



MODERN MARKETS
INITIATIVE

July 13, 2023

By electronic mail to rule-comments@sec.gov

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

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

Dear Ms. Countryman:

This is a follow up letter to prior comments (including a [letter](#) sent on May 6, 2021 and a [letter](#) sent on June 21, 2022), by Modern Markets Initiative (“MMI”), to the U.S. Securities and Exchange Commission (the “SEC” or “Commission”) in connection with the Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail (*File No: 4-698*)(or “the Proposed Funding Model”).

MMI strongly supports the SEC’s mission to protect investors, including with regard to creation of the consolidated audit trail (“CAT”) as a means to provide additional tools for surveillance and oversight. However, MMI is concerned that the funding structure for the CAT, as drafted in the most recent amendment (requested by the CAT Operating Committee for consideration by July 20, 2023), requires additional elements for accountability and oversight to mitigate serious accountability problems.

In the interest of moving the process forward, avoiding further delay, and ensuring financial accountability and trust from the investing public, MMI recommends that the Commission should make a foundational change to the CAT’s governance structure. Our suggestions include:

- Reconstitute the CAT Operating Committee. Include representation of brokers as “Industry Members” in order to re-establish trust; provide needed functional guidance; mitigate the SROs’ inherent conflict of interest; and guard against runaway costs. The Industry Members’ voting rights should be commensurate with their expected allocation of costs;

- Or, alternatively: the SEC should abandon the notion that CAT is an “NMS Plan”, and acknowledge that it is in fact an SEC system, required by and dictated by the SEC. The CAT budget should be subject to Congressional approval and oversight; and funding should be supported in the same way as other SEC functions. (However, while this suggestion would provide needed budget constraint, it does not solve the lack of meaningful Industry Member input into CAT operations).

The CAT’s lack of transparency and governance has resulted in the delay of consensus and approval of a funding model and the lack of transparency and ineffective governance must be addressed in order to come to agreement on a funding model. MMI believes that the following are critical elements that are not included in the amended Proposed Funding Model, requiring urgent attention in order to avoid negative impact on the equities markets, liquidity provision, and capital formation:

- (1) **Is an NMS plan the appropriate model for the CAT?** The SEC should consider if the CAT would be better governed as a Commission database that is subject to public notice and comment and Congressional oversight with respect to scope and cost. The scope of the CAT has expanded dramatically over the past years, with new system features and reporting requirements that would benefit from cost-benefit analysis.
- (2) **Representation from Broker Community in Serious and Meaningful Collaboration.** The SEC should require the SROs to engage in a serious and meaningful collaboration, with Industry Member representation on the CAT Operating Committee, before any Fees proposal will be approved. MMI recommends that SIFMA should be brokers’ representative, and strongly supports SIFMA’s letter noting the urgency for “meaningful dialog and collaboration with industry” and for establishment of an “independent cost review mechanism.”¹ Ultimately, the representation of Industry Members on the CAT Operating Committee should be proportionate to financial obligation of funding the CAT.
- (3) **Disclosure and Mitigation of Conflicts of Interest.** The Proposed Funding Model should acknowledge and address the conflict of interest in the process of allowing the SROs to propose a fee structure. The SROs (forced to pay for CAT until now, and ongoing) are the direct beneficiaries of any fees collected. Brokers will bear the brunt of the costs. For the SROs to be allowed to demand repayment from brokers, with no input from brokers about the fee structure, is unfair and inappropriate, and creates a moral hazard. As yet, the Operating Committee has declined to engage in meaningful conversation with the broker community about the various Proposed Funding Models. As a result, the proposals fail to understand key concepts (such as the conflicting definitions of “Executing Broker”, and the difficulty for brokers to rebill CAT fees to each other in the latest proposal).

¹ MMI concurs with SIFMA on the need for “the SROs to engage in meaningful dialog and collaboration with the industry prior to submitting a formal CAT funding model with the Commission.” MMI further agrees with SIFMA on the need for establishment of an “independent cost review mechanism.” See SIFMA letter to SEC re: File No 4-698 (June 5, 2023), at <https://www.sec.gov/comments/4-698/4698-199319-399182.pdf>

(4) Cost Control Mechanism for Funding of Annual Budget Approaching Agency-Size Scale.

The Proposed Funding Model should include the establishment of a cost control mechanism, in order to provide for accountability and predictability in the budget. Of note, the size of the annual budget of the CAT is approaching the size and scale of a federal agency in everything but name, but without the Congressional oversight or public notice and comment and cost/benefit analysis controls of a government agency. For example, the 2023 CAT budget of \$240 million for 2023 is twice the size of the International Trade Commission's 2023 budget, half the size of the Federal Trade Commission's 2023 budget, a third of size of the CFTC's 2023 budget, and is approaching 10% of the SEC's annual budget.² Further, the 2023 budget of the CAT represented a 30% increase from the prior year 2022. However, CAT has no transparency or mechanism to prevent further cost increases.

As discussed in a GAO Report, "Federal User Fees: A Design Guide," protocols for reviewing funding of agency programs to ensure equity, efficiency and revenue adequacy concerns, include:³

- Substantive review and reporting on fees, projected future program costs;
- Effective communication with stakeholders - sharing analysis and information and providing opportunities for stakeholder input. (GAO notes: "In past user fee reviews, we have reported that agencies that do not communicate with stakeholders miss opportunities for meaningful feedback that could affect the outcome of changes in fees and program implementation"⁴);
- Periodic reviews connected to the annual appropriations process, with varying substance of fee reviews (ranging from budget management reviews, to complicated reviews identifying fee amounts and allocations across different parts of regulated industry).⁵

Of note, there is a foreseeable unchecked increase in future CAT budgets without cost controls typical in the design of funding of federal programs. The SEC staff have required the CAT Operating Committee to expand the reporting requirements and specifications in various ways, which have increased the cost and complexity of CAT itself, as well as the cost for the brokerage community to perform daily reporting. There is currently no control mechanism, transparency, or cost/benefit analysis to contain this, and the broker community's appeals to the SEC staff have not effected any change. MMI urges the SEC

² <https://www.usaspending.gov/agency>

³ "Federal User Fees: A Design Guide," GAO Report (2008) <https://www.gao.gov/assets/gao-08-386sp.pdf> (page 33-34.).

⁴ "Federal User Fees: A Design Guide," GAO Report (2008) <https://www.gao.gov/assets/gao-08-386sp.pdf> (page 37).

⁵ Federal User Fees: Key Considerations for Designing and Implementing Regulatory Fees (GAO Report, Sept. 2015) at <https://www.gao.gov/assets/gao-15-718.pdf>

to review the letter submitted by the Financial Information Forum, detailing examples of these issues.⁶

Additionally, if market trading (or *messaging*) volumes increase, this will necessarily further multiply the cost of operating CAT; and there is no mechanism to cap those costs, nor any mechanism to force a review of the costs if they spiral out of control. The CAT budget does not impose any requirements of fiscal responsibility; rather it is simply a backward-looking estimate, and the Proposal simply divides X by Y and charges brokers with the full burden of paying for it. (As others have pointed out, the proposal overtly says that brokers will pay two-thirds. However, as FINRA is a nonprofit, and 100% of its costs are passed back to brokers, brokers would actually pay around 80%. For-profit exchanges will also likely pass through CAT fees to members as they do with Section 31 fees.)

The impact of CAT on the brokerage community must be taken seriously by the SRO committee, and brokers need their voice heard on the committee's recommendations. To date, we have seen little evidence of either. On the most critical questions, the SROs have responded to brokers' concerns by simply pointing to Rule 613, and by stating that the SEC staff insist on certain interpretations of the Rule. The serious cost implications have so far been all but ignored.

(5) Inclusion of Additional Layer of Cost Oversight for Allocation of Financial Responsibility and Apportionment. It is MMI's belief that there are mechanisms that could help provide an additional review mechanism as an additional layer of oversight on apportionment of financial responsibility. Examples of governance structures to add additional oversight might include, for example:

- Accounting and transparency regarding CAT budget as an SEC system, in everything but name; e.g. preparation of an annual Budget Justification and Performance Plan
- A cap on the budget for CAT, as is done with other government agency functions, utilizing, if budget increases over a set threshold level, Congressional budget oversight;
- Incentivization of cost-consciousness and accountability for SEC interpretations and mandates for CAT reporting, specifications, interpretations, and usage of CAT.
- Human resource allocation for oversight governance - e.g. identifying industry experts to help build the complex industry system of the CAT with deep understanding of industry workflows and public-private engagement to maximize efficiency;
- Accountability for historic costs and review of current market percentage share dictating cost structure - e.g. industry fluctuations - how current market share not reflective of past/future market shares- need for adjustments;
- Review of alternative approach for funding, e.g., extent to which funding of the CAT could be covered by Section 31 fees.

⁶Financial Information Forum (FIF) letter to SEC, "Retirement of legacy reporting systems" (June 15, 2023.)

(6) **Transparency Re: Status of Potential Cost Offsets from Retired Programs Redundant to the CAT.** MMI echoes the questions raised by the Financial Information Forum (FIF) in their letter, dated June 15, 2023, to the SEC, requesting further transparency on the status of retirement of legacy reporting rules under Commission Rule 613(a)(1)(ix) that are redundant with the CAT.⁷ Such information would be useful in calculating potential cost offsets to participants, regarding the anticipated future net cost of the CAT, as offset by expiring redundant programs, which could be useful for public transparency and more informed and productive discussion concerning the amended, Proposed Funding Model.

MMI appreciates the opportunity to submit further comments regarding the Proposed Funding Model, and is pleased to be a resource.

Very truly yours,



Kirsten Wegner
Chief Executive Officer
Modern Markets Initiative

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

⁷ For example, FIF notes in its letter two items that may be redundant with CAT, and potentially eliminated: (1) SEC Rule 17a-25 which requires brokers and dealers to submit electronically to the SEC information on Customers and firms securities trading; and (2) SEC Rule 17h-16 concerning the identification of large traders and the required reporting obligations of large traders.