



January 12, 2023

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

**Re: *Joint Industry Plan; Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail; File No. 4-698***

Dear Ms. Countryman:

On behalf of our member firms, the Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> respectfully submits this additional comment letter to the U.S. Securities and Exchange Commission (the “Commission”) in response to the Commission’s publication of the November 16, 2022 submission (“November Submission”)<sup>2</sup> by the self-regulatory organizations (“SROs) to significantly and materially change their previous May 13, 2022 proposal (“May Proposal”) to establish a revised funding model (“Executed Share Model”)<sup>3</sup> for the consolidated audit trail (“CAT”).<sup>4</sup> While we continue to believe the SROs should be required to withdraw the May Proposal and file the New Executed Share Model as a new amendment to the CAT NMS Plan, we are submitting this additional comment letter to set forth in more detail our substantive comments on the November Submission. As discussed

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<sup>1</sup> 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 industry’s one million employees, we advocate on 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). For more information, visit <http://www.sifma.org>.

<sup>2</sup> See Release No. 34-96394 (November 28, 2022), 87 FR 74183 (December 2, 2022) (November Submission). Capitalized terms not otherwise defined in this letter have the same meanings as they do in the CAT NMS Plan, the May Proposal, and/or the November Submission.

<sup>3</sup> See Release No. 34-94984 (May 25, 2022), 87 FR 33226 (June 1, 2022) (May Proposal to establish the Executed Share Model).

<sup>4</sup> As we noted in our December 14, 2022 comment letter on the November Submission, by including significant changes to the Executed Share Model, as well as omitting critical information necessary to understand the changed model, the November Submission effectively creates a new Executed Share Model (“New Executed Share Model”) that should be treated as an entirely new amendment to the National Market System Plan Governing the Consolidated Audit Trail (the “CAT NMS Plan”). See (<https://www.sec.gov/comments/4-698/4698-20152795-320485.pdf>) (“December 2022 Comment Letter”).

extensively in our first two comment letters on the Executed Share Model and further supplemented in this letter,<sup>5</sup> the SROs as the CAT NMS Plan Participants (“Participants”) have not demonstrated that the proposed amendment to the CAT NMS Plan meets the relevant standards governing SRO fees under the Securities Exchange Act of 1934 (“Exchange Act”).

As we have stated in the past, we recognize and accept that Industry Members will be responsible for a portion of CAT costs. Nonetheless, we continue to believe that the process followed in connection with establishing and now amending the Executed Share Model has been significantly flawed. As we have noted previously, the SROs have not meaningfully solicited industry input in initially establishing the Executed Share Model. Furthermore, the Commission is now allowing the SROs to significantly and materially amend the Executed Share Model to establish the New Executed Share Model through a “Partial Amendment” that the Commission has published for a very brief 21-day comment period in the Federal Register.

We believe for the reasons set forth below, as well as in our prior comment letters, that the Commission should disapprove the New Executed Share Model as the Participants have not met their burden under the Exchange Act of demonstrating that the proposal (1) provides “for the equitable allocation of reasonable dues, fees, and other charges,” (2) is “not designed to permit unfair discrimination between customers, issuers, brokers or dealers,” and (3) does not “impose any burden on competition not necessary or appropriate in furtherance of the purposes” of the Exchange Act. While we support a number of changes made in the November Submission as described below, we believe that:

- the Participants’ decision to allocate two-thirds of CAT costs to Industry Members is unfair and unreasonable because the Participants are equally responsible for the complexity of the trading activity in the equity and options markets, complexity that could exponentially increase if the Commission moves forward with its equity auction and new minimum pricing increment proposals;<sup>6</sup>
- the CAT continues to need an independent cost review mechanism to help ensure that future CAT fees are fair and reasonable;
- the proposed method for assessing Historical CAT Cost does not provide for the fair and reasonable allocation of CAT Fees and should be modified in the manner described below; and
- the failure to define “executing brokers” in a transaction and the uncertainty of how fees would be assessed for transactions on an alternative trading system (“ATS”) make it impossible for Industry Members to fully understand and meaningfully comment on this latest proposal.

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<sup>5</sup> See (<https://www.sec.gov/comments/4-698/4698-20132695-303187.pdf>) (“June 2022 Comment Letter”) and (<https://www.sec.gov/comments/4-698/4698-20145239-310561.pdf>) (“October 2022 Comment Letter”).

<sup>6</sup> See Release No. 34-96495 (December 14, 2022), 88 FR 128 (January 3, 2023) (Order Competition Rule); Release No. 34-96494 (December 14, 2022), 87 FR 80266 (December 29, 2022) (Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders).

Our comments are set forth in more detail below.

## **I. Discussion**

### **A. Industry Member Allocation**

In seeking to demonstrate that the proposed allocation of one-third of CAT costs to Participants and two-third of CAT costs to Industry Members meets the Exchange Act fee standards,<sup>7</sup> the Participant Exchanges argue that while determining the precise cost burden of each CAT Reporter is not feasible, the use of executed share volume (i.e., trading activity) is a reasonable proxy for a CAT Reporter's cost burden on the CAT.<sup>8</sup> The Participant Exchanges then argue that Industry Members' chosen business models and their resulting trading activity are substantial drivers of CAT costs, and that, accordingly, it is reasonable to allocate two-thirds of CAT cost to Industry Members.

In making these assertions, the Participant Exchanges fail to consider that they are equally responsible for the complexity of the trading activity in the equity and options markets. Industry Members' varied business models and trading activities are a direct result of the large number of equity and options exchanges established by the exchange families with fundamentally different execution models and order types. Indeed, it is precisely because there are 16 distinct equities exchanges and 16 distinct options exchanges that Industry Members must grapple with where and how to route orders for execution.

For instance, in the options market, all transactions must occur on the exchanges, as there is no over-the-counter trading facility for options trading. Thus, the complexity of the trading activity in the options market is a direct result of the options exchanges' chosen business models to establish 16 exchanges with three different models with differing fees and complicated order types, including sophisticated routing strategies. Similarly, while there is off-exchange trading in the equity markets, the amount of trading on exchanges frequently accounts for 60% or more of all trading activity in NMS stocks.<sup>9</sup> Thus, a significant amount of the trading complexity in the specific business models chosen by the equity exchanges. Moreover, this complexity could exponentially increase if the Commission seeks to move ahead with its proposals to reduce some tick size increments to 1/10 of a penny and to effectively mandate that "segmented orders" be

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<sup>7</sup> We note that we use the reference "Participant Exchanges" in certain parts of this letter rather than "Participants," as it is clear that the large exchange groups are dictating the CAT funding model decisions based on the CAT NMS Plan voting structure. For instance, in the November Submission, the CAT NMS Plan Operating Committee states that it "has approved the proposed amendments to the Proposed Amendment as set forth in Section II of this letter in accordance with the CAT NMS Plan," and that "CAT LLC notes that the responses set forth in Section III of the letter represent the consensus of the Participants, but that all Participants may not fully agree with each response set forth in this letter." Our October 2022 Comment Letter highlights the problems with the current CAT NMS Plan voting structure, which continues to result in the unfair and inequitable treatment of treatment of the Financial Industry Regulatory Authority, Inc. ("FINRA") in the November Submission.

<sup>8</sup> See (<https://www.sec.gov/comments/4-698/4698-20136270-307325.pdf>).

<sup>9</sup> See, e.g., Release No. 34- 96495 (December 14, 2022), 88 FR 128 (January 3, 2023) (Order Competition Rule). In the Commission's proposed Order Competition Rule, the Commission found that 59.7% of all trading activity in NMS stocks occurred on exchanges in Q1 2022.

run through exchange-sponsored auctions.<sup>10</sup> In other words, the Participant Exchanges' chosen business models of establishing multiple exchanges with differing execution models and complicated order types are equally responsible for the complexity of the trading activity in the equity and options markets that drives CAT costs.

In seeking to allocate two-thirds of the CAT costs to Industry Members, the Participant Exchanges also argue that there are more Industry Members than Participants and that the Industry Members receive more in revenue than the Participants.<sup>11</sup> Neither one of these assertions demonstrates that the proposed allocation of CAT costs is fair and reasonable. Such simplistic assertions are akin to deciding to assign costs to the group with the most members or the most revenue, regardless of whether that group was responsible for the costs. This is why prior versions of the CAT funding models focused on allocating costs based on the parties responsible for generating them.

Accordingly, we continue to believe that assigning 50% of CAT costs to the Participant Exchanges and 50% to Industry Members is a more fair and reasonable way to allocate CAT costs than what is being proposed by the Participants. As we have stated previously, this allocation would provide for an equal sharing of CAT costs between Participant Exchanges and Industry Members and would be justifiable under the Exchange Act because it treats Participant Exchanges and Industry Members the same from a cost allocation perspective based on their responsibility for generating CAT costs, thus satisfying the fair and reasonable and other Exchange Act fee standards. As we have noted previously, under such an approach, FINRA could be assessed a nominal regulatory user fee to access CAT Data to perform its regulatory role.<sup>12</sup> Treating FINRA differently from the Participants Exchange would be justifiable under the Exchange Act fee standards because it is a non-profit and it conducts the vast majority of the self-regulatory activity for the brokerage industry.

In connection with the Participants' proposed cost allocation approach, we also continue to have significant concerns regarding the Participants' lack of consideration or analysis of the costs incurred by Industry Members in building their systems to accommodate CAT reporting. In approving the CAT NMS Plan, the Commission analyzed and considered Industry Member costs in its economic analysis, finding that broker-dealers' implementation costs would be magnitudes greater than the Participants' implementation costs.<sup>13</sup> However, in seeking to allocate two-thirds of CAT cost to Industry Members, the Participants do not account for or otherwise address the time and expense Industry Members have devoted to develop and will continue to devote to maintain internal systems to be able to report to the CAT. Some of the larger firms spent millions of dollars and devoted countless staff hours to developing internal systems capable of reporting order, transaction and customer data to the CAT and workable reporting specifications for the CAT. Ongoing compliance costs for CAT and CAIS will be substantial. Yet nowhere in the Participants' discussion of its decision to allocate two-thirds of

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<sup>10</sup> See the Commission's "Order Competition Rule" and "Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders" proposals.

<sup>11</sup> Id.

<sup>12</sup> See October 2022 Comment Letter, *supra* note 5.

<sup>13</sup> See Release No. 34-79318 (November 15, 2016), 81 FR 84696 (November 23, 2016).

the CAT costs to Industry Members are the costs of these efforts by Industry Members analyzed. We believe this omission is a fundamental flaw with the Participants' decision to allocate two-thirds of the CAT costs to Industry Members and its inclusion would demonstrate that the Participants' approach does not provide for the equitable allocation of reasonable fees.

## **B. Cost Control and Fee Setting Process**

We appreciate and support the changes in the November Submission to provide more detail regarding the CAT Fee determination process, including providing detail on the rule filings that the Participants would file under Section 19(b) of the Exchange Act to collect CAT Fees from Industry Members. Nonetheless, as noted in our June 2022 Comment Letter, we continue to have significant concerns about the lack of an independent cost control mechanism for the CAT budget that would help ensure that future CAT Fees are fair and reasonable. As we understand the contemplated CAT budget process under the November Submission, the Participants still are not planning to include a mechanism for the public to review and provide input on the development of the annual CAT budget prior to it being finalized. Rather, the only opportunity that Industry Members and other members of the public have to review the budget would be when the individual SROs file fee changes to collect fees to fund the current CAT budget, well after the CAT budget is agreed to and approved by the Participants. A post-hoc review of the CAT budget is not an effective mechanism to help ensure that future CAT Fees are fair and reasonable.

We continue to strongly believe that the CAT needs an independent review mechanism of proposed CAT expenditures to help ensure that the process fosters appropriate and cost-effective CAT spending, consistent with the Exchange Act. While we appreciate the Participants' decision in the November Submission to provide greater transparency regarding the CAT Fee setting process and CAT costs through the rule filing process, their approach continues to be flawed because it provides no mechanism for the public to review the proposed CAT budget prior to it being implemented. One way to address this flaw is for the Participants to provide the public with notice of the proposed CAT budget prior to each SRO individually filing fee changes with the Commission to set the current Fee Rate. This could be accomplished by the CAT Operating Committee publishing the proposed budget for comment on the CAT NMS Plan website prior to each SRO submitting rule changes under Section 19(b) of the Exchange Act to implement the budget. This approach would be similar to SROs' solicitation of comments on contemplated proposed rule changes prior to filing them with the Commission. For example, we note that given its regulatory importance to the brokerage industry, FINRA often engages in such a practice with regard to significant rulemakings that would change the compliance obligations of its members.<sup>14</sup>

Although we recognize that this process is cumbersome, an effective CAT cost review mechanism needs to allow the public to provide input prior to the CAT budget being finalized. Absent adding Industry Member representation to the CAT Operating Committee, the approach that we set forth above is potentially one way to address this issue. We continue to remain open

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<sup>14</sup> See, e.g., FINRA RN 21-19, in which FINRA sought public comment about potential changes to its short interest reporting rule (Rule 4560) and other contemplated short sale-related proposals prior any formal rule filing(s) with the Commission (<https://www.finra.org/rules-guidance/notices/21-19>).

to discussing other approaches with the Participants that are designed to provide an independent review mechanism of CAT spending choices. Among other things, such an independent review mechanism is critical given that one of the primary designers and beneficiaries of the CAT – the Commission – has no funding obligations for it. Given this dynamic, we also believe that it is critical that the Participants’ proposed budget include as a line item any usage costs and projected system change costs related to the Commission’s use and design of the CAT System.

As part of this vetting process for a proposed CAT budget, as well as any fee filings the SROs make under the approach outlined in their November Submission, we request as we have previously that the Participants provide significantly more detail on the spending choices they make in the CAT budget, particularly regarding technology spending. In the November Submission, the Participants have committed to providing “a brief description of each line item in the budget, including technology, legal, consulting, insurance, professional and administration, and public relations costs, a reserve and/or such other categories as determined by the Operating Committee to be included in the budget.” While we support this addition, we continue to believe that these categories are too high-level to allow the public to meaningfully understand and evaluate CAT spending choices.<sup>15</sup>

For instance, with regard to technology spending, we recommend that CAT be required to break out technology spending in the manner it did in the September 21, 2021 CAT costs webinar.<sup>16</sup> This would include further breakdowns of the technology costs for (i) cloud hosting services; (ii) operating fees; (iii) CAIS operating fees; and (iv) change request fees. In the webinar, the Participants broke-out cloud hosting fees into production costs and other cost categories, and further broke-out the production costs into subcategories such as linker costs and storage costs. While this level of detail may seem unnecessary for the Participants, it allows Industry Members and other members of the public to understand and evaluate in more detail CAT spending choices. Most importantly, it allows Industry Members and other members of the public to bring their collective expertise as technology consumers to bear on how CAT may be able to spend money more efficiently.

### **C. Past CAT Costs**

We appreciate the Participants’ decision in the November Submission to provide more detail regarding the process to collect Historical CAT Costs. While we will not discuss in detail in this comment letter the concerns we have expressed previously about the appropriateness of assigning certain Historical CAT Costs to Industry Members, we continue to strongly object to the allocation of certain such costs to Industry Members, such as the allocation of any costs related to the Participants’ failed decision to designate Thesys Technologies, LLC as the CAT

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<sup>15</sup> We note that the Participants in the November Submission have explicitly provided for a reserve of not more than 25% of the CAT budget as part of the budget. The Participants essentially argue that such an amount is reasonable because they have exceeded the CAT budget by approximately 20% in each of the last three years. In addition to the 25% being excessive, the Participants’ rationale for providing for a reserve, namely their inability to accurately forecast CAT costs, demonstrates the need for an independent cost review mechanism.

<sup>16</sup> See ([https://catnmsplan.com/sites/default/files/2021-09/09.21.21-CAT-Costs\\_0.pdf](https://catnmsplan.com/sites/default/files/2021-09/09.21.21-CAT-Costs_0.pdf)).

Plan Processor and any legal and consulting costs incurred prior to the CAT NMS Plan's approval in November 2016.<sup>17</sup>

In this comment letter, we want to focus on our continued concern that the Participants' choice of assessing Past CAT Costs based on an Industry Member's current trading activity is neither fair nor reasonable. Under the Participants' proposed approach, for example, a new Industry Member would be assessed a share of Past CAT Costs even if the Industry Member did not exist at the time those Past CAT Costs were incurred by the Participants. In addition, the new Industry Member would be responsible for a portion of Past CAT Costs attributable to other Industry Members that are no longer in business.

We believe a more fair and reasonable approach is for the Participants to assign Past CAT Costs to the Industry Members based on the lesser of (i) the CAT Fees that would be assessed on an Industry Member under the Participants' proposed approach of using current trading activity or (ii) the CAT Fees that would be assessed on such member based on their prior trading activity in the years since 2016 when the CAT was being built and then operationalized (subject to the exclusions noted above and previously for certain Past CAT Costs). We believe this "lesser of" approach meets the fair and reasonable Exchange Act standard because it would more appropriately account for the costs associated with the delays caused by the Participants in standing up the CAT and the time and expense Industry Members have incurred in connection with these efforts, as well as recognize the changes in Industry Members' business models and associated trading activity over the years. Under our proposed approach, we would expect that FINRA, the Participants and/or the Commission – through the Form BD or otherwise - would have records of the Industry Members that were in business in prior years, and that the Participants would have records of each such Industry Member's trading activity. For those Industry Members that are no longer in business, their share of Past CAT Cost in each year they were in business could be calculated using the approach described above and then equally divided among the current Industry Members. For those Industry Members that commenced operations after certain Past CAT Costs were incurred, their assessment of Past CAT Cost would start in the year in which they commenced operation based on the approach set forth above.

We believe that such an approach is significantly closer to the fair and reasonable standard in the Exchange Act than the approach set forth by the Participants in the Executed Share Model. While such an approach will require more effort by the Participants, given that the amount of Past CAT Costs is likely approaching if not exceeding \$500 million, it is critical that the Participants employ a more precise model than the one they are proposing in the Executed Share Model to allocate Past CAT Costs consistent with the Exchange Act fee standards.

#### **D. Lack of Definition of Executing Broker and ATS Impact**

As noted in our December 2022 Comment Letter, we support the Participants' decision to allocate CAT costs to executing brokers rather than clearing brokers. The Participants' initial decision to allocate CAT costs to clearing brokers would have led to unfair burdens on them and could have resulted in them shouldering the burden of CAT costs in scenarios in which they

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<sup>17</sup> See *supra* note 5.



could not determine which clearing client was responsible for the costs. Nonetheless, we believe the Participants need to provide significantly more detail than they currently have in the November Submission regarding how the CAT costs would be determined for Industry Members serving as executing brokers.

As a threshold matter, the Participants have not provided a definition of “executing broker” that would allow Industry Members to gauge their share of CAT costs.<sup>18</sup> SIFMA has understood the concept to generally refer to the Industry Member initiating the order. However, as demonstrated by a recently submitted comment letter, at least one Industry Member acting as an order consolidator expressed significant, well-founded concerns that such firms would be the only ones defined as executing brokers.<sup>19</sup> While the SROs suggest that Industry Members could calculate their own fees using their own submitted CAT data, they have failed to provide a definition of who would be treated as an “executing broker” in a transaction that would facilitate such an undertaking. A clear definition is critical for Industry Members to understand when and in what situations they would be assessed costs under the November Submission, and the lack of such a definition is already leading to confusion and significant concerns.

Similarly, nowhere do the SROs address how the CAT Fees for transactions executed on an ATS would be assessed, such as which party to a transaction on an ATS would be treated as the “executing broker(s).” We note, for example, that transactions on ATSs can be reported to the tape in multiple ways, including in the name of the clearing broker for the ATS even though the clearing broker was not involved in executing the trade on the ATS. Yet none of these scenarios is addressed in the November Submission, leaving both Industry Members acting as ATSs and Industry Members executing on them in the dark about how they might be assessed CAT fees for ATS transactions.

Moreover, unlike in other CAT fee model submissions, the Participants have provided no data in the November Submission that would give Industry Members defined as executing brokers the opportunity or ability to understand the costs they would face under the New Executed Share Model.<sup>20</sup> Previously, the Participants provided a chart in which individual Industry Members could see their projected CAT cost under the proposed model. The November Submission, however, fails to include any such data.

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SIFMA greatly appreciates the opportunity to comment on the November Submission. For the reasons discussed above, we strongly urge the Commission to disapprove the proposed model. If you have any questions or require additional information, please do not hesitate to contact us by calling Ellen Greene at [REDACTED] or Joe Corcoran at [REDACTED]

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<sup>18</sup> The term “executing broker” is used in a variety of contexts in the industry and is sometimes applied to various brokers who have a role in the lifespan of a single order.

<sup>19</sup> See (<https://www.sec.gov/comments/4-698/4698-20154122-322324.pdf>).

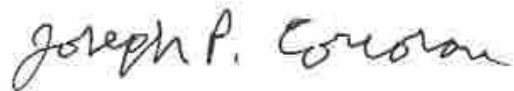
<sup>20</sup> See, e.g., the May Proposal and Release No. 34-91555 (April 14, 2021), 86 FR 21050.



Sincerely,



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Cc: The Hon. Gary Gensler, Chair  
The Hon. Hester M. Peirce, Commissioner  
The Hon. Caroline A. Crenshaw, Commissioner  
The Hon. Mark T. Uyeda, Commissioner  
The Hon. Jaime Lizarraga, Commissioner  
Mr. Haoxiang Zhu, Director, Division of Trading and Markets