PARALLAX
VOLATILITY ADVISERS

June 28, 2021

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

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

Ladies and Gentlemen:

We appreciate the opportunity to comment on the funding model and related rule changes proposed for the Consolidated Audit Trail (CAT) as set forth in Securities Exchange Act Release Number 91555, published in the Federal Register April 21, 2021 (the "Proposing Release"). We are a registered investment adviser to 3(c)(7) private funds that invest in the public equities and options markets.

We request the Commission reject the amendments set forth in the Proposing Release until the Participants establish a more transparent, objective structure that permits the Commission to better monitor and verify the self-regulatory organizations' (SROs) fulfillment of their regulatory obligations. We look forward to the CAT NMS Plan serving SROs and the Commission as they protect investors and the efficient functioning of the securities markets through timely and effective surveillance -- at reasonable cost.

1. **The lack of transparency and accountability for costs must be addressed before the Participants are allowed to seek reimbursement from other parties.** As the Commission and others are well aware, the costs for the CAT NMS Plan have not been transparent. The wasted Thesys expenditures are the most notable of the excessive historical costs that the Participants recently disclosed. The Commission was correct, "The SROs bear responsibility for the requirements of the CAT NMS Plan and therefore bear the risk of non-performance by the contractor, Thesys."[1] Accordingly, the Participants must meet a high bar for the Commission to alter course and support any proposed rule changes that require non-Participants to pay the Thesys costs.

Costs, however, are relevant regardless of whether the Participants try to pass them along. Controlling costs is not simple, particularly with a mandate to achieve a wholly new regulatory system, but the Commission and the SROs know that budgets and costs reveal

[1] Letter dated May 1, 2018 from the Brett Redfearn, Director, Securities and Exchange Commission Division of Trading and Markets, to Michael Simon, Chair CAT NMS Plan Operating Committee.

priorities in expenditures and the effectiveness of organizational controls. Wasted resources for a regulatory entity typically forces tough decisions about where to focus efforts.

Problematically, Participants estimate ongoing costs that follow past practice, including being much higher than many informed industry participants estimate is necessary. Without greater accountability and controls, either the regulatory mission will suffer or Industry Members will pay for the waste. There may well be appropriate -- or at least understandable -- reasoning for historical and ongoing costs to greatly exceed expectations, and that is for the Participants to explain and the Commission to review as part of its oversight of the SROs.[2]

As revealed by the proposed allocation of Thesys costs to Industry Members as part of the flawed allocation structure, the Participants desire to allocate costs regardless of any accountability for their reasonableness. Costs are not deemed reasonable because they can be shared among multiple payors (such as thousands of Industry Members); because a party can afford it; or because it is not so large as to be material.

The Operating Committee should provide more detailed and complete information in support of the changes requested in the Proposing Release, and on an ongoing basis. Towards that goal, we support altering the composition of the Operating Committee to admit Industry Members and independent parties as members. We agree with the Operating Committee that public disclosure of certain costs or other aspects of the CAT NMS Plan activities would be detrimental to its functioning. We also have not seen any specific proposals for a workable structure that would provide accountability to Industry Members through public disclosures. Revising the composition of the Operating Committee along with full internal disclosure of costs and their purpose would seem to offer significant benefit to the functioning of the CAT NMS Plan.

2. **The allocation of costs proposed by the Participants is arbitrary and must be rejected.** The SROs, through the Operating Committee, are advising the Commission that the regulatory system and the associated costs they have incurred, and will incur, are so excessive that they must be paid by Industry Members, but after choosing a new (and still arbitrary) percentage amount to allocate the costs between Participants and Industry Members and then general principles to guide the allocations among each group, the Operating Committee overrides them.

In addition to adjusting allocations for market makers as a sub-group of Industry Members, the proposed funding model makes adjustments for certain Industry Members who might pay too much, in the eyes of the Operating Committee. They also make adjustments to exclude OTC Equity Share volume as a more simple approach "from an administrative perspective."

[2] The Commission has regularly undertaken analyses to provide estimates of the time and expense required of the Participants and others in the CAT NMS Plan approval process. These analytics and the information provided by the Participants give the Commission greater insight than members of the public or even Industry Members.

However, for those Industry Members with negligible message traffic, the Operating Committee chooses to set a minimum payment requirement, instead of setting a minimum level of message traffic that triggers a payment requirement. OTC Equity Share volume message traffic gets a discount and brokers who submit little if any message traffic pay a premium. The Operating Committee has submitted to the Commission a proposed funding model full of contradictions.

The massive discounts for market maker activity proposed by the Operating Committee is striking. The SROs, in their capacity as such, are essentially saying they have not found a way to perform the core functions needed for market surveillance, without the cost of it putting at risk of an entire segment of the industry.

There are many aspects of message traffic that deserve careful evaluation. For example, the exchanges' market maker structures that permit quotes far away from the market, indeed require it, may not contribute to liquidity and be less deserving of discounts or may best be allocated to the Participants, in their capacity as for-profit exchange operators. Certainly the order (quote)-to-trade ratios deserve more analysis and attention. We suggest there may be a need to revisit a tiered approach, particularly with respect to market-making, and including an analysis of what portion of the message traffic is exchange Participant driven.

The Operating Committee has failed to provide the Commission with data and a logical basis to approve a proposed funding model that shifts the regulatory cost of overseeing one Industry Member to another Industry Member. While regulatory costs are a cost of doing business, regulatory systems and requirements should not be purposefully designed to require some for-profit businesses to subsidize others. The smallest market makers should not subsidize the largest market makers. Brokers with negligible CAT reportable events should not subsidize every other broker. Retail investors that transact with smaller brokers should not indirectly subsidize sophisticated investors that transact equities and options at high volumes with large market-makers.

For regulatory purposes, every order and transaction that is a CAT reportable event is relevant to creating an accurate surveillance trail, and the Operating Committee has not provided a sufficient regulatory case for a proposed funding model which imposes different costs for the same CAT reportable events.

3. **The Commission's evaluation of the Proposing Release and the ongoing implementation and operation of the CAT NMS Plan must recognize and address the conflicts of interest to assure investors do not fund, directly or indirectly, through regulatory structures and fees, the for-profit exchanges and broker dealers.** While some commenters have characterized as "potential," the exchange Participants' conflicts of interest between their goals as for-profit exchanges and their obligations as SROs, the conflicts of interest for the exchange Participants is actual. Many controls have been implemented to

address them, but conflicts of interest remain problematic, as is shown in the proposed funding model.

The exchanges set the standards for market-making, including standards that may permit message traffic with low order (quote) to trade ratios. While continuous quoting requirements are mandated, other requirements are purely business driven. A discussion of quote requirements, order types, order routing, "lit" and "dark" markets and the variety of incentives offered by exchanges and others is far too complex to capture in a comment letter; our point is that every CAT reportable event is part of a for-profit structure, including the exchange Participants seeking to capture market share, receive revenue and profit for the benefit of their stockholders. The Operating Committee's decisions to favor market makers in designing the proposed funding model benefits the exchange Participants, and as discussed above, it has failed to logically explain why this is appropriate from a regulatory perspective.[3]

The Operating Committee also fails to address specifics regarding its handling of fines, such as confirming that payments of fines for transaction reporting violations would be credited to the CAT NMS Plan operations, though we expect that should non-controversial. More complicated is understanding the extent to which brokers benefit under the proposed funding model from reduced assessments for market making activity, and if so whether there would be back-assessments and penalties to brokers who wrongfully identify themselves or their activity in that category. To the extent that the Operating Committee provides benefits to certain Industry Members, there should be processes to confirm that the benefits were appropriately obtained, including taking action against any misidentified market makers.

The considerations we have raised are particularly relevant to the proposed funding model and also to considerations of alternative models proposed by commenters. The NYSE, a Participant dissenting from the Operating Committee's proposed funding model, seeks to assess costs against buyers and sellers.[4] Without knowing more, the NYSE may mean costs should be assessed against the ultimate account holders, including investors. Other commenters have suggested the Commission consider the model for Section 31 fees, which also may be passed along to investors in various forms.

Retail investors in particular rarely choose the market in which their brokers effect transactions. Rather, they rely heavily on brokers to choose the best execution. Many Industry Members have suggested the fees they pay for regulatory oversight is too high and, to the extent possible they may pass these costs, directly or indirectly, to customers. Therefore, in addition to reviewing the proposed funding model with a view to achieving the sound operation of a vital regulatory system, it is incumbent upon the Commission to

[3] There are other operational aspects of the CAT NMS Plan that raise concerns. For example, certain time frames for reporting appear to be extremely lax. The CAT was proposed in response to a flash crash and to the extent any system can capture data faster without unduly burdening reporters, it should do so.

[4] Letter dated May 12, 2021 from Michael Blaugrund, Chief Operating Officer, NYSE, to Vanessa Countryman, Secretary, Securities and Exchange Commission.

PARALLAX
VOLATILITY ADVISERS

consider the potential for increased costs to investors, and whether investors should bear these costs.

Without a more comprehensive discussion of expenditures and a reasoned basis to allocate them to other parties that meets the Exchange Act standards, we oppose the Participants requiring any other parties to pay for the development costs for the CAT NMS Plan. Thank you to the Commissioners, the Commission staff and the many other industry constituents that have expended significant time and effort to implement the CAT.

Sincerely,

DocuSigned by:
William Bartlett
72E9B9FEB64A480...

William Bartlett
Parallax Volatility Advisers, L.P.

C: Gary Gensler, Chairman
Hester M. Pierce, Commissioner
Elad L. Roisman, Commissioner
Allison H. Lee, Commissioner
Caroline A. Crenshaw, Commissioner
Christian R. Sabella, Acting Director, Division of Trading and Markets