requiring the reporting of certain held away assets (at least initially); (5) permitting firms with flexibility on how to report CARDS information to FINRA (*e.g.*, directly, through a clearing firm, or through a service bureau); and (6) permitting the non-standardized reporting of suitability type information.³

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, please visit www.sifma.org.

² Comment Letter from Ira D. Hammerman, Exec. Vice President and Gen. Counsel, SIFMA, to Marcia E. Asquith, Office of the Corporate Secretary, FINRA (Mar. 21, 2014) [available at <http://www.sifma.org/issues/item.aspx?id=8589948105>] (last visited June 27, 2014).

³ See Rick Ketchum Speech at 2014 FINRA Annual Conference (May 19, 2014) [available at <http://www.finra.org/Newsroom/Speeches/Ketchum/P506341>] (last visited June 18, 2104).

While SIFMA commends FINRA for these positive developments, this supplemental comment letter is intended to focus on remaining issues that SIFMA encourages FINRA to publicly address as it continues to consider the CARDS concept.

I. FINRA HAS NOT PUBLICLY SHARED ITS COST-BENEFIT ANALYSIS

FINRA should perform and publicly share⁴ a cost-benefit analysis of CARDS because the proposal will impose significant costs for member firms and ultimately investors. SIFMA believes that FINRA should (i) explain why it needs (as opposed to wants) CARDS, (ii) justify that the costs and burdens associated with CARDS are necessary and (iii) demonstrate that there are no other reasonable alternatives given existing FINRA, SEC and other self-regulatory organization (“SRO”) systems that meet FINRA’s regulatory needs.

In SIFMA’s experience, small to mid-size firms in particular will bear heavy costs associated with FINRA’s imposing additional required technological and personnel resources. Before pursuing such an endeavor, FINRA should perform a cost-benefit analysis consistent with that required of new rules. A few short months prior to the issuance of Regulatory Notice 13-42, FINRA committed to engaging in a consultative process and enhancing its economic impact assessments of rules with the adoption of the *Framework Regarding FINRA’s Approach to Economic Impact Assessment for Proposed Rulemaking*.⁵ At the time, FINRA’s Chief Economist noted that the framework increases transparency and ensures that “[FINRA] more formally, rigorously, and consistently develop[s] rules that are effective and efficient.”⁶

⁴ Public Statement, FINRA, *Framework Regarding FINRA’s Approach to Economic Impact Assessment for Proposed Rulemaking* (Sept. 2013) (stating that FINRA’s economic analysis framework “is intended to better inform policy making, increase stakeholder participation in the rule development process and increase transparency into FINRA’s rulemaking”, “FINRA believes that clarity with regard to the potential economic impact of proposed rulemaking increases both transparency and accountability”, and “FINRA rulemaking proposals should discuss the elements outlined [in FINRA’s economic analysis framework] in sufficient detail to provide the public the rationale and evidence in support of the proposed rule”) [available at <http://www.finra.org/web/groups/industry/documents/industry/p346389.pdf>] (last visited June 25, 2014).

⁵ *Id.* (stating economic analysis provides “a formal way of organizing the evidence on the key effects, good and bad, of the various alternatives that should be considered in developing regulations.” (citing Office of Management and Budget, *Circular A-4* (Sept. 2003)). Compare with SEC RSFI and OGC Guidance on Economic Analysis in SEC Rulemakings (March 16, 2012) [available at http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf] (last visited June 25, 2014).

⁶ News Release, FINRA, *FINRA Issues Public Statement, Framework Regarding FINRA’s Approach to Economic Impact Assessment for Proposed Rulemaking* (Sept. 19, 2013) [available at <http://www.finra.org/Newsroom/NewsReleases/2013/P346388>] (last visited June 25, 2014).

SIFMA encourages FINRA to publicly share its cost-benefit analysis, including the analysis and answers to the following issues:

- Identifying the problem, issue or practice that necessitates regulatory action;
- The baseline against which to measure the likely economic consequences of the proposed regulatory action;
- The reasonable alternative options available; and
- The anticipated economic impacts associated with the options, including the costs and benefits and distributional impacts, in particular as to efficiency, competition and capital formation.⁷

Prior to proceeding with the CARDS proposal, FINRA should perform the requisite cost-benefit analysis and such process and resulting cost-benefit analysis should be open for public comment. FINRA's guidelines for its approach to economic impact analysis of proposed rules provides that FINRA's "rulemaking will clearly present [FINRA's] analysis, including assumptions and risks, as to why the proposal is necessary and how it best achieves its stated goal(s). This analysis, in turn, will be valuable to the public and other stakeholders as they assess and comment on the rule proposal."⁸

II. DUPLICATIVE & SUPERFLUOUS REPORTING

Before FINRA proceeds with its proposal for a new, significant and potentially costly reporting regime, FINRA should perform an extensive and detailed review and analysis of all currently required reporting to FINRA, other SROs and the SEC to determine whether and how much of the information believed necessary to meet the intended purposes of CARDS is already being collected through one or more existing reporting systems. The parameters of the review and its results should be described in the next Regulatory Notice. FINRA also should include in the next Regulatory Notice a description of where CARDS will and will not overlap with existing information collection systems and an explanation of why existing systems cannot be used to meet FINRA's regulatory needs.

While FINRA has committed that CARDS would eventually replace the use of existing data systems and feeds, such as INSITE, and that it would conduct a thorough analysis to avoid duplicative reporting, to ensure that FINRA's data collection needs are met in a manner that maximizes efficiency and minimizes costs, this assessment should be

⁷ *Supra* note 4 at p. 6.

⁸ *Supra* note 4 at p. 2.

done *prior* to the design or implementation of CARDS. This analysis should be comprehensive, identifying opportunities to eliminate duplicative or out-dated reporting which may occur through INSITE, TRACE, OATS, RTRS, Large Option Position Reporting, Blue Sheet Reporting, CAT and other existing facilities.

Redundant systems should be identified and a plan of action, including timelines, for retiring redundant or out-dated systems should be created before FINRA files a CARDS proposal with the SEC. FINRA should retire redundant or out-dated systems in a timely manner either concurrent with or prior to the roll-out of the CARDS concept.

III. INFORMATION COLLECTED THROUGH CARDS

FINRA's concept proposal indicates that FINRA plans to collect client level data through CARDS.⁹ Many of the examples that FINRA officials use to explain the need for CARDS, however, center on firm level risk.¹⁰ SIFMA believes that FINRA should clarify why it needs client level data instead of firm level data. SIFMA believes that if FINRA proceeds with the CARDS proposal, FINRA should limit the data collected through CARDS to firm level data.

IV. CONCERNS REGARDING PRIVACY & RE-IDENTIFICATION OF PII

On March 4, 2014, FINRA announced that the CARDS proposal would not require the submission of information that would identify to FINRA the individual account owner, particularly, account name, account address or tax identification number. This announcement was made prior to the expiration of the comment period in response to comments and discussions with industry participants. FINRA's determination to forego such sensitive information in connection with the submission of information was a positive development and potentially mitigates certain risks, but it does not fully address the significant privacy and cyber-security concerns.

A. Privacy

The U.S. Supreme Court recently held that individual rights sometimes outweigh the convenience of government. SIFMA believes FINRA must be viewed as a government actor in this context. In *Riley v. California*, the U.S. Supreme Court extended federal constitutional privacy protections to the vast amounts of data that individuals store on hand-held devices. The justices rejected law-enforcement arguments that warrantless

⁹ See FINRA Regulatory Notice 13-42.

¹⁰ See Rick Ketchum Speech at 2014 FINRA Annual Conference (May 19, 2014) (pointing to Puerto Rican bond sales as an example for needing a CARDS system) [available at <http://www.finra.org/Newsroom/Speeches/Ketchum/P506341>] (last visited June 18, 2104).

searches of cell phones were constitutional and crucial to combating crime. Chief Justice Roberts said the court is aware of the trade-offs between privacy and security: “We cannot deny that our decision today will have an impact on the ability of law enforcement to combat crime. Cell phones have become important tools in facilitating coordination and communication among members of criminal enterprises, and can provide valuable incriminating information about dangerous criminals. Privacy comes at a cost.”¹¹

A similar analysis should be considered when a quasi-governmental organization, such as FINRA,¹² collects, stores, and searches vast amounts of investor information. Regulatory convenience should not outweigh investor privacy rights. As the Supreme Court stated: “Privacy comes at a cost.”¹³

B. Re-Identification Risk

SIFMA believes that there remain material re-identification concerns raised by CARDS.¹⁴ The ability, for example, to re-identify individual investors through the use of algorithms and/or linking of the CARDS database to other databases (such as the proposed Consolidated Audit Trail) raises significant privacy concerns even if CARDS does not directly collect or store PII. Indeed, the linkage of personal information and the potential for collateral, downstream intrusions are legitimate threats.¹⁵ This concern is exacerbated if FINRA makes CARDS data available to third-parties such as the SEC, other U.S. government agencies such as the U.S. Treasury, non-U.S. government agencies, and other

¹¹ *Riley v. California*, U.S. Supreme Court Slip Opinion 13-132, p. 25 (June 25, 2014) [available at http://www.supremecourt.gov/opinions/13pdf/13-132_819c.pdf] (last visited June 26, 2014).

¹² See generally FINRA 2013 Year in Review and Annual Financial Report p. 8 (stating “[wh]ile FINRA is not part of the government, we are authorized by Congress to take action to ensure that investors are protected. We do the front-line work for the SEC under that agency’s oversight”).

¹³ *Riley*, *supra* note 11 at 25.

¹⁴ See, e.g., Paul Ohm, *Broken Promises of Privacy: Responding to the Surprising Failure of Anonymization*, 57 UCLA L. Rev. 1701 (2010); Arvind Narayanan & Vitaly Shmatikov, *Robust De-anonymization of Large Sparse Datasets*, 2008 Proc. of IEEE Symp. on Security & Privacy 111; Latanya Sweeney, *Simple Demographics Often Identify People Uniquely 2* (Carnegie Mellon Univ., Data Privacy Working Paper No. 3, 2000).

¹⁵ See, e.g., *eBay Hack ‘One of the Biggest Data Breaches in History,’ The Week* [available at <http://www.theweek.co.uk/technology/58624/ebay-hack-one-of-the-biggest-data-breaches-in-history>] (last visited May 22, 2014) (noting hackers have a list of personal information that could be used to steal identities or to access other systems).

parties (and these third-parties share CARDS information with other persons – such as the Office of Financial Research, NSA, or IRS).¹⁶

Even under FINRA’s modified approach, FINRA will remain a repository of vast amounts of sensitive data for which it has not and cannot guarantee absolute safeguarding. As discussed in SIFMA’s initial Comment Letter, FINRA needs to address which parties will be liable in the event of a breach and whether FINRA will indemnify firms if a breach occurs at FINRA.

V. CONCERNS REGARDING CIVIL LIBERTIES

SIFMA believes CARDS raises significant civil liberties and related concerns. Regardless if CARDS will directly collect or store PII, CARDS will be an NSA-like system for the mass surveillance of customer accounts. One FINRA official has orally described CARDS as a bird’s eye, satellite view of financial activities/accounts that will complement the activities of the FINRA boots on the ground. CARDS will enable FINRA to look over every investor’s shoulder through an extensive data collection, manipulation and storage system. This raises questions, in our view, about where to draw the line between the legitimate exercise of regulatory functions from the inappropriate intrusion on personal privacy/civil liberties. A report recently issued by the President’s Council of Advisors on Science and Technology raised similar questions and concerns.¹⁷ SIFMA believes that until this issue is more fully vetted through public dialogue, including a broader US government initiative on the appropriate use of big data, FINRA should not move forward with CARDS.¹⁸

¹⁶ See, e.g., Section 112 of the Dodd-Frank Act (granting the FSOC broad access to information held by member agencies) and Section 152 of the Dodd-Frank Act (granting OFR broader authority to acquire financial information). FINRA also states that it routinely will provide information to third-parties in various situations. See, e.g., Regulatory Notice 09-17 (stating that “[i]nformation acquired during an investigation may be disclosed in connection with an investigation or disciplinary proceeding, in response to requests from the [SEC] or other governmental agencies and pursuant to a lawfully issued subpoena and/or information-sharing agreements entered into between FINRA and other regulators”) and FINRA 2013 Year in Review and Annual Financial Report p. 8 (stating “[w]hen we share information with other regulators, it leads to important actions . . .”).

¹⁷ See Report to the President, Big Data and Privacy: A Technological Perspective (May 2014) [available at http://www.whitehouse.gov/sites/default/files/microsites/ostp/PCAST/pcast_big_data_and_privacy_-_may_2014.pdf] (last visited June 18, 2014).

¹⁸ In his concurring opinion in *Riley v. California*, Justice Alito stated that the *Riley* ruling may not be the final word on privacy protections in the context of modern technological advances. Justice Alito stated:

While I agree with the holding of the Court, I would reconsider the question presented here if either Congress or state legislatures, after assessing the legitimate needs of law enforcement and the privacy interests of cell phone

VI. FINRA SHOULD ISSUE ANOTHER REGULATORY NOTICE PRIOR TO FILING ANY CARDS PROPOSAL WITH THE SEC

Regulatory Notice 13-42 solicited comments on a *concept proposal* to develop CARDS. SIFMA commends FINRA for approaching the CARDS proposal through the initial issuance of a concept proposal rather than rushing head first into a full Regulatory Notice or formal rule filing with the SEC. Given the significant issues raised by the CARDS proposal, SIFMA believes that if FINRA, after reviewing the comments, is still determined to proceed further with CARDS, FINRA should follow a thorough and formal vetting process that permits all interested parties sufficient time to consider and comment on a formal CARDS proposal.¹⁹ At a minimum, SIFMA believes that, after considering the comments received on Regulatory Notice 13-42, FINRA should issue another Regulatory Notice soliciting comments on a more detailed and fully developed CARDS proposal. The Regulatory Notice must provide all interested parties with sufficient time to review and comment on a more fully developed CARDS proposal. SIFMA believes that FINRA must provide at least a 60-day comment period in the event of a next Regulatory Notice on CARDS.

VII. CARDS MUST BE FILED WITH THE SEC UNDER SECTION 19 OF THE EXCHANGE ACT

After issuing another Regulatory Notice and providing a sufficient comment period to permit interested parties enough time to review and consider a more fully developed CARDS proposal, FINRA must file the CARDS proposal with the SEC under

owners, enact legislation that draws reasonable distinctions based on categories of information or perhaps other variables.

[It] would be very unfortunate if privacy protection in the 21st century were left primarily to the federal courts using the blunt instrument of the Fourth Amendment. Legislatures, elected by the people, are in a better position than we are to assess and respond to the changes that have already occurred and those that almost certainly will take place in the future.

Riley, *supra* note 11 at pp. 37-38.

¹⁹ SIFMA appreciates that FINRA reached out early in the process to solicit feedback from certain member firms through individual meetings, pilot programs, sounding boards, and advisory committees. SIFMA, however, believes that any informal process for soliciting member firm feedback is not a substitute for a formal notice and comment process that provides all interested parties, including members of the general public, the opportunity to review and comment at the same time to a fully developed CARDS proposal. Even if FINRA informally approaches select member firms based on differing business models or other indicia that are meant to represent a diverse sample of firms, this approach is not a substitute for permitting each member firm and the general public with the opportunity to individually review and comment on the CARDS proposal at the same time within the same comment period.

Section 19(b)(4) of the Securities Exchange Act of 1934 (the “Exchange Act”)²⁰ since CARDS raises significant issues, including important privacy and cost-benefit issues. CARDS should not be filed as a Section 19(b)(3) “effective upon filing” proposal because CARDS is not a “stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing [FINRA] rule.”²¹

As you are aware, Section 19 of the Exchange Act requires the SEC to act on SRO rule filings within very narrow timeframes. These Exchange Act mandated timeframes generally result in the SEC providing a relatively short 21-day comment period on SRO rule filings. Given that CARDS was proposed as a concept proposal and raises significant issues, SIFMA believes that FINRA should include in its initial 19b-4 filing with the SEC a grant of additional time for the SEC to review the CARDS proposal. In addition, FINRA should indicate in its 19b-4 filing that FINRA believes the SEC should consider providing at least a 60-day comment period for the proposal. The significant and complex issues raised by the CARDS concept, including potential significant cost implications, require more than a 21-day comment period so that interested parties can fully consider and comment on the proposal. This additional time is necessary even if FINRA issues another Regulatory Notice because CARDS raises issues, such as privacy, that implicate the general public, which typically is not attuned to, or even aware of, FINRA Regulatory Notices.

VIII. PHASED IMPLEMENTATION OF CARDS

FINRA has indicated that CARDS will be implemented in phases. SIFMA appreciates FINRA’s consideration of a phased implementation, but SIFMA has concerns that FINRA has not fully described what a phased implementation will entail. To properly comment on CARDS as a system, the industry needs to know, for example, the number of phases, the particular requirements implemented at each phase, and whether currently removed requirements, such as the collection of PII or the linking of accounts, will be reinstated in a later phase. This information should be shared up front with interested parties so that they can fully consider the implications of CARDS, including any cost-benefit and privacy related implications.

SIFMA also believes that FINRA should commit to a full Regulatory Notice and 19b-4 filing process for any future phases, changes or additions to the CARDS concept and

²⁰ See Securities Exchange Act of 1934 §19(b), 15 U.S.C. §78s(b)(1) (providing that “no proposed rule change shall take effect unless approved by the Commission” or an exception applies). See generally 17 C.F.R. § 240.19b-4 (2014) and SEC Form 19b-4.

²¹ Exchange Act §19(b)(3)(A), 15 U.S.C. §78s(b)(3)(A).

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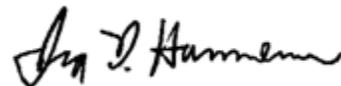
any books and records requirements that firms will be required to retain pursuant to CARDS.

IX. CONCLUSION

SIFMA appreciates FINRA's efforts in issuing its request for comment and meeting regularly with SIFMA regarding the concept proposal. We look forward to a continuing dialogue and working together to an appropriate resolution.

If you have any questions or require further information, please contact the undersigned at (202) 962-7373 or Kevin Zambrowicz, Associate General Counsel & Managing Director, SIFMA, at (202) 962-7386 (kzambrowicz@sifma.org).

Very truly yours,



Ira D. Hammerman
Executive Vice President and
General Counsel

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