

Faculty Supervisors

DAVID N. DORFMAN
MARGARET M. FLINT
ROBIN FRANKEL
ELISSA GERMAINE
JILL GROSS
VANESSA MERTON
JASON PARKIN

JOHN JAY LEGAL SERVICES, INC.

PACE UNIVERSITY SCHOOL OF LAW
80 NORTH BROADWAY
WHITE PLAINS, NY 10603
TEL 914-422-4333
FAX 914-422-4391
JJLS@LAW.PACE.EDU

Executive Director

MARGARET M. FLINT

Clinic Administrator

ROBERT WALKER

Staff

IRIS MERCADO

December 1, 2014

VIA ELECTRONIC SUBMISSION

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

Re: Regulatory Notice 14-37, Rule Proposal to Implement the Comprehensive Automated Risk Data System

Dear Ms. Asquith:

The Pace Investor Rights Clinic at Pace Law School, operating through John Jay Legal Services, Inc. (“PIRC”),¹ welcomes the opportunity to comment on FINRA’s rule proposal to implement the Comprehensive Automated Risk Data System (“CARDS”). PIRC is committed to investor education and has a strong interest in investor protection. PIRC generally supports the proposal, the goal of which is to ensure integrity in the financial markets by enhancing investor protection. CARDS intends to accomplish this goal by collecting certain information in a standardized format from all broker-dealers on a regular basis. However, as detailed more fully below, PIRC is concerned about information security and the likelihood that broker-dealers will pass on the costs of implementation to customers.

PIRC’s General Support of CARDS

FINRA proposes implementing CARDS in two phases in order to reduce costs and simplify the data delivery process for firms and FINRA. The first phase would require approximately 200 carrying or clearing firms (i.e., firms that carry customer or non-customer accounts or clear transactions) to periodically submit in an automated, standardized format specific information that is part of the firms’ books and records relating to their securities accounts and the securities accounts for which they clear. The second phase of CARDS would require fully-disclosed introducing firms to submit the specified account profile-related data

¹ PIRC opened in 1997 as the nation’s first law school clinic in which J.D. students, for academic credit and under close faculty supervision, provide pro bono representation to individual investors of modest means in arbitrable securities disputes. See Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); see also Press Release, Securities Exchange Commission, SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors - Levitt Responds To Concerns Voiced At Town Meetings (Nov. 12, 1997), available at <http://www.sec.gov/news/press/pressarchive/1997/97-101.txt>.

elements either directly to FINRA or to FINRA through a third party. CARDS would not require the collection of personally identifiable information (“PII”) for customers, including account name, account address and tax identification number.

The periodic review of information that CARDS will collect should not only help FINRA identify patterns that indicate misconduct of a particular broker-dealer, branch office, or registered representative, but should also provide valuable information to firms that compliance and supervisory staff can use to enhance their operations. Likewise, the collection of this data on a regular basis should also permit FINRA to react more quickly and effectively to unexpected and rapidly developing events that threaten customer accounts and identify potentially suspicious activity in accounts that may call into question the adequacy of the firm’s anti-money laundering programs. CARDS should also allow FINRA to monitor more effectively for problem areas such as pump and dump schemes, suitability, churning, mutual fund switching, and concentrations of high-risk securities. This is especially important since these problem areas are presently far too common in the securities industry.

CARDS should also result in more effective on-site inspections. These examinations, which FINRA conducts at broker-dealers every one to four years, are based on a combination of sampling methodologies, reviews of customer and firm activities, focused reviews in priority areas of concern, and interactions with firm staff to understand the specific circumstances surrounding areas highlighted through data analysis. While CARDS would require the submission of data on a regular, automated basis, allowing FINRA to identify and quickly respond to high-risk areas and suspicious activities, FINRA would likewise have the ability to review firm data prior to individual examinations, leading to more focused examinations.

PIRC believes that CARDS will be a helpful mechanism for generating a more complete flow of data that should give FINRA a more comprehensive depiction of industry operations. Although FINRA currently gathers data about firm operations through its on-site examinations and through the Securities Exchange Commission’s Consolidated Audit Trail (“CAT”), the ability to collect standardized data in an automated way will help FINRA be a more proactive regulator of the industry and will allow FINRA to better tailor efforts to address the riskiest firms and business practices.

PIRC’s Concerns Regarding Implementation of CARDS

However, while PIRC generally supports the rule proposal to implement CARDS because of the protection it will afford investors, we are hesitant to fully support the implementation until FINRA has addressed our concerns regarding the security of the information to be collected through CARDS and the costs associated with the system. Our concerns are detailed below.

The proposal does not specifically describe how CARDS will benefit investors and what problems CARDS intends to resolve.

PIRC believes that CARDS would be a helpful mechanism for generating a more complete flow of data that should give FINRA a more comprehensive depiction of industry operations. However, many commenters responding to the original concept proposal questioned why FINRA is seeking to propose CARDS at the same time that the SEC is finalizing the Consolidated Audit Trial (“CAT”). PIRC appreciates FINRA’s clarification that the CAT

system does not collect information regarding customer risk tolerance, investment objectives, money movements, margin requirements, and position data that FINRA uses to conduct its reviews. Such information will be collected using CARDS. While FINRA asserts that this distinction is a core feature of CARDS and emphasizes FINRA's investor protection mission, PIRC recommends that FINRA provide more detail with respect to the problems that CARDS intends to solve, including why the current examination methodology fails to solve those problems and why the additional information being collected through CARDS is more beneficial. Additionally, FINRA should provide more specific and detailed information regarding how it intends to solve these problems.

The significant costs of CARDS will likely be passed onto investors.

FINRA estimates that developing the technological infrastructure for CARDS will cost firms approximately \$390,000 to \$9.33 million.² Further, FINRA estimates that annual maintenance of CARDS will cost firms anywhere from \$76,000 to \$2.44 million.³ PIRC is concerned that firms may pass on to investors the costs of implementing and maintaining CARDS in the form of higher fees, reduced service quality, or less competition if smaller firms are unable to continue operating due to compliance costs. PIRC does not support the practice of passing costs on to investors; however, PIRC acknowledges that in reality, firms may do so.

FINRA asserts that while CARDS will be costly, the benefits will outweigh the costs since CARDS will protect investors and potentially save firms the cost and time associated with preparing for cycle and cause examinations. However, the proposal does not provide sufficient information for the public to weigh these costs and benefits. Therefore, PIRC requests that FINRA provide more detailed information as to how firms are expected to handle the costs of implementing CARDS, as well as reliable estimates regarding how much money CARDS will save investors. PIRC also requests that details be provided regarding how such estimates are reached. Further, FINRA should publish data on an ongoing basis for the public to assess whether CARDS is achieving its goals.

CARDS poses a risk to customers' information security.

While FINRA has addressed many serious issues with respect to the privacy of customer information,⁴ PIRC remains concerned. PIRC appreciates FINRA's decision to not collect PII in CARDS, including account name, account address, and tax identification number. Further, PIRC understands that all data would be encrypted in transmission and after receipt in a way that lowers the risk of potential hacker activity. Nevertheless, PIRC believes that CARDS will be an attractive target for hackers, and the data transmitted through CARDS will still contain information that potentially may be linked back to customers.

Although FINRA has addressed many commenters' concerns regarding customer security, PIRC recommends that more information be provided on how FINRA will assure that

² Preliminary estimates are based on information FINRA collected from a limited number of clearing and self-clearing firms. FINRA, *Regulatory Notice 14-37*, 19 (Sept. 2014), <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p600964.pdf>.

³ *Id.*

⁴ *Id.* at 5-8.

data is kept safe. First, FINRA does not appear to be bound to confidentiality by statute, agreement, or other type of obligation and is not bound by Regulation S-P regarding the protection of customer and consumer information. FINRA asserts that its “program is based upon industry best practices, is guided by relevant federal and international standards, and is compliant with relevant data security privacy laws and regulations.”⁵ However, this statement is vague. Thus, PIRC requests that FINRA provide specific and detailed information about which laws and regulations FINRA is subject to with respect to holding such customer information in its database. PIRC also recommends that FINRA provide information as to how FINRA will ensure it complies with those laws and regulations.

Second, while PIRC appreciates FINRA’s dedication to ensuring cybersecurity, which shows its commitment to protecting customer information, FINRA should explain the legal consequences of a data breach, including but not limited to FINRA’s liability and that of firms who are providing data for CARDS. Specifically, FINRA should address legal remedies for customers in the event that a data breach occurs.

CARDS may be used as a defense by firms.

FINRA’s proposal asserts that CARDS will not duplicate the legal, compliance, and supervisory programs that firms administer. Further, firms remain responsible for granular oversight to prevent and detect problems. In this respect, while this proposal appears to be intended to protect investors, PIRC is concerned that firms may attempt to use CARDS as a potential defense to claims in arbitration and other cases. For example, if an investor sues a firm for losses caused by negligent supervision, the firm may argue that CARDS did not detect any issue and try to pass on the blame to FINRA. As a matter of public policy and to provide sufficient safeguards to the customer, PIRC recommends that FINRA ensure investors that CARDS will not place an additional burden on investors and cannot be used against customers in future disputes.

In sum, PIRC generally supports FINRA’s proposal to implement CARDS and believes the proposal is consistent with FINRA’s goal of protecting investors. However, PIRC is hesitant to fully support the implementation until FINRA has addressed our concerns regarding the security of the information to be collected and the costs associated with the system.

Respectfully yours,

Olivia Darius & Kiera Fitzpatrick
Student Interns, PIRC

Elissa Germaine, Esq. & Jill Gross, Esq.
Supervising Attorneys, PIRC

⁵ *Id.* at 4.