

1 December 2014

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

Re: Comprehensive Automated Risk Data System (Regulatory Notice 14-37)

Dear Ms. Asquith:

CFA Institute¹ appreciates the opportunity to comment on a proposal by FINRA that would implement a comprehensive automated risk data system (CARDS). While we believe this project to be well-intended, we nonetheless have a number of concerns about certain of the proposed provisions and the scheduled implementation timing of such a system.

CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

Executive Summary

CFA has regularly and strongly supported provisions that increase meaningful protections for investors. However, we question the timing of implementing the proposed CARDS so soon after the Consolidated Audit Trail (CAT) was mandated by the Securities and Exchange Commission (SEC). An important concern is that a number of firms would be tasked with building the technological infrastructure, testing, and launching two extensive information gathering systems in relatively similar timeframes, thus requiring firms to participate in two significant technological upgrades and efforts almost simultaneously. Instead of having both efforts proceed on separate but nearly simultaneous tracks, we urge creation and implementation of one system before undertaking the creation of another. And given that the SEC's efforts will apply to a broader spectrum of investment firms, we suggest that the SEC's CAT go first.

¹ CFA Institute is a global, not-for-profit professional association of more than 125,300 investment analysts, advisers, portfolio managers, and other investment professionals in 148 countries, of whom nearly 118,500 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.

Discussion

Through its proposal to implement the CARDS initiative, FINRA would require its members to deliver to it, on a monthly automated basis and in a standardized format, information falling within five broad categories: securities transactions, account transactions, holdings, account profile information and securities reference data. Planned to be established in two phases, about 200 clearing firms would be in the first group and would submit information through CARDS, followed by information submissions from about 1,850 broker-dealers.

FINRA contends that the ability to collect this information on a systematic basis and in standardized format will allow it to more easily identify potential problems at firms earlier than through in-person examinations. Such examinations are now conducted at firms every four years, so the program would close important oversight gaps. FINRA's proposal is premised on the goal of enhancing investor protection and helping to restore and maintain investor confidence.

We support the overall objective of the CARDS proposal as a means of more efficiently collecting data about registered representatives ("brokers") in its traditional examinations of broker-dealers (the "Firms"). We also recognize that because this is data that FINRA substantially already collects about Firms' accounts and brokers, it should make it easier for the regulator to monitor broker activity, and if needed, take steps to diminish the potential for, and the effects of, fraud.

Changes from Concept Proposal. We fully support FINRA's decision to exclude from this proposal the collection of personally identifiable information (PII), which would have included customers' account name, account address and tax identification number. To have proceeded with collection of PII, as was originally included in the Concept Proposal, CARDS could have compromised investor protections by making the collection and storage of such sensitive information increasingly vulnerable to computer hackers and thus raised security issues.

Timing of Implementation. An equally important concern relates to the timing of the CARDS introduction. In particular, we are concerned that the introduction will occur nearly simultaneously with the implementation of the SEC-mandated consolidated audit trail. Requiring firms to build and implement two extensive data gathering and reporting systems within essentially the same time period is imprudent, without a demonstrated compelling need. While FINRA has defined objectives for its CARDS program as strengthening investor protections, we believe the implementation of CARDS should wait until firms have first been able to build and test CAT.

Rule 613 under the Securities Exchange Act of 1934 became effective on October 1, 2014. This rule—adopting CAT—would require national exchanges and self-regulatory organizations, including FINRA, to submit a national market system (NMS) plan to create

and implement a consolidated order tracking system, or consolidated audit trail, for the trading of NMS securities. This system would “capture customer and order event information for orders in NMS securities, across all markets, from the time of order inception through routing, cancellation, modification, or execution.”

FINRA has noted that it believes the information tracked through CARDS is not substantially duplicative of the information that would be captured through CATS. We nonetheless think that requiring firms to implement two labor-, capital- and information-intensive systems at the relatively same time invites problems. Setting up separate collection and transmittal processes will no doubt be labor-intensive, costly, and more prone to errors than would be a one-system-at-a-time approach. Building and maintaining one required infrastructure first would also have the added benefit of allowing firms to address the problems in one system before undertaking the design and implementation of another. Moreover, FINRA would be able to determine what portion of their CARDS system is redundant to the SEC's CAT system before proceeding.

We therefore suggest that these systems be implemented one at a time, rather than in tandem. To that end, we urge FINRA and the SEC to work together in deciding the timing sequence that best serves investor protection issues and agree as to whether CARDS or CATS proves more urgent and thus should be implemented first. Whichever of the two is implemented second will then “piggy back” on, and benefit from mistakes remedied in the first. We believe that this approach will allow a more measured use of firm resources and ultimately prove to be more efficient in allowing the full implementation of one system before starting that of another.

Select Account Profile Data Element. As proposed, FINRA hopes to “identify patterns or transactions that indicate bad behavior on the part of a particular broker-dealer, branch office or registered representative, and monitor more effectively for problems such as pump-and-dump schemes, suitability, churning, mutual fund switching and concentrations of high-risk securities.” Under the proposal, select account profile data would be provided through CARDS in the second phase of implementation. This category would include: investment time horizon, investment objective, risk tolerance, net worth, and servicing representative compensation allocation.

We believe that some of this information may not translate well when gathered in the means that CARDS will use, and instead may lead FINRA to draw incorrect correlations between the data and what it may interpret as alarming behavior on behalf of the firm or registered representative. For example, the use of a 30-day reporting period may skew certain data. In new issues, for example (the most common category being IPOs), money is taken out of accounts that leaves no money and makes it appear that the clients have lost all their value (until transactions of this type settle, which can take 2-3 weeks). If this occurs on the last week of the 30-day period, CARDS data capturing this information can clearly raise false red flags.

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We thus encourage FINRA to review and reconsider this aspect of the proposal with an eye to eliminating information gathering in a way that generally leads to misleading conclusions. To this end, we encourage continued communications—through focus groups or otherwise—with Firms and brokers for their input as to ensure, as the proposal suggests, “that granular oversight to ensure compliance to prevent and detect problems with individual customers and transaction remains the central role of a firm’s compliance and supervisory programs” rather than that of CARDS.

Costs. Finally, we encourage FINRA to continue evaluation of ways to reduce the substantial costs that CARDS would impose upon affected firms, and particularly with respect to smaller firms. While we understand some of the baseline costs may be unavoidable, we also recognize that excessive cost burdens can serve as a barrier to entry for smaller firms. Allowing firms to implement CARDS before undertaking CAT may allow these firms to better manage the substantial investments these systems will require.

Conclusion

We support actions that result in added investor protections and overall increased confidence in the capital markets. As with any initiative of this magnitude, CARDS must show that it is capable of providing this service without resulting in undue costs to investors or overly-strained market resources. Should you have any questions about our positions, please do not hesitate to contact James C. Allen, CFA at james.allen@cfainstitute.org, 434.951.5558; or Linda L. Rittenhouse at linda.rittenhouse@cfainstitute.org or 434.951.5333.

Sincerely,

/s/ James C. Allen

/s/ Linda L. Rittenhouse

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