

# FINRA Proposes New “CARDS” Data Collection System

October 30, 2014

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The Financial Industry Regulatory Authority (“**FINRA**”) recently unveiled a detailed **proposal** to implement its planned Comprehensive Automated Risk Data System (“**CARDS**”) initiative. If adopted, CARDS would require FINRA members, on an automated monthly basis, to submit extensive data to FINRA regarding, among other things, customers’ profiles and their securities transactions and holdings. CARDS would allow FINRA to standardize and automate its collection of certain securities and account transaction data.

In addition to allowing FINRA to better understand members’ businesses, FINRA believes CARDS will enhance its ability to quickly identify and respond to potential suitability failures, anti-fraud violations, or other potential misconduct. Overall, FINRA claims that CARDS would revolutionize its oversight and examination of sales practices. However, despite these potential benefits, CARDS is controversial. The Chairman of the House Financial Services Committee’s Subcommittee on Capital Markets and Government-Sponsored Enterprises recently **criticized** CARDS and questioned whether the expense and burden of CARDS were justified. Many in the brokerage industry have also expressed concerns, specifically stressing implementation costs as well as difficulties (and potential duplicative effort) of implementing CARDS at the same time as the SEC-mandated Consolidated Audit Trail (“**CAT**”).

CARDS was originally announced in a **Concept Release** late last year, and FINRA conducted an elaborate and inclusive process for gathering input from a range of constituencies. In response to concerns raised by firms, the current proposal made a number of changes to CARDS, including, most significantly, eliminating collection of customers’ personally identifiable information (“**PII**”).

Comments on the CARDS proposal are due by December 1, 2014.

## Types of Data to Be Submitted

### (Abridged)

The following are examples of the types of information FINRA intends to collect for each data category:

- a chronological list and transaction details (e.g., account numbers, quantity, price, time, fees) of cleared securities transactions on a per trade date basis and dividend reinvestment information;

## Proposed Rule Requirements

### *Data Submission*

CARDS would require firms to submit to FINRA specified information that falls within five broad categories: securities transactions; account transactions; holdings; account profiles; and securities reference data (examples of the proposed types of information to be collected for each category are set forth in the accompanying side bar). Products not held, custodied, or executed through the clearing member, such as variable annuities, private placements and unregistered securities, would be excluded from CARDS reporting.

Firms would provide CARDS information to FINRA for each calendar month by the tenth business day of the following month. Though submitted

**Types of Data to Be Submitted (cont.)**

- ACATS and Non-ACATS account and position transfer information, such as information on security account transfers between member firms and information, by security, on transferred positions, as well as account additions and withdrawals and margin calls;
- stock record information for each security carried long or short by the member firm for all securities accounts and the aggregated position for each security on the member's stock record and specified allocation pair-off details;
- account profile information, such as account classification, owner type (e.g., individual or corporation), margin eligibility, account servicing representative, and investment profile (e.g., investment objective, risk tolerance, net worth); and
- securities reference data, such as symbols and CUSIPs, for all securities.

FINRA proposes to exclude PII from the required data.

**Select Account Profile Data Elements**

CARDS would require introducing firms to submit the following data elements during the second implementation phase:

- investment time horizon;
- investment objective;
- risk tolerance;
- net worth;
- servicing representative compensation allocation;

monthly, the securities and account transaction information must be furnished with daily granularity. For holding and account profile submissions, firms would be required to submit a single monthly snapshot as of the last day of the reporting month. FINRA will provide standardized formats for information submissions.

Automated validations would be performed on all submitted data and the results provided to the firms; members would be required to correct any errors within seven business days of receipt of the validation results.

**Phased Approach**

FINRA plans to implement CARDS in two phases. During the first phase, a carrying or clearing firm would submit the required data that the firm maintains as part of its books and records.

FINRA acknowledges that certain data regarding introduced accounts are often not held in a clearing firm's books and records, but rather held by the introducing firm. As a result, the first phase would not include the submission of certain data (referred to by FINRA as "**Select Account Profile Data Elements**" and detailed in the side bar below) by a carrying or clearing firm for securities accounts that the firm carries or clears for introducing firms. The second phase would require introducing firms to submit Select Account Profile Data Elements for all of its introduced securities accounts.

Firms may contract with third parties to submit information through CARDS.

FINRA anticipates the first phase to begin approximately nine months after CARDS is approved by the SEC. The second phase would begin approximately fifteen months after SEC approval. Carrying and clearing firms would also be required to submit historical purchase and sales transaction information for the period of time between SEC approval and the date the firms begin reporting under CARDS, which FINRA intends to use to run analytics upon implementation of CARDS.

**Additional Concerns**

**Potential Duplicative Reporting**

In response to the Concept Release, many commenters noted the duplicative nature of the information collected by CARDS and questioned FINRA's judgment in moving forward with CARDS at the same time that CAT is being developed. FINRA distinguished CARDS from CAT, asserting that only limited overlap exists between the CARDS and CAT data sets. Specifically, FINRA stated that CAT would not collect information regarding customer risk tolerance, investment objectives, money movements, or position data that FINRA uses to conduct its reviews. This response does not fully address industry criticisms. In particular, many of the same Operations, Technology and Compliance staffs would have to be involved, and the same internal systems would need to be modified or drawn upon for both efforts, leading to concerns about internal capacity to execute both projects effectively at the same time.

**Select Account Profile Data Elements (cont.)**

- servicing representative identifier;
- serviced-by representative group flag;
- branch CDR number;
- registered representative CDR number;
- self-directed account flag;
- birth year;
- account participant related to employee flag;
- control person for public company flag;
- account participant politically exposed person flag; and
- account participant related to employee of another broker-dealer flag.

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FINRA has also sought to address questions about duplicative reporting requirements by identifying systems in which duplication would exist once CARDS is deployed. In particular, FINRA has indicated that its INSITE and the Automated Exam Program will be retired once CARDS is operational.

**Information Security**

Commenters also raised concerns regarding data security, specifically that the information collected through CARDS would be vulnerable due to being held in a single database. While FINRA expressed confidence in its data security measures, in light of the recent data breaches at large financial institutions, this will likely remain a concern for both firms and investors.

**Costs**

Lastly, the costs of CARDS remains a primary concern to the industry. Carrying and clearing firms would incur steep costs to develop and maintain the infrastructure necessary to submit the required data collection through CARDS, likely at the same time as they will be required to build out systems to report to CAT. The size and impact of these costs on members and, ultimately investors, are not yet known.

**Specific Questions for Comment**

In addition to requesting comment on the proposal generally, FINRA also provided fourteen specific questions for comment. The questions touched on various areas of the proposal, including anticipated costs and benefits for implementing and complying with CARDS, the extent to which firms intend to use third parties to report their required CARDS information, and whether FINRA should consider certain exceptions to the CARDS reporting requirements based on business activity.

**Timing and Implementation**

Any rule changes would not become effective until filed with and approved by the SEC, following an SEC comment period. FINRA proposes to require carrying and clearing firms to begin CARDS reporting nine months following SEC approval.

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