



**VIA ELECTRONIC MAIL**

December 1, 2014

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

**Re: Regulatory Notice 14-37: Request for Comment on a Rule Proposal to Implement the Comprehensive Automated Risk Data System**

Dear Ms. Asquith:

Thank you for the opportunity to comment on Financial Industry Regulatory Authority ("FINRA") Regulatory Notice 14-37 ("Proposed Rule") released on September 30, 2014 regarding the proposed implementation of the Comprehensive Automated Risk Data System ("CARDS"). The Proposed Rule amends a prior concept proposal to develop CARDS originally set forth in FINRA Regulatory Notice 13-42 released in December 2013 ("Concept Release").

Cambridge Investment Research, Inc. ("Cambridge" or "the firm") is an independent, privately owned broker-dealer located in Fairfield, Iowa. Cambridge has over 2,500 independent registered representatives throughout the country. Cambridge acts as an introducing broker-dealer and maintains relationships with two national clearing firms. Cambridge's independent registered representatives also conduct extensive non-brokerage business directly with numerous product sponsor companies.

Cambridge acknowledges and appreciates that FINRA's underlying motivation behind the CARDS proposal is investor protection. Cambridge has several comments and suggestions for FINRA in light of the specific information included in the Proposed Rule. A discussion of each of these topics is included below.

**I. Collection and Use of Suitability Data**

In the Concept Release, FINRA stated that "CARDS would provide a more holistic view of customer accounts, thereby allowing FINRA to better pinpoint where suitability risks might exist by identifying groups of customers holding high-risk products, branch offices with

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concentrations of such products and registered representatives selling those products.” See *Regulatory Notice 14-37*, at 17. FINRA has also stated that CARDS would allow FINRA to detect instances where firms consistently sell products that present higher risk to customers and appear to be unsuitable for those customers. See *Remarks of Susan Axelrod, Oct. 29, 2014*, available at <http://www.finra.org/Newsroom/Speeches/Axelrod/P601434>. In response to the foregoing statements, Cambridge has serious concerns about FINRA’s possible use of suitability data provided to CARDS for the following reasons.

Cambridge does not believe collecting and analyzing suitability data of customers will further FINRA’s stated goals of implementing CARDS because such activity will not improve FINRA’s ability to identify and respond to high risk areas and suspicious activity by helping FINRA track product mixes, monitor for problem areas such as pump and dump schemes, churning, mutual fund switching or concentrations of high-risk securities, or the other suggested benefits such as understanding the overall risk profile of a firm or allowing FINRA to conduct more targeted sweeps, firm-wide initiatives, or examinations. It appears FINRA could make these determinations solely based on the product data collected through CARDS. In fact, collecting and analyzing suitability data may overwhelm the stated purpose of CARDS because the majority of suitability data collected by firms such as Cambridge is not uniformly collected, stored, evaluated or reported and requires a high degree of subjective interpretation for each individual customer. Only a small percentage of suitability data is objective in nature such as age, net worth and investment time horizon.

If CARDS attempts to collect and analyze the suitability data from member firms, this can realistically only be done through a formulaic process that evaluates all data in a uniform manner due to the volume of data FINRA will be analyzing. A formulaic process, however, is contrary to the purpose of FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability) because a formula cannot determine if a transaction or investment strategy was recommended on a reasonable basis after an evaluation of the facts and circumstances unique to each customer. To the contrary, firms such as Cambridge rely on individuals to perform such an analysis and there has been no indication that FINRA will have individuals on staff to analyze suitability information. Furthermore, there is no uniform industry definition of the numerous suitability factors used by member firms so one firm’s definitions and suitability determinations may vary greatly from others. Because of this, any process developed by FINRA through CARDS will generate a significant amount of false positives that will require manual review by individuals. This has the potential to overwhelm the FINRA staff or, alternative, member firms responding to such inquiries because someone will be required to expend significant resources to review and respond to these determinations.

Based on the comments above, Cambridge requests that FINRA refrain from collecting individual suitability data through CARDS, specifically since FINRA has stated publicly that it does not intend to utilize suitability information to conduct individual suitability determinations. Analysis of suitability data would be incomplete without access to the entirety of a client’s holdings, or the understanding of the many personal factors that contribute to investment decisions, which CARDS will not have. Additionally, the presence of suitability data in CARDS could encourage FINRA to second guess the determinations made by the firm in its suitability reviews. If FINRA does not intend to utilize suitability information to conduct individual

suitability determinations, firms will be assured that FINRA will not venture into this area if FINRA simply clarifies that suitability data will not be collected.

In the alternative, Cambridge asks FINRA to clarify that subjective suitability data will not be collected and requests that FINRA specify which objective suitability data will be collected and evaluated such as age, net worth and time horizon. This will help alleviate the need for future inquiries by reducing the likelihood that FINRA will inquire about potential issues. Additionally, it will help deter firms from establishing suitability thresholds based on a formulaic approach in order to meet FINRA's suitability "expectations" which would unintentionally harm investors who need a comprehensive, holistic analysis completed by their financial advisors and broker dealers.

## **II. Direct Business Data**

Cambridge's independent registered representatives conduct extensive non-brokerage business directly with numerous product sponsor companies, including mutual fund companies, variable annuity providers, and alternative investment sponsors. Commonly referred to as "direct business", these transactions are often conducted through the "check and app" process. Cambridge's registered representatives perform a suitability analysis for the client pursuant to FINRA Rule 2111, obtain the client's signed application and a check, and then submit this to his or her Office of Supervisory Jurisdiction to conduct principal review, Know Your Customer ("KYC"), and Anti-Money Laundering ("AML") processes before forwarding these materials to the product provider. Upon reviewing the application, the product provider makes the investment, sends the commissions to Cambridge, and generates statements, tax reports, and other documents which are sent directly to the client. Although Cambridge retains the required books and records for these transactions, including documentation with respect to suitability, KYC, and AML, this information does not flow through the clearing firm platform, and therefore will not be collected by CARDS under the current proposal. The absence of direct business data in CARDS would skew the profile of Cambridge, its registered representatives and customers because any analysis by CARDS based solely on clearing firm data would not be representative of Cambridge's product mixes, concentrations, trading activities or risk profile and it would not be an accurate representation of customers' profiles, trading activities, patterns or trends.

The failure of FINRA to collect direct business data on firms such as Cambridge during the initial implementation of CARDS will result in an incomplete picture to FINRA of firms on an ongoing basis and will inevitably lead to misperceptions and inaccurate conclusions that can only be resolved through the expenditure of significant resources by FINRA and firms like Cambridge to review and respond to these determinations. This will create significant inefficiencies and wasted resources for all parties. Even if FINRA ultimately works toward collecting direct business data through CARDS at some point in the future, the question remains as to what value CARDS will provide to FINRA and firms like Cambridge in the interim period.

In light of this, Cambridge believes that prior to implementing any portion of CARDS, FINRA should more closely study this issue and fully address the fact that direct business data is not uniformly collected, stored or reported by product companies. Further, Cambridge requests FINRA study how direct business data could be consolidated, standardized and transmitted to clearing firms or FINRA, a feat that is much broader in scope than the Concept Proposal but undeniably necessary to make CARDS a success.

### III. Collection of Data on Accounts Serviced by Registered Investment Advisors

Cambridge periodically engages with Registered Investment Advisors (“RIAs”) or Investment Advisor Representatives (“IARs”) that do not hold any type of securities license. These RIAs/IARs do often custody their client accounts at one of Cambridge’s clearing firms.

Cambridge has contacted its clearing firms about the nature and extent of data being provided to FINRA for the beta testing of CARDS and is concerned that FINRA has likely received, and will continue to receive, data transmissions for clients and accounts that are managed by RIAs/IARs who are not subject to FINRA jurisdiction. Cambridge believes that its clearing firms have likely delivered data for this category of accounts to FINRA from broker-dealer books and records. Cambridge has not determined whether there is any reasonable method that its clearing firms could employ within their current systems to identify or filter this data. This revelation, if true, raises the following concerns for Cambridge.

- Customer privacy. If RIA/IAR only customer accounts are not subject to FINRA oversight, what purpose is served by FINRA receiving or possessing this data?
- Data quality. Because the CARDS data set is designed to represent the securities activity of a broker-dealer and its related accounts, the presence of unrelated RIA/IAR only account data degrades the quality of the overall data set. In Cambridge’s case, it may be difficult or impossible for FINRA to effectively quantify or improve the degree of data quality after the unrelated RIA/IAR only data has been delivered.
- Validity of data analysis. Any analysis that FINRA performs using the Cambridge broker-dealer data with this unrelated RIA/IAR only data being present could result in invalid conclusions, or of reduced or unknown accuracy, since the analysis will have been performed using data that the analysis was not designed to include. For example, data collected on actively managed RIA/IAR only customer accounts may trigger a CARDS alert for churning if viewed as broker-dealer activity, which will trigger inflated numbers or false positives even though such activity is perfectly appropriate.

Cambridge does not believe that it is the only broker dealer that this issue will apply to. Cambridge requests that prior to implementing any portion of CARDS, FINRA should closely study this issue and fully address if data is being received or will be received by CARDS for RIA/IAR only customer accounts not subject to FINRA oversight. If the answer is in the affirmative, Cambridge encourages FINRA to provide justification for receiving such data and requests a comprehensive explanation as to how FINRA intends to utilize the data given FINRA has no oversight authority over the account activity.

### IV. Collection of Data on Closed/Dormant Accounts

FINRA has indicated in the Proposed Rule that the first phase of CARDS will require the carrying or clearing firms to submit the data set forth in the CARDS data specifications that firms have as part of their books and records relating to their securities accounts and securities accounts for which they clear. This would include information relating to securities and account transactions, holdings, account profile information (excluding personally identifiable information “PII”) and securities reference data “**for all securities accounts.**” See *Regulatory Notice 14-37*,

at 9 (*emphasis added*). During phase 2, CARDS would add the collection of the Select Account Profile Data Elements (described in the Proposed Rule), as set forth in the CARDS data specifications, from fully disclosed introducing firms “**for all the firms’ introduced securities accounts.**” See *Regulatory Notice 14-37, at 10 (emphasis added)*. Upon inquiry, Cambridge has learned that FINRA intends to seek CARDS data from clearing firms and fully disclosed introducing firms on literally all accounts, including closed/dormant accounts.

Cambridge is concerned that CARDS data will be sought from both clearing firms and introducing firms on closed/dormant accounts for various reasons. First, there does not appear to be any nexus between analyzing data on closed/dormant accounts and the stated purpose of CARDS which is to allow FINRA to enhance investor protection and help restore and maintain investor confidence while also helping FINRA to identify and quickly respond to potentially fraudulent and abusive behavior that it might not see through its current surveillance or examination programs. Second, to the extent any nominal value may be obtained by analyzing data on closed/dormant accounts, this benefit will be significantly offset by the resources used by FINRA, the clearing firms and introducing firms in responding to inquires related to data analysis on such accounts given that the clients will most likely be unavailable, financial advisors to the client accounts may no longer be associated with the data supplying firms, and certain data elements and client files may be unavailable or difficult to obtain. Finally, depending on how the client account was set up or transferred in to the clearing firm or introducing firm, significant account data may not exist that is required by CARDS.

Cambridge encourages FINRA to study and address the concerns expressed above related to collecting data on closed/abandoned accounts prior to implementing CARDS to ensure resources of FINRA, clearing firms and introducing firms are utilized appropriately and in the most efficient manner.

## **V. Cost/Benefit Analysis**

In the Proposed Rule, FINRA’s economic impact assessment estimated very broad ranges of costs to FINRA, clearing firms and introducing firms to develop and comply with CARDS on an ongoing basis. Cambridge believes FINRA needs to conduct a more in-depth economic impact assessment to share with member firms prior to implementing the Proposed Rule so that all parties have a more accurate understanding of the true financial impact created by the proposed CARDS system. Since broad estimates are not very predictive of the true economic impact, it is difficult for firms like Cambridge to provide an accurate assessment of the economic impact to the firm until FINRA provides greater details on how CARDS will be implemented and how the data will be used by FINRA. Nonetheless, in a best efforts attempt to estimate the economic impact to Cambridge, it is estimated that Cambridge would incur the following costs based off of its current understanding of how the CARDS data will be collected and utilized, assuming FINRA does not generate inquires based on individual suitability data. Implementation Costs = \$235,000. Annual Recurring Costs = \$125,000. These costs do not include the time and resources of Cambridge’s registered representatives who would be required to assist in obtaining certain data elements or responding to data inquires generated by CARDS.

Cambridge's estimates indicate that it will face a substantial financial burden to comply with the CARDS system, like all of the other member firms, even though the value of the CARDS system is unproven. In the event that FINRA implements the Proposed Rule, Cambridge requests that FINRA commit to conducting annual economic assessments that are published for review by member firms to evaluate the total costs incurred by FINRA to implement and maintain the CARDS system and the costs incurred by member firms to satisfy the requirements of the CARDS system. Additionally, Cambridge requests that FINRA conduct annual quantitative assessments that are published for review by member firms to evaluate if CARDS has reduced burdens on firms and lowered costs due to eliminating intermittent, and sometimes frequent and extensive, information requests from FINRA for the information CARDS will allegedly cover as well as whether the CARDS system has eliminated some sweeps, reduced the burdens associated with targeted, multi-firm initiatives, and streamlined reviews conducted as part of on-site visits to firms that pose low risks of harm to investors.

## **VI. Data Protection and Liability**

On March 4, 2014, FINRA announced that it would not collect personally identifiable information ("PII") through CARDS in response to commenter concerns regarding investor privacy. Additionally, in the Proposed Rule, FINRA committed to obtain Service Organization Controls (SOC) 2 and 3 reports prior to the implementation date for CARDS. While Cambridge appreciates each of these efforts to limit the privacy and security risks posed by CARDS to ordinary investors, Cambridge still has several concerns regarding data security and potential procedures in the event of a data breach.

FINRA stated in the Proposed Rule that it would obtain SOC 2 and 3 reports prior to the CARDS implementation date. Cambridge compliments FINRA on taking this step because such an audit would hold FINRA to the same standards as other private sector data centers. However, Cambridge is concerned that FINRA has not committed to obtaining SOC 2 and 3 reports on an annual basis after the implementation of CARDS. Cambridge believes it is vitally important for FINRA to obtain these reports annually in order to maintain investor confidence and to ensure that FINRA creates a process to update its security controls to meet the evolving challenges of cyber threats. Cambridge further requests that FINRA provide a disclosure to investors explaining that their private information will be housed in a system subject to these two audits and requests that FINRA share the annual audit reports with members so we may evaluate the security of our customers' data. These reports should include any deficiencies identified in the audits and details on how FINRA will update its controls to address such deficiencies.

Cambridge is additionally concerned about limiting access to raw CARDS data. Cambridge therefore requests that FINRA detail which individuals and entities may have access to CARDS data and how that data will be protected in subsequent transmissions and upon being shared. This would include any third part vendors, auditors, state or federal agencies or regulators, and individuals. Cambridge believes FINRA should publish rules and procedures for vetting the credentials and data security systems utilized by any third parties who may obtain access to or receive data from FINRA.

Data breach controls and mitigation are also issues that Cambridge believes needs further attention. Cambridge believes the potential for a breach of CARDS exists due to the attractive nature of the underlying data, and that hackers may be able to use CARDS data in conjunction

with data obtained from a breach of a different system to reunite sensitive client data. In light of Cambridge's concerns, Cambridge requests that FINRA disclose how it would handle a breach of the CARDS system, including how FINRA would notify members and investors of a breach of CARDS. If a breach does occur, FINRA should assure firms that they are temporarily allowed to suspend CARDS transmissions until the vulnerability has been repaired.

Lastly, FINRA has not addressed who is liable for a CARDS data breach. In the event the CARDS database is compromised through FINRA's systems, Cambridge believes FINRA should assume sole liability for any such security breaches and indemnify investors, clearing firms and broker-dealers for any legal or regulatory liability. Any refusal by FINRA to take accountability for such data security breaches would ultimately result in harm to investors, clearing firm and broker-dealers and would increase costs for all parties. A breach of the CARDS system would pose significant financial, litigation and reputational risk to both FINRA and member firms and degrade investor confidence. Consequently, Cambridge requests that FINRA acknowledge sole liability to investors in the event of a CARDS breach and requests that FINRA agree to indemnify member firms, including Cambridge, for any costs or damages incurred as a result of a CARDS data breach occurring after firms have provided CARDS data to FINRA.

Thank you for your consideration of Cambridge's comments.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Seth Miller", written in a cursive style.

Seth A. Miller, Esq.  
Senior VP, Risk Management  
General Counsel