



December 1, 2014

**VIA ELECTRONIC MAIL (pubcom@finra.org)**

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

**Re: Regulatory Notice 14-37  
Comprehensive Automated Risk Data System  
Comment Letter of Charles Schwab & Co., Inc.**

Dear Ms. Asquith:

Charles Schwab & Co., Inc. ("Schwab") appreciates the opportunity to comment on proposed FINRA Rule 4540 Series which would establish the Comprehensive Automated Risk Data System ("CARDS") as announced in FINRA Regulatory Notice 14-37 (the "Regulatory Notice"). Schwab continues to have significant concerns, as initially outlined in our previous comment letter<sup>1</sup> to the concept proposal, that the risks posed by CARDS outweigh any potential benefits. We respectfully suggest that as an alternative to proceeding with CARDS rulemaking, FINRA should leverage and enhance existing examination and data collection systems and processes to improve the effectiveness and efficiency of its national examination program.

Schwab would like to reiterate and supplement the points raised in our initial comment letter on the following topics:

- **Privacy and Fraud Risks.** The information requested in the CARDS proposal is highly confidential. Schwab has concerns about how the data will be protected and how it will be shared.
- **Impact of CARDS on Self-Regulation.** There is a significant risk that the collection of the data described in the Regulatory Notice will fundamentally alter the nature of FINRA's oversight of member firms.
- **Existing Data Collection Methods.** FINRA already receives large quantities of data which should first be fully utilized in order to allow it to meet the achievable objectives of CARDS.

Based on these concerns, we urge FINRA to withdraw the CARDS proposal as outlined in the Regulatory Notice.

#### **Privacy and Fraud Risks**

If implemented, FINRA would hold and control a centralized repository of highly confidential, sensitive, private information that would include account numbers, account types, investment profile information (such as investment objectives, risk tolerance, and age), investments, securities transactions, cashing and money movements, and borrowing activity of virtually every customer of every U.S. broker-dealer. In addition to the significant privacy and confidentiality interests of individual investors, data regarding brokerage accounts and account activity represent highly confidential proprietary business information of member firms. The data provide a road map of core components of each firm's business model, client

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<sup>1</sup> Comment Letter from Scott Cook, Senior Vice President, Compliance and CCO, Charles Schwab & Co., Inc., to Marcia E. Asquith, Office of the Corporate Secretary, FINRA (Mar. 21, 2014).

base and sales activities that if inappropriately disclosed, shared or stolen, could cause significant harm to a member firm's business.

Perhaps the most consistent theme among the many hundreds of comment letters submitted in response to the concept proposal was that CARDS presented an undue risk of privacy breach and fraud even though it would not contain names, addresses, and tax identification numbers (collectively "PII"). Commenters, including Schwab, called on FINRA to respond to reasonable questions about how the information would be shared, who would be responsible in the event of a breach, and what additional security measures would be taken in light of the extraordinary value of the information. Most of these questions went unaddressed in the Regulatory Notice. Rather, FINRA responded with a conclusory statement of its belief that the removal of PII and the application of *existing* security protocols resulted in a "remote risk" that the data in CARDS could be misused.

Other than restricting access to the raw data, the Regulatory Notice left unanswered significant open questions associated with the access to and use of CARDS. It remains unclear if FINRA intends to restrict access and use of CARDS to employees supporting the examination program. FINRA has not explained whether it contemplates use of the data in support of rulemaking or the issuance of Regulatory Notices, to drive investor bulletins or communications, or in support of any other aspect of FINRA's activities. FINRA has not committed to notifying member firms when, why and how their submitted CARDS data are accessed and used. FINRA has not addressed whether it will seek to sell, market or otherwise make available CARDS data elements, nor has it explained how limitations on use of CARDS data within FINRA will be controlled and enforced. We believe it is critical to have full transparency regarding the possible scope of use of CARDS within FINRA and a full vetting of issues associated with all aspects of such use.

FINRA also has not yet addressed the potential for providing access to CARDS data to other SROs, the SEC, other state and federal agencies and private third parties. The potential access to and use of CARDS outside of FINRA expands and raises new the concerns regarding privacy, data protection, use and misuse that need to be considered and presented directly and with transparency. For example, other securities regulators may wish to incorporate CARDS in their regulatory examination and enforcement programs, and the details, risks and controls associated with such use require clarity and analysis. Individual investors and firms may have significant and differing concerns if CARDS information is made available to and used by federal agencies such as the I.R.S., Department of Justice or the N.S.A. At a minimum, oversight protocols and procedural protections, including notice and an opportunity to challenge any such production, must be addressed. The possibility of government and third-party use of CARDS and FINRA's authority to deny or limit requests by other agencies or third parties for access needs to be vetted fully.

Without cross-reference to outside data sources, CARDS would internally contain sufficient investor detail to allow fraudsters to attempt social engineering attacks on customer service center and branch personnel. Moreover, if linked to other sources, CARDS data carries significant risk that the account holder's PII will be "re-identified." FINRA should specifically address how it will manage the risk of re-identification given that, in addition to CARDS data, its personnel will have access to PII in other databases such as Electronic Blue Sheets, Large Option Position Reports, and the Consolidated Audit Trail which can readily be linked to CARDS by account number.

#### **Impact of CARDS on Self-Regulation.**

FINRA asserts that CARDS "will not establish a transaction-by-transaction based exception program. Granular oversight to ensure compliance or prevent and detect problems with individual customers and transactions remains the central role of a firm's compliance and supervisory programs." At the same time, FINRA states that CARDS would "enable FINRA to enhance its ability to . . . identify patterns of transactions that indicate bad behavior on the part of a particular . . . branch office or registered representative." This suggests a more granular use of CARDS data to target individuals or particular offices, superseding the roles of firm compliance and supervisory functions. Additionally, the gathering of transaction details such as dividend reinvestments and ACAT transfers are examples in the specifications of data that would most likely have value for conducting surveillance at the account level rather than

supporting trend analyses. Schwab remains concerned that FINRA's use of CARDS could negatively impact the respective roles of FINRA and firm compliance and supervisory programs.

As we noted in our prior comment letter, even if FINRA does not, at the outset, monitor for sales practice abuse at the account level, a failure to identify or promptly act upon an indication of violative activity that could have been detected in CARDS will be deemed a failure of regulation. Over time, external pressures to utilize the data to seek to identify individual instances of misconduct will drive a transformation of FINRA oversight from examination of the systems of supervision and control of member firms to day-to-day supervision of registered representative and customer activity. Such activity would be duplicative of firm compliance and supervision efforts, and if not supplanting internal control efforts, would create significant redundancies with member firm compliance and supervision programs. That result would be both highly inefficient and ineffective. Consistent with FINRA rules, day-to-day supervision and compliance efforts are appropriately the responsibility of member firm personnel who are accountable for designing and implementing controls that are tailored to the unique business model of each firm. Internal compliance and supervisory personnel have access to information and understanding of internal systems, business activities and personnel to identify and act upon red flags far more effectively than FINRA examiners or other FINRA personnel data mining CARDS.

Today, FINRA properly oversees firm supervisory and oversight programs through its national examination program. FINRA does not have the level of access to and understanding of each firm's business practices, systems, policies, procedures and personnel to support an expansion of its role to conduct day-to-day supervision of business and customer activity efficiently or effectively. In fact, the existing examination process fulfills FINRA's regulatory obligations in an appropriate and meaningful way. Significant amounts of information and data are provided in advance of the examination for review and analysis and the onsite portion of the exam is essential to interpreting and providing context for the information and data produced, including how it connects to a particular business line and the procedures, supervision and personnel supporting that business. Without the interpretation and context, the utility of the information is questionable as it can result in inaccurate assumptions, false positive predictions and skewed analysis.

FINRA has not addressed our previously stated concern that the collection of so much client data unrelated to sales activity or member firm misconduct will lead to investigations into customer activities where there is no nexus to the member firm, its registrants or associated persons. Because FINRA is limited in its ability to take direct action against individual investors, data mining of customer activity may lead to more referrals to government agencies (e.g. the SEC, Department of Justice, State Attorneys General), and even development of programmatic surveillance of customers on behalf of those agencies. Such a development would represent a significant expansion of FINRA's role in the regulation of the financial services marketplace, raising significant jurisdictional, public policy, and legal questions that must be fully considered and addressed transparently with the SEC, member firms and legislative and other public policy forums representing the interests of individual investors.

#### **Existing Data Collection Methods.**

As CARDS is not intended to be used to support a transaction-by-transaction exception program, the goals enunciated by FINRA that are most likely to be achieved through standardized data analysis include a greater understanding of the business and risk profiles of its member firms and an enhanced ability to track trends in the mix of products each firm sells relative to its peers. FINRA currently collects large quantities of standardized data (e.g. AEP, EBS, FOCUS, INSITE, OATS, TRACE, and LOPR) that could facilitate such enhanced comparative analysis. We believe FINRA should first leverage these systems and the proposed Consolidated Audit Trail ("CAT") to support its examination program before pursuing implementation of CARDS.

FINRA should seek to expand integration of existing collected data into its national examination program. For example, FINRA already collects data regarding all securities holdings through the full stock record in the Automated Exam Program ("AEP"). This data is currently available to FINRA personnel to track trends in the mix of products held by the firm's customers or within each branch office. Concentrations of high-risk securities which vary from industry norms, or between branches within the firm, can already be

identified using AEP and could readily lead to targeted Electronic Blue Sheet ("EBS") requests to determine which purchases were solicited, informing on-site testing and examination. Similarly, business risks are measurable as all holdings in proprietary trading accounts are visible to FINRA, and the profits and losses from such trading are transparent in regular FOCUS filings, which are now more robust with the addition of the new Supplemental Inventory Statement and Supplemental Statement of Income. FINRA routinely seeks interpretation of information provided in these filings, often asking for further documentation and meetings with business personnel to explain how the data connects with the business.

Instead of proceeding with CARDS, Schwab urges FINRA to compile a complete inventory of the data it regularly receives and conduct a gap analysis relative to the goals in the Regulatory Notice that don't serve to establish a transaction-by-transaction surveillance system. FINRA could then seek enhancements to CAT or other existing platforms to address any needs identified. Enhancement to existing systems could be implemented much more quickly and cost efficiently than CARDS implementation. We believe this approach would effectively address FINRA's regulatory objectives without introducing the fraud, privacy and regulatory risks associated with the CARDS proposal.

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Schwab thanks FINRA for consideration of the points raised in this letter and welcomes any further discussions or questions. Please feel free to contact the undersigned to discuss them in more detail.

Very truly yours,

A handwritten signature in black ink, appearing to be 'Scott Cook', with a long horizontal flourish extending to the right.

Scott Cook  
Senior Vice President Compliance  
Charles Schwab & Co., Inc.