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

Dear Ms. Asquith:

Thank you for the opportunity to comment on Regulatory Notice 2013-42, the CARDS proposal. Wulff, Hansen & Co. is a registered broker/dealer and FINRA member. The writer currently serves on FINRA's Small Firm Advisory Board but the views and comments expressed herein are those of the firm and do not necessarily reflect those of the SFAB.

Timeliness:

In recent years FINRA has made material changes to its examination and surveillance programs. Moving from the old check-the-box approach to the new risk-based exam focus is expected to make FINRA's oversight much more effective in the future. FINRA has repeatedly stated as much in many different forums. Why, then, is a proposal as costly, complex, and disruptive as CARDS being undertaken before the significantly improved exam program has even been given a chance to prove itself? Many resources went into developing that program, and if it works as well as hoped – and as advertised - the perceived need for CARDS could be greatly reduced. Further, to the extent that CARDS could replace much of the onsite examinations, there would be an intangible cost to both FINRA and to firms. The best way to understand a firm is to learn about its culture. FINRA knows that a 'culture of compliance' is a positive indicator, and it obtains that information through the onsite exams. Culture, suitability, and 'knowing your customer' are intangibles not amenable to precise measurement, and CARDS is an attempt to reduce those intangibles to numbers and statistics.

We believe that this proposal is not timely, and should be withheld until the new exam program is given time to prove themselves. Should the risk-based exam program fail to meet expectations, CARDS could then be reconsidered as an option.

Limitations:

As we understand it, the CARDS program fails to capture any business done away from the clearing firms and the traded securities markets. It appears that the system would be incapable of capturing much, if any, application-way and similar business. This fact has two implications: First, many of the products generating the greatest suitability concerns are sold in exactly this manner and thus would be outside the purview of CARDS. Second, to the extent that the surveillance program is effective, persons wishing to engage in abusive behavior will simply transfer their activities to business lines having lower visibility.

Privacy and Data Security:

The Request for Comment gave rise to a great outcry from persons concerned with privacy and data security. To its credit, FINRA responded by modifying the request before the comment period ended, and has stated that CARDS "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."

We strongly concur with the many previous comments on privacy and data security and will not belabor those subjects here. Collecting and storing personally identifiable information as originally proposed is highly risky and problematic for the multitude of reasons well explained in the comments. However, in the absence of that information we are concerned that the system would generate a great number of 'false positives' because the activities of the many customers possessing multiple accounts at specialized firms will be analyzed in isolation with misleading results.

For example, we are primarily a municipal bond firm. Our customer accounts are thus quite naturally heavily concentrated in municipal bonds. That is why people choose to be our customers: We provide them with value in that segment of the market. Most of them have accounts elsewhere in order to diversify their investments by dealing with specialists in other asset classes. An investor may buy highly speculative stock at one firm while holding very conservative investments at another. Seen in isolation, a great deal of activity which is in fact reasonable would likely trigger inquiries which would burden both FINRA and the firms involved.

Without the personally identifiable information that FINRA has agreed to forgo, much of the point of CARDS is lost. While each investor could be assigned a code to identify him across firms, that would bring back many of the privacy and data protection concerns in that an intrusion at any one of the firms would expose that code or that the investor's full record could be obtained by legal process or otherwise.

Another basis for concern about 'false positives' arises from industry experience with existing compliance and oversight programs. Firms using some of these automated systems can be inundated with unavoidable 'red flags' of which only a tiny fraction actually indicate a problem. We have experienced this ourselves with a clearing firm's systems. To the extent that CARDS suffers from the same problem as its private-sector peers, both FINRA and firms will be expending resources to no purpose in responding to such 'false positives'. In addition, as another commenter points out, firms and individuals may modify their behavior and fail to do what they believe is best for a client in order to avoid the burden of responding to a system-generated inquiry.

Practicality:

FINRA appears to believe that most, but not all, data that CARDS would collect is already stored in an automated format at clearing firms. We think this belief is mistaken. In our own case and that of many small firms with whom we've discussed the matter, only a portion of the relevant data is at the clearing firm. In many cases the clearing firm's records hold merely a partial and skeletal outline of the account's suitability information; the detailed information and the full profile required to 'Know the Customer' is held only at the introducing firm, and not in a particularly automated way employing uniform data structures. This is true for two reasons: The cost and burden of moving it to the clearing firm's systems would be prohibitive even if the systems could handle it and the fact that those systems are limited, inflexible, and in many ways incapable of accepting and maintaining the data in a manner and form that is useful to the introducing firm.

FINRA specifically acknowledges this fact in the Request, where it states: "Currently, FINRA information requests often require firms to produce information they maintain in multiple systems…". This is true because firms have no alternatives which are both viable and not cost-prohibitive. Forcing clearing firms to overhaul their data structures and then forcing introducing firms to extract and transfer masses of data held in various forms in various systems (or on paper) would be unlikely to meet either of these standards.

Our comments on the limitations of clearing firm data are based on our own knowledge and experience. During 2013 we converted from being a self-clearing firm to being an introducing firm with one of the industry's largest clearing organizations. We learned at firsthand how rigid and limited a clearing firm's data files and formats can be, and how little of our suitability information they can actually hold. Consequently, much of our customer profile information is maintained manually, often on paper.

The Request for Comment does not specify whether, in FINRA's 'proof of concept', the participating clearing firms were transmitting to CARDS the meaning and content of the suitability information or simply the codes appearing in their data files mapped to a set of default meanings. Some of our comments below are based on the assumption that they were not 'personalizing' the information by firm.

For example, a clearing firm's system may employ a single-byte numeric code to represent a 'net worth' field. This limits the number of brackets to ten (0-9). A firm may have, and need, fifteen – as indeed we do here. Further, two different introducing firms may use the same code to represent radically different brackets due to the difference in their business models. We know for a fact that in many firms the highest net worth bracket is 'over $1 million'. In others it may be 'over $5 million' or even 'over $50 million'. The very diversity that makes our industry strong means that one-size-fits-all data structures simply don't work very well. If the single byte in that field is a '3', that '3' signifies one thing at Firm A and something very different at Firm B. To successfully transmit accurate data to CARDS would thus require the clearing firm to translate each field in each record on-the-fly and deliver to CARDS the meaning applicable to the particular introducing firm.

One firm's business model may require that it record clients' income information with as many as three or four brackets below $100,000 per year. Another firm serving wealthier clients may have its very first breakpoint at $100,000. A given code in that 'income' bracket field will mean ' less than $25,000' at the first firm but 'less than $100,000' at the second.

Another pitfall is the fact that many clearing firm systems, including the largest, allow only one investment objective per account. Many, perhaps most, clients have more than one objective, and an introducing firm using such a limited system must therefore maintain its own information on investment objective because the clearing firm has no ability to accept and hold it. We could go on and on with other examples of how and why clearing firm data is not comparable across introducing firms, and how firms needing more granularity than a clearing agent's system provides must maintain the data themselves in whatever form is available and cost-effective.

Costs:

We find FINRA's lack of any serious cost-benefit analysis distressing, but realize that perhaps data produced in response to the Request will be used to create projections that can be shared with the industry and public and support a reasonable decision about whether the proposal makes economic sense. There is no doubt the costs will be high. The economic value of the benefits appears less clear, especially with the proposal gutted of client-identifiable information. In our review of the filed comments we were amused, if unsurprised, to note that some of the most supportive and enthusiastic comments came from those who make their living providing IT services to the industry.

We have noted above the fact that suitability information is maintained by firms in multiple ways and stored in various places, in many cases still on paper, and have attempted to explain why this is the case. We cannot imagine what it would cost the clearing firms and service bureaus to create structures that could properly handle the diversity of customer data that exists due to the many and varying business models and customer types that introducing firms present. One-size-fits-all simply doesn't work in this context.

If we are mistaken and such data structures could be created, firms would have to develop a method and system for loading their existing data into it. Whether in that context or one where small firms are left to create their own new CARDS-compatible system, transfer their firm-held data into it, and report regularly to CARDS as a supplement to what the clearing firm sends, the process would be extremely costly and overly burdensome. In our case, transferring data on a one-time basis to a clearing firm equipped to handle and retain it would likely require one additional employee for several months and programming costs of perhaps $10,000, plus the significant increase in clearing firm charges as they recovered their development costs. If we were left to create our own system and do the ongoing supplemental upload to CARDS ourselves, we estimate the same additional employee need and also one-time programming costs of $25,000 to $50,000 plus an ongoing charge of a few thousand dollars per year for transmission. The estimate for programming costs could be too low, based on what we have paid for certain work in the past. If indeed a 12-to-18 month revision cycle is required on our part of the data provision, it would likely add several thousand dollars per year to our costs.

If implementing CARDS required industrywide one-size-fits-all standardization of customer suitability information, we would be forced to repaper all of our customer accounts. The time and effort required – not to mention the resulting customer annoyance – would be extremely burdensome and would cost in the tens of thousands.

Whether clearing firms spend the millions needed to build new systems with the flexibility required to address the limitations discussed above, or simply patch up their existing ones piecemeal to meet the CARDS requirements and leave the introducing firms to provide the rest of the data directly, their development and operating costs will ultimately be passed on to the small introducing firms whose data they hold. Some of those costs will be passed on to customers, and on a nationwide level we question whether CARDS will result in benefits sufficient to justify the costs of developing and operating the system. Costs not recovered from customers will be absorbed by the introducing firms, and will likely be sufficient to eliminate some of them from the industry.

Our current system isn't broken. America enjoys the safest and most transparent investment markets in the world, and the newly overhauled examination program is intended to make them even safer. The economic benefit of the CARDS endeavor, if any, would be only the difference between customer losses avoided by CARDS and the customer losses successfully prevented by the existing regulatory regime. To make an intelligent decision, we all need to know exactly why FINRA thinks the benefits will exceed the costs and its quantitative basis for that conclusion.

Respectfully submitted,

Chris Charles
President