

**Davis, Mary**

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**From:** wachtelco.bonnie@gmail.com on behalf of bonnie wachtel <bonnie@wachtelco.com>  
**Sent:** Monday, December 01, 2014 3:22 PM  
**To:** Comments, Public  
**Subject:** CARDS NTM 14-37 Comment Letter Attached  
**Attachments:** Wachtel & Co.CARDS2.wpd; Wachtel CARDS Attachment.wpd

**Follow Up Flag:** Follow up  
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**Categories:** Unique Comment

Attached please find our CARDS comment letter dated December 1, 2014 and, as an attachment to that letter, our comments dated March 17, 2014.

Thank you.

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Bonnie K Wachtel tel 202-898-1144  
Wachtel & Co Inc  
1101 14th Street NW # 800  
Washington, DC 20005

**Wachtel & Co., Inc**  
**1101 Fourteenth Street, NW - Ste 800 Washington, DC 20005 202-898-1144**

December 1, 2014

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

Re: CARDS Rule Proposal - Regulatory Notice 14-37  
Need for Exemptive Relief

Dear Ms. Asquith:

Wachtel & Co Inc is a small self-clearing broker dealer. This will expand our original comments dated March 17, 2014 which describe the destructive effect of CARDS if applied to a certain class of firm. Such firms do not warrant additional surveillance because they already limit or avoid entirely high risk behavior as that term is commonly understood; show superior internal review by a record free of disciplinary problems or complaints; and operate at a volume of business where the cost of any new IT system would be highly disproportionate to the industry and threaten the model of the firm. As described in our earlier letter, this firm fully meets that description, and to minimize repetition a copy of that letter is attached.

Key to our comments is the following: whatever the regulatory justification of CARDS for large firms, that analysis is turned on its head when applied to a firm such as ours. **We submit that this firm and others like it—where the regulatory need is the least and approaches nonexistent—will bear the highest proportionate cost; rather than supporting and rewarding firms with an excellent record, FINRA threatens their viability.** In a regulatory framework constantly stressing “risk-focused” approaches, CARDS is not risk-focused because it is a one size fits all endeavor regardless of size and business model cost/benefit. Universal application will have the perverse effect of pushing some firms toward adopting higher risk practices to cover expenses (please see our earlier comments attached) or of FINRA “improving” its client protection by pushing the most protective firms out of business. **Unless the goal is to consolidate this industry for FINRA’s convenience, this is counterproductive in the extreme.**

**We simply ask that FINRA use the large amounts of information already available, and risk profiling approaches already employed, to limit application of CARDS to where it makes regulatory sense.** A comprehensive risk profile of this firm can be derived from our Focus reports (which include our financial position and sources of revenue along with much other information, and could also be modestly expanded); our past exams and disciplinary history; record of client complaints (none); and the limited and low risk nature of our products and services offered. The resulting depiction of an extremely low risk entity—already in place—contradicts any justification for a further profiling tool piled on top of it.

One more preliminary comment, on the subject of cost. We are very disturbed to see the subject proposal refer several times to concerns about “small or midsize introducing firms” as if no self-clearing firm could

meet the designation of small or midsize. **But we are a self-clearing firm—and a DTC member for more than 25 years—yet small and low volume on every measure relevant to cost or benefits from CARDS.** We further submit that self-clearing only strengthens our profile of low risk: this firm has been rock solid—with no problems whatsoever—through every financial crisis of the past 50 years, including 1973-74, 1987, 2001-03 and 2008. The easy characterization of our firm for CARDS purposes as equivalent to Goldman Sachs simply by virtue of self-clearing status runs directly into the counterproductive regulatory paradox described above. With a sensibly crafted exemption, this is easy to avoid.

**I. Cost/Benefit Analysis: as applied to this firm, benefits would be nil.** In the Background and Discussion portion of Notice 14-37, FINRA lays out its objectives for CARDS. We paraphrase these below to demonstrate their vanishingly small relevance to our business, along with the substantial duplication of other information sources already at hand. Specifically, FINRA suggests that CARDS will enhance its ability to:

a) *understand the business profile of a firm for planning and risk assessment purposes.* (But our profile is so simple it can be described in a sentence or two—see our original comment letter attached—and can be fully derived from our Focus report, which is a monthly report just like CARDS as proposed.)

b) *track product mix and changes across firms and in branches of each firm.* (We have no branches; our product mix of stock and bond revenues are clearly stated on Focus reports; these haven't materially changed in decades and no changes are planned. Tracking our static mix of negligible industry revenue could not possibly aid FINRA or justify additional costs of any amount.)

c) *understand where firms consistently sell higher risk products to customers inconsistent with risk tolerance and suitability profiles.* (But what is a higher risk product? We recommend ONLY unleveraged equity portfolios. If that's high risk, then everything is, which renders the concept of higher risk meaningless. FINRA may indeed want to focus on potentially problematic products such as, for example, private placements, variable annuities, high frequency or algorithmic trading, short selling, margin accounts, options, auction rate securities or non-traded REITS. That is no justification to include firms that don't recommend or even carry those products.)

d) *identify transaction patterns that indicate bad behavior...and monitor for pump and dump schemes; suitability; churning; mutual fund switching; and concentrations of high risk securities.* (Please see our previous answer: if a firm doesn't sell high risk securities it's improbable to have concentrations of such securities, or suitability problems. We don't do principal trades with our clients (classic mechanism of pump and dump) and don't custody open-end mutual funds so can't switch them excessively. If concerned about churning, please see our Focus reports for the ratio of total commissions against our client asset base. As to all of the market pattern data requested: each and every equity trade is reported to ACT or directly to FINRA through its equity TRACE ORF. Each and every bond trade, including commission detail, is reported directly to FINRA's TRAQS system. We know this data is already monitored because it is the basis for blue sheet requests. As to position data, like most firms, virtually all of our positions are held at DTC, and FINRA has access to those positions through a DTCC offering labeled "FINRA Exam Position Report." **We are both disappointed and concerned that FINRA completely ignored the suggestion that it coordinate with the clearing agencies for firm level information – as a first pass to determine if seeking account level information is warranted.** Finally, also at DTCC is a record of ACAT transfers, which for this firm average less than 10 per year. The number of full transfers—if not obtained in redacted form from DTC—could easily be added as a question on the SSOI. This would be another window on the stability of client accounts, and a basis to exempt stable small firms.)

e) *understand the overall risk profile of a firm, including where a firm is taking on too much market risk in proprietary trading or other risk-taking activities.* (The dollar value of all firm positions is shown on the Focus report, and our firm operates on the same limitations as our client accounts: completely unleveraged stocks and bonds. Additionally, we hold multiples of required net capital, of which about half is held in cash and equivalents. The “overall risk profile” of this firm is something FINRA already has and should understand. Our clean client history, strong financial position and limited investment offerings support a profile with VIRTUALLY NO RISK—certainly not a situation calling for a highly expensive new program developed for firms many times our size.)

f) *identify suspicious activity...that may call into question the adequacy of the firm's anti-money laundering program.* (In all the our years of OFAC and FinCen compliance—which is completely transparent to the Treasury and FBI—we have never had reason to file a suspicious activity report. Our clients are exclusively retail and either long-term relationships or referrals; we do not advertise and accept only one or two new clients a year, none outside the U.S. )

Notice 14-37 then goes on to specify how benefits to firms from the CARDS program may help defray costs. The suggested benefits flow from the following: shared information reports to manage compliance internally, and relief from information requests and sweeps. Once again: not for this firm. As described in our original comments, the principals here have no need for automated reports because we both know every client and sign off on every trade—a practice easily achieved at our volume of approximately 20 trades a day. We are almost never bothered by sweeps but have found their occasional use a well-targeted and cost efficient means of providing information. We do not participate in any other automated reporting tool to which the CARDS proposal refers.

## **II. Cost/Benefit Analysis: CARDS' cost is disproportionate and excessive as applied to this firm.**

Moving to the “Interim Economic Impact Assessment” of Notice 14-37, FINRA lays out the research from those firms it has chosen to sample to understand industry cost. The smallest such estimate was \$390,000 for development and \$76,000 annually for maintenance. Over the last several years, our firm's total revenues from activity requiring FINRA membership has averaged less than \$400,000 annually, which means the bottom rung development cost from this sample would be a full year's revenue, with maintenance almost 20% of sales each year—and that's revenue, not profit. No business could be expected to absorb such a level of cost. **And please recall the offsetting benefits are nil:** there will be no increase in investor protection from our current highly-protective, low risk operation; we do not seek relief from ad hoc information requests, and do not participate in automated regulatory reporting schemes from which we will be unburdened by CARDS. This is just a massive cost/benefit imbalance pointing conclusively to the need for exemptive relief.

## **III. An Exemption for Low Risk/Low Volume Firms.**

Relief is necessary to shield firms from CARDS where the cost/benefit balance does not justify imposing the rule. This is where imposition may threaten a firm's viability, or threaten its current business model by pressing it to expand toward higher risk products or lower standards of internal supervision. The latter are obviously counterproductive to FINRA's goal of greater investor protection. We suggest an exemption that takes account of both size and/or risk to cover both sides of the cost/benefit equation.

**a) Size/Volume Criteria.** Because IT development and maintenance costs generally decrease proportionately with the volume of business over which they are defrayed, revenue is a potential key measure. Other metrics such as number of customers, or number of trades per day, may also be useful because they indicate a scope and volume of business more easily subject to internal supervision. We suggest any combination of the following as initial qualification for relief:

- less than 500 active customers (holding positions or trading the past year);
- fewer than 40 client trades per day (averaged over a year);
- revenue from FINRA regulated activity of less than \$5 million per year;
- total firm revenue of less than \$10 million per year.

**b) Low Risk Criteria.** Higher risk products and services may entail higher regulatory costs. Accordingly, we suggest the following as additional or alternative requirements for an exemption:

Exclusion of the following products: Variable annuities; non-traded REITS; auction rate securities; private placements; options.

Excluded services: High frequency trading; principal trades with customers; market-making; possibly margin accounts.

These are suggestions. Only FINRA knows the identity of the areas with which it is most concerned. As new products are introduced, the list could be expanded with notice. Some exclusions should be restricted to solicited trades, or products only if comprising a material portion of a firm's business. Examples of the latter could include any ETF that FINRA classifies as high risk, or stocks trading under a dollar.

**c) Clean disciplinary criteria.** We support a structure under which the exemption can be lost, or denied initially, on the basis of repeated disciplinary infractions of any rules where FINRA oversight would be materially assisted by CARDS.

**d) Mixed criteria under general exemption authority.** Should FINRA choose not to set these criteria into a fixed exemption rule, there should still be a means by which individual firms may apply based on their own situation or cost/benefit model (such as that of this firm).

We have adapted the above from actual rules under which we operate in securities regulation and other laws. The basis for exemptions currently employed by this firm include the following: (1) the dollar value of customer credits; (2) the dollar value of payroll; (3) the number of trades routed per day; (4) our total number of employees; and (5) mixed size and risk considerations, integrating all the approaches suggested above. One particularly useful comparison is the program currently underway to offer broad regulatory relief for limited purpose broker-dealers, which we have heard described as a program to "regulate on the front-end, not on the back." The limited product and service offerings that we suggest as a possible requirement for a CARDS exemption can be viewed as analogous. In all cases, the goal is the same: balance cost and benefit and shield regulation from where it's overly burdensome and/or not warranted.

**IV. The CARDS Project as a whole needs further analysis and review.** We have targeted our comments to the impact of CARDS on certain small firms. However, we also support the view, expressed by others, that cost/benefit justification has not been shown for the industry as a whole. Such an analysis based on a beta test of certain firms would include, at a minimum: (1) the cost of the system tested; (2) the likelihood that exceptions revealed through CARDS would have been obtained through the current exam process; (3) the estimated dollar benefit of any exceptions revealed uniquely (or with unique speed and efficiency) through CARDS; and (4) the extent to which benefits from CARDS could be obtained through alternative means. Simply announcing that the beta test has turned up some reporting infractions is NOT cost/benefit comparison, yet that's the entirety of what's been announced by FINRA with respect to its testing to date. Further, the so-called unique aspects of CARDS—movement of dollars

and position reporting—do not appear to have figured in test results, as those results highlight findings (regarding holdings of Puerto Rican debt, other undisclosed high risk securities and penny stock liquidations) where data is available through current market surveillance channels—and in the case of debt, FINRA’s own reporting facility. We think this entire system needs much more review in those firms that have volunteered to be early adopters—before imposition as a widespread industry standard. Such review should extend to discrete elements (such as the movement of dollars) so that the cost effectiveness of each is documented in its own right.

**V. Conclusion.** FINRA already collects massive amounts of data—certainly enough to create a risk profile for each firm. For entities distinguished by clean records, strong financial position and avoidance of complex offerings, that profile indicates low risk. Such profiles do not support expectation of any material benefit from enhanced surveillance or imposition of CARDS. At the same time, low volume firms would bear a disproportionate burden from imposition of a new IT system—without sufficient revenue to justify the cost. For firms that are both low risk and low volume, **CARDS is not just bad regulation but completely misconceived**—the cost/benefit balance is reversed. Universal application will **decrease investor protection** through at least two unanticipated means: either the most protective firms will leave the industry, or will gravitate to higher risk business as a means to cover costs. **FINRA can easily avoid the most egregiously counterproductive application of CARDS through an exemption such as that outlined above.** However, we believe the entire proposal requires more study in large firm early adopters, to quantify and demonstrate with particularity substantial achievement of the benefits sought.

We appreciate the opportunity to provide these comments. Please contact the undersigned for further information or discussion.

Sincerely yours,

Bonnie K Wachtel, CEO

Wendie L Wachtel, CFO

**Wachtel & Co., Inc**  
**1101 Fourteenth Street, NW – Ste 800 Washington, DC 20005 202-898-1144**

March 17, 2014  
2014

Attachment to Comments dated December 1,

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

Re: CARDS Concept Proposal – Regulatory Notice 13-42

Dear Ms Asquith:

This firm is a small self-clearing broker dealer, and we submit this comment on behalf of ourselves and other similar firms. Among previously published comments, we largely support those of Diamant Investment Corporation, LM Kohn & Company, Kern & Company Advisory and First Allied Securities to the extent that they address the cost impact of CARDS on small firms. We submit the following additional thoughts on this critical point.

In brief, CARDS is destructive without small firm relief. The proposal as described by FINRA is of, by and for large firms—where (1) the volume of data is substantial, (2) associated revenue is available to defray the cost, and (3) automated supervisory practices—especially with use of new products—may warrant heightened surveillance. None of this is true for our firm, where sales practice violations are almost inconceivable—as backed up by a fifty year record—and a huge disproportionate cost is inescapable in creation and maintenance of any new IT system. Without relief, CARDS runs directly counter to FINRA’s most cherished and often repeated regulatory mantra – the “risk focused” regulatory approach – because CARDS is not risk focused; it is a one size fits all undertaking which threatens the viability of well-managed small firms where the need is least and the cost is the most.

Should this proposal go forward, we would be happy to work with FINRA to create an exemption where CARDS can be restricted to firms where it is cost/benefit justified on a risk control basis. As described below, that would not include Wachtel & Co Inc.

**1. CARDS Effect on our Firm: No Benefit Whatsoever/ Wasteful & Counterproductive**  
This firm was founded in 1961 and has always been owned and managed by members of the Wachtel family. The undersigned, Bonnie & Wendie Wachtel, are CEO and CFO respectively, and together have more than seventy years of experience running the firm. Over that time, we have never received a non-trivial customer complaint, never been named in any arbitration or litigation, and never been cited for a sales practice violation in dozens of examinations. That’s

ZERO violations in FIFTY years.

This is largely due to our substantial investment in eliminating regulatory risk by keeping our affairs simple and straightforward. We handle debt and equities on an agency basis—a business that has barely changed in twenty years. We do not offer margin accounts, short sales, stock loan, proprietary trades with clients or network mutual funds (meaning two of CARDS data elements—mark ups and mutual fund switches—have no application to our business at all). We do not prioritize trade reviews or use automated exception reports; both principals sign off on each and every trade. By way of size, our well-capitalized firm has approximately 200 clients, no full-time IT support and modest staff and commission revenue (for details, see any of our multitude of Focus Reports). In short, this is a high-touch/ low volume business model that runs directly counter to the automated high volume industry leaders that may be well suited to CARDS. No benefit will accrue from any additional surveillance, because there is not the slightest scintilla of evidence to suggest that there ever has been or ever will be a sales practice violation at this firm.

Having established the expected benefit of this system at zero, we now turn to the cost. Diamant Investment Corp. estimates that the cost of compliance with CARDS for their firm will be upwards of \$1 million. Like them, this firm does not maintain client profile information in electronic format and uses proprietary software not available to any service bureau or outside provider. We have made a deliberate decision to not offer electronically delivered statements to our clients, and much of the data cited for CARDS we never provide electronically for any reason. This creates a system which our largest clients prefer, and which has benefits in the realms of privacy, security and efficient use of resources.

It should be obvious from the foregoing—together with consideration of our small staff and revenue base—that creation of a new interface for CARDS would be highly burdensome, and daily use and maintenance of the system, including attention to glitches and failures, even worse. Rather than state a cost dollar figure, however, we wish to highlight the disproportionate impact. Let us know the estimated cost of CARDS to a major firm as a proportion of revenue or profits, and we'll show you how it's ten, twenty or thirty times more expensive on the same basis for us. **And please recall, we have a human surveillance system far superior to the major firms based on the record of violations—the need for CARDS has nothing to do with this firm and its extra review would be entirely superfluous.**

But CARDS wouldn't be just wasteful; it also promises to be counterproductive. In the name of client protection, FINRA will be providing exactly the opposite—by degrading the ability of our principals to provide investment research and client service—the only reason why anyone should do business at this firm. In short, we view CARDS (and other systems like it) as an invitation from the regulators to close this firm, despite our superior record on every regulatory front. These systems interfere with competition by forcing firms to adopt a high volume/high profit/higher violation approach so as to defray the cost of mandated regulatory technology or go out of business. This undifferentiated approach—where the cumulative cost of oversight threatens a firm's viability in the face of overwhelming evidence that its current systems are perfectly adequate—is surely the definition of destructive regulation. This isn't client protection



and should be stopped in its tracks.

## **2. CARDS Alternatives Available to FINRA.**

Diamant suggested that FINRA develop a tighter regulatory profile from information it already has. That includes from the clearing agencies (which have a record of all securities held or transacted by any firm) and in the SSOI, which documents sources of revenue. Such an approach would be ideal. Can FINRA assure us that co-ordination with Nasdaq, NSCC and DTC has been maximized to obtain trade patterns without placing extra burdens on firms? We request that they do. If CARDS does go forward, we suggest an exemption which begins with firms collecting less than a few million dollars in client-derived revenue, and may also have added requirements. As a last resort, firms should be able to apply for exemptive relief on an individual basis.

Such an exemption should not clash with any other supposed benefit of this system to FINRA or other firms. The vast majority of securities industry revenue flows through large firms; their reporting will suffice to provide industry trends. Any exempt firm that believes this system will reduce their regulatory burden through examinations (we don't) would be free to adopt it voluntarily. And finally, as to the notion that this system will allow regulators to "risk focus" their examinations, we have to shake our heads. FINRA has a fifty year history on us, and review of any recent exam or Focus Report--filings that we spend hours and hours producing--will tell examiners exactly what we do. For any further update, a 15 minute pre-exam telephone call has always sufficed. This is another distinction between smaller, more narrowly focused entities and our larger firm counterparts.

## **3. Conclusion.**

Our primary concern is the "one size fits all" nature of the CARDS proposal. CARDS is not risk-based, and tilts the securities industry toward one business model (high volume with attenuated, layered supervision) while destroying the alternative (tightly managed, low volume firms where the cost of automated systems dwarfs any possible benefit). For us, the fact that CARDS proof of concept has worked in connection with large firms means absolutely nothing--their cost/benefit dynamics are the opposite of ours. Both FINRA and the SEC (along with US Treasury) have recognized this disjunction in providing exemptive relief and other limitations on electronic system requirements. **At the risk of repetition, we cannot assert strongly enough the need to retain this approach if firms like ours are to continue serving our clients rather than being crushed by needless rules developed for firms many times our size.**

We appreciate the opportunity to present these comments. Please feel free to contact us for further discussion.

Sincerely yours,

Bonnie K Wachtel, CEO

Wendie L Wachtel, COO