June 30, 2022

Via email to rule-comments@sec.gov

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: SIFMA Comment Letter Addressing Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail, dated May 20, 2022; File No. 4-698

Dear Ms. Countryman:

On behalf of our member firms and their customers, the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced proposed amendment (the "Proposal")[2] to the National Market System Plan Governing the Consolidated Audit Trail (the "CAT NMS Plan").[3] The Proposal would authorize CAT LLC to revise the CAT Reporter Agreement and the CAT Reporting Agent Agreement (each a "CAT Agreement" and collectively, the "CAT Agreements") as follows:

1) remove the arbitration provision from each and replace it with a forum selection provision requiring that any dispute regarding CAT reporting be filed in U.S. District Court for the Southern District of New York, or in the absence of federal subject matter jurisdiction, a New York State Supreme Court within the First Judicial Department;

2) revise the existing choice of law clause to provide that any dispute will be governed by federal law (in addition to New York law);

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our members, their customers, and nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] Release No. 34-95031 (June 3, 2022), 87 FR 35273 (June 9, 2022), https://www.govinfo.gov/content/pkg/FR-2022-06-09/pdf/2022-12398.pdf.

[3] Unless otherwise defined herein, capitalized terms in this letter have the same meanings as they do in the CAT NMS Plan and the Proposal.

3) add a jury waiver provision; and
4) add a disclaimer of warranties clause.

Although SIFMA does not oppose the proposed removal of the arbitration provision or the choice of law modifications, SIFMA strongly objects to the proposed waiver of jury trial provision and the disclaimer of warranties clause.

In particular, the proposed disclaimer of warranties is flatly inconsistent with the SEC's most recent ruling relating to the CAT System, would weaken the incentives of the Participants to properly protect the CAT System (and the data in the CAT System) and represents poor and inefficient policy choices. The proposed disclaimer of warranties clause should be rejected for the same reasons that the SEC previously rejected similar limitation of liability provisions including a nearly identical disclaimer of warranties clause.

Executive Summary

For nearly a decade, SIFMA consistently has expressed support for development of the CAT because it provides a critical market infrastructure resource for oversight of equity and options trading activity across markets. The CAT System collects trading data and certain personally identifiable information ("PII") from every retail and institutional investor in the U.S. Once fully operational, the CAT will be the largest database regarding securities transactions ever built, containing a treasure trove of valuable and potentially vulnerable information.

The CAT is owned and operated by 25 self-regulatory organizations (the "SROs") including exchanges owned by for-profit, publicly-traded holding companies. As currently configured, once broker-dealers report trade and PII data to the CAT, as mandated by the SEC, all control, access and protection of that data shifts to the SROs and their thousands of employees and contractors. For that reason, SIFMA also has consistently raised concerns about the security of CAT Data, its susceptibility to breach or misuse, and the potentially significant liabilities that could flow from such breach or misuse of CAT Data or the CAT System.

The SROs have offered repeated assurances that CAT Data will be fully secured. Yet, they undercut those assurances by repeatedly seeking to limit their own liability for breach or misuse of the data – as they do now, once again, in the Proposal. SIFMA consistently has

opposed,[4] and the SEC ultimately disapproved,[5] the inclusion of limitation of liability provisions, including a proposed disclaimer of warranties clause,[6] in the CAT Agreements.

The proposed disclaimer of warranties clause is essentially identical to the warranty disclaimer that was included in both the original CAT Agreements, and in the SROs' recent proposal to re-insert limitation of liability provisions in the CAT Agreements – which were withdrawn by the Participants and/or rejected by the SEC. SIFMA strongly opposes the proposed disclaimer of warranties clause for all the same reasons that we previously opposed limitation of liability provisions in the prior CAT Agreements, and for the additional reasons detailed below. We strongly urge the SEC to disapprove the now re-proposed disclaimer of warranties clause in the CAT Agreements.

SIFMA also opposes the jury waiver provision. Although some CAT Data breaches may present complicated factual and legal issues best resolved by judges, others may present more simple and straightforward issues, or may otherwise be better suited for a jury trial. Every case is different. It is unnecessary to determine in advance the appropriate fact-finder for every prospective CAT Data breach case, and it would be unfair to deny Industry Members an important procedural right – the right to jury trial— by doing so. We also believe that preserving the right to jury trial will provide additional accountability to more strongly incentivize the SROs to prioritize and invest in data security. For these reasons, we urge the SEC to disapprove the jury waiver provision in the CAT Agreements.

1. The proposed disclaimer of warranties clause functions as a limitation of liability provision. SIFMA already has successfully negotiated the clause out of the CAT Agreement, and the SEC already has disapproved the clause.

The proposed disclaimer of warranties clause (the "DWC") provides that the SROs, CAT LLC, and FINRA CAT "disclaim any, and make no, representations or warranties…regarding the CAT System or any other matter pertaining to this agreement…[including] without limitation, any representation or warranty of or relating to…quality; fitness for a particular purpose…accuracy or completeness of information." The purpose for including this clause is to ensure that the SROs cannot be held *liable* for any alleged breach of a representation or warranty. Rather than disclaim liability directly, the DWC does so indirectly by seeking to eliminate certain claims (i.e., claims based upon breach of a representation or warranty) for which the SROs could be held liable. In this respect, the DWC functions just like any of the other limitation of liability provision by which the SROs seek to limit their liability for breach or

[4] SIFMA comment to SEC re: CAT limitation of liability provisions (Jan. 27, 2021), https://www.sec.gov/comments/4-698/4698-8298026-228278.pdf; SIFMA comment to SEC re: limitation of liability order (May 3, 2021), https://www.sec.gov/comments/4-698/4698-8751243-237404.pdf.

[5] Order Disapproving CAT NMS Plan Amendment ("Disapproval Order"), Release No. 34-93484 (Oct. 29, 2021), https://www.sec.gov/rules/sro/nms/2021/34-93484.pdf.

[6] See more detailed discussion on this point, *infra* Section 1.

misuse of CAT Data. In the Proposal, the SROs acknowledge that the DWC in fact functions as a limitation of liability provision, stating that "the Participants should not be held *liable* for damages based on warranties or representations that they did not explicitly make." (emphasis added)[7]

In 2019, in preparation for CAT reporting, CAT LLC drafted the original CAT Agreements. Industry Members and their reporting agents were required to sign these agreements as a condition to submitting reports to the CAT.[8] The original CAT Agreements contained several limitation of liability provisions, including:

- A disclaimer of all damages,
- A *disclaimer of all representations and warranties* (which is essentially the same as the DWC that the SROs now seek to reinsert in the CAT Agreements), and
- A cap on the liability of CAT LLC, the SROs, and FINRA CAT to any CAT Reporter at $500/year

(collectively, the "Limitation of Liability Provisions").

In April 2020, SIFMA filed an administrative proceeding, arguing that requiring Industry Members to sign these agreements as a condition to reporting to the CAT constituted a denial of access to SRO services in violation of Section 19(d) of the Exchange Act. In May 2020, SIFMA and the SROs reached a settlement that allowed Industry Members to report to the CAT under a revised version of the CAT Agreement that excluded *all* of the Limitation of Liability Provisions (including the *warranty disclaimer*) (the "Settlement"). The SROs acknowledge that they *agreed* to remove the warranty disclaimer (along with the rest of the Limitation of Liability Provisions) from the CAT Agreement.[9]

In December 2020, the SROs filed a proposed amendment to essentially re-insert the *same* limitation of liability provisions in the CAT Agreements that had been removed pursuant to the Settlement (the "Limitation of Liability Proposal").[10] The SROs expressly acknowledged that their proposed limitation of liability provisions were essentially the same as the Limitation of Liability Provisions included in the original CAT Agreements (including the warranty

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[7] Proposal, 87 FR at 35278.

[8] SIFMA has not identified any records indicating that either of the full versions of the CAT Agreements have ever been submitted for public review and comment by Industry Members and their reporting agents, among others, or for review and approval by the SEC. *See* Release No. 34-90826 (Dec. 30, 2020), 86 FR 591, 592 (Jan. 6, 2021), https://www.govinfo.gov/content/pkg/FR-2021-01-06/pdf/2020-29216.pdf ("On August 29, 2019, CAT LLC's Operating Committee approved the then-draft [CAT] Agreement – including the limitation of liability – by unanimous written consent." (citing CAT NMS Plan, Section 4.1 (Operating Committee))).

[9] Proposal, 87 FR at 35278.

[10] Limitation of Liability Proposal, 86 FR 591.

disclaimer).[11] These proposed limitation of liability provisions (including a proposed disclaimer of representations and warranties) were listed in an appendix appropriately entitled, *Limitation of Liability Provisions in the CAT Reporter Agreement*.[12]

In October 2021, the SEC issued an order disapproving *all* of the limitation of liability provisions listed in the appendix to the Limitation Of Liability Proposal (including the warranty disclaimer) for a variety of reasons, including those discussed in Sections 2 through 5 *infra*.[13] The SEC's Order disapproving the proposed amendment (including the re-proposed warranty disclaimer) observed, among other things, that the proposal "would reduce the Participants' incentives to invest in CAT data security….[L]iability rules that incentivize appropriate security measures are likely to increase efficiency while rules that potentially disincentivize participants from securing CAT Data may reduce efficiency."[14] The SROs expressly acknowledge that the Disapproval Order encompassed the warranty disclaimer.[15]

The DWC is essentially identical to the warranty disclaimers included in the original CAT Agreements (which SIFMA successfully negotiated out), and in the Limitation of Liability Proposal (which the SEC disapproved). In both cases, the SROs included the warranty disclaimer among a list of other limitation of liability provisions. Now, through the Proposal, the SROs assert that because the warranty disclaimer was included among a list – and the entire list was removed from the original CAT Agreement pursuant to the Settlement – and the entire list was disapproved by the SEC pursuant to the Disapproval Order, that no commenter or Industry Member ever *specifically* objected to the warranty disclaimer clause.[16]

We strongly disagree. SIFMA consistently has opposed *all* limitation of liability provisions in the CAT Agreements, including warranty disclaimer clauses. In fact, we specifically referenced the warranty disclaimer clause in our May 2021 comment letter to the SEC.[17] The SEC already has conclusively ruled on warranty disclaimer clauses, including the DWC. The DWC is, and remains, an improper limitation of liability provision that should continue to be excluded from the CAT Agreements. The SEC should reject this third attempt by the SROs to impose, without any proper basis, a limitation on their CAT duties, responsibilities and potential liability.

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[11] *Id.* at 593.

[12] *Id.* at 598.

[13] *See* Disapproval Order.

[14] Disapproval Order at p. 38.

[15] Proposal, 87 FR at 35278.

[16] *Id.*

[17] SIFMA comment to SEC re: limitation of liability order (May 3, 2021) at p.2 (observing that CAT LLC purports to make "no representations or warranties regarding the CAT System or any other matter").

2. The SROs should not be permitted to disclaim representations or warranties or impose liability limitations regarding the CAT System, which they operate and control (including the CAT Data within the CAT System).

Virtually all of the substantial risks of breach or misuse of CAT Data are *entirely* beyond the control of Industry Members. The SROs exclusively developed, and are exclusively responsible for operating and maintaining, the CAT System. The SROs also are exclusively responsible for ensuring the security and confidentiality of the CAT Data. Given the highly sensitive and proprietary nature of the CAT Data, it will no doubt be an attractive target for exploitation and/or misuse for improper competitive purposes by not only nation states, hackers, and bad actors, but also potentially by the hundreds of employees and contractors of the SROs, as well as others granted access to the CAT System by the SROs.

Any breach or misuse of CAT Data would almost certainly result from action or inaction of the SROs. The SROs have complete dominion and control over the CAT System. The SROs should therefore bear responsibility for the CAT System and liability for its breach or misuse.

Through the DWC, the SROs seek to limit their responsibility and potential liability by disclaiming all representations and warranties. That should not be permitted. It is unfair and bad policy to eliminate in advance SRO responsibility for representations and warranties that may be applicable to its operation of the CAT System, including responsibility for good faith and fair dealing, quality, fitness for a particular purpose, compliance with applicable law; and sequencing, timeliness, accuracy and completeness of information.

It is seriously concerning that the SROs appear simultaneously to be telling Industry Members and the SEC that the CAT System and CAT Data are appropriately protected, but that the SROs are unwilling to be responsible for basic representations and warranties regarding the integrity and security of the system that they control and operate. The impermissible goal of the DWC proposed by the SROs is to (again) seek to shift risk/responsibility/potential liability away from the SROs (which fully control and operate the CAT System and the data that is part of the CAT System) and toward Industry Members (and their customers) whose data is embedded within the system, but which exercise no control over the safety, security, integrity or operations of the system.

For the same reasons that the similar (and in part nearly identical) allocation of risk/limitation of liability already was successfully challenged by SIFMA and rejected by the SEC, this newest proposal should be swiftly rejected. As the Commission expressly observed in its prior Disapproval Order:

> The Commission believes the Participants are best poised due to information asymmetry to understand the risks inherent in collecting and using CAT Data, and, because of moral hazard, to mitigate those risks through operational measures to promote CAT data security and securing insurance to mitigate financial risks associated with CAT data security. Efficiency is likely to be reduced to the extent the Proposed Amendment

disincentivizes the Participants from investing in CAT data security and thus potentially increases the likelihood of a data breach.[18]

3. SROs already benefit from judicially-created regulatory immunity for their regulatory (non-commercial) activities and therefore additional, contractual, liability limitations, like the DWC, are unnecessary and inappropriate.

To the extent the SROs are acting in their regulatory capacity when operating the CAT, the SROs may assert the judicial doctrine of regulatory immunity in seeking to limit potential liability. To the extent the SROs use CAT Data or the CAT System for commercial purposes, or otherwise outside of their regulatory capacity, the doctrine should not apply.[19] Given that regulatory immunity is a judicial doctrine, it is up to the courts to decide whether or not the doctrine applies under any particular set of circumstances. The SEC should clarify that it is not prejudging or expressing any views as to the potential applicability or scope of regulatory immunity.

It is unnecessary and would be inappropriate to attempt to embody or potentially broaden regulatory immunity in the CAT Agreements. First, as discussed, it is for the courts to decide whether and how the doctrine applies, if at all. Second, attempting to do so would run the substantial risk of establishing areas of immunity beyond the scope of regulatory immunity. The SEC already has determined that expanded liability protections for SROs would be inconsistent with the Exchange Act.[20]

Finally, SIFMA rejects the entire premise of the SROs seeking to impose conditions, limitations, disclaimers and other terms through the CAT Agreements, given that the CAT Agreements are by definition contracts of adhesion.[21] They are not commercial agreements, negotiated at arms-length, between parties of equal bargaining power. Rather, they are unilaterally imposed agreements that Industry Members are mandated to enter into as a condition to submitting data to the CAT.

Reporting to the CAT is *not* an option for Industry Members. If Industry Members disagree with the terms of the CAT Agreements, they are not free to reject those terms and report to a *different* Plan Processor. Rather, Industry Members are required by regulation to execute the agreements and report pursuant to the current CAT NMS Plan.

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[18] Disapproval Order at p. 37–38.

[19] *Id.* at p. 29.

[20] *Id.* at 29 – 30.

[21] A contract of adhesion is generally defined as a contract offered intact to one party by another under circumstances requiring the second party to accept or reject the contract in total without having the opportunity to bargain over the terms.

Not only do Industry Members have no hand in drafting the terms of the CAT Agreements, but also never know when the SROs will unilaterally seek to change the terms yet again. On each and every occasion, Industry Members try to quickly mobilize to fight for their legal rights, and for fairness and balance in the CAT Agreements. Given the power and control imbalance between the SROs (as regulators) and Industry Members (as captive regulatees), we urge the SEC to help protect against overreach by the SROs, especially with respect to limitation of liability provisions, such as the DWC.

4. If SROs are allowed to shift liability to Industry Members, then SROs would be improperly disincentivized to provide adequate security for the CAT System, which will ultimately increase costs for investors.

Permitting the SROs to disclaim liability for a breach or misuse of CAT Data (and to thereby shift liability to Industry Members) is not only fundamentally unfair, but also would improperly incentive the SROs, as the operators of the CAT, to under-invest in data security and cyber insurance for the CAT System. That, of course, would place investors at greater risk of, and eventually result in investors, having their data compromised. As noted in an economic analysis by Professor Craig M. Lewis – which we referenced in our comment letter rejecting the previous proposal – altering CAT LLC's incentives through the DWC "would result in a reduction of investor welfare."[22] "Investors would be at greater risk of having their data compromised since CAT LLC's incentives to invest in security to protect the CAT Data would be reduced."[23] In turn, the SROs' insufficient investment in security and inefficient purchase of insurance would require Industry Members to absorb the SROs' liability expenses (for events over which Industry Members have no control), and those expenses would likely be passed downstream to investors, resulting in higher costs to investors.

When the SEC previously disapproved the DWC (together with the other Limitation of Liability Provisions), the SEC recognized these risks, stating among other things:

- "uncertainty regarding liability in case of a CAT data breach thus serves as an incentive for the [SROs] to invest in data security…."[24]
- "reducing the [SROs] existing incentives to properly invest in data securities activities might disincentivize individual [SROs] from appropriately investing in the screening and monitoring of their own employees and contractors that will access CAT Data."[25]

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[22] Professor Craig M. Lewis, "White Paper: Economic Analysis of Proposed Amendment to National Market System Plan Governing the Consolidated Audit Trail," February 2021, p. 1.

[23] *Id.*

[24] Disapproval Order at p. 42.

[25] *Id.* at 44 – 45.

- "To the extent that the scope of limitation of liability in the [CAT Agreements] exceeds what might be expected from the doctrine of regulatory immunity, [that] would further disincentivize [the SROs] from activities that promote CAT Data security…."[26]

For these same reasons, the SEC should again strike the DWC from the CAT Agreements.

5. Limitation of liability provisions in the CAT Agreements, like the DWC, are inconsistent with the efficiency, competition, and capital formation purposes of the Exchange Act.

Limitation of liability provisions in the CAT Agreements, such as the DWC, do not promote the Exchange Act's goals of efficiency, competition and capital formation because they would ultimately lead to higher costs for investors. The SEC previously concluded that the Limitation of Liability Provisions: "would likely have significant negative effects on efficiency…."[27] and "might have negative effects on competition and capital formation…."[28] These factors likewise weigh in favor of the SEC disapproving inclusion of the DWC in the CAT Agreements.

6. The proposed jury waiver provision should be rejected.

SIFMA also urges the SEC to disapprove the jury waiver provision in the CAT Agreements because it would improperly limit the rights of Industry Members to pursue claims for potential damages and disincentivize the SROs from investments in system security, as explained in further detail in the Executive Summary, *supra*.

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[26] *Id.* at 43.

[27] *Id.* at 37.

[28] *Id.* at 38.

For all the foregoing reasons, we strongly urge the Commission to disapprove the Proposal in its current form and specifically to disapprove inclusion of both the DWC and the waiver of jury trial provisions in the CAT Agreements. SIFMA greatly appreciates the SEC's consideration of our comments and recommendations. We would be pleased to discuss them in greater detail with you.

Sincerely,

Ellen Greene
Managing Director
Equity and Options Market Structure

Kevin M. Carroll
Managing Director and
Associate General Counsel,
Office of General Counsel

cc: The Honorable Gary Gensler, Chair
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Allison Herren Lee, Commissioner
The Honorable Hester M. Peirce, Commissioner

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