



**Marcia E. Asquith**  
Corporate Secretary, EVP  
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April 11, 2023

Ms. Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Via Email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

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

Dear Ms. Countryman:

The Financial Industry Regulatory Authority, Inc. (“FINRA”)<sup>1</sup> appreciates the opportunity to provide the Securities and Exchange Commission (“SEC” or “Commission”) with comments on the above-captioned proposed amendments to the National Market System Plan Governing the Consolidated Audit Trail (“Plan” or “CAT NMS Plan”). The Operating Committee for the Consolidated Audit Trail, LLC (“Operating Committee”) filed proposed amendments to the Plan on March 15, 2023, over FINRA’s objections, to implement a funding model that is based on the executed equivalent share volume of transactions in eligible securities (“Funding Model”).<sup>2</sup>

FINRA urges the Commission to disapprove the Fee Proposal. As discussed below, the Fee Proposal fails to adequately address concerns that have been previously

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<sup>1</sup> FINRA is submitting this letter solely in its capacity as a participant of the CAT NMS Plan. This letter does not reflect or represent the views of FINRA CAT, LLC, which is a distinct corporate subsidiary of FINRA that acts as the CAT Plan Processor pursuant to an agreement with Consolidated Audit Trail, LLC.

<sup>2</sup> See Securities Exchange Act Release No. 97151 (March 15, 2023), 88 FR 17086 (March 21, 2023) (Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail) (“Fee Proposal”).

raised both by FINRA and industry members regarding, among other things, the inequitable allocation to FINRA of a disproportionate share of the total CAT costs to be borne by the self-regulatory organization (“SRO”) participants to the CAT NMS Plan (“Participants” or “Plan Participants”), the reasonableness and fairness of such an approach, and the impact it would have on FINRA and FINRA members. Any funding model adopted by the Participants must be consistent with the CAT Plan and the Securities Exchange Act of 1934 (“Exchange Act”).

Similar to the recently withdrawn CAT funding model proposal,<sup>3</sup> the Fee Proposal would charge fees based on the executed equivalent share volume of transactions—for each transaction in an eligible security, the industry member that is the executing broker member for the seller in the transaction, the industry member that is the executing broker for the buyer in the transaction, and the applicable Participant for the transaction each would pay a fee calculated by multiplying the number of executed equivalent shares in the transaction by the applicable fee rate, and dividing the product by three.<sup>4</sup> The concerns FINRA raised in its prior comment letter regarding the executed equivalent share volume model remain relevant here, and have not been adequately addressed in the Fee Proposal.<sup>5</sup> FINRA continues to support the goal of adopting a transparent funding model that reasonably and fairly allocates CAT costs among Participants and industry members based on objective criteria. Although the Fee Proposal claims otherwise, it does not meet these objectives because it fails to provide for reasonable fees that are equitably allocated and not unfairly discriminatory, nor does it reflect a reasonable approach to allocating costs amongst the Participants.

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<sup>3</sup> See Securities Exchange Act Release No. 94984 (May 25, 2022), 87 FR 33226 (June 1, 2022); and Securities Exchange Act Release No. 96394 (November 28, 2022), 87 FR 74183 (December 2, 2022), together “2022 Fee Proposal.” See also Letter from Brandon Becker, CAT NMS Plan Operating Committee Chair, to Vanessa Countryman, Secretary, Commission, dated March 1, 2023.

<sup>4</sup> The applicable Participant for the transaction would be the national securities exchange on which the transaction was executed, or FINRA for each transaction executed otherwise than on an exchange. See Fee Proposal, *supra* note 2, at 17107.

<sup>5</sup> We incorporate by reference FINRA’s prior comments regarding Securities Exchange Act Release No. 94984 (May 25, 2022), 87 FR 33226 (June 1, 2022) (“June 2022 Comment Letter”), attached. See Letter from Marcia Asquith, Executive Vice President, FINRA to Vanessa Countryman, Secretary, SEC, dated June 22, 2022 (“June 2022 Comment Letter”). See also Letter from Marcia Asquith, Executive Vice President, FINRA to Vanessa Countryman, Secretary, SEC, dated May 12, 2021, discussing Securities Exchange Act Release No. 91555 (April 14, 2021), 86 FR 21050 (April 21, 2021).

## **I. Proposal Does Not Achieve a Fair and Equitable Approach to CAT Cost Allocation Amongst the Participants**

The Fee Proposal seeks to allocate to FINRA a disproportionate share of CAT costs without sufficient analysis and justification regarding how this achieves a fair and equitable result. Specifically, under the Fee Proposal<sup>6</sup>, FINRA—a not-for-profit national securities association—would be assessed an estimated 34% of the total CAT costs to be borne amongst the 25 SRO Plan Participants (based on 2021 data), even though FINRA is the only Participant that does not operate a market. In attempting to justify this outsized allocation to FINRA in light of its unique status, the Fee Proposal states that, “[a]ll Participants are self-regulatory organizations that have the same regulatory obligations under the Exchange Act, regardless of whether they operate as a for-profit or not-for-profit entity” and that, “just like the exchange Participants,” FINRA also has revenue sources other than member fees.<sup>7</sup>

However, these arguments are neither accurate nor well-reasoned, and ignore several marked, significant, and fundamental differences between FINRA and the 24 Participants that operate exchanges. First, and importantly, while the NMS stock allocation to FINRA under the Funding Model is based on transactions that are reported to FINRA trade reporting facilities (“TRFs”), these transactions are not executed on a FINRA marketplace and FINRA does not retain commercial revenues from those transactions.<sup>8</sup> Each FINRA TRF is operated by an exchange business member that is also a CAT Plan Participant, and such exchanges retain the market data and trade reporting revenue generated by the TRFs, subject to payments to FINRA for costs

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<sup>6</sup> See 2022 Fee Proposal, *supra* note 3, 87 FR 33226, 33246-47 and Fee Proposal, *supra* note 2, at 17107.

<sup>7</sup> See Fee Proposal, *supra* note 2, at 17107.

<sup>8</sup> Members report over-the-counter transactions in listed stocks to one of four FINRA facilities. Three of these facilities are TRFs operated by an exchange—there are two FINRA/Nasdaq TRFs and a FINRA/NYSE TRF. Under agreements with the respective exchange business members, FINRA has sole regulatory responsibility for each TRF and the business member is primarily responsible for the management of TRF business affairs, including establishing pricing for use of the TRF, to the extent those affairs are not inconsistent with the regulatory and oversight functions of FINRA. In addition, each business member is obligated to pay the cost of regulation and is entitled to the profits and losses, if any, derived from its operation of the TRF. Members also may report over-the-counter transactions in listed stocks to the FINRA Alternative Display Facility, though the vast majority of transactions are reported to a TRF.

associated with regulation of TRF trading.<sup>9</sup> Therefore, the exchanges have revenue streams that are related to the transactions that are taxed using the executed equivalent share volume metric under the Fee Proposal, while FINRA generally does not. In addition, unlike FINRA, exchanges also generate revenue from listing fees and proprietary data feeds for NMS securities. These are examples of the critical distinctions between FINRA and the exchanges and illustrates the unaddressed incongruencies, unfairness and inequities of the Fee Proposal.

Further, the Fee Proposal states that FINRA can recoup costs through the Regulatory Services Agreements (“RSAs”) it has entered into with various exchanges to perform regulatory oversight and market surveillance functions. However, RSAs, including the associated payments and terms, are highly negotiated with each participating exchange, who may dispute what if any CAT costs may be charged under the RSA. Thus, unless the participating exchanges intend to agree up front to such an allocation, RSAs cannot be relied upon as a source of sustainable CAT funding.

Notwithstanding FINRA’s unique status—or, perhaps, because of it, given FINRA’s limited voting power in Plan governance—the exchange Plan Participants propose to concentrate a substantial share of the SRO responsibility for funding CAT on FINRA—more than double that of the next highest Participant and \$4 million more than all option exchanges combined.<sup>10</sup> As was noted in our June 2022 Comment Letter, FINRA does not control, nor is it under common control with, any other Participant. Because the CAT NMS Plan provides that each Participant shall be entitled to one vote, FINRA is entitled to only one out of 25 votes for purposes of determining the funding model for the CAT, as well as all other decisions regarding the operation of the CAT. In contrast, affiliated exchange groups voting as blocs enjoy substantially greater influence over such decisions. In addition, industry members are not entitled to vote on CAT Plan matters. It was pursuant to this voting structure that the Operating Committee approved the Funding Model that allocates to FINRA the disproportionate burden of paying a greater share of the costs of the CAT than any other Participant (and a greater share than any group of affiliated Participants).

FINRA also notes that the analysis provided in the Fee Proposal is incomplete in that it does not incorporate available data for the full 2022 calendar year. The CAT budget has grown significantly since 2021. FINRA strongly urges the Commission to require the Operating Committee to amend the Fee Proposal to include data and fee allocation estimates covering the entire 2022 calendar year to provide the industry and

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<sup>9</sup> In line with the Funding Model, which seeks to assess CAT costs for listed stocks based on TRF volume, FINRA likewise is seeking to recover a corresponding amount of its allocated CAT costs pursuant to its contractual arrangements with the TRF business members.

<sup>10</sup> See 2022 Fee Proposal, *supra* note 3, 87 FR 33226, 33246-47.

the public with more fulsome data and information regarding the potential year-to-year variance in the impact of the Fee Proposal on various parties.

In addition, the Fee Proposal fails to adequately consider and address potential alternatives that, unlike the Funding Model, may meet Exchange Act standards. For example, the Commission received comment letters suggesting a model similar to Section 31 fees in which the CAT fee could be passed through to industry members and ultimate customers.<sup>11</sup> A member of the CAT Plan Advisory Committee submitted a letter to the Commission stating that the similar 2022 Fee Proposal was “arbitrary and largely unfounded on principles upon which the Commission could reasonably conclude that CAT NMS would be fairly funded.”<sup>12</sup> The Harris Letter recommends that policymakers base a CAT funding model on two broadly accepted and widely respected principles of equity and fairness—the cost recovery principle and the benefits received principle.<sup>13</sup> These comments and recommended alternatives were not meaningfully analyzed in the Fee Proposal, and the Commission should require that an analysis of these alternatives be undertaken. The Fee Proposal states that “[t]he Exchange Act does not require CAT LLC to demonstrate that the Funding Proposal is superior to any other potential proposal. Instead, CAT LLC must demonstrate that the Funding Proposal is consistent with the Exchange Act and the rules and regulations thereunder.” However, as discussed here, the Fee Filing falls short of meeting this standard.<sup>14</sup>

## **II. Proposal Fails to Address Concerns Regarding the Impact of the FINRA Allocation on Market Participants**

The Fee Proposal fails to adequately analyze and provide justification for the Funding Model’s impact on market participants, including FINRA members and investors. If the Fee Proposal is approved, as stated previously, FINRA, as a not-for-profit national securities association that relies primarily on regulatory fees from members for funding, must increase member fees to fund CAT costs so as not to jeopardize FINRA’s ability to meet its regulatory mission.<sup>15</sup> As discussed above, the fact that FINRA does not derive trading revenues from the TRFs nor generate revenue from operating a marketplace necessarily points to member firms as the source of funding to

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<sup>11</sup> See Section A.10 of Fee Proposal.

<sup>12</sup> See Letter from Lawrence Harris, Fred V. Keenan Chair in Finance, Professor of Finance and Business Economics, USC Marshall School of Business to Vanessa Countryman, Secretary, SEC, dated June 21, 2022 (“Harris Letter”).

<sup>13</sup> *Id.*

<sup>14</sup> See also June 2022 Comment Letter.

<sup>15</sup> See *supra* note 5.

cover any CAT costs that FINRA is unable to recover from contractual arrangements with TRF business members. The Fee Proposal fails to adequately analyze this impact, including whether the Funding Model would effectively result in industry members bearing a greater than two-thirds share of total costs. Industry members acknowledged the realities of FINRA's funding sources and the resultant relationship between the FINRA CAT cost allocation and member fees in connection with the 2022 Fee Proposal. In this regard, the SIFMA Letter noted that the proposal was "flawed because it fails to appropriately consider that Industry Members pay the full costs of operating FINRA."<sup>16</sup>

The Fee Proposal does not sufficiently address these points. Instead, it states that these concerns "fail to recognize the basic fact that Industry Members themselves face the same issue that they raise with regard to FINRA" and that the industry may pass their

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<sup>16</sup> See Letter from Ellen Greene, Managing Director & Joseph Corcoran, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), to Vanessa Countryman, Secretary, SEC, dated October 7, 2022 ("SIFMA Letter").

The SIFMA Letter also recognized that the exchanges have sought to treat FINRA inconsistently under different NMS Plans—depending on what would be most financially advantageous to the exchanges under the circumstances. Specifically, the SIFMA Letter states:

[T]he exchange Participants should not be able pick and choose whether to treat FINRA as a market center for purposes of an NMS Plan based on the outcome that leads to the greatest financial benefit to the exchanges, especially given FINRA's regulatory role in the marketplace. In the Executed Share Model, the exchange Participants are effectively choosing to treat FINRA as a market center responsible for all Participant fees for off-exchange transactions. In contrast, they have chosen to not treat FINRA as a market center for purposes of the CT Plan, stating that FINRA is not considered a market center under the CT Plan solely by virtue of facilitating trades through any trade reporting facility FINRA operates in affiliation with a national securities exchange designed to report transactions otherwise than on an exchange. The result of this decision in the CT Plan is that the exchange Participants have limited FINRA to only one vote for purposes of governance of the CT Plan, thus limiting FINRA's ability to determine how to allocate the lucrative market data revenue to be distributed under the plan. These two conflicting decisions by the exchange Participants demonstrate that they will choose to treat FINRA for purposes of NMS plans involving money in the way that is most financially beneficial to them and without regard to FINRA's critical role in the marketplace.

direct CAT cost allocation, as well as any additional costs resulting from an increase in FINRA fees, on to customers “thereby alleviating Industry Members of any burden of funding the CAT.”<sup>17</sup> Summarily stating that investors can be made to bear the costs resulting from the Funding Model without a detailed description of and transparency into how these fees would be determined or passed on to customers is inadequate, and does not provide interested parties sufficient information to consider the costs and benefits related to the Fee Proposal.

FINRA believes that the Fee Proposal should be disapproved by the Commission. However, should the Commission nonetheless determine to approve the Fee Proposal, FINRA requests that the Commission acknowledge in its approval order FINRA’s need and ability to cover CAT costs that are not recovered through contractual arrangements through member fee increases, so as not to jeopardize FINRA’s ability to carry out its critical regulatory mission. If the Funding Model is approved by the Commission, FINRA intends to file a rule change to increase member fees simultaneous with the filing of any proposed rule change to effectuate the Funding Model.

### **III. The Proposal Lacks Principled Justification Concerning Cost Alignment**

FINRA has previously discussed its concerns regarding deleting a core concept of equity and fairness from the CAT Plan’s funding principles—*i.e.*, that a party’s responsibility for bearing CAT costs should be aligned with that party’s impact on generating such costs. While earlier iterations of proposed CAT fee models sought to achieve cost alignment by, to varying degrees, using message traffic as proxy for cost generation, this principle has since been abandoned by the Operating Committee in favor of a formula based solely on an executed equivalent share volume metric.

The Fee Proposal claims that the Funding Model “reflects a reasonable effort to allocate costs based on the extent to which different CAT Reporters participate in and benefit from the equities and options markets.”<sup>18</sup> However, it is unclear—particularly in the context of the allocation amongst Plan Participants—how the outsized allocation to FINRA is based on the extent to which *FINRA participates in and benefits from the markets*. In addition, this rationale conflates the costs to create and operate CAT with the usage of CAT data.

The Fee Proposal also continues to liken the Funding Model to other fees, such as FINRA’s Trading Activity Fee (“TAF”). However, the TAF is one of several regulatory fees that FINRA has carefully calibrated—and justified with extensive economic analysis—to achieve reasonable and equitable funding across its membership in support

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<sup>17</sup> See Fee Proposal, *supra* note 2, at 17108.

<sup>18</sup> See Fee Proposal, *supra* note 2, at 17087.

of its regulatory obligations, given the fluctuations in different revenue streams and costs drivers that are naturally expected to occur.<sup>19</sup> The Fee Proposal disregards FINRA’s extensive analysis and instead focuses solely on the superficial connection between the proposed transaction-based CAT fee and the TAF, stating that “[t]he CAT fees calculated under the Funding Proposal would be similar to the FINRA TAF in that they would be transaction-based fees intended to provide funding for regulatory costs.” However, it is unclear how assessing on FINRA the largest allocation of the SRO portion of CAT expenses “provides funding for regulatory costs” in any reasonable and equitable sense comparable to the TAF, which is but one component of FINRA’s fee structure.

Moreover, the Fee Proposal overlooks another critical distinction—namely, that FINRA’s TAF is designed to recover the costs of FINRA’s *regulatory activities*, while the Fee Proposal ostensibly is designed to “align with the anticipated costs to build, operate, and administer the CAT,” consistent with the CAT NMS Plan’s approved funding principles. FINRA has stated previously that it is not opposed to fees based on regulatory usage, provided such fees are not applied on an unsupported and *ad hoc* basis solely to FINRA.<sup>20</sup> As was the case with previous CAT fee proposal iterations, the Fee Proposal does not meaningfully address these points. The Fee Proposal also states that trading activity “provides a reasonable proxy” for costs associated with the CAT, and “therefore is an appropriate metric for allocating CAT costs among CAT Reporters;”<sup>21</sup> and that “executed equivalent share volume is related to, but not precisely linked to, the CAT Reporter’s burden on the CAT.”<sup>22</sup> However, the Fee Filing neither explains how nor the extent to which this is the case.<sup>23</sup> While FINRA is receptive to modifying the current funding principles, where warranted, any change to the core funding principles must be well-reasoned and transparent and must continue to support the achievement of a

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<sup>19</sup> See Securities Exchange Act Releases No. 90176 (October 14, 2020), 85 FR 66592, 66597 (October 20, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-032).

<sup>20</sup> See *supra* note 5.

<sup>21</sup> See Fee Proposal, *supra* note 2, at 17103.

<sup>22</sup> *Id.*

<sup>23</sup> As discussed herein, under the Funding Model, FINRA would be allocated the largest portion of CAT fees of any single Participant or Participant group—largely based on transaction volume reported to the TRFs. However, TRF transactions correspond to a relatively low burden on CAT, from a cost-generation perspective, compared to other cost drivers, such as options activity. Thus, while roughly 75% of total SRO fees under the Fee Proposal would be for equities activity and only 25% for options activity, this distribution does not correspond to actual cost generation.

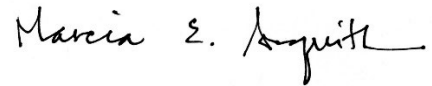
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fair and equitable outcome.

#### **IV. Conclusion**

Due to the deficiencies discussed above and in FINRA's June 2022 Comment Letter, FINRA believes that the Fee Proposal is inconsistent with the Exchange Act and should not be approved by the Commission in its current form. FINRA continues in its strong commitment to working with other regulators and market participants to achieve a well-reasoned, fair, and sustainable approach to funding CAT that is consistent with the Exchange Act. FINRA thanks the Commission for its attention to FINRA's comments on the Fee Proposal and looks forward to continued engagement.

Sincerely,



Marcia E. Asquith  
Corporate Secretary, EVP  
Board and External Relations

Attachment



**Marcia E. Asquith**  
Corporate Secretary, EVP  
Board and External Relations

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June 22, 2022

Ms. Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Via Email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)**

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

Dear Ms. Countryman:

The Financial Industry Regulatory Authority, Inc. (“FINRA”)<sup>1</sup> appreciates the opportunity to provide comments on the above-captioned proposed amendments to the National Market System Plan Governing the Consolidated Audit Trail (“Plan” or “CAT NMS Plan”). The Operating Committee for the Consolidated Audit Trail, LLC filed the proposed amendments on May 13, 2022, which seek to implement an “executed share” funding model for the CAT (“Executed Share Model”) and to establish a fee schedule for Participant CAT fees based on the Executed Share Model.<sup>2</sup>

FINRA supports the goal of adopting a transparent funding model that reasonably and fairly allocates CAT costs among Participants and industry members based on objective criteria. The need for reasonable, long-term funding has become increasingly evident as the complexity and cost of the CAT continue to grow well beyond initial

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<sup>1</sup> FINRA is submitting this letter solely in its capacity as a participant of the CAT NMS Plan. This letter does not reflect or represent the views of FINRA CAT, LLC, which is a distinct corporate subsidiary of FINRA that acts as the CAT Plan Processor pursuant to an agreement with the self-regulatory organization (“SRO”) participants to the CAT NMS Plan (“Participants” or “Plan Participants”).

<sup>2</sup> See Securities Exchange Act Release No. 94984 (May 25, 2022), 87 FR 33226 (June 1, 2022) (Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail) (“Proposal”).

estimates. Unfortunately, the Proposal fails to accomplish this goal. In fact, the Executed Share Model—which was approved by the Operating Committee over FINRA’s objections—contains features that are more problematic than the unsuccessful funding model that was withdrawn last year.<sup>3</sup>

The Proposal would establish a structure whereby the fees charged to Participants and industry members are based on the executed equivalent share volume of transactions in eligible securities. Under the Proposal, for each transaction in an eligible security, the industry member that is the clearing member for the seller in the transaction, the industry member that is the clearing member for the buyer in the transaction, and the applicable Participant for the transaction each would pay a fee calculated by multiplying the number of executed equivalent shares in the transaction and the applicable fee rate, and dividing the product by three<sup>4</sup>—i.e., for each transaction, the buy-side would pay one-third of the fee obligation, the sell-side would pay one-third of the fee obligation, and the relevant Participant for the transaction would pay the remaining one-third of the fee obligation.

As discussed below, the Executed Share Model abandons core cost alignment principles and lacks critical transparency about its true impacts. Accordingly, FINRA believes the Proposal is inconsistent with the Securities Exchange Act of 1934 (“Exchange Act”) and should not be approved by the Securities and Exchange Commission (“SEC” or “Commission”) in its current form.

### **I. The Proposal Lacks Principled Justification Concerning Cost Alignment**

FINRA has been consistent in its view that long-term sustainable CAT funding must be grounded in principle and consistent with the Exchange Act. As FINRA discussed in its comment letter on funding last year,<sup>5</sup> there were six governing funding principles in the CAT NMS Plan initially approved by the SEC:

- (a) to create transparent, predictable revenue streams for CAT LLC that are aligned with the anticipated costs to build, operate and administer the CAT

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<sup>3</sup> See Letter from Marcia Asquith, Executive Vice President, FINRA to Vanessa Countryman, Secretary, SEC, dated May 12, 2021 (“FINRA Comment Letter”), discussing Securities Exchange Act Release No. 91555 (April 14, 2021), 86 FR 21050 (April 21, 2021) (“2021 Proposed Funding Model”).

<sup>4</sup> The applicable Participant for the transaction would be the national securities exchange on which the transaction was executed, or FINRA for each transaction executed otherwise than on an exchange. See Proposal at 33226.

<sup>5</sup> See FINRA Comment Letter, *supra* note 3, available at <https://www.sec.gov/comments/4-698/4698-8793900-237824.pdf>.

and the other costs of CAT LLC;

- (b) to establish an allocation of the Company's related costs among Participants and Industry Members that is consistent with the Exchange Act, taking into account the timeline for implementation of the CAT and distinctions in the securities trading operations of Participants and Industry Members and their relative impact upon Company resources and operations;
- (c) to establish a tiered fee structure in which the fees charged to: (i) CAT Reporters that are Execution Venues, including ATSS, are based upon the level of market share; (ii) Industry Members' non-ATS activities are based upon message traffic; and (iii) the CAT Reporters with the most CAT-related activity (measured by market share and/or message traffic, as applicable) are generally comparable (where, for these comparability purposes, the tiered fee structure takes into consideration affiliations between or among CAT Reporters, whether Execution Venues and/or Industry Members);
- (d) to provide for ease of billing and other administrative functions;
- (e) to avoid any disincentives such as placing an inappropriate burden on competition and a reduction in market quality; and
- (f) to build financial stability to support CAT LLC as a going concern.<sup>6</sup>

Up to this point, as reflected in the Plan's funding principles, message traffic has been a key proxy for cost-generation in seeking to align CAT fees with CAT costs. Since these funding principles were approved by the SEC, the Participants have attempted to file two different funding models, and both prior models included message traffic components.<sup>7</sup> In using message traffic to align CAT fees with costs, the Participants previously argued that "message traffic is a key component of the costs of operating the CAT."<sup>8</sup>

The current Proposal departs from utilizing message traffic and instead seeks to establish a cost allocation methodology based on executed share volume entirely. The Proposal describes that the Executed Share Model would equally allocate costs by thirds to the Participant, the buy-side, and the sell side, but it offers no underlying justification as to why this methodology is equitable in the context of the CAT NMS Plan. The

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<sup>6</sup> See CAT NMS Plan, Section 11.2(a) through (f).

<sup>7</sup> See 2021 Proposed Funding Model, *supra* note 3, and Securities Exchange Act Release No. 82451 (January 5, 2018), 83 FR 1399 (January 11, 2018).

<sup>8</sup> See FINRA Comment Letter, *supra* note 3, at 6 n.14 (citing letter from CAT NMS Plan Participants to Brent J. Fields, Secretary, SEC (June 29, 2017)).

Proposal also asserts that the Executed Share Model is fair as it operates in a manner that is similar to other fee rules, like the TAF, Section 31, and the options regulatory fee assessed by the options exchanges, which the SEC previously found to be consistent with the Exchange Act. However, the Proposal provides no insight as to why these other fee frameworks, which apply to completely different contexts, should serve as a model here. The Proposal also does not provide adequate support for the overall allocation between Participants and industry members or the allocation of costs between equity and options.

In an acknowledgement that the proposed methodology is incompatible with the cost alignment principle, the Proposal seeks to delete the Plan funding principle language that requires the Participants to take into account “distinctions in the securities trading operations of Participants and Industry Members and their relative impact upon Company resources and operations.”<sup>9</sup> This principle is clearly grounded in concepts of fairness and equity.

Without offering adequate analysis, the Proposal summarily and erroneously concludes that this cost alignment language “is no longer relevant.”<sup>10</sup> This conclusion appears to be based on yet another unreasoned conclusion that “[i]n light of the many inter-related cost drivers of the CAT (*e.g.*, storage, message traffic, processing), determining the precise cost burden imposed by each individual CAT Reporter on the CAT is not feasible.”<sup>11</sup> The Proposal also states that executed share volume “is related to, but not precisely linked to, [a] CAT Reporter’s burden on the CAT.”<sup>12</sup>

Stating that executed share volume—the single measure proposed to be used as the basis for the proposed allocation methodology—is “related to, but not precisely linked to” CAT cost-generation, is inadequate in demonstrating that use of the measure is reasonable and equitable. And while cost drivers may be multifaceted, the Plan, as approved, requires the Participants to seek to achieve cost alignment, because such is consistent with Exchange Act principles. In this regard, the Proposal fails to establish a sufficient nexus between executed share volume and the technology burdens that generate CAT costs and fails to relate each reporter group’s allocation to the burden that each reporter group imposes on CAT.

Rather than propose a funding model that is consistent with the funding principles, the Proposal instead seeks to amend the core funding principles to align with an unjustified allocation methodology. The Proposal must offer a principled justification for why the current principles, which relate to equity and cost alignment, are no longer

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<sup>9</sup> See Proposal, *supra* note 2, at 33238.

<sup>10</sup> See *id.*

<sup>11</sup> See *id.* at 33232.

<sup>12</sup> See *id.*

appropriate, consistent with the Plan, or consistent with the Exchange Act.

FINRA, consistent with its prior position, is receptive to modifying the current funding principles where warranted. However, FINRA believes changes to core funding principles must be well-reasoned and transparent and must continue to support the achievement of a fair and equitable outcome. In contrast, the Executed Share Model appears to place the greatest emphasis on the principle relating to the “ease of billing and other administrative functions,” favoring that principle over cost alignment. FINRA recognizes the importance that the ultimate funding model be workable from an administrative perspective and supports that existing principle. It is essential, however, that any such tradeoffs between principles be presented clearly and analyzed fully against their impacts and prevailing Exchange Act requirements. As discussed below, that is not the case with the current Proposal.

## **II. The Proposal Lacks Fundamental Transparency About Cost Allocation between Participants and the Industry**

The Proposal lacks transparency regarding its true impacts. The Proposal claims that it “addresses feedback expressed by some commenters on prior fee filings about the amount allocated to Participants versus Industry Members.”<sup>13</sup> Specifically, the Proposal states that, in contrast to the previously proposed 75/25 split between industry members and Participants, the current proposal “substantially increases the Participant allocation and substantially reduces the Industry Member allocation from prior proposals.”<sup>14</sup> However, the Proposal does not disclose that the increase in Participants’ share is disproportionately allocated to FINRA rather than equitably allocated amongst the Participants. In fact, under the Proposal, the exchange Participants’ share of total costs would remain almost the same as under the previous proposal. Notably, using trade volumes from 2021, FINRA would pay roughly \$19 million per year under the Proposal, which is \$4 million more than all the options exchanges combined. In percentage terms, as compared to the previous proposal, FINRA’s share would more than double from 4.1% of total costs to 10.8%. In contrast, the options exchanges’ collective share would decrease from 10.4% to 8.9%, the equity exchanges’ share would increase modestly from 10.5% to 13.6%, and the total share for all equity and options exchanges combined would increase only from 20.9% to 21.9%.

Rather than addressing these outcomes transparently so that the public may provide informed feedback, the Proposal touts that the Executed Share Model “substantially increases the Participant allocation and substantially reduces the Industry Member allocation from prior proposals.” Subsumed within an accompanying footnote, the Proposal notes only that “FINRA’s contribution *likely* would increase under the

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<sup>13</sup> See *id.* at 33233.

<sup>14</sup> See *id.*

[current Proposal] in comparison to prior models.”<sup>15</sup> The Proposal adds even further confusion in the single sentence it offers in attempting to justify FINRA’s allocation. According to the Proposal, FINRA’s allocation is appropriate “given FINRA’s responsibility for securities traded in the over-the-counter market.”<sup>16</sup> However, the Proposal is intended to recover the costs of the CAT’s operation as a system, *not* the costs associated with using CAT data for regulatory purposes. FINRA commented on this flawed rationale in connection with a previous proposal, noting that FINRA is not opposed to fees based on regulatory usage, provided such fees are not applied on an unsupported and *ad hoc* basis solely to FINRA.<sup>17</sup> Not only does the current Proposal, which does not seek to amend the funding principles to take into consideration regulatory usage, fail to correct this problematic rationale, but it also dramatically amplifies the problem with an outsized yet opaque increase in FINRA’s allocation.

### III. The Proposal Would Result in an Undue Burden

By shifting nearly all of the Participants’ increased share to FINRA, the current Proposal places an undue burden on FINRA, notwithstanding FINRA’s standing among Participants as the only not-for-profit national securities association that relies primarily on regulatory fees from its members for funding and the only Participant not operating a national securities exchange. As FINRA explained in its comment on the previous funding model proposal, given FINRA’s unique nature, FINRA necessarily must seek recovery in turn for the costs it is allocated.<sup>18</sup> Further, as noted above, the costs at issue here concern the operation of CAT as a system, not FINRA’s separate costs to conduct regulation using CAT data. Accordingly, while FINRA recently implemented a plan to increase its regulatory fees to correct a structural deficit in its regulatory funding, FINRA explained in detail that its regulatory fee changes were not designed to cover any costs it is allocated for the operation of the CAT NMS Plan.<sup>19</sup>

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<sup>15</sup> See *id.* at 33233 n.37. (*emphasis added*).

<sup>16</sup> See *id.*

<sup>17</sup> See FINRA Comment Letter, *supra* note 3.

<sup>18</sup> *Id.*

<sup>19</sup> See Securities Exchange Act Release No. 90176 (October 14, 2020), 85 FR 66592, 66602-03 (October 20, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-032). As FINRA explained (*with emphasis added* below):

In addition to costs associated with its CAT reporting compliance program, FINRA must account for significant costs to integrate CAT data into its regulatory systems. These include one-time costs to migrate regulatory systems into an environment that can interact with CAT data, with

As described in the Proposal, the Executed Share Model would allocate substantial costs to FINRA based on over-the-counter executions reported to FINRA's trade reporting facilities for listed stocks (the "TRFs"). In line with the approach in the instant proposal to assess CAT costs for listed stocks based on TRF volume, FINRA likewise is seeking to recover a corresponding amount of its allocated CAT costs pursuant to its contractual arrangements with the TRF business members.<sup>20</sup> Notably, under the TRF contractual arrangements, FINRA has agreed not to retain associated trade reporting or market data revenues. Rather, the business members are entitled to trade reporting fees and market data revenues, and while they then share a percentage of market data revenues with FINRA member TRF participants in the form of transactions credits, they also retain market data revenues from the TRFs. If the Proposal is approved, FINRA will need to fund any costs that are not recovered under these contractual arrangements through increases to FINRA member fees. Unlike the exchanges, who may also seek to pass along all or some portion of their allocated CAT costs, FINRA does not

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the potential for greater migration costs as a result of any future regulatory changes, such as under the Commission's recently proposed amendments to the CAT NMS Plan. FINRA also is making significant investments in enhanced surveillance technology to account for and use CAT data in FINRA's oversight of various market integrity rules, as CAT includes expanded audit trail data for options and equities. *Importantly, these costs are separate from and in addition to FINRA's obligation to contribute funding for the development, maintenance, and operation of the CAT system incurred by the CAT Plan Processor.*

And:

As a result, if the CAT NMS Plan Participants file a separate proposal to recover some portion of CAT NMS Plan costs through a direct CAT fee assessment on industry members, the effectiveness of such a filing would not reduce the amount that FINRA projects it needs to raise with this proposal to correct its structural deficit.

<sup>20</sup> The FINRA TRFs are facilities of FINRA that are operated by exchange business members. There are two FINRA/Nasdaq TRFs and a FINRA/NYSE TRF. Under agreements with the respective business members, FINRA has sole regulatory responsibility for each TRF and the business member is primarily responsible for the management of TRF business affairs, including establishing pricing for use of the TRF, to the extent those affairs are not inconsistent with the regulatory and oversight functions of FINRA. Additionally, each business member is obligated to pay the cost of regulation and is entitled to the profits and losses, if any, derived from its operation of the TRF.

retain revenue in connection with the TRFs—like TRF market data revenues noted above, or other market data revenues—that could be used to offset its costs. Although the potential downstream industry impacts of FINRA’s allocation were raised by commenters regarding the previously proposed funding model, these impacts are neither acknowledged nor addressed in the current Proposal.<sup>21</sup>

#### **IV. Alternative Models and Process**

Like the other Participants, FINRA is strongly invested in the long-term financial sustainability of the CAT. However, FINRA believes a more transparent and fundamentally sound funding model is required, and that such a model requires a fundamentally sound process. In terms of alternatives, following last year’s proposal, FINRA had developed a revised message traffic alternative that was presented publicly in an industry webinar.<sup>22</sup> Notably, this alternative sought to address concerns about previous message traffic models by providing for more predictable fees based on prospective (rather than retrospective) rates. FINRA is generally aware that some industry members believe message-traffic models are too complex. Accordingly, as noted above, FINRA is receptive to models that employ workable cost proxy metrics, provided they are principled and consistent with the Exchange Act.

While FINRA is open to other alternatives, FINRA believes a better, more inclusive process involving all parties who will contribute to the costs of the CAT is needed for any alternative to be successful. In addition to its status as the only not-for-profit SRO among the Participants, FINRA also does not control, nor is it under common control with, any other Participant. Because the CAT NMS Plan provides that each Participant shall be entitled to one vote, FINRA is entitled to only one out of 25 votes for purposes of determining the funding model for the CAT, as well as all other decisions regarding the operation of the CAT. In contrast, affiliated exchange groups voting as blocs enjoy substantially greater influence over such decisions. In addition, industry members are not entitled to vote on CAT Plan matters. It was pursuant to this voting structure that the Operating Committee approved a funding model that allocates to FINRA the disproportionate burden of paying a greater share of the costs of the CAT than any other Participant (and a greater share than any group of affiliated Participants).

While FINRA appreciates the challenges of this exercise and recognizes the need for principled tradeoffs, FINRA believes such tradeoffs must be identified and

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<sup>21</sup> See, e.g., Letters from Matthew Price, Chief Operations Officer, Fidelity Investments, to Vanessa A. Countryman, Secretary, SEC, dated May 12, 2021; Ellen Greene, Managing Director, SIFMA, to Vanessa A. Countryman, Secretary, SEC, dated May 12, 2021; and Thomas M. Merritt, Deputy General Counsel, Virtu Financial, to Vanessa A. Countryman, Secretary, SEC, dated May 12, 2021.

<sup>22</sup> See CAT Funding Presentation (September 22, 2021), available at <https://catnmsplan.com/sites/default/files/2021-09/09.22.21-CAT-Fee-Model.pdf>.

Ms. Vanessa Countryman

June 22, 2022

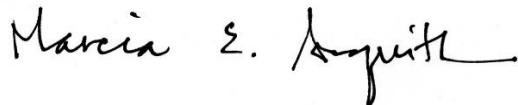
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analyzed with meaningful input from various CAT stakeholders. In this respect, FINRA would welcome constructive input from the industry on a reasonable framework, and, importantly, SEC guidance on how the Participants can manage more successfully to develop a funding model consistent with prevailing requirements.

## V. Conclusion

FINRA thanks the Commission for its attention to FINRA's comments on the Proposal and looks forward to continued engagement with the Plan Participants, SEC, and market participants to achieve a sustainable solution to CAT's funding needs.

Sincerely,

A handwritten signature in black ink that reads "Marcia E. Asquith". The signature is written in a cursive style with a long horizontal flourish at the end.

Marcia E. Asquith  
Corporate Secretary, EVP  
Board and External Relations