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July 20, 2016

Via Electronic Mail (rule-comments@sec.gov)

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Filing of a National Market System Plan Governing the Consolidated Audit Trail; Exchange Act Release No. 77724; File No. 4-698

Mr. Fields:

KCG Holdings, Inc. (“KCG”)¹ appreciates the opportunity to submit comments in response to the above referenced filing by the national securities exchanges and FINRA (collectively, the “SROs”) with the Securities and Exchange Commission (the “SEC” or “Commission”) of a National Market System Plan Governing the Consolidated Audit Trail (“CAT NMS Plan”).²

Recognizing the regulatory data infrastructure currently relied on by the SROs and the SEC has failed to keep pace with today’s complex, dispersed, and highly automated market, the Commission adopted Rule 613 directing the SROs to jointly develop a national market system (“NMS”) plan to create, implement and maintain a comprehensive consolidated audit trail (“CAT”). KCG supports the fundamental objectives behind Rule 613 as it is important for regulators’ tools and processes to evolve and keep pace with the market and a consolidated audit trail would serve as a key component of our national market system. While we support the creation of the CAT and believe the CAT NMS Plan proposed by the SROs is a positive step in that

¹ KCG is a global financial services firm that offers market participants a range of services designed to address their trading needs across asset classes, product types and time zones. As an independent electronic market maker, KCG combines advanced technology with exceptional client service to deliver greater liquidity, lower transaction costs, improve pricing, and provide execution choices.

² Securities Exchange Act Release No. 77724 (April 27, 2016) 81 FR 30614 (May 17, 2016)(“Release”).



direction, we have significant concerns about the following aspects of the proposal, discussed in greater detail below, including:

- Elimination of reporting systems rendered duplicative by the CAT;
- Ensuring a fair allocation of the CAT funding model;
- Lack of broker-dealer representation on the CAT Operating Committee;
- Broker-dealer usage and ownership of their own CAT data;
- SRO usage of data stored in the CAT central repository; and
- CAT error correction timeframes.

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1. Elimination of reporting systems rendered duplicative by the CAT

KCG's View: *The CAT NMS Plan should be amended to provide a detailed framework for eliminating reporting systems rendered duplicative and outdated by CAT implementation and set forth a prioritized timetable for retirement of such redundant systems. Also, there should be cessation of any changes to duplicative reporting systems during the period leading up to the CAT compliance date.*

The elimination of redundant reporting systems was a key benefit recognized by the SEC when it adopted Rule 613. The Commission noted its belief that implementation of a plan to eliminate duplicative systems would increase efficiencies for market participants who otherwise would need to comply with disparate and redundant reporting requirements. To that end, Rule 613 requires the CAT NMS Plan to set forth a plan to identify and eliminate systems (or components thereof) that will be rendered duplicative by the CAT.

The proposed CAT NMS Plan does not contain a detailed approach for retiring duplicative reporting systems; it simply anticipates market participants would be subject to duplicative audit trail data reporting responsibilities for a period of up to 2.5 years after the CAT becomes operational, during which time broker-dealers would be required to report data to both the CAT and to the legacy data reporting systems that the CAT would replace (*e.g.*, OATS, Blue Sheets, Large Trader). The CAT NMS Plan's lack of a detailed strategy for retiring redundant regulatory reporting systems fails to meet the clear directives of Rule 613. This is significant, as



the Commission estimates broker-dealer costs for keeping redundant audit trail reporting systems running during this duplicative reporting period could amount to an additional \$1.6 billion or more each year.³

Therefore, the CAT NMS Plan should be amended to (1) provide a detailed framework for elimination of reporting systems to be rendered duplicative and outdated by CAT implementation, and (2) set forth a prioritized timetable for retirement of such duplicative systems. In addition, in an effort to mitigate the burden and additional costs to broker-dealers during any duplicative reporting period, the CAT NMS Plan should be amended to include an exemption from duplicative reporting obligations for individual broker-dealers based on meeting certain CAT reporting quality metrics. A broker-dealer whose CAT submissions meet a specified data reporting quality threshold should no longer be required to continue submitting data to any legacy duplicative reporting system. This approach should help mitigate some of the burdens and additional costs faced by broker-dealers during the lengthy and expensive transition to the CAT system.

Finally, there should be a cessation of any changes to duplicative reporting systems during the period leading up to the CAT compliance date and certainly once broker-dealers have to begin reporting to the CAT. Any changes regulators anticipate making to reporting systems to be replaced by the CAT should be tabled and instead built-in to the CAT system. This deferral would mitigate some of the burdens during the duplicative reporting period while also helping to prioritize the retirement of redundant reporting systems and to accelerate roll-out of the CAT system.

2. Ensuring a fair allocation of the CAT funding model

***KCG's View:** Implementing the CAT will be extremely costly so it is critical to fairly allocate the costs and funding of the CAT NMS Plan among all market participants. Unfortunately, the proposed funding model submitted by the SROs unfairly shifts the costs for building and maintaining the CAT central repository to the broker-dealer community and away from SROs. Therefore, the SEC should engage an independent*

³ See Release at 30708.



third party to review and make recommendations regarding the proposed CAT funding model.

All observers agree that creation of the CAT is an unprecedented undertaking that promises to be enormously expensive across the industry. CAT cost categories include (1) the costs of building and operating the CAT central repository to receive, process and store all data submitted to CAT; (2) the costs to regulators to create and maintain their own systems to use CAT data retained in the central repository; and (3) the costs faced by broker-dealers to adapt their existing regulatory reporting systems and then maintain those systems to meet the enhanced reporting requirements of the CAT. Broker-dealers' CAT-related costs are estimated by the SEC to far exceed all other categories of costs.

The SEC estimates aggregate industry-wide costs for the CAT NMS Plan would be \$2.4 billion in one-time implementation expenses and \$1.7 billion in ongoing annual costs. Notably, of the \$1.7 billion in ongoing annual costs for the CAT, \$1.5 billion (88%) are allocated to broker-dealers meeting their regulatory obligation to report data to the CAT central repository. By comparison, the costs of building and operating the CAT central repository are much less significant. The SEC estimates the costs associated with building the CAT central repository are approximately \$92 million and annual operating costs of the CAT central repository are approximately \$135 million.

The proposed CAT NMS Plan recommends the build and operational costs of the CAT central repository should be shared among the SROs and SRO members (*i.e.*, the broker-dealer community). Although it is not specified in the CAT NMS Plan filed by the SROs, we understand they anticipate allocating 75% of CAT central repository build/operation costs to broker-dealers and 25% to execution venues (*i.e.*, SROs and ATSS). This would shift the majority of CAT build and operation costs away from the SROs and place them instead on the broker-dealer community who are already subject to much more significant CAT-related costs. The impact of this funding model would increase the broker-dealer portion of annual CAT-related costs from approximately 88% to more than 96%. This methodology is inequitable and serves to underscore the inherent conflicts of interest the SROs face with respect to CAT



funding and the effects of precluding broker-dealers from meaningfully participating in management of the CAT.

Given these concerns, the SEC should direct the SROs to engage an independent third-party to review and make recommendations for a transparent and equitable funding model for the CAT central repository taking into account all relevant factors, including the anticipated CAT-related costs of SROs and broker-dealers in adopting and maintaining their internal systems to meet the requirements of CAT. Also, as discussed below, it is critical that representatives of broker-dealers and other non-SROs are included on the CAT Operating Committee.

Another aspect of the CAT funding model that deserves scrutiny is the proposed treatment of profit and loss. While the CAT NMS Plan would fund the CAT central repository by broadly allocating costs across broker-dealers and the SROs (*i.e.*, exchanges and FINRA), net profit or net loss would be allocated solely among the SROs. This proposed approach is inequitable and should be revised.

The SEC envisions the CAT will serve a utility function at the core of the national market system that will benefit all market participants, including regulators, broker-dealers, and investors.⁴ As such, it should operate as a non-profit industry utility; the CAT Operating Committee can raise fees to meet the unlikely event of any losses and profits should be distributed back to all entities that fund CAT operations instead of being allotted solely to the SROs.

3. Lack of broker-dealer representation on the CAT Operating Committee

KCG's View: *The CAT NMS Plan governance structure should include broker-dealers and other non-SRO participants with voting representation on the Operating Committee. Incorporating a wider range of market participants on the Operating*

⁴ See Release at 30655 (noting the CAT NMS Plan will significantly improve regulators' ability to reconstruct and analyze broad-based market events with the goal to "better inform both regulators and investors about such market events."); See also Release at 30655 (stating the CAT NMS Plan will facilitate consideration of policy questions that will potentially influence regulatory decisions "to the benefit of investors and the market more generally." See also Release at 30748 (noting how the analysis in the CAT NMS Plan's analysis that it may improve capital formation by improving investor confidence in the market by improvements in surveillance).



Committee will help ensure the CAT NMS Plan is administered and operated in a transparent manner and that CAT governance is designed to benefit the market as a whole instead of serving to advance the commercial interests of a discreet group of market participants.

The SROs propose the CAT NMS Plan be managed by an Operating Committee comprised solely of SROs (*i.e.*, national securities exchanges and FINRA). This insular managerial structure, where broker-dealers and other market participants are not included on the Operating Committee, is contrary to the public interest and fails to recognize the CAT system as a core market utility meant to benefit all market participants. Not surprisingly, the flawed governance structure of the CAT NMS Plan is modelled off other NMS plans that also afford the SROs with exclusive governance rights. Concern about the need to reform NMS plan governance to include voting representation by non-SRO stakeholders is not limited to broker-dealer community and, in fact, is appreciated by some SROs.⁵

We are unaware of any Exchange Act provision or Commission rule barring broker-dealers from voting participation in CAT NMS Plan governance. Section 11A of the Exchange Act empowers the Commission to compel joint SRO action in connection with developing NMS plans and does not in any way preclude voting participation by non-SRO representatives in NMS plan governance. Likewise, Rule 608 authorizes the SROs to jointly file NMS plans with the Commission and does not contain any language that would prohibit broker-dealer representation on NMS plan operating committees. Finally, Rule 613 directs the SROs to jointly file an NMS plan to create and operate a consolidated audit trail and is very specific regarding many aspects and requirements of such a CAT NMS Plan. Despite this specificity, Rule 613 is void of any language prohibiting broker-dealers from sitting on the operating

⁵ See Letter from Donald Bollerman, Head of Market Operations, IEX Services LLC to Mary Jo White, Chair, Commission, dated December 10, 2014, <https://www.iextrading.com/policy/sec/02/> ("IEX Letter")(citing the need to amend NMS plans relating to SIP governance to include voting representation by investors and broker-dealers); See also Reuters article "BATS seeks to change how U.S. stock market data systems are run" available at <http://www.reuters.com/article/batsexchange-markets-sip-idUSL1N0XY48520150507>.



committee or otherwise fully participating in CAT governance. CAT is envisioned to be an industry utility intended to benefit (and impact) the market and all market participants yet the proposed governance structure affords one group of market participants (*i.e.*, the SROs) with exclusive governance rights over all aspects of the CAT NMS Plan to the exclusion of non-SRO market participants.

The CAT NMS Plan does call for an Advisory Committee to “advise” the SROs on the implementation, operation and administration of the central repository. Although establishment of an Advisory Committee may prove useful for certain matters, it is not an adequate substitute for providing non-SROs with full voting power on the CAT NMS Plan Operating Committee. Feedback related to the administration and operation of other NMS plans (*e.g.*, CTA, UTP) indicates that Advisory Committee members have limited visibility into the actions of the Operating Committee and almost no voice in the operation NMS plans. Indeed, the CAT NMS Plan specifically notes that the Advisory Committee will not have the right to vote on any matter considered by the Operating Committee or any Subcommittee and executive session may be held based on a simple majority vote.

As a critical market utility designed to benefit the national market system and all market participants, the governance and operation of the CAT NMS Plan should be structured to obtain meaningful input from the broker-dealer community. Unfortunately, the insular governance structure outlined in the CAT NMS Plan submitted to the Commission prioritizes the commercial interests of a discreet group at the expense of other market participants, fails to manage inherent conflicts of interest, and therefore should be amended.

4. Broker-dealer usage and ownership of their own CAT data

KCG’s View: *The CAT NMS Plan should be amended to indicate that broker-dealers retain ownership rights in all data they report to the CAT and are permitted to access, export, and use their data within the CAT central repository at no charge.*

The CAT NMS Plan provides that regulatory staff for the SEC and the SROs will have broad access to all data that CAT Reporters submit to the CAT central repository, including the ability to run complex searches and generate reports. Regulators will have two methods of accessing CAT data: (1) an online target query



tool with predefined selection criteria; and (2) user-defined direct queries and bulk extractions of data via a query tool or language allowing querying of all available attributes and data sources. The second method would permit regulators to extract large data sets for internal surveillance or market analysis.

Broker-dealers reporting to the CAT, however, will not have full access to their own data submissions to the CAT central repository; they will only be able to view their CAT data submissions online in a read-only, non-exportable format limited solely for error identification and correction purposes. Limiting broker-dealers' ability to access their CAT data in this manner is far too restrictive.

The benefits of allowing broker-dealers to access, export and use large sets of their own data retained in the CAT central repository are numerous. Broker-dealers could use their CAT reported data to run complex searches and generate reports to (1) meet their regulatory surveillance requirements; (2) conduct best execution analysis; and (3) conduct transaction costs analysis. Permitting broker-dealers to access, export, and use their own CAT data could also provide them with a significant tool for lowering CAT reporting error rates as more fulsome access to CAT data - beyond a read-only, non-exportable format contemplated in the proposed CAT NMS Plan - could allow for better error identification, analysis, and correction. Finally, providing broker-dealers with greater access and export capabilities of their CAT data may help offset a small portion of the enormous CAT-related costs expected to be borne by broker-dealers as expanding their CAT data access may allow them to create efficiencies and streamline their own internal surveillance and compliance infrastructure.

In addition, broker-dealers should not be charged a separate fee for accessing their own data within the CAT central repository. As the Commission has observed, broker-dealers are already expected to shoulder the bulk of all costs related to implementation and operation of the CAT system. Given the unprecedented anticipated costs to be borne by broker-dealers for the CAT, it would be unreasonable to subject them to additional and separate fees for accessing, exporting, and using the very data they already submitted to the CAT central repository, especially when doing so in order to meet regulatory obligations. Further, imposition of additional fees may dissuade broker-dealers from using their CAT data to make improvement to their regulatory and compliance programs.



5. SRO usage of data stored in the CAT central repository

KCG's View: *The CAT NMS Plan should be amended to indicate that the SROs may not use data stored in the CAT central repository – beyond the data they submit to the CAT - for their own commercial purposes.*

The CAT NMS Plan notes that SROs may use their *own* data that they submit to the CAT central repository for “commercial or other purposes.” Although SROs should be permitted to use their own CAT data for commercial or other purposes, they should not be allowed to commercialize information obtained from the CAT central repository that contains data submitted by other CAT Reporters. Likewise, the CAT Processor should not be permitted to use CAT data obtained from the CAT central repository for commercial purposes.

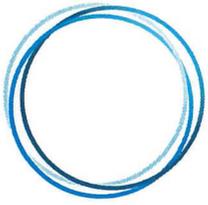
6. CAT error correction timeframes

KCG's View: *The CAT NMS Plan proposes an error correction timeframe for CAT data that is too aggressive and should be amended to comport with existing timeframes for error correction.*

The CAT NMS Plan sets forth an error correction timeframe that, among other things, includes a requirement for CAT Reporters to resubmit corrected data by 8:00 a.m. Eastern Time on T+3. Given industry experience with implementing new regulatory reporting systems much less complex than the CAT system, and the fact that roll-out of the CAT will include a sharp learning curve for broker-dealers and regulators as they understand and absorb the intricacies of new and complex system such as the CAT, the error correction timeframe in the CAT NMS Plan appears too aggressive at this time. The CAT NMS Plan should be amended to maintain current error correction timeframes until CAT reporting errors are analyzed and better understood by broker-dealers and exchanges, and regulators.

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KCG appreciates the opportunity to comment on the proposed CAT NMS Plan. Please



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do not hesitate to contact me [REDACTED] or [REDACTED] or Tom Eidt ([REDACTED] or [REDACTED]) if you have questions regarding any of the comments provided in this letter.

Sincerely,

John A. McCarthy
General Counsel