

July 18 2016

To the Commission:

The comments below speak to the need and desirability of exempting firms that are currently OATS exempt on the basis of low volume /manual orders from order reporting in CAT. The first two sections were submitted to CAT DAG in March 2015, however to the best of our knowledge, the group did not address the issue—preferring to leave it to the Commission. Please also note that CAT DAG included no OATS exempt members, although this firm volunteered to participate representing the group.

These comments follow up on our original letter addressing this issue dated **November 24, 2010**. **The Commission responded in 2012 and we have addressed those responses below.**

We believe these comments are best classified as an amendment—via expansion—of the current exemption regime under CAT.

The Compelling Case for Extending FINRA Rule 7470 (OATS Exemption for Qualifying Small Firms that Use Manual Orders) to Order Reporting in CAT

(A partial exemption for OATS-Exempt firms, not a full exemption for small firms.)

These summarized comments are provided by Wachtel & Co Inc, a small self-clearing broker dealer that is OATS exempt per the above rule.

I. The exemption should be extended because it both advances good regulation and is required to keep firms in business.

--Not a giveaway: to qualify, firms must eliminate many practices of regulatory concern including principal trades with customers, market making and clearing for other firms. Size limit is \$2 million in annual revenue and firms must have **perfect regulatory history** to maintain.

--Time tested and approved: exemption has been in place since 2006 approved by FINRA and SEC; has not caused any problem. FINRA requested extension in its original written SEC comments pertaining to CAT.

--Guarantee of well-managed firms: the disciplinary record requirements (which we think should be modified—but only slightly) assure that exempt

firms have not been and are unlikely to be the subject of any significant industry problem.

--Little impact on CAT: the exemption excludes reporting only of events that take place prior to delivery of an order to a market venue (for which paper records will be maintained at the firm). Once received at the market maker these orders are electronically traceable for purposes of market surveillance. **Re insider trading: the SEC will have all the information currently provided by blue sheet reporting (only unexecuted orders will be retained at the firm).** **Re market manipulation: exemption only covers manual orders where agency firm personnel—not the customer-- take responsibility for the manner of placing the order. Practices like spoofing and high frequency trading cannot reasonably be undertaken with manual orders.**

--Necessary to keep firms in business: the price charged by third party providers is a reasonable proxy for the cost of order reporting for small firms. These providers have minimum charges (currently unknown for CAT, but presumably higher than for OATS). At \$5,000 per month, that charge will be more than 15% of associated revenue for this firm and we believe hugely disproportionate to the industry for the universe of currently OATS exempt firms.

Bottom line: cost/benefit justified and beneficial on every level: exempt firms' restriction to pure agency orders, small size and clean disciplinary record provides a "win win" for regulators that should outweigh an insignificant loss of data for CAT. **Moreover, without this exemption, CAT will have the greatest burden—including forced merger or liquidation-- on those firms having the smallest justification for regulatory concern.**

II. As an interim step, OATS exempt firms should be granted small firm status and provided an extra year per the current SEC Rule.

--Under Rule 613, the SEC granted small firms an extra year to comply with CAT. Small was defined as less than \$500,000 in capital, a definition not revisited since 1996.

--FINRA defines a small firm (e.g. for purposes of representation on its Board of Directors) as those with less than 150 registered persons.

--CAT Advisory Plan also adopts 150 registered persons as cutoff for lowest tier of firm representation on its advisory committee.

--Other industry rules on order reporting, such as SEC Rule 11Ac1-6 regarding order routing and the FINRA OATS exemption outlined above, use cut-offs for exemption based on the number of orders routed or total firm revenues. These

are functional definitions tied to the goals of the regulation and amount of business being done that pertains to it.

--This firm, which is OATS exempt, has only four registered persons but requires at least \$1 million in capital for self-clearing. Therefore, we are classified as large by the SEC under CAT. Despite our capital position, we do not have sufficient revenue to absorb the cost of order reporting, and **do not have the trading and market impact of many firms with less capital** that are classified as small.

--We submit that the SEC definition does not take into account the large market impact that introducing firms can have using relatively small amounts of capital. It also does not take into account increasing requirements for capital in even small self-clearing firms. Accordingly, the SEC definition is insufficient/incomplete with respect to the regulatory impact of CAT.

--The easiest way to correct this is to include OATS exempt firms in the definition of small firms. This will allow additional time to obtain the true cost of CAT order reporting for these firms.

III. SEC Comments in the Proposing Release are Consistent with the Exemption Requested. In answer to commenters including FINRA and this firm, the SEC discussed a small firm exemption on pages 99-105 of the release adopting the CAT final rule. This section concluded as follows:

“The Commission notes that **completely exempting** small broker-dealers from reporting requirements would be contradictory to the goal of Rule 613.....and notes that illegal activity, such as insider trading and market manipulation, can be conducted through accounts at small broker-dealers as readily as it can through large broker-dealers....granting an exemption ...might create incentives for prospective wrongdoers to utilize such firms to evade effective oversight. The Commission believes, however, that small broker-dealers, particularly those that operate manual systems, might be particularly impacted because of their more modest financial resources.....and thus believes that allowing ..up to an extra year to begin reporting...is appropriate.” (Pp.104-5; emphasis added.)

When terms are defined and certain issues addressed, there is no impediment in these remarks to continuing the manual order exemption. Please note the following:

1. **OATS Exempt firms and small firms are not the same.** The former have **less** market activity; are voluntarily **restricted** from operations such as market making and trading with customers; only use manual orders, and meet standards of compliance otherwise unknown in the industry. Small firms meet none of this.

2. **A complete exemption is not requested** – only from order reporting prior to delivery to a market maker or exchange.

3. **Wrongdoers will NOT be attracted to exempt firms because compliance at these firms is higher than industry standard and CAT audit trail goals will be 99% met.**

a. Re market manipulation: exemption is only for manual orders, which must be entered by agency firm personnel. Hence the agency firm—not the customer--has full responsibility for any irregularity. Manual orders do not lend themselves to spoofing or HFT and we seriously doubt that any firm owner would allow the possible loss of an exemption through prohibited activity--which would of course be traceable back to the firm. This will definitely not attract wrongdoers!

b. Re insider trading: the SEC will have the same comprehensive transaction reporting as currently provided by blue sheets for insider trading surveillance. Records for unexecuted orders will be maintained at the firm and the SEC will have the firm's client list should suspicion develop as to any account. (In 50 years of blue sheet reporting, this firm has never had a substantive follow-up on any report.) Again--no reason to believe any wrongdoer would be attracted to such a firm.

4. Finally, as to cost, our concern is not that we have insufficient capital to install a new system-- but that **such a system is so disproportionately expensive that it destroys the business model and profitability of this well-managed low volume firm.**

In short, the SEC's comments to date do not contradict the compelling cost/benefit justification for continuing the current exemption. **A similar exemption--developed by the SEC or by FINRA--should be included in the CAT final rule.**