



By Regular and Electronic Mail: ([pubcom@finra.org](mailto:pubcom@finra.org))

December 1, 2014

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

Re: **Regulatory Notice 13-42: DST Market Services LLC's Comments on FINRA's Proposal On  
FINRA's Proposal Regarding the Comprehensive Automated Risk Data System ("CARDS")**

Dear Ms. Asquith:

DST Market Services, LLC ("DST Market Services") appreciates the opportunity to comment on the concept proposal by the Financial Industry Regulatory Authority ("FINRA") to implement the Comprehensive Automated Risk Data System ("CARDS").<sup>1</sup> DST Market Services supports FINRA's goal of enhancing FINRA's ability to assess business conduct patterns and analyze market trends. However, as currently contemplated, CARDS would place significant regulatory and compliance burdens on FINRA member firms without any corresponding regulatory benefit. For this reason, among the others noted below, we would be hesitant to support FINRA's proposal in its current form.

#### **DST Market Services, LLC**

DST Market Services, LLC provides full service clearing, custody and execution services for independent broker-dealers looking to operate more efficiently and grow their firm's business. DST Market Services also delivers omnibus subaccounting solutions to broker-dealers, with tailored solutions that eliminate barriers for smaller firms. DST Market Services, LLC, a wholly-owned subsidiary of DST Systems, Inc., is a member of FINRA and SIPC.

#### **Analysis**

##### ***Little or No Regulatory Benefit***

We are concerned that FINRA does not provide evidence that more statistical information by itself yields any additional regulatory benefit. This is a common theme that is found in many other comment letters and in the criticism of this proposal by FINRA's former General Counsel, Marc Menchel.<sup>2</sup> Mr. Menchel in a recently published article noted that "more information by itself becomes more noise than signal and actually

<sup>1</sup> Regulatory Notice 13-42, Comprehensive Automated Risk Data System, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p413652.pdf>.

<sup>2</sup> See Mark Menchel, Menchel Consulting, LLC "The Card Shark's Sleight of Hand" Memo (November 17, 2014).

obfuscates the decision-maker's ability to ferret out the important and relevant information. Furthermore, the accurate reading of statistical information is encumbered when the party evaluating the predictive qualities of that information has a bias....." He adds that "FINRA appropriately has a bias toward investor protection that requires skepticism of information presented to it for analysis." Therefore, the predictive purposes of CARDS information are likely to be skewed and FINRA is not likely to analyze objective data in an objective manner.

Moreover, the duty of compliance and supervision sits properly within the broker-dealer because the collection of data is only the beginning of the compliance process. For example, a firm must have access to its registered persons and customers in order to understand whether frequent trading is churning or whether suitability is an issue in a trade. FINRA is too removed from the associated persons conducting the business and customers. Therefore, the utility of the CARDS information likely would not assist FINRA in evaluating investor protection concerns.

We also believe that FINRA has not adequately explained why the information it already collects or has access to is insufficient to allow FINRA to regulate broker-dealers such that the additional burden of CARDS is warranted. This existing information includes annual compliance reports of members, FINRA's extensive branch examinations, the reporting on Forms U4 and U5, member firms CEO compliance certifications, taping of certain problem broker-dealers, member continuing application filing requirements related to a material change in a member's business, and FINRA Rule 4530 which requires timely reporting of customer complaints and other specified events. This information is reported in virtual real time, is factual, observable, and subject to additional scrutiny. This information represents actual problems. It is not subject to the bias and misinterpretation of CARDS data. We also believe there is little evidence that FINRA has made the most of the information it already collects or to which it has access.

#### ***Data Security, Data Privacy, and Potential Liability***

As many industry commentators have suggested, the CARDS concept proposal further raises significant issues regarding data security, data privacy, and potential liability in the event of a security breach. As proposed, CARDS will collect the following information:

- Account information to be used for sales practice reviews including suitability, commissions, markup/down, account types, customer investment profiles, and representative and branch CRD numbers;
- Account activity information related to suitability, anti-money laundering, fraud detection, purchase and sales dates, margins, and account balances; and
- Security identification information such as CUSIP.

The sensitivity of this information cannot be overstated particularly when considering the data and security breaches that have recently occurred to major retailers<sup>3</sup> and government agencies.<sup>4</sup> The magnitude and scope of CARDS' data collection make it an attractive target for hackers and other online criminals that may

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<sup>3</sup> See Mark Hosenball, "Target vendor says hackers breached data link used for billing," Reuters (Feb. 6, 2014), available at <http://www.reuters.com/article/2014/02/06/us-target-breach-vendor-idUSBREA1523E20140206>.

<sup>4</sup> See Rory Carroll, "Snowden used simple technology to mine NSA computer networks," The Guardian (Feb. 9, 2014), available at <http://www.theguardian.com/world/2014/feb/09/edward-snowden-used-simple-technology-nsa>.

access and misuse this information. Broker-dealers and the investing public have raised legitimate and serious privacy and data security concerns regarding the CARDS proposal.<sup>5</sup>

In addition, due to FINRA's status as a non-governmental self-regulatory organization (SRO), broker-dealers and advisers have significant concerns regarding accountability, legal liability, and reputational harm when a data security breach occurs. Broker-dealers and advisers take seriously their duties to safeguard the personal information of their clients. In the event of a breach, however, investors will likely place blame on broker-dealers and advisers if FINRA fails to keep safe personal and financial information collected through CARDS.

The CARDS concept proposal should clarify legal liability with respect to data security and state privacy law. If not, broker-dealers may find themselves subject to state and federal civil regulatory liability in the event of a breach of CARDS data. Broker-dealers may also be sued by clients for damages in the event that FINRA's controls or the clearing firms' controls are inadequate to prevent a breach and the data is misused. FINRA should clarify that it alone would be liable in the event that its systems are compromised and individual clients have their data stolen or misused. Current litigation between retailers and banks with regard to financial liability in the wake of security breach highlights this concern.

An additional concern for broker-dealers is state consumer data privacy laws. Individual state legislatures have proposed or passed laws that place a variety of restrictions and requirements on broker-dealers with respect to the collection and transmission of client data. Broker-dealers have concerns that they will either violate state data privacy laws or incur significant legal fees to fully understand and comply with the variety of state requirements that impact their ability to transmit client data as required by CARDS. However, even if a breach occurred and FINRA is fully liable, FINRA would be unable to compensate broker-dealers for the reputational harm broker-dealers would suffer as a result.

#### ***May Exceed Regulatory Authority***

Lastly, we are concerned that the CARDS may exceed FINRA's statutory authority granted under Section 15A of the Securities Exchange Act. FINRA's mission is to promulgate rules to prevent violations of the Act and the just and equitable principles of trade. FINRA does not appear to have articulated what FINRA rules are lacking that would now be remedied by the CARDS initiative. The existing broker and market conduct rules demonstrate no gap in coverage by existing FINRA rules. Indeed, existing rules are replete with prescriptive and principle-based requirements that address the Act and the just and equitable principles of trade. Thus, we believe that, where no such gap exists, any additional burden on the industry by rulemaking is inappropriate.

In Regulatory Notice 13-42, FINRA states that, "CARDS would not supplant the legal, compliance and supervisory programs broker-dealers administer. Rather, a firm's compliance and supervisory programs would continue to have the obligation to conduct oversight to prevent and detect problems based on the full information broker-dealers hold." However, the Notice also provides that, "FINRA would use the information to run analytics that identify potential red flags of sales practice misconduct (e.g., churning, excessive commissions, pump and dump schemes, markups, mutual fund switching)..." Therefore, the CARDS information would be duplicative of the current compliance and supervisory obligations and functions of every registered broker-dealer and their associated persons.

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<sup>5</sup> See Dan Jamieson, "Brokers Want To Thwart Finra's CARDS Plan To Collect Client Data" FA Magazine (March 3, 2014), available at <http://www.fa-mag.com/news/brokers-want-to-thwart-finra-plan-to-collect-client-data-17126.html>

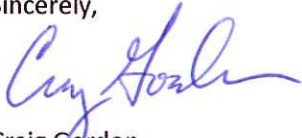
Thus, we believe that this proposal does not meet the balancing requirements of Section 15A because it would further burden the industry in areas already addressed by comprehensive regulation without adding any additional regulatory benefits.

#### Conclusion

DST Market Services understands and agrees in principal with FINRA's desire to enhance FINRA's ability to assess business conduct patterns and analyze market trends. However, we encourage FINRA to more closely examine the unintended consequences and burdens of its proposal on regulated entities. We also hope that FINRA would look closely at the current tools it has and evaluate whether they can be used in a more efficient manner to protect the investing public. Lastly, FINRA should more fully explore the administrative costs that clearing firms will be forced to bear under the proposed changes.

If you have any questions concerning these comments, please contact the undersigned at (612) 238-1518 or Kevin Armstrong, General Counsel, DST Market Services, LLC at (612) 238-1580.

Sincerely,



Craig Gordon  
Vice President  
Head of Clearing  
DST Market Services, LLC