

March 21, 2014

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)

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”) concept proposal for a Comprehensive Automated Risk Data System (CARDS), as outlined in Regulatory Notice 13-42. 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).<sup>1</sup> Currently, LFN maintains an affiliation with over 8,500 advisors, which include registered representatives, investment advisor representatives, insurance brokers and agents. LFN has an open architecture business model, allowing its 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).

FINRA’s CARDS program would allow FINRA to automatically collect from member firms various types of customer account information, including investor profile information, investor’s net worth, transactional activity, fees/commissions and security identification information. Introducing firms such as LFN’s broker-dealers would be required to transmit specific information on a regular basis either to FINRA or their clearing firms, who would then transmit the data to FINRA. The stated purpose for this proposal is to identify risks, assist firms with their compliance and supervisory programs, and to assist FINRA in assessing business conduct patterns and trends in the industry.

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<sup>1</sup> The affiliated companies of Lincoln Financial Group 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.

Securities and Exchange Commissioner Daniel Gallagher noted at an *Annual Market Structure Conference* that 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 15<sup>th</sup> Annual Market Structure Conference (Oct. 4, 2012), *available at* <http://www.sec.gov/news/speech/2012/spch100412dmg.htm>. With any rulemaking, Commissioner Gallagher articulated that a thorough analysis of both the benefits and costs needs to be undertaken. Specifically, the rulemaker should evaluate the impact on affected parties and whether alternative solutions are available. *Id.*

Both FINRA and the SEC have publicly stated that FINRA, although not obligated to do so by regulation, should engage in an economic assessment or cost-benefit analysis of its proposed rules. Indeed, FINRA has hired a Chief Economist to oversee this process for FINRA rule proposals and filings. While CARDS is not yet a rule proposal, the same assessment should be conducted, even at this early stage, to determine whether the concept proposal is appropriate.

LFN appreciates some of FINRA’s arguments relating to the benefits of CARDS. LFN also understands why, during this age of technology, FINRA seeks to collect data in a more efficient manner and utilize the data to increase investor protection by focusing on key risks and industry trends. However, as currently proposed, CARDS presents significant issues and obstacles for LFN and the investing public. Each of these issues is discussed in more detail below.

#### **A. Exorbitant Costs**

CARDS will result in increased and exorbitant costs to FINRA member firms. First, FINRA will experience significant costs associated with building, maintaining and utilizing this technology platform. This will include both technology costs to ensure that the infrastructure and programs are operational as well as analysts and additional staff to help interpret the data. These costs, while substantial, will likely be passed along to member firms through increased member firm surcharges or increased enforcement actions/regulatory settlements.

Second, the Regulatory Notice confirms that both clearing firms and introducing firms will incur costs to ensure that the new CARDS data feeds are provided to FINRA. LFN is confident that any costs incurred by clearing firms will be passed along to introducing firms. In addition to these costs, Lincoln will also incur costs to provide additional data points/information to FINRA or the clearing firm, as the clearing firm does not maintain all aspects of the customer profile or suitability information that was outlined in the CARDS proposal. As a result, LFN would need to develop, program and maintain another data feed of specific customer information. It is challenging to reasonably approximate the costs associated with these efforts because the concept proposal, and more recent FINRA guidance, has been inconsistent and ambiguous in describing the type and specificity of data that would be included in CARDS data feeds. Whatever the costs, they are likely to be steep and an unintended consequence is that

these costs could be passed onto customers in the form of higher transactional or servicing costs or fees.

Third, the costs associated with the effort to “standardize” the data types in a uniform format which is accepted 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. However, 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. Thus, FINRA may have to 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 may 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 (which would include a combination of start-up costs and recurring annual costs). The cost estimate includes, but is not limited to, items such as:

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

With all of these system and documentary changes, there will be a notable impact on advisors and the clients that they service. Unfortunately, a cost that cannot be quantified is the impact on a financial advisor and the customer experience, as advisors will need to communicate with customers and explain why additional, standardized information is being required by FINRA.

Finally, while the costs of developing a CARDS compliant program seem 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 like churning and suitability. 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.

## **B. Information Security, Privacy and Confidentiality Concerns**

The protection of LFN's customer's non-public personal information is of paramount concern. Initially, FINRA's concept proposal required member firms to provide FINRA with customer specific information, including account information, social security number and investment profile, which could include net worth and investment objectives. More recently, FINRA has backed away from some of these requirements, validating the industry's reaction that FINRA would be the repository for the world's investors' non-public information and a perfect target for cybercriminals.

While FINRA's more recent retractions alleviate some of the privacy concerns, Lincoln feels that FINRA's actions do not go far enough, as there is still significant risk for data breach. 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 implications.

In the event of an intrusion or privacy breach, it is unclear who bears the liability – introducing/clearing firms for submitting information to FINRA or FINRA, if the intrusion occurred at their level. 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's transparency 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. Increased Regulatory Burden**

FINRA believes 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 may be true (i.e., this proposal could mean a greater regulatory burden, cost and more time-consuming and inefficient interactions with FINRA).

During member firms cycle examinations, 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 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. Oftentimes, FINRA's suitability conclusions 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.<sup>2</sup> 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

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<sup>2</sup> 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."

the 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.

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.

Further, under CARDS, 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 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 feels that the opposite is the case. If FINRA sees anything that looks suspicious, FINRA will likely conduct a subsequent inquiry. CARDS will not allow FINRA any real "policing power". 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. If FINRA is putting all of their efforts and review into CARDS, FINRA will miss the real-time data available in other reporting mechanisms that could potentially prevent an unsuitable transaction from occurring.

#### **D. 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 and TRACE already provide real-time reporting data on equity and fixed income 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 and TRACE 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 or TRACE reporting, to eliminate duplication and additional burdens.

Lincoln is supportive of FINRA’s efforts to more efficiently and effectively supervise member firms and protect the investing public. However, these objectives are not without significant costs and can be avoided through other, less burdensome and expensive alternatives. Lincoln looks forward to a continuing dialogue with FINRA in the hopes that FINRA can identify alternative, less costly solutions. If you have any questions, please do not hesitate to contact me at 484.583.1413 or [carrie.chelko@lfg.com](mailto:carrie.chelko@lfg.com).

Respectfully Submitted,



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