CITADEL | Securities

July 14, 2023

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

Re: 2023 CAT Funding Proposal (File No. 4-698)

We appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on the CAT Operating Committee's proposal to offload the costs of the Consolidated Audit Trail ("CAT") to the industry (the "2023 Funding Proposal").[1] The 2023 Funding Proposal determines how over *a billion dollars* of CAT costs would be allocated by the end of 2024, and establishes the framework pursuant to which many more billions will be allocated in perpetuity. This extremely important filing is glaringly inconsistent with the Securities Exchange Act of 1934 (the "Exchange Act") – including Section 6(b)(4) (*requiring the equitable allocation of reasonable fees*), Section 6(b)(5) (*requiring that exchange rules protect investors and the public interest and not permit unfair discrimination*), and Section 6(b)(8) (*requiring that exchange rules do not unduly burden competition*). As a result, this filing must be disapproved.

Instead, we provide a comprehensive set of constructive recommendations in Section IV of this letter that solve for these material shortcomings and that should underpin a new CAT funding proposal. These recommendations are summarized on page 3 and are designed to:

(1) Achieve a more equitable cost allocation;

(2) Reduce overall operating costs; and

(3) Improve governance and budget transparency.

As it stands, the 2023 Funding Proposal does not equitably allocate fees as required by Section 6(b)(4) of the Exchange Act, as the proposed allocation methodology is only a façade. Despite purporting to allocate the costs to build and operate CAT among Industry Members,[2] FINRA, and the exchanges, the filing in fact seeks to offload *all* of these costs to Industry Members. In particular, in addition to the industry's explicit allocation, the filing acknowledges that FINRA's portion will be passed-on to Industry Members and specifically contemplates that exchanges may also pass-on their purported allocation. This means that the firms governing CAT would not be bearing any of the associated costs, distorting incentives and hindering the prioritization of critical cost-control measures.

Even the explicit allocation to Industry Members of 67% of the total costs to build and operate CAT does not represent an equitable allocation of reasonable fees as required by the Exchange

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[1] 88 Fed. Reg. 17086 (Mar. 21, 2023), available at: https://www.govinfo.gov/content/pkg/FR-2023-03-21/pdf/2023-05690.pdf (the "2023 Funding Proposal").

[2] The 2023 Funding Proposal defines "Industry Member" as "a member of a national securities exchange or a member of a national securities association." 2023 Funding Proposal at FN 11.

Act. In fact, there is little explanation as to how the CAT Operating Committee arrived at this figure. For example, there is no suggestion that Industry Members somehow receive 67% of the benefits from CAT, given that it is a system specifically designed for regulators to more effectively conduct market surveillance. In addition, the magnitude and trajectory of total costs cannot be considered reasonable, particularly since Industry Members are already bearing *nearly all* of the total CAT-related costs as a result of implementing the associated reporting requirements.

Meanwhile, annual CAT operating costs continue to dramatically increase each year – at a rate of up to 40% – and are now approximately 5 times more than initial Commission estimates. Based on the average annual increase, the CAT operating budget alone will be more than $1 billion per year by 2030, representing nearly 50% of the Commission's entire current budget. And other Commission proposals could further increase these figures significantly – for example, the recent Regulation SCI proposal would *double the overall CAT budget* if adopted.[3]

Despite being allocated these massive costs, Industry Members lack even a single representative on the CAT Operating Committee and, therefore, cannot vote on the design, implementation, or funding of CAT. In addition, astonishingly little transparency is provided regarding the origin of, or the key drivers for, these spiraling costs, with the CAT Operating Committee simply pointing to the broad expense categories contained in financial statements. This lack of transparency prevents the Commission from concluding that the proposed allocation is reasonable as required by the Exchange Act and raises concerns that clearly inappropriate expenses will also be allocated to Industry Members, such as expenses relating to the CAT Operating Committee's ongoing litigation with the Commission and expenses that the CAT NMS Plan expressly prohibits the CAT Operating Committee from recovering due to missed implementation deadlines. It is clearly inequitable to compel Industry Members to provide a blank check to fund these spiraling costs in perpetuity, without any governance role or any plan to contain overall costs.

A similar lack of detail plagues the CAT Operating Committee's feeble attempt to assess the impact of the 2023 Funding Proposal on market efficiency, competition, and capital formation as required by Sections 6(b)(5) and 6(b)(8) of the Exchange Act. In particular, the 2023 Funding Proposal will impose a new significant and rapidly increasing trading expense on all investors in U.S. equities and options markets, negatively impacting overall liquidity and efficiency in violation of Section 6(b)(5) of the Exchange Act. In addition, the proposal to allocate costs *among* Industry Members based on executed share volume disproportionately impacts market makers (as 20 firms will bear the vast majority of total costs) and retail investors (given their share of trading activity in sub-dollar NMS stocks that dramatically increases executed share volume) in violation of Section 6(b)(8) of the Exchange Act. By failing to even attempt to analyze these impacts on market functioning and competition, the CAT Operating Committee has not met its burden to demonstrate that the 2023 Funding Proposal is consistent with the Exchange Act.

Urgent action is required to reverse the current trajectory – the current filing should be rejected and a new proposal should incorporate the constructive recommendations set forth herein.

[3] Letter from the CAT Operating Committee Chair (June 21, 2023) at 2, available at: https://www.sec.gov/comments/s7-07-23/s70723-208299-421042.pdf.

Constructive Recommendations For A New CAT Funding Proposal

A. Achieving A More Equitable CAT Cost Allocation

(i) Prospective Costs

1. Any allocation of costs to Industry Members should leverage the "originating broker" model in order to allocate costs to the party originating an order.
2. Allocation split:
   - In no event should Industry Members be allocated more than 50% of ongoing CAT costs (including any allocation to FINRA).
   - Prohibit the exchanges from passing-on (directly or indirectly) their portion of CAT costs.
   - Consider allocating a portion of costs to the Commission to align incentives.
3. Allocation methodology:
   - Disperse costs more evenly across Industry Members.
   - Ensure specific market segments are not subject to an inequitable allocation (e.g. retail).

(ii) Historical Costs

Industry Members should not bear historical costs.

(iii) Other Allocation Suggestions

1. Exchanges should be responsible for any costs over the approved budget.
2. Exclude costs for matters/functionality/change requests specific to the SROs or Commission.

B. Key CAT Enhancements

(i) Reducing Overall CAT Operating Costs

1. Cease from making further changes to the CAT at this time. The CAT Operating Committee should file an updated NMS Plan to reflect the current *status quo*.
2. Identify technical requirements that should be modified to materially reduce costs without sacrificing key benefits (e.g. moving certain timelines to T+2 from T+1).
3. Further streamline the CAT submission process (e.g. implementing further data validation)

(ii) Improving CAT Governance and Budget Transparency

Independent Cost Review Mechanisms

1. An independent expert committee should review the CAT budget on an annual basis (including assessing whether current cost levels and third-party arrangements are reasonable).
2. The Commission should formally approve the CAT budget on an annual basis.
3. All CAT operating budgets should remain published on the CAT website.

Advance Notice of Material Changes to the CAT System and Related Costs

Any material change should require an NMS Plan amendment, including a cost-benefit analysis.

Fairer Voting Rights

1. Allocate voting rights similar to the NMS Plan for consolidated equity market data.
2. All actions relating to funding should require authorization by a Supermajority vote.
3. Provide Industry Members with voting representation commensurate with any costs allocated.

Data Security

Finalize the data security plan amendments to address CAT-related data security concerns.

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I. The 2023 Funding Proposal is an Outgrowth of Governance Failures and Spiraling Costs

In 2012, the Commission finalized Rule 613 (*Consolidated Audit Trail*)[4] requiring that the national securities exchanges and FINRA file a national market system plan ("NMS Plan") to create, implement, and maintain a consolidated audit trail. While this Commission rule set forth certain requirements for the CAT, the exchanges and FINRA were given significant flexibility to determine the governance framework and implementation plan.[5] Unfortunately, this delegation of responsibility by the Commission has resulted in spiraling costs, with the annual CAT budget now approximately *5 times* more than the Commission's original estimate in 2016 (and rising).

Rather than providing adequate transparency regarding the key drivers of these spiraling costs and soliciting input on concrete recommendations to contain the CAT budget, the 2023 Funding Proposal appears myopically focused on offloading all of these costs to Industry Members. As detailed in Section II below, even the costs purportedly allocated to exchanges may, nonetheless, be passed-on to Industry Members, with the filing stating that "each Participant may determine to charge their members fees to fund their share of the CAT fees."[6] A funding model that allocates essentially all of the spiraling costs to build and operate CAT to firms that are not represented on the CAT Operating Committee distorts incentives and hinders the prioritization of critical cost-control measures, as the firms governing CAT are not bearing the associated costs.

Experience has shown that the model the Commission contemplated more than a decade ago is simply not working.[7] With all the changes and cost overruns, the Commission today is confronted with a CAT structure that is unrecognizable compared to one contemplated in 2012. It is time for the Commission to revisit the assumptions upon which it relied when approving the CAT NMS Plan, many of which have proven grossly inaccurate, such as overall cost estimates, the failure to retire duplicative systems, the impracticality of technical requirements, the lack of effective governance, and no processes to consider the ever-expanding requests to add more data.

A. The CAT Governance Structure is Deeply Flawed

The CAT is currently governed by an Operating Committee, which is composed of representatives from FINRA and the 24 securities exchanges.[8] Each of the 25 members of the CAT Operating Committee receive one vote, and many decisions are taken by simple majority,

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[4] 77 Fed. Reg. 45722 (Aug. 1, 2012), available at: https://www.govinfo.gov/content/pkg/FR-2012-08-01/pdf/2012-17918.pdf ("Rule 613").

[5] *See, e.g.,* Rule 613 at 45725.

[6] 2023 Funding Proposal at 17107.

[7] *Cf. Sierra Club v. EPA*, 671 F.3d 955, 965 (9th Cir. 2012) (overturning as arbitrary and capricious an agency's action for failing to consider newer "data [that] told a different story than that told by the earlier data").

[8] *See, e.g.,* 81 Fed. Reg. 84696 (Nov. 23, 2016) at 84701, available at: https://www.govinfo.gov/content/pkg/FR-2016-11-23/pdf/2016-27919.pdf ("2016 CAT NMS Plan"); and Testimony of Michael J. Simon, Operating Committee Chairman Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Oct. 22, 2019) at 3-4, available at: https://www.banking.senate.gov/imo/media/doc/Simon%20Testimony%2010-22-19.pdf ("Simon Testimony").

including with respect to funding-related matters. Exchange groups with multiple affiliated exchanges have significant influence under this voting structure, with two exchange groups allocated six votes each and another exchange group allocated five votes.[9] In other words, three exchange groups alone can dictate many CAT-related decisions, including with respect to funding.

The Commission also has an important role in the current governance structure. Commission staff attend "nearly all CAT meetings and calls," and "have played an important role in discussions related to the development of the CAT," [10] including by interpreting what is required by Commission Rule 613 and the 2016 CAT NMS Plan. However, the Commission has not regularly assessed whether the costs resulting from a specific interpretation of Rule 613 or the 2016 CAT NMS Plan outweigh any associated benefits.

The 2023 Funding Proposal exposes the inherent flaws in this governance structure. *First*, the current governance structure enables a small group of exchanges to dictate how CAT costs are allocated, including to competitor firms, creating an inherent conflict of interest.[11] Industry Members lack even a single representative on the CAT Operating Committee and, therefore, cannot vote on the design, implementation, or funding of CAT. While there is a separate Advisory Committee that contains industry representation, its recommendations are non-binding and thus can be (and have been) completely ignored by the CAT Operating Committee. For example, the Advisory Committee did not support the 2023 Funding Proposal.[12] This flawed governance structure leads to the current proposal, which allocates essentially all of the truly staggering CAT-related costs to Industry Members, insulating the firms actually governing CAT from bearing any of the associated costs.

Second, the current governance structure allows the CAT Operating Committee to provide only minimal information regarding the CAT costs that are proposed to be allocated to Industry Members via the 2023 Funding Proposal. In particular, the CAT Operating Committee publishes audited financial statements[13] and an annual "financial and operating budget."[14] These disclosures group CAT operating expenses into several broad categories,[15] but fail to provide any detail

[9] *See* March 2023 Funding Proposal at 17131.

[10] Simon Testimony at 6.

[11] The Commission has specifically acknowledged this conflict of interest. See 85 Fed. Reg. 65470 (Oct. 15, 2020) at 65482, available at: https://www.govinfo.gov/content/pkg/FR-2020-10-15/pdf/2020-18572.pdf ("the SROs have potential conflicts of interest with respect to allocating costs related to the CAT Plan").

[12] 87 Fed. Reg. 54558 (Sept. 6, 2022) at FN 336, available at: https://www.govinfo.gov/content/pkg/FR-2022-09-06/pdf/2022-19111.pdf.

[13] *See* https://www.catnmsplan.com/audited-financial-statements.

[14] *See* https://www.catnmsplan.com/cat-financial-and-operating-budget. This document only appears to be provided for the current and immediately prior fiscal year. In addition, the annual budget has not proven to accurately predict actual costs. According to the 2023 Funding Proposal, "[a]n analysis of budgeted CAT costs and actual CAT costs for 2020, 2021 and the first nine months of 2022 demonstrates that actual CAT costs were approximately 20% higher than budgeted amounts over this period on a cumulative average basis." 2023 Funding Proposal at 17090.

[15] The "Statement of Activities" in the audited financial statements groups CAT operating expenses into the following categories: (1) technology costs, (2) legal, (3) amortization of developed technology, (4) consulting, (5) insurance, (6) professional and administration, and (7) public relations. Technology costs are further divided into (i)

regarding the origin of, or the key drivers for, these costs. For example, there is no information regarding the specific legal or technological requirements that are proving particularly responsible for the significant increases in overall costs, nor the various technical design alternatives that were considered before implementing these requirements. As a result, market participants are unable to assess whether the total CAT costs are reasonable and are limited in their ability to put forward constructive alternatives designed to achieve significant cost savings. Instead, they are expected to rely on the CAT Operating Committee to contain the overall budget, even though the members of the CAT Operating Committee will be largely insulated from these spiraling costs.

Third, though CAT is operated by the securities exchanges and FINRA pursuant to an NMS Plan, there have nevertheless been many ad-hoc discussions between the CAT Operating Committee and the Commission regarding what is required by the NMS Plan without adequate notice to Industry Members or due consideration of the costs and benefits associated with such interpretations. Remarkably, the CAT Operating Committee and the Commission have strongly disagreed on the scope of the 2016 CAT NMS Plan,[16] leading to unresolved litigation that could further increase overall CAT costs, including the significant implementation costs already being borne by Industry Members in order to comply with CAT reporting requirements.[17] The current governance structure does not require that the CAT Operating Committee and the Commission jointly assess whether the costs resulting from a specific interpretation of the 2016 CAT NMS Plan outweigh any associated benefits (in which case amending the 2016 CAT NMS Plan would appear to be the appropriate course of action). Once again, a funding model that allocates essentially all CAT-related costs to firms that are neither represented in these discussions nor the ongoing litigation between the CAT Operating Committee and the Commission only serves to further marginalize cost-related considerations.

B. CAT Costs Have Spiraled Out of Control

It is indisputable that CAT costs have spiraled completely out of control under the current governance structure. When approving the 2016 CAT NMS Plan, the Commission estimated that it would cost \$37.5 million to \$65 million to build CAT and that annual operating costs would range from \$36.5 million to \$55 million.[18] These estimates were directly based on information provided by members of the CAT Operating Committee, which touted that "the expected Plan Processor costs are less than originally proposed."[19] In subsequent filings made in 2017 and 2018, members of the CAT Operating Committee continued to estimate that annual CAT costs would be

cloud hosting services, (ii) milestone fees, (iii) operating fees, (iv) data service fees, and (v) change request fees. The "financial and operating budget" uses these same categories.

[16] *See, e.g.,* 88 Fed. Reg. 33655 (May 24, 2023), available at: https://www.govinfo.gov/content/pkg/FR-2023-05-24/pdf/2023-11031.pdf.

[17] We note that the CAT Operating Committee has redacted its estimates regarding the impact of these interpretative disputes on overall CAT costs, leaving the industry unable to fully assess the potential ramifications of this litigation. *See, e.g.,* "Motion for Partial Stay of Order 34-90688," available at: https://www.sec.gov/rules/other/2022/34-95235-motion-for-stay-of-688-order.pdf and "Motion for Partial Stay of Order 34-90689," available at: https://www.sec.gov/rules/other/2022/34-95235-motion-for-stay-of-689-order.pdf.

[18] 2016 CAT NMS Plan at 84801.

[19] https://www.sec.gov/comments/4-698/4698-33.pdf.

approximately $50 million.[20] Now, just five years later, annual operating expenses for CAT are at least $234 million.[21] This stands in stark contrast to a world where the underlying costs of data management systems have steadily declined. For example, hard drive cost per gigabyte continues to decrease year-over-year.[22]

Critical missteps began almost immediately. When selecting the entity to build and operate CAT in 2017, members of the CAT Operating Committee awarded the contract to a firm that could not deliver. After this engagement "did not progress in a satisfactory manner,"[23] the CAT Operating Committee effectively started-over two years later by selecting FINRA to build and operate CAT in Q2 of 2019. This misstep resulted in significant implementation delays[24] and more than $100 million in wasted expenditures.[25]

However, replacing the entity responsible for building and operating CAT was only the beginning of spiraling costs. The chart below sets forth annual CAT costs once FINRA was selected to build and operate CAT (beginning with 2020, the first full year of FINRA's tenure):

Year	Annual CAT Costs	Change From Prior Year
2020	103M[26]	
2021	144M[27]	**+40%**
2022	179M[28]	**+24%**
2023	234M[29]	**+31%**

[20] Release No. 34-80930 (July 14, 2017) at 30, available at: https://www.sec.gov/rules/sro/nms/2017/34-80930.pdf ("2017 Funding Proposal") and Release No. 34-82451 (Jan. 5, 2018) at 32, available at: https://www.sec.gov/rules/sro/nms/2018/34-82451.pdf ("2018 Funding Proposal").

[21] Based on the CAT operating budget for 2023. https://www.catnmsplan.com/sites/default/files/2023-03/03.28.23-CAT-Q1-2023-Budget.pdf. Actual costs for 2023 are likely to be significantly higher, as costs typically exceed the estimated budget by an average of 20%. 2023 Funding Proposal at 17090.

[22] *See, e.g.,* https://www.backblaze.com/blog/hard-drive-cost-per-gigabyte/.

[23] Simon Testimony at 5.

[24] According to Chair Clayton at the time, "the development and implementation process remains slow and cumbersome due largely to what I believe are project governance and project management issues experienced by the SROs." Testimony of Chairman Jay Clayton Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Dec. 11, 2018), available at: https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0.

[25] *See* Letter from Tower Research Capital (May 12, 2021) at 8, available at: https://www.sec.gov/comments/4-698/4698-8793895-237841.pdf ("Tower Letter").

[26] Based on the difference in "Total Liabilities" between 2019 and 2020 from the published CAT financial statements.

[27] Operating expenses for Period 3. *See* 2023 Funding Proposal at 17111.

[28] *See* https://www.catnmsplan.com/sites/default/files/2022-11/11.14.22-CAT-Q4-2022-Budget.pdf. Actual costs for 2022 are likely to be significantly higher, as costs typically exceed the estimated budget by an average of 20%. 2023 Funding Proposal at 17090.

[29] *See* https://www.catnmsplan.com/sites/default/files/2023-03/03.28.23-CAT-Q1-2023-Budget.pdf. Actual costs for 2023 are likely to be significantly higher, as costs typically exceed the estimated budget by an average of 20%. 2023 Funding Proposal at 17090.

Not only are total costs continuing to dramatically increase each year (at a rate of up to 40%), the CAT Operating Committee appears unable to exert sufficient control over costs to even allow the setting of an accurate annual budget. According to the 2023 Funding Proposal, "[a]n analysis of budgeted CAT costs and actual CAT costs for 2020, 2021 and the first nine months of 2022 demonstrates that actual CAT costs were approximately 20% higher than budgeted amounts over this period on a cumulative average basis."[30]

C. The CAT Operating Committee Has Repeatedly Attempted to Allocate CAT Costs in an Unlawful Manner

Rather than providing adequate transparency regarding the key drivers of the spiraling CAT costs and putting forward concrete recommendations to contain the CAT budget, there appears to be a myopic focus on offloading all of these costs to Industry Members. As detailed in the chart below, the 2023 Funding Proposal represents the fifth unlawful attempt by the CAT Operating Committee to allocate massive CAT costs to Industry Members:

Year	**Metric Used to Allocate Costs to Industry Members**	**% of Costs Allocated to Exchanges**	**Result**
2017[31]	Message Traffic	11.65%[32]	Withdrawn
2018[33]	Message Traffic	14.5%[34]	Withdrawn
2021[35]	Message Traffic	22%[36]	Withdrawn
2022[37]	Volume (by shares)	22%[38]	Withdrawn
2023	Volume (by shares)	22%[39]	[?]

This summary of funding proposals highlights a few points. *First*, rather than engaging the industry in constructive dialogue, the CAT Operating Committee continues to file funding

[30] 2023 Funding Proposal at 17090.

[31] 2017 Funding Proposal, *supra* note 20.

[32] Calculated by determining the exchanges' share of total costs allocated to equity execution venues and options execution venues. *See* 2017 Funding Proposal at 34-35 and Appendix B.

[33] 2018 Funding Proposal, *supra* note 20.

[34] Calculated by determining the exchanges' share of total costs allocated to equity execution venues and options execution venues. *See* 2018 Funding Proposal at 36-38 and Appendix B.

[35] Release No. 34-91555 (Apr. 14, 2021), available at: https://www.sec.gov/rules/sro/nms/2021/34-91555.pdf ("2021 Funding Proposal").

[36] *See* Letter from NYSE (May 10, 2021) at 4, available at: https://www.sec.gov/comments/4-698/4698-8779961-237701.pdf ("2021 NYSE Letter").

[37] Release No. 34-94984 (May 25, 2022), available at: https://www.sec.gov/rules/sro/nms/2022/34-94984.pdf ("2022 Funding Proposal").

[38] Calculated by subtracting FINRA's estimated allocation of 11% of total costs from the 33% allocated to members of the CAT Operating Committee. *See* Letter from FINRA (April 11, 2023) at 3, available at: https://www.sec.gov/comments/4-698/4698-20164063-334005.pdf and 2021 NYSE Letter at 4.

[39] *Id.*

proposals that are blatantly inconsistent with the Exchange Act (see Section II below), leading to their eventual withdrawal.[40]

Second, despite the dramatic increase in overall costs, the exchange members appear unwilling to bear more than 22% of total costs (and, as detailed below, continue to reserve the right to pass-through even these costs to Industry Members). It is notable that, even after significantly restructuring the proposed funding approach to allocate costs to Industry Members based on volume (by shares) instead of message traffic, the share of costs purportedly allocated to exchanges remained exactly the same.

Third, members of the CAT Operating Committee have failed to articulate a coherent position on how to allocate costs to Industry Members fairly and equitably, and instead appear more focused on ensuring that their own costs are minimized (or eliminated). For example, after initially stating that "charging broker-dealers based on message traffic is the **most equitable** means for establishing fees (emphasis added),"[41] the members of the CAT Operating Committee now concede that "imposing CAT fees on each CAT Reporter based on its message traffic may have an adverse effect on competition, liquidity or other aspects of market structure."[42] As detailed in Section II below, the 2023 Funding Proposal fails to explain why allocating the same percentage of total costs to Industry Members[43] using a different metric – executed share volume – should be considered equitable as required by Section 6(b)(4) of the Exchange Act, particularly in light of the inaccurate statements made by the CAT Operating Committee regarding the equitability of prior proposals.

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[40] *See, e.g.,* Simon Testimony at 11 ("the Participants withdrew their rule changes when it became clear that the SEC was going to disapprove those fees").

[41] Letter from the CAT NMS Plan Participants (June 29, 2017) at 6, available at: https://www.sec.gov/comments/sr-batsbyx-2017-11/batsbyx201711-1832632-154584.pdf ("2017 CAT Response Letter").

[42] 2023 Funding Proposal at 17102.

[43] Includes the costs allocated to FINRA, which FINRA has explicitly stated will be allocated to Industry Members (as detailed below).

II. The 2023 Funding Proposal Is Not Permitted by the Exchange Act

The 2023 Funding Proposal contemplates the following allocation of CAT costs:

Time Period	Industry Members[44]	FINRA[45]	Exchanges[46]	Total
Historical Costs				
Pre-2022	226.5M	37M	74.5M	338M[47]
Period 4 (2022-23)[48]	276.5M	45.5M	91M	413M[49]
Annual Operating Expenses				
Current Budget (2024)	157M	25.5M	51.5M	234M[50]
25% Reserve (2024)	39.5M	6.5M	13M	59M[51]
In perpetuity (2025-)	67%	11%	22%	[?]
Total (through 2024)	699.5M	114.5M	230M	**1.04B**

A. The 2023 Funding Proposal Does Not Contain Sufficient Detail for the Commission to Perform the Required Economic Analysis

As shown above, this filing determines how over *a billion dollars* of CAT costs would be allocated by the end of 2024, and establishes the framework pursuant to which many more billions in costs will be allocated in perpetuity. Before approving such a filing, the Commission is required to carefully assess the potential impact on market efficiency, competition, and capital formation under Sections 6(b)(4), 6(b)(5), and 6(b)(8) of the Exchange Act and Commission Rules 608 and 613(a)(5). The 2023 Funding Proposal does not provide the Commission with the information necessary to conduct such an analysis.

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[44] Industry Members are explicitly allocated 2/3 of costs under the 2023 Funding Proposal.

[45] FINRA is allocated approximately 11% of costs under the 2023 Funding Proposal. *See supra* note 38. As detailed below, FINRA has explicitly stated these costs will be allocated to Industry Members.

[46] Exchanges are allocated approximately 22% of costs under the 2023 Funding Proposal. As detailed below, it appears these costs may also be allocated to Industry Members.

[47] 2023 Funding Proposal at 17130.

[48] Assumes full implementation of CAT is not achieved until 2024. As detailed below, the 2023 Funding Proposal contemplates "Period 4" costs being assessed via another "Historical CAT Assessment." 2023 Funding Proposal at FN 43.

[49] Based on the CAT operating budget for 2022 and 2023. Actual costs for 2022 and 2023 are likely to be significantly higher, as costs typically exceed the estimated budget by an average of 20% according to the CAT Operating Committee. *See supra* notes 28 and 29.

[50] Based on the CAT operating budget for 2023. Actual costs for 2024 are likely to be significantly higher, as actual 2023 costs typically exceed the estimated budget by an average of 20% and actual 2024 costs are likely to be approximately 32% above 2023 levels (based on the average annual increase under the current Plan Processor).

[51] Not incorporated in the current CAT operating budget for 2023, so calculated by multiplying the current 2023 budget by 25%. Actual reserve costs are likely to be significantly higher, as the actual 2024 budget is likely to be significantly higher. *See id.*

(i) The Commission Must Perform a Thorough Economic Analysis

In connection with considering the impact of the 2023 Funding Proposal on market efficiency, competition, and capital formation, the Commission must update the economic analysis contained in the 2016 CAT NMS Plan.

First, the Commission must update its estimates of the costs to build and operate CAT using the actual costs incurred. These costs have proven to be many multiples of the Commission's initial estimates in 2016.[52] Given the dramatic year-over-year increases that continue to occur (see Section I.B above), the Commission's economic analysis should also project average annual increases in the CAT operating budget going forward. Based on the observed average annual increase of 32% over the last 3 years, the CAT operating budget would be more than $1 billion per year by 2030, representing nearly 50% of the Commission's entire current budget.[53] This trajectory does not even take into account the impact of other Commission proposals on the overall CAT budget. For example, the CAT Operating Committee has indicated that the Commission's recent Regulation SCI proposal would *double the overall CAT budget* if adopted.[54]

Second, the Commission must update its analysis of the CAT-related costs that are proposed to be borne by Industry Members. Since the 2016 CAT NMS Plan did not set forth a funding model,[55] the Commission did not consider the implications of allocating the costs to build and operate CAT to Industry Members.[56] As detailed in Section II.B below, the 2023 Funding Model provides that at least 78% (and likely up to 100%) of these costs will be allocated to Industry Members, with a small group of broker-dealers responsible for the vast majority of these costs.[57] This proposed allocation will have dramatic effects on market efficiency, competition, and capital formation.

Third, the Commission must update its analysis of the implementation costs borne by broker-dealers to comply with CAT reporting requirements. The 2016 figures grossly underestimated implementation costs for larger broker-dealers, in particular, by incorrectly assuming that significant savings would be realized through the retirement of other reporting systems, such as

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[52] When approving the 2016 CAT NMS Plan, the Commission estimated that it would cost $37.5 million to $65 million to build CAT and that annual operating costs would range from $36.5 million to $55 million. 2016 CAT NMS Plan at 84801.

[53] *See* https://www.sec.gov/files/fy-2024-congressional-budget-justification_final-3-10.pdf at 13.

[54] *Supra* note 3. Several of the Commission's recent equity market structure proposals would also be expected to increase the CAT budget as a result of increasing overall message traffic.

[55] *See, e.g.,* 2016 CAT NMS Plan at 84881 ("Fees to pay for the maintenance and operation of the Central Repository will be allocated via the funding model, and the current allocation of fees between broker-dealers and exchanges has not been determined.").

[56] *See, e.g.,* 2016 CAT NMS Plan at 84864 (broker-dealers are not assigned any costs associated with building or operating CAT).

[57] In addition, Industry Members may be required to fund historical costs and ongoing costs at the same time. *See* 2023 Funding Proposal at 17097 ("even if Industry Members were required to pay a Historical CAT Assessment and the ongoing CAT Fee at the same time.").

the Electronic Blue Sheet system (which has not transpired).[58] The Commission must obtain data regarding actual broker-dealer implementation costs as part of assessing the overall impact of allocating significant additional costs to broker-dealers via the 2023 Funding Proposal.

(ii) The 2023 Funding Proposal Does Not Provide Sufficient Detail for the Commission to Conduct the Required Economic Analysis

As detailed in 2019 staff guidance,[59] the Commission must carefully scrutinize filings from exchanges and FINRA that impose fees on industry members to ensure that these fee filings are consistent with the Exchange Act. Taking into consideration that the 2023 Funding Proposal determines how over *a billion dollars* of CAT costs would be allocated by the end of 2024, and establishes the framework pursuant to which many more billions in costs will be allocated in perpetuity, it is clear that the CAT Operating Committee has not met its burden to demonstrate that the proposed allocation of fees is consistent with the Exchange Act.

The 2023 Funding Proposal provides the following level of detail regarding CAT costs (we note this chart covers 2021 – the most recently published audited financials):[60]

Operating Expense	Historical CAT Costs for Period 3
Capitalized Developed Technology Costs*	$10,763,372
Technology Costs:	$123,639,402
Cloud Hosting Services	$94,574,759
Operating Fees	$23,106,091
CAIS Operating Fees	$5,562,383
Change Request Fees	$396,169
Legal	$6,333,248
Consulting	$1,408,209
Insurance	$1,582,714
Professional and administration	$595,923
Public relations	$92,400
Total Operating Expenses	**$144,415,268**

* The non-cash amortization of these capitalized developed technology costs of $5,108,044 incurred during Period 3 have been appropriately excluded from the above table.

According to the CAT Operating Committee, this level of detail provides "substantial cost transparency" and a level of transparency that is "above and beyond what is required under the CAT NMS Plan."[61] These statements reveal a startling disconnect with reality.

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[58] *See* 2016 CAT NMS Plan at 84862.

[59] Staff Guidance on SRO Rule Filings Relating to Fees (May 2019), available at: https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fees.

[60] The table is copied from the 2023 Funding Proposal at 17111.

[61] 2023 Funding Proposal at 17109.

In practice, the CAT Operating Committee has resisted cost transparency at every turn. Repeated requests for more detailed breakdowns of the broad expense categories above, including the technology costs that "account for more than 90% of CAT costs,"[62] have been flatly refused.[63] Similarly, there is no attempt to provide any detail regarding the origin of, or the key drivers for, these massive costs, such as explaining the specific legal or technological requirements that are proving particularly responsible for the significant increases in overall costs, and the various technical design alternatives that were considered before implementing these requirements. Instead of providing this critical cost transparency, the CAT Operating Committee has pointed market participants to "public webinars providing additional detail about CAT costs."[64]

The overall lack of cost transparency has been documented by the Commission as it has considered prior funding proposals from the CAT Operating Committee, such as in the 32 detailed questions included in its Order Instituting Proceedings on the 2022 Funding Proposal.[65] Instead of responding to these questions, the CAT Operating Committee simply withdrew the 2022 Funding Proposal and refiled an almost identical 2023 Funding Proposal[66] while asserting that "[a]dditional public cost transparency is not necessary for the SEC to evaluate the proposal under the Exchange Act" and that the Commission should specifically request "additional financial information about CAT LLC to the extent necessary."[67]

These statements appear to ignore that under the Commission's Rules of Practice,[68] the burden to demonstrate that a NMS plan filing is consistent with the Exchange Act is on the plan participants that make the filing. In addition, Rule 613 requires the members of the CAT Operating Committee to: "(1) provide an estimate of the costs associated with creating, implementing, and maintaining the consolidated audit trail under the terms of the NMS plan submitted to the

[62] 2023 Funding Proposal at 17090.

[63] *See, e.g.,* 2023 Funding Proposal at 17090 ("CAT LLC currently does not propose to require the disclosure of additional subcategories of cost information, such as a further breakdown of the category of cloud hosting services into production costs, including linker costs and storage costs.") and Letter from the CAT Operating Committee Chair (Aug. 16, 2022) at 18, available at: https://www.sec.gov/comments/4-698/4698-20136270-307325.pdf ("2022 CAT Response Letter") ("Despite the substantial disclosures about CAT finances, commenters request detailed information about all costs necessary to operate the CAT, which is not necessary to evaluate a fee proposal.").

[64] 2022 CAT Response Letter at 32.

[65] Release No. 34-95634 (Aug. 30, 2022), available at: https://www.sec.gov/rules/sro/nms/2022/34-95634.pdf ("2022 OIP").

[66] *See* Letter from the CAT Operating Committee Chair (June 15, 2023) at 2, available at: https://www.sec.gov/comments/4-698/4698-206179-414982.pdf. We note that, in withdrawing the 2022 Funding Proposal and refiling an almost identical proposal, comment letters submitted in response to the 2022 Funding Proposal appear to have been removed from consideration (*see* Release No. 34-97750 (June 16, 2023), available at: https://www.sec.gov/rules/sro/nms/2023/34-97750.pdf). The Commission should ensure a procedural gimmick does not negate consideration of comments made regarding the substance of the 2023 Funding Proposal. These comments build on the comments that have already been submitted in File No. 4-698; the Commission must grapple with all of the comments in the file, including comments that the Commission's website identifies as "Older." See https://www.sec.gov/comments/4-698/4-698-a.htm.

[67] 2022 CAT Response Letter at 18-19.

[68] Rule 700(b)(3)(ii).

Commission for its consideration; (2) discuss the costs, benefits, and rationale for the choices made in developing the NMS plan submitted; and (3) provide their own analysis of the submitted NMS plan's potential impact on competition, efficiency and capital formation."[69] Given the massive increase in costs since the Commission's most recent estimate in 2016, and the commercial significance of this proposed amendment to the 2016 CAT NMS Plan, the Commission should require the members of the CAT Operating Committee to update the analysis required by Rule 613. In any event, the lack of transparency provided by the CAT Operating Committee prevents the Commission from concluding that the proposed allocation methodology is reasonable as required by the Exchange Act.

(iii) The 2023 Funding Proposal is the Critical Filing Requiring a Thorough Economic Analysis

In the event the 2023 Funding Proposal were approved, the exchanges and FINRA would make an additional filing to set forth the billing process and fee schedule for Industry Members. However, this does not relieve the Commission of conducting the thorough economic analysis required by the Exchange Act and the 2016 CAT NMS Plan.

First, the 2023 Funding Proposal contemplates that such additional filing would be effective upon filing pursuant to Rule 19b-4.[70] This means that Industry Members would immediately be assessed fees, even if the filing was later suspended by the Commission. We note that this approach appears inconsistent with recent Commission rulemaking designed to ensure that fee filings relating to an NMS Plan (specifically including the CAT NMS Plan) can no longer be effective upon filing.[71]

Second, even if such additional filing was submitted as an amendment to the CAT NMS Plan, the fundamental issues are being decided in this filing, as the allocation methodology represents the single most important commercial issue. Once the Commission approves a methodology for allocating CAT costs, the CAT Operating Committee would simply apply that approved methodology to the costs incurred during a specific time period. However, the methodology presented in the 2023 Funding Proposal is inconsistent with the Exchange Act for a multitude of reasons (as detailed below), including (a) the clearly excessive percentage of total costs proposed to be allocated to Industry Members in aggregate and (b) the unfair method for allocating costs *among* Industry Members. The allocation methodology will have a direct and negative impact on market efficiency, competition, and capital formation, and the Commission must comprehensively assess those impacts before approving this filing.

This further underscores the fact that the Commission cannot ignore the glaring deficiencies in the 2023 Funding Proposal, which is the operative vehicle for allocating a truly staggering sum of costs to Industry Members.

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[69] Release No. 34-77724 (Apr. 27, 2016) at 183, available at: https://www.sec.gov/rules/sro/nms/2016/34-77724.pdf.

[70] 2023 Funding Proposal at FN 38.

[71] *See* 85 Fed. Reg. 65470 (Oct. 15, 2020), available at: https://www.govinfo.gov/content/pkg/FR-2020-10-15/pdf/2020-18572.pdf.

B. The Proposed Allocation Methodology is Inconsistent with the Exchange Act

The 2023 Funding Proposal can be summed-up by the following: Industry Members will have to pay 100% of the costs, representing at least a billion in expenses through 2024, and many more billions in the future.

The 2023 Funding Proposal explicitly allocates 67% of CAT costs to Industry Members. In addition to this explicit allocation, the 2023 Funding Proposal is clear that the 11% allocation to FINRA will be passed-on to Industry Members and the 22% allocation to exchanges may also be passed-on to Industry Members (at the discretion of each exchange). This farcical outcome renders the proposed allocation methodology meaningless, and distorts incentives and hinders the prioritization of critical cost-control measures, as the firms governing CAT are not bearing the associated costs.

The proposed allocation methodology is put forward without any serious consideration of the effects on market efficiency, competition, and capital formation. Inconvenient facts are simply ignored, such as that Industry Members are already bearing *nearly all* CAT-related costs due to the associated implementation costs and that a small group of 20 firms will be responsible for nearly 75% of the billions in additional costs to be allocated to Industry Members under this proposal. The 2023 Funding Proposal cannot be considered to equitably allocate reasonable fees as required by Section 6(b)(4) of the Exchange Act, and will harm market efficiency, competition, and capital formation in a manner inconsistent with Sections 6(b)(5) and 6(b)(8) of the Exchange Act.

(i) Allocating 67% of CAT Costs to Industry Members Based on Share Volume is Inconsistent with the Exchange Act

Time Period	Industry Members	FINRA	Exchanges	Total
Historical Costs				
Pre-2022	226.5M	37M	74.5M	338M
Period 4 (2022-23)	276.5M	45.5M	91M	413M
Annual Operating Expenses				
Current Budget (2024)	157M	25.5M	51.5M	234M
25% Reserve (2024)	39.5M	6.5M	13M	59M
In perpetuity (2025-)	67%	11%	22%	[?]
Total (through 2024)	699.5M	114.5M	230M	**1.04B**

The 2023 Funding Proposal explicitly allocates 67% of the costs to build and operate CAT to Industry Members, representing at least $700 million in expenses through 2024, and many more billions in the future. In doing so, the CAT Operating Committee fails to address two critical issues.

1. Allocating 67% of Costs to Industry Members Is Not Equitable or Rational

The 2023 Funding Proposal does not demonstrate that it is equitable (as required by Section 6(b)(4) of the Exchange Act) or even rational (as required by the Administrative Procedure Act) to explicitly allocate 67% of CAT costs to Industry Members. In fact, there is little explanation as to how the CAT Operating Committee arrived at this figure.[72] For example, there is no suggestion that Industry Members somehow receive 67% of the benefits from CAT, given that it is a system specifically designed for regulators to more effectively conduct market surveillance.[73]

Instead, the CAT Operating Committee makes two main arguments as to why they believe it is appropriate to allocate costs in this manner. *First*, the 2023 Funding Proposal asserts that, since there are many more Industry Members than members of the CAT Operating Committee, Industry Members have "greater financial resources" and therefore should be allocated most of the costs.[74] This line of argument is deeply flawed. As detailed below, the overwhelming majority of Industry Members will pay little to no CAT costs under the 2023 Funding Proposal, even though CAT is designed to facilitate market-wide surveillance across all market participants. Instead, a small group of 20 firms will be responsible for nearly 75% of the total costs allocated to Industry Members. Notably, this outcome is effectively the opposite of what the CAT Operating Committee claims – its members actually outnumber the Industry Members who ultimately will bear most of the costs. The 2023 Funding Proposal fails to explain why it is equitable to allocate approximately 50% of total CAT costs to 20 Industry Members,[75] while only allocating 22% to 24 exchanges.

Furthermore, by facilitating market surveillance and enforcement activities, CAT is a revenue generator for the exchanges. Moreover, Industry Members *already* provide the exchanges a substantial amount of funding for regulatory matters, including through membership fees, registration fees, market data fees, and other regulatory fees. Those fees must be factored into any equitable or rational allocation of CAT costs.

Second, the 2023 Funding Proposal asserts that Industry Members should be considered responsible for CAT costs since they "originate market activity" that must be reported to CAT and have adopted business models that "bring [a] level of complexity to the markets."[76] Aside from appearing to penalize Industry Members simply for fostering liquid and efficient securities markets that facilitate capital formation in accordance with the Commission's mission and benefit the exchanges, this line of argument appears to contradict other statements from the CAT Operating

[72] *Cf. Comcast Corp. v. FCC*, 579 F.3d 1, 8 (D.C. Cir. 2009) (finding that a "30%" limit was arbitrary and capricious because the agency could not "satisfactor[ily]" explain why it picked that level)

[73] *See, e.g.,* Release No. 34-97530 (May 19, 2023) at 1, available at: https://www.sec.gov/rules/exorders/2023/34-97530.pdf ("2023 Exemptive Order") ("The goal of Rule 613 was to create a modernized audit trail system that would provide regulators with timely access to a comprehensive set of trading data, thus enabling regulators to more efficiently and effectively analyze and reconstruct market events, monitor market behavior, conduct market analysis to support regulatory decisions, and perform surveillance, investigation, and enforcement activities.").

[74] 2023 Funding Proposal at 17104.

[75] *See* Exhibit C of the 2023 Funding Proposal.

[76] 2023 Funding Proposal at 17104.

Committee that suggest the "stringent performance, timelines and operational requirements for processing CAT Data" are significant drivers of overall CAT costs.[77] In this regard, it is notable that one of the members of the CAT Operating Committee – with intimate knowledge of the CAT budget and expenses – has indicated that the 2023 Funding Proposal does not "transparently or accurately present information regarding the true sources of cost burdens on the CAT."[78] Furthermore, the CAT Operating Committee's arguments about general market "complexity" would appear to suggest that costs should be more evenly dispersed across Industry Members, instead of being concentrated among a small group of broker-dealers based on volume (by shares).

When taking into account other existing CAT-related costs, such as the implementation costs incurred by Industry Members, it is even clearer that the proposed allocation is not equitable. In 2016, the Commission estimated that broker-dealers would incur approximately 90% of total CAT-related costs, even if they were not allocated *any* costs for building and operating CAT.[79] In addition, these Commission figures grossly underestimated implementation costs for larger broker-dealers, in particular, by incorrectly assuming that significant savings would be realized through the retirement of other reporting systems, such as the Electronic Blue Sheet system (which has not transpired).[80] As a result, Industry Members are already bearing *nearly all* of the total CAT-related costs, at a rate much higher than the Commission estimated in its approval of the 2016 CAT NMS Plan.

The CAT Operating Committee has argued that these implementation costs are not relevant for purposes of the 2023 Funding Proposal, asserting that "[t]here is no precedent for regulatory fees to be determined based on the cost of compliance of the regulated entity."[81] However, this argument misses the point – the CAT Operating Committee has not shown that allocating billions of dollars in additional costs to Industry Members is equitable and will not negatively impact market efficiency, competition, and capital formation in light of the fact that Industry Members *are already* bearing billions of dollars in CAT-related costs. In this regard, it is notable that Rule 613 specifically requires consideration of "the costs to members of the plan sponsors, initially and on an ongoing basis, for reporting the data required by the national market system plan" and members of the CAT Operating Committee have previously acknowledged that their decisions regarding how to structure and implement CAT have "a financial impact on the broker-dealers' costs of compliance."[82] Assessing whether the 2023 Funding Proposal is equitable requires taking into account the allocation of all CAT-related costs, including those already allocated to Industry Members as a result of decisions taken by the CAT Operating Committee in implementing the NMS Plan (without any industry voting representation).

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[77] 2023 Funding Proposal at 17102.

[78] Letter from FINRA (May 25, 2023) at 4, available at: https://www.sec.gov/comments/4-698/4698-194699-386902.pdf.

[79] 2016 CAT NMS Plan at 84864.

[80] *See* 2016 CAT NMS Plan at 84862.

[81] 2022 CAT Response Letter at 9. See also 2023 Funding Proposal at 17105.

[82] Letter from Bats Exchange, et al. (Sept. 23, 2016) at FN 30, available at: https://www.sec.gov/comments/4-698/4698-32.pdf ("2016 CAT Response Letter").

2. Allocating Costs Among Industry Members Based On Share Volume Is Inconsistent with the Exchange Act

The 2023 Funding Proposal allocates the costs among Industry Members based on executed volume (by shares). In doing so, the filing asserts that "trading activity provides a reasonable proxy for cost burden on the CAT."[83] However, there is no evidence to substantiate that assertion. Indeed, members of the CAT Operating Committee have also noted other significant drivers of overall CAT costs, such as "message traffic"[84] and the "stringent performance, timelines and operational requirements for processing CAT Data."[85] In addition, one member of the CAT Operating Committee has indicated that, in fact, equities trading volume creates "a relatively low burden on CAT, from a cost-generation perspective, compared to other cost drivers, such as options activity."[86]

Allocating costs based on volume (by shares) leads to several problematic outcomes that are inconsistent with Sections 6(b)(5) and 6(b)(8) of the Exchange Act. *First*, these massive costs would be largely allocated to an extremely small group of broker-dealers, thereby unduly burdening competition. The 2023 Funding Proposal indicates that the top 10 (20) Industry Members would be allocated more than 50% (70%) of total industry costs.[87] There is no consideration of the potential impacts on market competition, efficiency, and liquidity resulting from allocating these costs to such a small group of broker-dealers, particularly since CAT is designed to facilitate market-wide surveillance across all market participants. For example, the section of the 2023 Funding Proposal that purports to analyze the "Impact on Competition" is one paragraph in length and completely silent on this critical point.[88] This omission is particularly glaring given that the CAT Operating Committee now acknowledges that prior funding proposals based on message traffic "could impose an outsized adverse financial impact on certain Industry Members."[89] It is arbitrary for the CAT Operating Committee to recognize this deficiency in past proposals, but yet replicate that error in the current proposal.

The potential for some of these costs to be passed-on by broker-dealers to other market participants does not alleviate the concern. The 2023 Funding Proposal misleadingly suggests that "the two-thirds allocation of CAT costs to Industry Members may be entirely passed through to investors, thereby alleviating Industry Members of any burden of funding the CAT."[90] This

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[83] 2023 Funding Proposal at 17103.

[84] 2016 CAT Response Letter at 23.

[85] 2023 Funding Proposal at 17102.

[86] Letter from FINRA (Apr. 11, 2023) at FN 23, available at: https://www.sec.gov/comments/4-698/4698-20164063-334005.pdf ("2023 FINRA Letter").

[87] *See* 2023 Funding Proposal at FN 116 and Exhibit C. We note there is also no analysis of the aggregate impact on affiliated entities, which deviates from the approved 2016 CAT NMS Plan requirement to take into account "affiliations between or among CAT Reporters." Section 11.2(c) of the 2016 CAT NMS Plan.

[88] 2023 Funding Proposal at 17122.

[89] 2023 Funding Proposal at 17102.

[90] 2023 Funding Proposal at 17108. *See also* 2023 Funding Proposal at 17103 ("CAT LLC does not believe that the proposal would burden CAT Executing Brokers.").

shockingly inaccurate statement completely ignores the fact that many of the largest broker-dealers will be allocated CAT fees based on their proprietary trading activity (including on-exchange market making), and, therefore, these fees cannot be "passed through to investors." In addition, for those transactions where a broker-dealer may be theoretically able to pass-through the fee to another market participant, there is no consideration of the costs associated with requiring the entire industry to build completely new systems to facilitate such an arrangement nor the expected impact to market volumes (and in particular retail investors) of instituting a new trading expense. The CAT Operating Committee has also stubbornly resisted industry suggestions to allocate fees to the "originating broker" rather than the "executing broker" in order to attempt to streamline the process and more accurately allocate costs to the party originating an order.[91]

Second, allocating costs based on volume (by shares) results in arbitrary and unfair outcomes that discriminate against certain market participants. Commenters have noted, for example, that a "100-share transaction in a $2 stock would impose the same fee obligation as a 100-share transaction in a $2,000 stock, despite the 1,000-fold difference in principal value and associated risk transferred."[92] In addition, the 2023 Funding Proposal makes significant adjustments to OTC Equities volumes due to the large number of shares transacted in sub-dollar securities,[93] but no similar adjustment is made for sub-dollar trading activity in NMS stocks.[94] In turn, a fractional share transaction is rounded-up to 1 share, in effect overstating this trading volume. Both of these aspects of the 2023 Funding Proposal discriminate against Industry Members handling retail orders, given the amount of retail activity in sub-dollar stocks and fractional share trading. For example, data shows that approximately 33% of total retail NMS stock trading activity is now in sub-dollar NMS stocks. Once again, the 2023 Funding Proposal does not explain why volume by shares was chosen instead of another metric (such as notional) nor attempt to assess the impact of these inequitable outcomes on specific Industry Members, retail investors, or overall market competition, efficiency, and liquidity.

[91] Letter from the CAT Operating Committee Chair (May 18, 2023) at 3, available at: https://www.sec.gov/comments/4-698/4698-191099-378422.pdf.

[92] Letter from Larry Harris (June 21, 2022) at 11, available at: https://www.sec.gov/comments/4-698/4698-20132692-303181.pdf ("Harris Letter").

[93] 2023 Funding Proposal at 17093 ("the Funding Proposal would count each executed share for a transaction in OTC Equity Securities as 0.01 executed equivalent shares.").

[94] *See also* Harris Letter at 12 ("Charging fees 100 times smaller for identical-sized transactions for OTC and NMS stocks that trade at the same price unfairly subsidizes the OTC market.").

(ii) Industry Members Will Also Pay the 11% of CAT Costs Allocated to FINRA

Time Period	Industry Members	FINRA	Exchanges	Total
Historical Costs				
Pre-2022	226.5M	37M	74.5M	338M
Period 4 (2022-23)	276.5M	45.5M	91M	413M
Annual Operating Expenses				
Current Budget (2024)	157M	25.5M	51.5M	234M
25% Reserve (2024)	39.5M	6.5M	13M	59M
In perpetuity (2025-)	67%	11%	22%	[?]
Total (through 2024)	699.5M	114.5M	230M	**1.04B**

The 2023 Funding Proposal allocates 11% of the costs to build and operate CAT to FINRA, representing at least $115 million in expenses through 2024. FINRA has clearly indicated that, if this approach is approved, all of these costs will be passed-on to Industry Members.[95] As a result, at least 78% of the costs to build and operate CAT will be allocated to Industry Members in practice, representing over $800 million in expenses through 2024.

This additional allocation of costs to Industry Members only exacerbates the concerns detailed above, including the inconsistencies with Sections 6(b)(4), 6(b)(5), and 6(b)(8) of the Exchange Act. In addition, it brings the total industry allocation to the same percentage (78%) set forth in the unlawful 2021 Funding Proposal.[96] While the CAT Operating Committee now concedes that the 2021 Funding Proposal "may have an adverse effect on competition, liquidity or other aspects of market structure,"[97] it fails to explain why allocating the same percentage of total costs to Industry Members using a different metric – executed share volume – would not be expected to result in similar negative consequences. Finally, in contrast to suggestions that the 2023 Funding Proposal is "neutral as to the location and manner of execution,"[98] counterparties to off-exchange transactions would be assessed higher fees than on-exchange transactions (if the CAT fee assessed to an exchange is not separately passed-on to Industry Members as discussed below).

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[95] *See* 2023 FINRA Letter at 7 ("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.").

[96] *See* 2021 NYSE Letter at 4.

[97] 2023 Funding Proposal at 17102.

[98] 2023 Funding Proposal at 17087.

(iii) Industry Members May Also Pay the 22% of CAT Costs Allocated to Exchanges

Time Period	**Industry Members**	**FINRA**	**Exchanges**	**Total**
Historical Costs				
Pre-2022	226.5M	37M	74.5M	338M
Period 4 (2022-23)	276.5M	45.5M	91M	413M
Annual Operating Expenses				
Current Budget (2024)	157M	25.5M	51.5M	234M
25% Reserve (2024)	39.5M	6.5M	13M	59M
In perpetuity (2025-)	67%	11%	22%	[?]
Total (through 2024)	699.5M	114.5M	230M	**1.04B**

The 2023 Funding Proposal allocates 22% of the costs to build and operate CAT to the exchanges, representing at least $230 million in expenses through 2024. However, despite this purported allocation, the 2023 Funding Proposal suggests that these costs may, nonetheless, be passed-on to Industry Members, stating "each Participant may determine to charge their members fees to fund their share of the CAT fees."[99]

This would be a farcical outcome that renders the proposed allocation methodology meaningless, as Industry Members would be responsible for 100% of the CAT costs, representing at least a billion in expenses through 2024, and many more billions in the future. It would also distort incentives and hinder the prioritization of critical cost-control measures, as the firms governing CAT are not bearing any of the associated costs. It simply cannot be consistent with the requirement to equitably allocate reasonable fees under Section 6(b)(4) of the Exchange Act. As such, it is absolutely critical that the Commission prohibit the exchanges from passing-on (directly or indirectly) their portion of CAT costs to market participants.

[99] 2023 Funding Proposal at 17107.

C. The Types of Costs Proposed to be Allocated to Industry Members are Inconsistent with the Exchange Act

The 2023 Funding Proposal simply groups CAT expenses into broad categories, raising significant questions about the specific types of historical costs that are proposed to be allocated to Industry Members, and the future trajectory of the overall budget. Exchange Act Sections 6(b)(4), 6(b)(5), and 6(b)(8) do not permit this private entity to require Industry Members to provide them with a blank check to fund their costs in perpetuity, as doing so does not represent an equitable allocation of reasonable fees and greatly harms market competition, efficiency, and liquidity.

(i) The Historical Costs are Clearly Excessive and Inconsistent with the 2016 CAT NMS Plan

Time Period	Industry Members	FINRA	Exchanges	Total
Historical Costs				
Pre-2022	226.5M	37M	74.5M	338M
Period 4 (2022-23)	276.5M	45.5M	91M	413M
Annual Operating Expenses				
Current Budget (2024)	157M	25.5M	51.5M	234M
25% Reserve (2024)	39.5M	6.5M	13M	59M
In perpetuity (2025-)	67%	11%	22%	[?]
Total (through 2024)	699.5M	114.5M	230M	**1.04B**

The 2023 Funding Proposal seeks to allocate hundreds of millions in historical costs to Industry Members through several charts that simply group expenses into broad categories. This lack of cost transparency raises numerous questions regarding the types of costs that are being allocated to Industry Members. Examples include:

- Are Industry Members being allocated any costs relating to when Thesys was the Plan Processor?[100] If so, why? Furthermore, did the original reporting framework designed by Thesys constrain FINRA's design decisions and result in inefficient outcomes?

- Are Industry Members being allocated costs relating to the ongoing litigation between the CAT Operating Committee and the Commission? If so, how does that impact overall governance incentives regarding the implementation and interpretation of the NMS Plan?

[100] We note the 2023 Funding Proposal excludes $64 million in costs related to the failed engagement of Thesys, but estimated costs incurred prior to FINRA's tenure are much higher. In addition, FINRA was not formally engaged until Q2 of 2019. *See* Tower Letter at 8.

- Are Industry Members being allocated costs relating to the repeated filing of funding models that are not consistent with the Exchange Act? If so, how does that impact incentives to engage in constructive dialogue with the industry?

These types of questions can only be addressed through the CAT Operating Committee providing a much greater level of cost transparency and prevents the Commission from concluding that the proposed allocation is reasonable as required by Section 6(b)(4) of the Exchange Act.

The proposed allocation of historical costs also raises unique considerations when assessing the impact on Industry Members and overall market efficiency, competition, and capital formation. For example, in contrast to assertions from the CAT Operating Committee,[101] there does not appear to be a clear mechanism to pass-on these costs to other market participants (given that they relate to historical costs rather than current trading activity). Instead, it is simply an unlawful trading expense that a small group of Industry Members will have to bear.

In addition to these issues, the Proposal inadequately addresses the "Period 4" expenses under the Financial Accountability Milestones contained in the current CAT NMS Plan. As set forth in the CAT NMS Plan, the CAT Operating Committee cannot recover expenses from Industry Members that were incurred between (a) December 31, 2021 and (b) the date on which full implementation of the CAT NMS Plan requirements is achieved ("Period 4") until such full implementation occurs.[102] In addition, if such full implementation occurs after December 30, 2022, there are restrictions in terms of the proportion of expenses that the CAT Operating Committee can recover for Period 4. Given that this deadline has passed and it is now more than 180 days after December 30, 2022, the CAT NMS Plan provides that the CAT Operating Committee can only recover a maximum of 25% of the expenses incurred in Period 4. If full implementation does not occur before September 27, 2023, then the CAT NMS Plan provides that the CAT Operating Committee cannot recover any of the expenses incurred in Period 4.

However, the 2023 Funding Proposal and recent actions by the CAT Operating Committee and the Commission have introduced significant uncertainty. *First,* the 2023 Funding Proposal specifically contemplates that the costs incurred during Period 4 may be allocated to Industry Members via additional assessments.[103] *Second*, the CAT Operating Committee has requested exemptive relief to extend the deadline for full implementation until August 31, 2024 (thereby allowing all of the Period 4 expenses to be allocated to Industry Members under the 2023 Funding

[101] 2023 Funding Proposal at 17108.

[102] 85 FR 31322 (May 22, 2020) at 31348, available at: https://www.federalregister.gov/documents/2020/05/22/2020-10963/amendments-to-the-national-market-system-plan-governing-the-consolidated-audit-trail.

[103] 2023 Funding Proposal at FN 43 ("Note that there may be one or more Historical CAT Assessments, depending upon the timing of any approval of the amendment to the CAT NMS Plan and the completion of the Financial Accountability Milestones.").

Proposal).[104] *Third*, the Commission has reserved judgment on whether the relevant provisions of the CAT NMS Plan will be enforced as written.[105]

The issue is highly relevant to the Commission's analysis of the 2023 Funding Proposal, as Period 4 will likely account for more than $400 million in expenses,[106] all of which may be allocated to Industry Members under this filing if the Commission does not enforce the terms of the current CAT NMS Plan. In our view, there are three alternatives for the Commission in the context of analyzing the 2023 Funding Proposal:

1. Clearly state that the relevant financial accountability provisions of the CAT NMS Plan will be enforced as written and permit the CAT Operating Committee to allocate Period 4 expenses only to the extent permitted under those financial accountability provisions under Section 11.3(b) of the CAT NMS Plan (as amended by the 2023 Funding Proposal). This means that Period 4 expenses would be reduced by at least 75% for purposes of assessing the potential impacts on market efficiency, competition, and capital formation of allocating these costs to Industry Members (and by 100% if full implementation does not occur before September 27, 2023).[107]

2. Defer judgment regarding whether the relevant financial accountability provisions of the CAT NMS Plan will be enforced as written, but provide that Period 4 expenses cannot be allocated to Industry Members under the 2023 Funding Proposal. This means expressly carving-out Period 4 expenses from Section 11.3(b) of the CAT NMS Plan (as amended by the 2023 Funding Proposal), and requiring an entirely new CAT NMS Plan Amendment that is specific to Period 4.

3. Defer judgment regarding whether the relevant financial accountability provisions of the CAT NMS Plan will be enforced as written and permit the CAT Operating Committee to allocate Period 4 expenses under Section 11.3(b) of the CAT NMS Plan (as amended by the 2023 Funding Proposal), in which case the Commission should analyze the potential impacts on market efficiency, competition, and capital formation assuming that all of these Period 4 costs will be allocated to Industry Members.[108]

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[104] CAT Exemptive Request (May 22, 2023), available at: https://catnmsplan.com/sites/default/files/2023-06/05.22.23-Exemption-Request-Regarding-FAM-4.pdf ("CAT Exemptive Request").

[105] 2023 Exemptive Order at FN 24 ("the Commission makes no determinations regarding the Participants' compliance or non-compliance with the conditions set forth in the prior orders or the potential impact of such compliance or non-compliance on the Participants' ability to meet the Financial Accountability Milestones set forth in Section 1.1 of the CAT NMS Plan or the potential application of fee reduction provisions set forth in Section 11.6 of the CAT NMS Plan"). *See also* 2022 OIP at FN 440

[106] Assumes full implementation of CAT is not achieved until 2024. *See* CAT Exemptive Request at 9.

[107] Note this assumes the relevant costs could not be passed-on to Industry Members in other ways, such as the exchanges are reserving the right to do for the share of costs purportedly allocated to them under this filing.

[108] If Period 4 expenses can be allocated under Section 11.3(b) of the CAT NMS Plan (as amended by the 2023 Funding Proposal), then this filing is a proposal "related to the imposition of CAT fees on broker-dealers." *See* 2023 Exemptive Order at FN 24.

As we detailed above in Section II.A(iii), the Commission cannot delay this analysis until a subsequent filing setting forth the billing process is made, as once the Commission approves a methodology for allocating CAT costs (including Period 4), the CAT Operating Committee would simply apply that approved methodology to the costs incurred during a specific time period.

(ii) The Trajectory of Annual Operating Expenses Is Unconstrained

Time Period	Industry Members	FINRA	Exchanges	Total
Historical Costs				
Pre-2022	226.5M	37M	74.5M	338M
Period 4 (2022-23)	276.5M	45.5M	91M	413M
Annual Operating Expenses				
Current Budget (2024)	157M	25.5M	51.5M	234M
25% Reserve (2024)	39.5M	6.5M	13M	59M
In perpetuity (2025-)	67%	11%	22%	[?]
Total (through 2024)	699.5M	114.5M	230M	**1.04B**

The 2023 Funding Proposal also does not provide sufficient information regarding the specific drivers of the enormous cost increases witnessed in recent years or estimates regarding the future cost trajectory, further preventing the Commission from concluding that the proposed allocation is reasonable as required by Section 6(b)(4) of the Exchange Act. Indeed, the CAT Operating Committee's acknowledgment that actual expenses typically exceed budgeted amounts by approximately 20%[109] and data showing that overall CAT expenses have increased by an average of 32% each year under the current Plan Processor[110] cause significant concern about the future trajectory.[111] In addition, the CAT Operating Committee has indicated that other Commission proposals may significantly increase future CAT budgets. For example, the CAT Operating Committee has indicated that the Commission's recent Regulation SCI proposal would *double the overall CAT budget* if adopted.[112]

Rather than taking steps to allay these concerns, the 2023 Funding Proposal suggests these overages will continue by requiring Industry Members to fund an additional 25% reserve above budgeted amounts each year.[113] In addition, the ongoing ad-hoc discussions (and litigation) between the CAT Operating Committee and the Commission regarding the scope of the 2016 CAT NMS Plan raise the specter of significant additional costs resulting from CAT implementation

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[109] 2023 Funding Proposal at 17090.

[110] *See* Section I.B above.

[111] Based on the average annual increase of 32% over the last 3 years, the CAT operating budget would be more than $1 billion per year by 2030.

[112] *Supra* note 3. Several of the Commission's recent equity market structure proposals would also be expected to increase the CAT budget as a result of increasing overall message traffic.

[113] 2023 Funding Proposal at 17090.

changes.[114] The 2023 Funding Proposal offers no overall constraint on costs and, once a single CAT fee filing is approved, it will automatically continue in perpetuity until it is replaced by another one approved by the Commission.[115]

The overall lack of cost discipline and transparency is why the frequent comparisons to other types of fees, such as Section 31 fees, the FINRA trading activity fee ("TAF"), and the options regulatory fee ("ORF'), are misplaced.[116] Even if the industry was able to develop the infrastructure necessary to pass-on certain of the CAT costs in a manner similar to these other regulatory fees, the total magnitude of CAT fees appears completely unconstrained and entirely out of the industry's control. In contrast, Section 31 fees are based on an annual budget set by Congress. FINRA has sought to avoid constant TAF increases, even leaving the TAF rate unchanged for a decade (2012-2022). And the ORF is only applied to customer transactions, ensuring all of these fees can be passed-on (in contrast to the significant CAT fees proposed to be assessed on market making activity).

There is no precedent for the CAT fees that are proposed to be allocated to Industry Members in perpetuity under the 2023 Funding Proposal. As the CAT Operating Committee has repeatedly stressed, "CAT LLC is not a governmental entity, with a responsibility to the taxpaying public."[117] While that may be true, the Exchange Act does not permit this private entity to require Industry Members to provide them with a blank check to fund all of their costs in perpetuity, negatively impacting participants in U.S. securities markets (including retail investors) and harming overall market efficiency, competition, and capital formation. The 2023 Funding Proposal must be rejected.

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[114] We note that the CAT Operating Committee has redacted its estimates regarding the impact of these interpretative disputes on overall CAT costs, leaving the industry unable to fully assess the potential ramifications of this litigation. *See, e.g.,* "Motion for Partial Stay of Order 34-90688," available at: https://www.sec.gov/rules/other/2022/34-95235-motion-for-stay-of-688-order.pdf and "Motion for Partial Stay of Order 34-90689," available at: https://www.sec.gov/rules/other/2022/34-95235-motion-for-stay-of-689-order.pdf.

[115] 2023 Funding Proposal at 17114 ("it is critical that a CAT Fee remain in place at all times.").

[116] *See* 2023 Funding Proposal at 17087.

[117] 2022 CAT Response Letter at 21.

III. The 2023 Funding Proposal is Unconstitutional

The 2023 Funding Proposal purports to allocate over a billion dollars of CAT costs to Industry Members by the end of 2024, and establishes the framework pursuant to which many more billions in costs will be allocated to Industry Members in perpetuity. As another commenter has detailed (in an argument which we incorporate by reference here),[118] the U.S. Constitution simply does not allow the members of the CAT Operating Committee, acting on behalf of the Commission, to compel Industry Members to pay for a law enforcement tool designed specifically for the Commission's use that has not been authorized by Congress.

Under the Constitution's Appropriations Clause and our government's separation of powers, funding for such a project, concerning core Executive Branch functions, must be appropriated by Congress, not acquired through the backdoor by requiring Industry Members to pay for the Commission's enforcement tool.[119] Here, Congress has not appropriated funding for anything even resembling what the Commission contemplates. Nor does the statute confer the authority to impose such a mandate. Authorizing the Commission to require exchanges to "act jointly"[120] or to facilitate the development of a national market system[121] is a far cry from authorizing the Commission to use the exchanges to establish an incredibly expensive, multi-billion dollar enforcement tool. For that type of funding, the Commission must go back to Congress and seek an explicit appropriation. Likewise, Section 11A's terms would have to be amended before the Commission could use a provision intended to facilitate a national market system as a means to burden market participants with the cost of a new enforcement program.

It is clear that CAT is a law enforcement tool for the Commission to employ in pursuit of its governmental functions.[122] As the Chair of the CAT Operating Committee noted, "the Commission conceived of and ultimately mandated the CAT System to more effectively and efficiently conduct cross-market supervision of trading activity."[123] Commission staff attend

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[118] Letter from SIFMA (June 5, 2023) at 7-8, available at: https://www.sec.gov/comments/4-698/4698-199319-399182.pdf. Others have raised additional Constitutional concerns (*see* https://www.cato.org/commentary/sec-starting-massive-database-every-stock-trade and "Statement of Hester M. Peirce in Response to Release No. 34-88890, File No. S7-13-19" (May 15, 2020), available at: https://www.sec.gov/news/public-statement/peirce-statement-response-release-34-88890-051520).

[119] *Cf. Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll.*, 2023 WL 4239254, at *23 (U.S. June 29, 2023) ("'[W]hat cannot be done directly cannot be done indirectly.' The Constitution deals with substance, not shadows ….").

[120] 15 U.S.C. § 78k-1(a)(3)(B).

[121] *Id.* § 78k-1(a)(2), (3).

[122] *See, e.g.,* https://www.sec.gov/litigation/litreleases/2022/lr25595.htm.

[123] Simon Testimony at 2. *See also* 2023 Exemptive Order ("The goal of Rule 613 was to create a modernized audit trail system that would **provide regulators** with timely access to a comprehensive set of trading data, thus enabling regulators to more efficiently and effectively analyze and reconstruct market events, monitor market behavior, conduct market analysis to support regulatory decisions, and perform surveillance, investigation, and enforcement activities.")(emphasis added). We note that the industry does not even have access to any CAT data (even an anonymized subset). *See, e.g.,* SIFMA FOIA Request (Feb. 8, 2023), available at: https://www.sifma.org/wp-content/uploads/2023/02/Information-Regarding-the-Data-Relied-upon-by-the-Commission-in-Proposing-Certain-Commission-Rulemaking-Related-to-Market-Structure.pdf.

"nearly all CAT meetings and calls,"[124] and "have played an important role in discussions related to the development of the CAT."[125] Furthermore, recent orders issued by the Commission, and the litigation initiated by members of the CAT Operating Committee, make clear that, although it is structured as an NMS Plan, the Commission often dictates the scope and technical requirements of the CAT system.[126]

It is important to note that, if approved, this filing is the first one that allocates specific costs relating to the building and operating of CAT to Industry Members, thereby creating a concrete harm. In approving Rule 613 in 2012, the Commission made clear that it was not specifying key details regarding the creation, implementation, and maintenance of CAT.[127] As a result, Rule 613 does not set forth how CAT costs would be allocated and the Commission explicitly deferred "its economic analysis of the actual creation, implementation, and maintenance of a consolidated audit trail itself until such time as it may approve the NMS plan submitted to the Commission for its consideration."[128]

In turn, the NMS Plan approved by the Commission in 2016 also omits key details regarding how CAT costs would be allocated. In its economic analysis of the 2016 CAT NMS Plan, the Commission made clear that the CAT funding model "has not yet been finalized"[129] and "the Funding Model will be filed with the Commission and subject to public comment."[130] As a result, the Commission's economic analysis did not allocate to Industry Members <u>any</u> costs to build and operate CAT.[131] Moreover, the costs contemplated by the 2023 Funding Proposal are not even in the ballpark of the costs contemplated in either 2012 or 2016.

The 2023 Funding Proposal provides the details that were lacking in Rule 613 and the 2016 CAT NMS Plan regarding concrete costs to the industry relating to the building and operating of CAT. Those details involve Industry Members providing the CAT Operating Committee with a blank check to fund 100% of costs in perpetuity for a law enforcement tool designed specifically for the Commission that has not been authorized by Congress. The 2023 Funding Proposal is unconstitutional.

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[124] Simon Testimony at 6.

[125] *Id.*

[126] *See, e.g.,* Release No. 34-90688 (Dec. 16, 2020), available at: https://www.sec.gov/rules/exorders/2020/34-90688.pdf; Release No. 34-95234 (July 8, 2022), available at: https://www.sec.gov/rules/exorders/2022/34-95234.pdf; 2023 Exemptive Order; "Motion for Partial Stay of Order 34-90688," available at: https://www.sec.gov/rules/other/2022/34-95235-motion-for-stay-of-688-order.pdf and "Motion for Partial Stay of Order 34-90689," available at: https://www.sec.gov/rules/other/2022/34-95235-motion-for-stay-of-689-order.pdf.

[127] *See, e.g.,* Rule 613 at 45802.

[128] Rule 613 at 45802.

[129] 2016 CAT NMS Plan at 84804.

[130] 2016 CAT NMS Plan at 84881.

[131] *See* Table 5 at 2016 CAT NMS Plan at 84864.

IV. <u>The Commission Must Consider Reasonable Alternatives</u>

As detailed above, the 2023 Funding Proposal is inconsistent with the Exchange Act and must be rejected by the Commission similar to the prior four funding proposals. It is clear that allowing the CAT Operating Committee to continue to unilaterally file funding proposals that do not reflect input from either the Commission or the industry is not constructive. As such, we urge the Commission to take urgent action to safeguard overall market efficiency, competition, and capital formation. Below, we set forth several suggestions for consideration designed to address issues identified above.

A. Achieving A More Equitable Cost Allocation

The methodology for allocating costs between industry members and the SROs is the single most important commercial element of the funding proposals. In our view, the members of the CAT Operating Committee have not adequately taken into consideration the enormous implementation costs already borne by Industry Members.

(i) Prospective Costs

Any allocation of costs to Industry Members should be done pursuant to the "originating broker" model put forward by SIFMA in order to attempt to streamline the process and more accurately allocate costs to the party originating an order (instead of the "executing broker" model contained in this filing).[132]

Taking into account the considerations discussed in Section II above, including (i) the lack of industry voting representation in CAT governance and (ii) the fact that Industry Members are already bearing nearly all of the total CAT-related costs,[133] in no event should Industry Members be allocated more than 50% of ongoing CAT costs (including any allocation to FINRA).

In addition, the exchanges should be expressly prohibited from passing-on (directly or indirectly) their portion of CAT costs to market participants. For example, exchanges should not be permitted to circumvent the access fee cap under Regulation NMS by introducing new transaction-based fees in order to recoup their portion of CAT costs.

The allocation methodology should also be improved to ensure that (a) a small group of firms are not disproportionately bearing costs given that CAT is designed to facilitate market-wide surveillance across all market participants and (b) specific market segments, such as retail trading activity in NMS stocks, are not subject to an inequitable allocation. A more thoughtful approach could include: (I) minimum and maximum fee levels, (II) appropriate calibrations for liquidity provision, (III) a volume component based on notional (instead of executed shares), and (IV) consideration of additional metrics that could achieve a more equitable outcome (e.g. broker-dealer capital). In addition, the approach of separately bucketing exchanges and Industry Members before allocating a pre-determined percentage of total costs appears to result in more arbitrary

[132] *See* Letter from SIFMA (June 5, 2023) at 5, available at: https://www.sec.gov/comments/4-698/4698-199319-399182.pdf ("the broker that originated the order" should be assessed any CAT fee).

[133] 2016 CAT NMS Plan at 84864 (estimating that broker-dealers would incur approximately 90% of total CAT-related costs).

outcomes than simply applying a consistent methodology to both exchanges and Industry Members.

Recommendations:

- Any allocation of costs to Industry Members should leverage the "originating broker" model.
- Allocation split:
  - In no event should Industry Members be allocated more than 50% of ongoing CAT costs (including any allocation to FINRA).
  - Prohibit the exchanges from passing-on (directly or indirectly) their portion of CAT costs.
  - Consider allocating a portion of costs to the Commission to align incentives.
- Allocation methodology:
  - Disperse costs more evenly across Industry Members.
  - Ensure specific market segments are not subject to an inequitable allocation (e.g. retail).

(ii) Historical Costs

In our view, it is inequitable to allocate *any* historical costs to Industry Members for several reasons. *First*, Industry Members are already bearing *nearly all* of the total CAT-related costs. For years, industry members have faced a near-constant barrage of changing technical specifications that have frequently and materially changed through the various implementation phases.[134] In 2016, the Commission estimated that broker-dealers would incur approximately 90% of total CAT-related costs, even if they were not allocated *any* costs for building and operating CAT.[135] Updating these estimates would show that this figure materially underestimates the total costs already being borne by broker-dealers.

Second, the historical bucket of costs contains many that are simply inappropriate to allocate to Industry Members. For example, the industry should not be paying any costs related to Thesys' stint as Plan Processor (including costs related to transitioning a project of this size and complexity to a new plan processor), nor should the industry be funding the CAT Operating Committee's litigation against the Commission or the various prior unlawful funding proposals.

Third, as noted above, the CAT NMS Plan specifies that the CAT Operating Committee can only recover a maximum of 25% of the expenses incurred in Period 4. If full implementation does not occur before September 27, 2023, then the CAT NMS Plan provides that the CAT Operating Committee cannot recover any of the expenses incurred in Period 4.

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[134] We note that there have been significantly more changes to the industry member technical specifications than to the participant specifications. *Compare* https://www.catnmsplan.com/specifications/participants and https://www.catnmsplan.com/specifications/im.

[135] 2016 CAT NMS Plan at 84864.

Fourth, it appears challenging for the CAT Operating Committee to allocate historical costs in a way that is directly tied to historical activity, which makes it more difficult for Industry Members to pass-on these costs to other market participants.

Finally, as another commenter has explained, it is manifestly inequitable to "force the Industry Members to pick up the historical costs for a mismanaged project over which they had no control or decision-making authority."[136]

> **Recommendation:** Industry Members should not bear historical costs.

(iii) Other Allocation Suggestions

To further incentivize cost control, the exchanges should be responsible for any costs over the approved budget.

In addition, Industry Members should not be allocated costs for matters that primarily benefit the CAT Operating Committee or the SROs, such as costs related to ongoing litigation or filings that are inconsistent with the Exchange Act. Industry Members should also not be allocated costs relating to how data is presented to, and used by, regulatory Staff at the SROs or the Commission. Finally, any change requests relating to CAT that do not involve specific NMS Plan requirements should be allocated directly to the requestor, including the Commission. For example, change requests related to the graphical user interface, application programming interface, or similar should be charged directly to the requesting party.

> **Recommendations:**
>
> - Exchanges should be responsible for any costs over the approved budget.
> - Exclude costs for matters/functionality/change requests specific to the SROs or Commission.

B. Key CAT Enhancements

In order to address the spiraling costs associated with operating CAT, any funding proposal should be coupled with structural enhancements designed to improve overall CAT governance and implementation.

(i) Reducing Overall CAT Operating Costs

The CAT Operating Committee and the Commission should cease making any further changes to the CAT at this time in order to stabilize operating costs. We understand that there are several changes that are currently subject to exemptive relief that are slated for development, including (i) interim order IDs; (ii) assignment of new CAT IDs for post T+5 error corrections; (iii) linkages

[136] Letter from Virtu Financial (June 22, 2022) at 4, https://www.sec.gov/comments/4-698/4698-20132715-303206.pdf.

of customer and representative orders; (iv) port-level settings; (v) lifecycle linkages; and (vi) a one-minute query requirement. Additional requirements arguably outside the scope of the approved NMS Plan, such as the reporting of non-actionable RFQ responses and the collection and reporting of price negotiations done via verbal and unstructured communications, continue to be promulgated by Commission staff. We understand that many of these items will result in significant additional implementation costs that outweigh any benefit (and, therefore, the NMS Plan should be amended to clarify these are not required).

In addition, the CAT Operating Committee should work with the Commission and the industry to identify technical requirements that should be modified through an NMS Plan amendment to materially reduce costs without sacrificing key benefits of the CAT system (e.g. moving certain timelines to T+2 from T+1).

Finally, concrete steps should be taken to streamline the CAT submission process, thereby minimizing reporting errors and reducing industry implementation costs. For example, additional data validations and reporting guidance should be implemented.

Recommendations:

- Cease from making further changes to the CAT at this time. The CAT Operating Committee should file an updated NMS Plan to reflect the current *status quo*.
- Identify technical requirements that should be modified to materially reduce costs without sacrificing key benefits (e.g. moving certain timelines to T+2 from T+1).
- Further streamline the CAT submission process (e.g. implementing further data validation).

(ii) Improving CAT Governance and Budget Transparency

1. <u>Independent Cost Review Mechanisms</u>

The CAT Operating Committee has provided only minimal information regarding the CAT costs that are proposed to be allocated to Industry Members. Given the spiraling costs and the exchanges' proposal to pass-on most (if not all) of CAT-related costs to Industry Members, additional independent reviews are warranted, both by an independent expert committee and by the Commission. The independent expert committee should assess whether current cost levels and third-party arrangements are reasonable, as well as whether any additional cost-control measures are warranted.

Recommendations:

- An independent expert committee should review the CAT budget on an annual basis (including assessing whether current cost levels and third-party arrangements are reasonable).
- The Commission should formally approve the CAT budget on an annual basis.

- All CAT operating budgets should remain published on the CAT website.[137]

2. Advance Notice of Material Changes to the CAT System and Related Costs

Though CAT is operated by the securities exchanges and FINRA pursuant to an NMS Plan, there have nevertheless been many ad-hoc discussions between the CAT Operating Committee and the Commission regarding what is required by the NMS Plan without adequate notice to Industry Members or due consideration of the costs and benefits associated with such interpretations. Going forward, any material change to the CAT system, related technology contracts, or implementation scope should require the filing of an NMS Plan amendment. Any amendment should articulate why a change is necessary and include a robust cost-benefit analysis. This process should ensure that industry members are afforded with all material information and an opportunity to comment.

Recommendation: Any material change should require an NMS Plan amendment, including a cost-benefit analysis.

3. Fairer Voting Rights

As detailed above, exchange groups with multiple affiliated exchanges have significant influence under the current voting structure. At a minimum, the Commission should take similar measures with respect to CAT governance as it did regarding the governance of consolidated equity market data.[138] Specifically, voting rights should be allocated so that each exchange group and national securities association has one vote on the operating committee, with a second vote provided if the exchange group or national securities association has a market center or centers that trade more than 15 percent of consolidated equity and options market share. Furthermore, all actions by the CAT Operating Committee relating to funding should require authorization by a Supermajority vote.

More fundamentally, the Commission should address the fact that Industry Members lack even a single representative on the CAT Operating Committee, even though Industry Members are expected to bear a significant portion of overall CAT costs. Logic would dictate that Industry Members should have voting representation commensurate with any costs allocated to them. To the extent appropriate industry representation cannot be achieved through the NMS Plan governance process, it further exposes that an NMS Plan is not the appropriate vehicle to govern CAT.

Recommendations:

- Allocate voting rights similar to the NMS Plan for consolidated equity market data.
- All actions relating to funding should require authorization by a Supermajority vote.

[137] Note that, at the moment, only the current and immediately prior annual budget appear to be available.

[138] Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a New National Market System Plan Regarding Consolidated Equity Market Data, 85 Fed. Reg. 28702 (May 13, 2020).

- Provide Industry Members with voting representation commensurate with any costs allocated.

4. Data Security

The Commission should prioritize addressing the significant data security concerns associated with the CAT. Plan amendments designed to enhance data security were proposed in 2020, but have still not been finalized.[139]

Recommendation: Finalize the data security plan amendments to address CAT-related data security concerns.

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We thank the Commission for considering our comments.

Please feel free to call the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

[139] Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail To Enhance Data Security, 85 Fed. Reg. 65990 (Oct. 16, 2020).