VIA EMAIL (rule-comments@sec.gov)

July 14, 2021

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

Re: File Number 4-698

Dear Ms. Countryman:

On March 31, 2021, the Operating Committee, on behalf of the Participants[1] in the National Market System Plan Governing the Consolidated Audit Trail[2] (the "CAT NMS Plan" or "Plan"), filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed amendment to the CAT NMS Plan. The SEC published the proposed amendment for comment on April 14, 2021 ("Proposing Release").[3] In the Proposing Release, the Operating Committee proposes to amend the CAT NMS Plan to implement a revised funding model ("Proposed Funding Model") for the consolidated audit trail ("CAT") and to establish a fee schedule for Participant CAT fees in accordance with the Proposed Funding Model.[4] Commenters have submitted nineteen comment letters in response to the Proposing Release.[5] The Operating Committee submits this letter to respond to certain issues raised in these comment letters regarding the Proposed Funding Model, including the allocation of CAT costs between Industry Members and Participants, Industry Member CAT fees, Participant CAT fees and the illustrative example of the Proposed Funding Model.[6] The Operating Committee notes that these

[1] The twenty-five Participants of the CAT NMS Plan are: BOX Exchange LLC, Cboe BYX Exchange, Inc., Cboe BZX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., Cboe C2 Exchange, Inc., Cboe Exchange, Inc., Financial Industry Regulatory Authority, Inc. ("FINRA"), Investors Exchange LLC, Long-Term Stock Exchange, Inc., MEMX LLC, Miami International Securities Exchange LLC, MIAX Emerald, LLC, MIAX PEARL, LLC, Nasdaq BX, Inc., Nasdaq GEMX, LLC, Nasdaq ISE, LLC, Nasdaq MRX, LLC, Nasdaq PHLX LLC, The NASDAQ Stock Market LLC, New York Stock Exchange LLC, NYSE American LLC, NYSE Arca, Inc., NYSE Chicago, Inc. and NYSE National, Inc.

[2] The CAT NMS Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Exchange Act and the rules and regulations thereunder. *See* Securities Exchange Act Rel. No. 79318 (Nov. 15, 2016), 81 Fed. Reg. 84696 (Nov. 23, 2016) ("CAT NMS Plan Approval Order"). The full text of the CAT NMS Plan is available at www.catnmsplan.com.

[3] Securities Exchange Act Rel. No. 91555 (Apr. 14, 2021), 86 Fed. Reg. 21050 (Apr. 21, 2021) ("Proposing Release").

[4] Unless otherwise defined herein, capitalized terms are defined as set forth in the CAT NMS Plan.

[5] The comment letters submitted in response to the Proposing Release are available at https://www.sec.gov/comments/4-698/4-698-a.htm. In addition to the nineteen comment letters, the Operating Committee also submitted a letter responding to requests for additional information related to the Proposed Funding Model. Letter from Mike Simon, CAT NMS Plan Operating Committee Chair, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 5, 2021) ("CAT Letter").

[6] The Operating Committee, on behalf of the Participants, also is submitting another comment letter to address certain other issues related to the Proposed Funding Model. Letter from Mike Simon, CAT NMS Plan Operating Committee Chair, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (July 14, 2021).

responses represent the consensus of the Participants, but that all Participants may not fully agree with each response set forth in this letter.

I. Allocation of CAT Costs between Industry Members and Participants

A. 75%-25% Allocation between Industry Members and Participants

Under the Proposed Funding Model, Industry Members as a group would pay 75% of the Total CAT Costs for the relevant period ("Industry Member Allocation"), and Participants as a group would pay 25% of the Total CAT Costs for the relevant period ("Participant Allocation"). Commenters have raised questions regarding whether the proposed 75%-25% allocation has been adequately justified.[7] The Operating Committee believes that the 75%-25% allocation continues to be an equitable allocation of reasonable CAT fees between Industry Members and Participants that balances the costs paid by each CAT Reporter and the regulatory benefits each receives.

The Operating Committee notes that the 75%-25% allocation would have the effect of increasing the cost allocation to Participants by approximately 8% of the total CAT costs in comparison to the Prior Fee Proposal.[8] The Prior Fee Proposal also relied upon a 75%-25% allocation between CAT Reporters, but the allocation was structured differently than in the Proposed Funding Model. In the Prior Fee Proposal, Industry Members (other than Execution Venue ATSs) would have paid 75% of the total CAT costs, and Participants and Execution Venue ATSs would have paid 25% of the total CAT costs.[9] Most ATSs were included in the 25% allocation for Execution Venues. ATSs accounted for approximately 8% of the total CAT costs in the Prior Fee Proposal, and approximately 32% of the Execution Venue allocation. By

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[7] Letter from Kelvin To, Founder and President, Data Boiler Technologies, LLC, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 3, 2021) ("Data Boiler Letter") at 7; Joanna Mallers, Secretary, FIA Principal Traders Group, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 12, 2021) ("FIA Letter 2") at 4; Letter from Matthew Price, Chief Operations Officer, Fidelity Capital Markets and National Financial Services LLC, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 12, 2021) ("Fidelity Letter") at 2-4; Letter from Marcia E. Asquith, Executive Vice President, Board and External Relations, FINRA, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 12, 2021) ("FINRA Letter") at 5; Letter from Michael Lewin, Chief Executive Officer, Istra LLC to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 27, 2021) ("Istra Letter") at 3; Letter from Kirsten Wegner, Chief Executive Officer, Modern Markets Initiative, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 6, 2021) ("MMI Letter") at 4; Letter from Michael Blaugrund, Chief Operating Officer, NYSE, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 10, 2021) ("NYSE Letter") at 2; Letter from William Bartlett, Parallax Volatility Advisers, L.P., to Vanessa Countryman, Secretary, SEC re File No. 4-698 (June 28, 2021) ("Parallax Letter") at 2; Letter from Ellen Greene, Managing Director, Equity and Options Market Structure, SIFMA, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 12, 2021) ("SIFMA Letter") at 5-8; Letter from James Toes, President and CEO, and Andre D'Amore, Chairman of the Board, Securities Trader Association, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (June 10, 2021) ("STA Letter") at 4; Letter from Kevin Donohue, General Counsel, Tower Research Capital LLC, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 12, 2021) ("Tower Research Letter") Letter at 4; Thomas M. Merritt, Deputy General Counsel, Virtu Financial, Inc., to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 12, 2021) ("Virtu Letter") at 3-4.

[8] For a description of the Prior Fee Proposal, *see generally* Securities Exchange Act Rel. No. 82451 (Jan. 5, 2018), 83 Fed. Reg. 1399 (Jan. 11, 2018) ("Prior Fee Proposal Release"). The Participants later withdrew this proposed amendment. *See* Securities Exchange Act Rel. No. 82892 (Mar. 16, 2018), 83 Fed. Reg. 12633 (Mar. 22, 2018).

[9] Prior Fee Proposal Release at 1408.

moving ATSs to the Industry Member Allocation, Participants would pay the full 25% of the total CAT costs allocated to Participants rather than approximately 68% of the 25% of Total CAT costs allocated to Execution Venues under the Prior Fee Proposal. Using total CAT cost data for 2020, 8% of total CAT costs would be approximately $6.8 million for 2020. The Operating Committee believes that this substantial increase in the Participant share of the total CAT costs addresses comments suggesting that Execution Venue ATSs should be treated like other Industry Members (rather than as Execution Venues) and indicating that the size of the percentage of total CAT costs to be paid by Industry Members as a group was too large.[10] Correspondingly, the 75% Industry Member Allocation would be shared among more Industry Members under the Proposed Funding Model as all ATSs will be Industry Members for purposes of CAT fees, not just ATSs other than Execution Venue ATSs.

The Operating Committee also considered alternatives to the Participant contribution besides the proposed 25% in which Participants paid larger contributions than 25% of the total CAT costs (*e.g.*, a 50%-50% allocation between Industry Members and Participants) and Participants paid smaller contributions than 25% of the total CAT costs.[11] In considering these alternative allocations with percentages greater than 25% of total CAT costs allocated to Participants, the Participants noted that there are far more Industry Members than Participants. There are only 25 Participants and approximately 1237 Industry Members, as of December 2020. Moreover, based upon an analysis of available CAT Reporter revenue, Participants only represented approximately 4% of the total CAT Reporter revenue; Industry Members represented 96% of the total CAT Reporter revenue.[12] In addition, various Industry Members have revenue in excess of some or all of the Participants. Accordingly, the Operating Committee determined that allocating more than 25% of the total CAT costs to the Participants was not a fair and equitable approach. Furthermore, with this allocation, the Industry Members with the most message traffic and the Participant complexes with the most market share would pay comparable CAT fees. For example, based on the data from the fourth quarter of 2020, the three Industry Members with the most message traffic would be subject to an annual CAT fee in the range of $5 to $6 million, and the Participant complexes with the highest CAT fees would pay an annual CAT fee in a similar range.

The Operating Committee also analyzed the possibility of allocating CAT costs among CAT Reporters – both Participants and Industry Members - based on revenue. Such a revenue-based allocation would impose a more significant portion of the CAT costs on Industry

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[10] *See* Securities Exchange Act Rel. No. 81067 (June 30, 2017), 82 Fed. Reg. 31656, 31664 (July 7, 2017) at 31662-3 ("Suspension Order").

[11] In the development of the Prior Fee Proposal and the Proposed Funding Model, the Participants explored a variety of other possible allocations. For example, in determining the cost allocation between Industry Members (other than Execution Venue ATSs) and Execution Venues for the Prior Fee Proposal, the Participants analyzed a range of possible splits for revenue recovery from such Industry Members and Execution Venues, including 80%-20%, 75%-25%, 70%-30% and 65%-35% allocations between Industry Members and Execution Venues. *See, e.g.*, Prior Fee Proposal Release at 1408.

[12] Industry Member revenue was calculated based on the total revenue reported in the Industry Member's FOCUS reports. Participant revenue was calculated based on revenue information provided in Form 1 amendments and/or publicly reported figures. Participants are not required to file uniform FOCUS-type reports regarding revenue like Industry Members. Accordingly, the revenue calculation for Participants is not as straightforward as for Industry Members.

Members. Industry Members would pay approximately 96% of the CAT costs and Participants would pay approximately 4% of the CAT costs. Because the revenue-based allocation would impose such a significant percentage of CAT costs on Industry Members, the Operating Committee determined not to pursue that approach. The Operating Committee also recognized the practical difficulties with determining the appropriate revenue figures for all CAT Reporters.

B. Elimination of Comparability Requirement

In concert with the elimination of tiered fees in the Proposed Funding Model, the Operating Committee proposes to eliminate the comparability requirement from the CAT NMS Plan. Specifically, the Operating Committee proposes to eliminate paragraph (iii) of Section 11.2(c) of the CAT NMS Plan, which states that the Operating Committee shall seek to establish a tiered fee structure in which fees charged to:

> the CAT Reporters with the most CAT-related activity (measured by market share and/or message traffic, as applicable) be generally comparable (where for these comparability purposes, the tiered fee structures takes into consideration affiliations between or among CAT Reporters, whether Execution Venues and/or Industry Members).

One commenter objected to the proposed deletion of this provision as the deletion would adversely affect the operation of the model.[13] Under the Original Funding Model,[14] the comparability provision was an important factor in determining the tiers for Industry Members and Execution Venues. Under the Proposed Funding Model, however, the comparability provision is no longer relevant, as a tiered fee structure would not be used for Industry Members or Participants. Accordingly, the Operating Committee determined that it was appropriate to delete the provision.

II. Industry Member CAT Fees

A. Contribution by Industry Members

Under the Proposed Funding Model, both Participants and Industry Members would contribute to the funding of the CAT by paying a CAT fee. Some commenters supported Industry Members contributing to the payment of CAT costs,[15] while others objected to Industry Members paying CAT fees.[16] The Operating Committee believes that Industry Members should contribute to the payment of CAT costs, and such contribution is in keeping with the requirements of Rule 613 and the CAT NMS Plan.

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13 FINRA Letter at 2-4.
14 The Original Funding Model is set forth in the CAT NMS Plan, which was approved in 2016. *See* CAT NMS Plan Approval Order at 84793-84798.
15 FINRA Letter at 2; NYSE Letter at 5.
16 MMI Letter at 3; Virtu Letter at 2-3.

As permitted by Rule 613, the CAT NMS Plan requires Industry Members to pay a CAT fee. Nevertheless, the Participants have paid the full cost of the creation, implementation and maintenance of the CAT since 2012, pending Commission approval of a fee program. The continued funding of the CAT solely by the Participants was and is not contemplated by the CAT NMS Plan, nor is it a financially sustainable approach.

Rule 613(a)(1)(vii)(D) contemplates Industry Members contributing to the payment of CAT costs. Specifically, this provision requires the CAT NMS Plan to address "[h]ow the plan sponsors propose to fund the creation, implementation, and maintenance of the consolidated audit trail, including the proposed allocation of such estimated costs among the plan sponsors, and between the plan sponsors and members of the plan sponsors."

In addition, as approved by the SEC, the CAT NMS Plan specifically contemplates CAT fees to be paid by both Industry Members and Participants. Section 11.1(b) states that "the Operating Committee shall have discretion to establish funding for the Company,[17] including: (i) establishing fees that the Participants shall pay; and (ii) establishing fees for Industry Members that shall be implemented by the Participants."[18] The Commission stated in approving the CAT NMS Plan the following:

> The Commission believes that the proposed funding model reflects a reasonable exercise of the Participants' funding authority to recover the Participants' costs related to the CAT. The CAT is a regulatory facility jointly owned by the Participants and, as noted above, the Exchange Act specifically permits the Participants to charge members fees to fund their self-regulatory obligations. The Commission further believes that the proposed funding model is designed to impose fees reasonably related to the Participants' self-regulatory obligations because the fees would be directly associated with the costs of establishing and maintaining the CAT, and not unrelated SRO services.[19]

In its recent amendments to the CAT NMS Plan, the SEC reaffirmed the ability for the Participants to charge Industry Members a CAT fee. Specifically, the SEC noted that the amendments were not intended to change the basic funding structure for the CAT, which may include fees established by the Operating Committee, and implemented by the Participants, to recover from Industry Members the costs and expenses incurred by the Participants in connection with the development and implementation of the CAT.[20]

Finally, as noted by the SEC, the CAT "substantially enhance[s] the ability of the SROs and the Commission to oversee today's securities markets,"[21] thereby benefitting all market

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17 As defined in the CAT NMS Plan, the Company is the Consolidated Audit Trail, LLC.

18 *See also* Sections 11.1(c), 11.2(c), and 11.3(a) and (b) of the CAT NMS Plan.

19 CAT NMS Plan Approval Order at 84794.

20 Securities Exchange Act Rel. No. 88890 (May 15, 2020), 85 Fed. Reg. 31322, 31329 (May 22, 2020).

21 Securities Exchange Act Rel. No. 67457 (July 18, 2012), 77 Fed. Reg. 45722, 45726 (August 1, 2012).

participants. As such, both Participants and Industry Members should contribute to covering the cost of the CAT.

B. Message Traffic

1. Use of Message Traffic

The Proposed Funding Model would allocate the Industry Member Allocation based on message traffic. Commenters questioned the justification for the use of message traffic for these purposes.[22] The use of message traffic for allocating CAT costs among Industry Members is consistent with the CAT NMS Plan as approved by the Commission, and the proposal did not seek to change the use of message traffic for this purpose in the Proposed Funding Model. Section 11.3(b) of the CAT NMS Plan, which states that "[t]he Operating Committee will establish fixed fees to be payable by Industry Members, based on the message traffic generated by such Industry Member."[23] The Operating Committee also analyzed the possibility of allocating the Industry Member Allocation among Industry Members based on revenue related to activities in Eligible Securities, which would have been derived from Industry Member revenue reported on FOCUS reports.[24] The Operating Committee concluded, however, that it may be difficult to determine which types of Industry Member revenue should be included in the calculation for a CAT fee under such an approach.

2. Definition of Message Traffic in Technical Specifications.

Under the Proposed Funding Model, message traffic would be calculated based on Industry Members' Reportable Events reported to the CAT as defined in the CAT Reporting Technical Specifications for Industry Members as amended from time to time. One commenter indicated that message traffic should be defined in the CAT NMS Plan if it is to be used as the basis for funding allocations.[25] The Operating Committee believes that delineating the method for reporting Reportable Events used in the message traffic count in the Technical Specifications, rather than the CAT NMS Plan, is appropriate as the technical approach to reporting specific Reportable Events may vary over time.

3. Significant Fees for Certain Industry Members

Some commenters expressed concern that, by using message traffic as the basis for allocating costs among Industry Members, a few Industry Members with significant message traffic would be required to pay a significant portion of the Industry Member costs.[26] The Operating Committee recognized this, and proposes the use of the Maximum Industry Member CAT Fee. As discussed in more detail below, the imposition of the Maximum Industry Member

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[22] Istra Letter at 4-5; MMI Letter at 4; and SIFMA Letter at 8-9.
[23] *See also* Section 11.2(c) of the CAT NMS Plan.
[24] This approach would have been similar to FINRA's imposition of the Gross Income Assessment, which is based on FOCUS report revenue. *See* Section 1(c) and (d) of Schedule A of FINRA By-Laws.
[25] Fidelity Letter at 2,3.
[26] MMI Letter at 2; Tower Research Letter at 6.

CAT Fee would serve as a method to institute a cap on fees in order to fairly allocate costs to Industry Members as using message traffic alone potentially may result in certain Industry Members paying a significant allocation of Total CAT Costs. In this way, the proposed Maximum Industry Member CAT Fee would address the potential for significant fees based on outsized message traffic that were previously addressed via the tiering and comparability provisions set forth in the Original Funding Model and the Prior Fee Proposal.

4. Effect on Different Business Lines

A commenter questioned whether sufficient analyses had been performed regarding the effect of the Proposed Funding Model on different types of business lines.[27] The Operating Committee has sought to limit negative effects in those situations in which the method of fee calculation may potentially affect certain groups of CAT Reporters adversely. For example, the Operating Committee has proposed market maker discounts to address the high levels of message traffic generally exhibited by market makers in NMS stocks and Listed Options. Similarly, as discussed above, the Operating Committee also has proposed the Maximum Industry Member CAT Fee to address the potential for significant fees based on outsized message traffic for certain Industry Members. Such a fee would prevent Industry Members from paying significantly larger CAT fees than Participant complexes.

5. Effect on Market Structure

Some commenters questioned whether the Operating Committee had adequately considered the effect of the use of message traffic for funding purposes on market structure, such as liquidity and competition in the market.[28] As discussed above, the Operating Committee has proposed various measures to address potential disincentives, including the market maker message traffic discounts and the Maximum Industry Member CAT Fee. The Proposed Funding Model also is structured to avoid a reduction in market quality because it discounts Options Market Maker message traffic and Equity Market Maker message traffic when calculating message traffic for Options Market Makers and Equity Market Makers, respectively. The proposed discounts recognize the value of the market making activity to the market as a whole.

C. Categorization of Alternative Trading Systems

Under the Proposed Funding Model, the Operating Committee proposes to treat ATSs like other Industry Members, rather than like Participants, in allocating CAT costs. One commenter objected to this treatment of ATSs, as the commenter believed that dark pools should be subject to higher fees due to their risky nature.[29] The Operating Committee believes that treating ATSs as Industry Members would address prior comments regarding the inclusion of ATSs in the Execution Venue category with Participants. First, this proposed change would

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27 Tower Research Letter at 6.

28 Istra Letter at 4; MMI Letter at 4; SIFMA Letter at 9; Letter from Gunjan Chauhan, Senior Managing Director, Global Head of SPDR Capital Markets, State Street Global Advisors to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 12, 2021) ("State Street Letter") at 2; Tower Research Letter at 1; and Virtu Letter at 5.

29 Data Boiler Letter at 8.

simplify the model by requiring all Industry Members to pay a fee based on message traffic, rather than treating certain Industry Members – Execution Venue ATSs – in the same manner as Participants, which would pay a fee based on market share. Second, this proposed change would address comments that treating Execution Venue ATSs like Participants would act as a barrier to entry for smaller ATSs.[30] Whether or not such a potential would exist, under the Proposed Funding Model, smaller ATSs would be treated like any other smaller Industry Member when calculating their CAT fee, thereby rendering comments regarding potential barriers to entry for smaller ATSs moot.

D. Tiering

The Operating Committee proposes to eliminate the use of tiered fees for Industry Members in the Proposed Funding Model. Instead, under the Proposed Funding Model, each Industry Member would pay a fee based solely on its percentage of total Industry Member message traffic (subject to the market maker message traffic discounts, the Minimum Industry Member CAT Fee and the Maximum Industry Member CAT Fee). One commenter wrote in support of the elimination of tiering.[31]

Utilizing a tiered fee structure, by its nature, would create certain inequities among the CAT fees paid by Industry Members. For example, two Industry Members with similar levels of message traffic may pay notably different fees if one falls in a higher tier and the other falls within a lower tier. Correspondingly, a tiered fee structure generally reduces fees for Industry Members with higher message traffic in one tier, while increasing fees for Industry Members with lower levels of message traffic in the same tier, as compared to a non-tiered fee. Furthermore, Industry Members in lower tiers potentially pay more than they would without the use of tiers. While tiering exists in various other fee programs and generally itself may not be an unfairly discriminatory practice, in response to feedback on the Prior Fee Proposal, the Participants are proposing to eliminate the tiering concept, rendering past comments about potential inequities that may exist using a tiering model moot.

By charging each Industry Member a CAT fee based on its own message traffic, rather than charging a tiered fee, the Proposed Funding Model will result in an Industry Member's CAT fee being tied more directly to the Industry Member's message traffic in the CAT. In contrast, with a tiered fee, Industry Members with different levels of message traffic that are placed in the same tier would all pay the same CAT fee, thereby limiting the correlation between an Industry Member's message traffic in the CAT and its CAT fee.

The proposed non-tiering approach is, arguably, more simplistic and objective to administer than the tiering approach. With a tiering approach, the number of tiers for Industry Members, the boundaries for each tier and the fees assigned to each tier must be established. In the absence of clear groupings of Industry Members by message traffic, selecting the number of, boundaries, and the fees associated with each tier would be subject to some level of subjectivity.

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[30] *See, e.g.*, Suspension Order at 31664.
[31] FIA Letter 2 at 4.

Furthermore, the establishment of tiers would need to be continually reassessed based on changes in message traffic, thereby requiring regular subjective assessments. Accordingly, the removal of tiering from the funding model eliminates a variety of subjective analyses and judgments from the model, and simplifies the determination of Industry Member CAT fees.

E. Market Maker Discounts

The Operating Committee proposes to discount Options Market Maker message traffic based on the trade-to-quote ratio for options when calculating the message traffic for Options Market Makers. Similarly, the Operating Committee proposes to discount Equity Market Maker message traffic based on the trade-to-quote ratio for NMS Stocks when calculating the message traffic for Equity Market Makers.[32] Commenters expressed support for market maker discounts[33] as well as opposition to the market maker discounts.[34] In addition, a commenter noted that the discounts add complexity to the funding model and prevent Industry Members other than market makers from calculating their own fees.[35] Other commenters questioned the justification for shifting costs from market makers to other Industry Members and for using the trade-to-quote ratio for discount purposes.[36]

In the Original Funding Model, Options Market Maker message traffic and Equity Market Maker message traffic would have been treated the same as other message traffic for purposes of calculating Industry Member CAT fees.[37] The Commission and commenters raised questions as to whether this treatment of market maker quotes may result in an undue or inappropriate burden on competition or may lead to a reduction in market quality.[38] For example, commenters noted that charging Industry Members on the basis of message traffic would impact market makers disproportionately because of their continuous quoting obligations. Moreover, in the context of Options Market Makers, message traffic would include bids and offers for all Listed Options strikes and series.[39] To address these issues, the Operating Committee proposes to discount Options Market Maker message traffic by the trade-to-quote ratio for Listed Options when calculating message traffic for Options Market Makers, and to discount Equity Market Maker message traffic by the trade-to-quote ratio for NMS Stocks when calculating message traffic for Equity Market Makers. The message traffic of Options Market Makers and Equity Market Makers, as discounted, would be counted as part of the total message traffic for all Industry Members. The practical effect of applying such discounts for market

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32 The discount is calculated by dividing the adjusted trade count (that is, the total number of trades for the quarter minus the total number of trade busts) by the total number of quotes received by the securities information processors ("SIP"). Proposing Release at 24924.

33 FIA Letter 2 at 4; Letter from Andrew Stevens, General Counsel, IMC Chicago, LLC, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 20, 2021) ("IMC Letter") at 2.

34 Data Boiler Letter at 7.

35 SIFMA Letter at 9.

36 Istra Letter at 2-4; Parallax Letter at 3; and Tower Research Letter at 5-6.

37 Note, however, that market maker discounts were included in the Prior Fee Proposal. *See* Prior Fee Proposal Release at 1418-9.

38 *See* Suspension Order at 31663-4.

39 *Id*. at 31664.

making activity would be to lower the CAT fees for Options Market Makers and Equity Market Makers.

By imposing a discount on Options Market Makers and Equity Market Makers' message traffic for the calculation of message traffic, the Operating Committee believes that the proposed CAT fees for market makers would satisfy the requirements of the funding principles set forth in Section 11.2 of the CAT NMS Plan as well as the requirements of the Exchange Act. First, the proposed market maker discounts are designed to address comments that the Original Funding Model could disproportionately affect market makers, thereby leading to a reduction in liquidity and market quality. Commenters noted that charging Industry Members on the basis of message traffic will impact market makers disproportionately because of their continuous quoting obligations. With their continuous quoting obligations, market makers would have higher levels of message traffic, and the type of message traffic (bids and offers rather than transactions) are not necessarily related to higher revenue. The SEC repeatedly has recognized the value of protecting the provision of market liquidity, and afforded market makers favorable regulatory treatment by virtue of their role as liquidity providers. For example, market makers receive favorable treatment under short sale rules,[40] margin rules,[41] pursuant to exchange fee schedules,[42] and under the Volcker Rule.[43] The proposed discounts are designed to put market makers and other market participants on a level playing field in the Proposed Funding Model, thereby preserving and incentivizing the ability of market makers to provide liquidity to the market, which liquidity ultimately benefits all market participants. Market makers' primary role is to provide the markets with competitive prices and quotes against which others may execute their orders. Market makers update their quotes continuously throughout each trading day to reflect changes in the market, and each update is additional message traffic that will be reported to CAT. If CAT fees made it unduly costly for market makers to provide this competitive liquidity, it could reduce the available liquidity against which customers could execute orders and create worse pricing for customers that do receive executions.

Second, although the proposed discounts would provide market makers with a benefit not provided to other market participants, such discounts would not amount to unfair discrimination or an unnecessary or inappropriate burden on competition. As discussed above, the SEC has recognized repeatedly that such favorable treatment for market makers in other contexts was not unfairly discriminatory or a burden on competition in light of its positive effects on market quality, nor was it considered to involve an inequitable allocation of fees among members.

Third, the Operating Committee believes that the proposed fees appropriately take into account the distinctions in the securities trading operations of different Industry Members, and avoid disincentives, such as a reduction in market quality, as required under the funding

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[40] *See, e.g.,* Rule 203(b)(2)(iii) of Regulation SHO under the Exchange Act (market maker exception for short sale locate requirement).

[41] *See, e.g.,* Section 7(c)(3) of the Exchange Act (market maker exception regarding margin requirements).

[42] *See, e.g.,* NYSE Arca Rule 8.800-E and Market Maker Fees and Credits, NYSE Arca Fees and Charges (incentive programs for market makers).

[43] *See* Section __.4(b) (market making exemption from the proprietary trading prohibition).

principles of the CAT NMS Plan.[44] The proposed discounts recognize the different types of trading operations presented by Options Market Makers and Equity Market Makers, as well as the value of the market makers' quoting activity to the markets as a whole. Accordingly, the Operating Committee believes that the proposed discounts will not impact the ability of Options Market Makers or Equity Market Makers to provide liquidity.

Finally, the Operating Committee believes that the trade-to-quote ratio is an appropriate method for discounting market maker message traffic, including because of the relatively few quotes that ultimately execute. As discussed above, the vast majority of quotes market makers submit are intended to price the market and provide liquidity against which orders may execute. The Operating Committee proposes to use the trade-to-quote ratio for calculating the discount because it directly relates to the issue regarding the quoting requirement (*i.e.*, fewer trades per quote for market makers due to their quoting activity) and it is an objective discounting method.

F. Minimum Industry Member CAT Fee

The Operating Committee proposes to impose a Minimum Industry Member CAT Fee of $125 per quarter on an Industry Member if its CAT fee would be less than $125 per quarter when calculated based on message traffic. One commenter stated that the proposal did not provide adequate justification for the proposed Minimum Industry Member CAT Fee,[45] and another commenter stated that the collection of such small fees was not an appropriate use of resources.[46]

A minimum fee of $125 per quarter ensures that all Industry Members provide a meaningful contribution to the funding of the CAT, as the CAT is intended to assist all market participants by creating enhanced oversight of the markets, and thus benefits all Industry Members, including those with small levels of message traffic.[47] Because some Industry Members may have very small levels of message traffic, their proposed CAT fee may be commensurately very small (*e.g.*, they could pay a CAT fee of pennies). However, the size of the $125 minimum quarterly fee is not so large as to be overly burdensome to Industry Members with small levels of message traffic. Accordingly, the minimum fee would be in keeping with the funding principle requiring the funding model to "avoid disincentives such as placing an inappropriate burden on competition and a reduction in market quality."[48] In addition, such a minimum fee also would contribute to the ease of billing and other administrative functions, in accordance with the funding principle set forth in Section 11.2(d) of the CAT NMS Plan.[49] Without such a minimum fee, the Participants would be required to oversee the payment of fees as little as pennies for certain Industry Members given their limited message traffic.

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44 Section 11.2(b) of the CAT NMS Plan.
45 FINRA Letter at 5-6.
46 Data Boiler Letter at 7.
47 *See, e.g.*, CAT NMS Plan Approval Order at 84698.
48 Section 11.2(e) of the CAT NMS Plan.
49 Section 11.2(d) of the CAT NMS Plan.

G. Maximum Industry Member CAT Fee

The Operating Committee proposes to establish a maximum fee to be paid by Industry Members. The maximum fee for Industry Members would be the fee calculated based on 8% of the total message traffic for Industry Members. Commenters commented that there was inadequate justification for the 8% maximum fee, and that the maximum fee added complexity to model that prevents other Industry Members not subject to the maximum fee from calculating their own CAT fees.[50]

The imposition of the Maximum Industry Member CAT Fee serves as a method to institute a cap on fees in order to fairly allocate costs to Industry Members as using message traffic alone potentially may result in certain Industry Members paying a significant allocation of Total CAT Costs. In this way, the proposed Maximum Industry Member CAT Fee would address the potential for outsized fees that were previously addressed via the tiering and comparability provisions set forth in the Original Funding Model and the Prior Fee Proposal. These provisions sought to impose similar levels of fees on comparable CAT Reporters.[51] Specifically, the Operating Committee proposes to limit the Industry Member CAT fee to 8% of the total message traffic as 8% would limit Industry Members to paying a fee comparable to the highest fee for Participant complexes. For example, using the CAT Data from the fourth quarter of 2020, the top three Industry Members would be subject to the Maximum Industry Member CAT Fee, as their message traffic exceeds 8% of the total Industry Member message traffic. These three Industry Members would be subject to annual CAT fees in the range of $5 to $6 million. Similarly, the Participant complexes with the highest CAT fees would pay an annual CAT fee in a similar range. Without the imposition of the Maximum Industry Member CAT Fee, the Industry Member with the highest CAT fee would pay almost $10 million for its annual CAT fee.

III. Participant CAT Fees

A. Use of Market Share

Under the Proposed Funding Model, the Adjusted Participant Allocation would be allocated among Participants based on market share. Certain commenters questioned the use of market share for allocating costs among Participants, particularly since costs were proposed to be allocated among Industry Members based on message traffic.[52] The use of market share for this purpose is in accordance with the CAT NMS Plan as adopted by the SEC. Specifically, the CAT NMS Plan contemplates Participants paying a CAT fee based upon market share.[53] The Operating Committee analyzed various alternative methods for allocating costs among

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[50] Data Boiler Letter at 7-8; FINRA Letter at 5-6; MMI Letter at 5; SIFMA Letter at 9; and Tower Research Letter at 6.

[51] The proposed deletion of the tiering and comparability provisions are discussed above.

[52] FIA Letter 2 at 3; Fidelity Letter at 4; FINRA Letter at 6-7; IMC Letter at 2; Letter from Gary Goldsholle, Chief Regulatory Officer and General Counsel, LTSE, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 19, 2021) ("LTSE Letter") at 2-3; MMI Letter at 5; NYSE Letter at 2; and SIFMA Letter at 8-9.

[53] *See* Sections 11.2(c), 11.3(a)(i) and 11.3(a)(ii) of the CAT NMS Plan.

Participants other than market share and continued to determine that using market share would equitably allocate CAT fees among Participants. In contrast to Industry Members, which determine the degree to which they produce message traffic that constitutes Reportable Events, the Reportable Events of Participants are largely derivative of quotations and orders received from Industry Members that they are required to display. The business models for Participants, however, generally are focused on executions and/or trade reporting in their marketplaces. As a result, the Operating Committee believes that it is more equitable to charge Participants based on their market share rather than their message traffic. Moreover, relying on market share would provide the Participants with a straightforward calculation using readily available market data. Such a basic calculation would be consistent with the CAT funding principle, which requires the model to "provide for ease of billing and other administrative functions."[54] Finally, the Participants have been voluntarily allocating CAT costs based on market share for the past eight years and are comfortable that allocating CAT cost based on market share is an appropriate way to allocate CAT costs, as it is consistent with the CAT NMS Plan.

B. No Tiered Fees for Participants

The Operating Committee proposes to eliminate the use of tiered fees for Participants in the Proposed Funding Model. The Operating Committee proposes to allocate the Adjusted Participant Allocation among Participants based on the Participant's market share without relying on tiered fees for the reasons discussed above with regard to Industry Members. One commenter expressed support for the elimination of tiering.[55]

C. 60%-40% Allocation between Equities Participants and Options Participants

Under the Proposed Funding Model, the Operating Committee proposes to divide the Adjusted Participant Allocation between Equities Participants and Options Participants. The Equities Participant Allocation would be 60% of the Adjusted Participant Allocation and, correspondingly, the Options Participants Allocation would be 40% of the Adjusted Participant Allocation. If a Participant has both options and equities market share, then such Participant will be treated as both an Equities Participant and an Options Participant. Certain commenters commented that the proposal does not provide sufficient justification of the 60%-40% allocation.[56] The Operating Committee believes that the proposed 60%-40% allocation between Equities Participants and Options Participants is an appropriate allocation among Participants.

The Operating Committee proposes to divide the Adjusted Participant Allocation between Equities Participants and Options Participants because it is difficult to compare market share between asset classes (*i.e.*, equity shares versus options contracts). This bifurcated approach to allocating costs among Equities Participants and Options Participants is consistent with the CAT NMS Plan, which specifically contemplates allocating Participant CAT fees based

54 Section 11.2(d) of the CAT NMS Plan.
55 FIA Letter 2 at 4.
56 FINRA Letter at 6; LTSE Letter at 5; MMI Letter at 5; and NYSE Letter at 2.

on options and equity activity.[57] The allocation among the Equities and Options Participants has been the subject of negotiations among the Participants. In addition, the proposed 60%-40% allocation is similar to the proposed allocation in the Prior Fee Proposal, which proposed a 67%/33% allocation between Equity Execution Venues and Options Execution Venues based on the comparability concept.[58]

D. Treatment of OTC Equity Securities

Under the Proposed Funding Model, the Operating Committee proposes to calculate market share for national securities associations solely based on share volume of trades reported in NMS Stocks. Correspondingly, the calculation of total market share and market share for each Equities Participant would not include reported share volume in OTC Equity Securities. One commenter questioned the special treatment of OTC Equity Securities, especially when other securities may raise similar issues (*e.g.*, thinly traded securities, ESGs).[59]

The Operating Committee proposes to calculate market share for national securities associations without reference to trades reported in OTC Equity Securities. Many OTC Equity Securities are priced at less than one dollar—and a significant number at less than one penny—per share and low-priced shares tend to trade in larger quantities. Accordingly, a large number of shares are involved in transactions involving OTC Equity Securities versus NMS Stocks. Because the proposed CAT fees for Equities Participants are based on market share calculated by share volume, FINRA would likely be subject to higher fees if OTC Equity Securities were included in the calculation of market share.

The Operating Committee proposes to exclude OTC Equity Securities share volume in the calculation of market share, rather than to use a discounting approach proposed in the Prior Fee Proposal. In the Prior Fee Proposal, the Operating Committee proposed to discount the share volume of trades reported in OTC Equity Securities when calculating the market share for national securities associations and Execution Venue ATSs.[60] At this time, the Operating Committee has determined that excluding OTC Equity Share volume entirely would be a more simple and straightforward approach from an administrative perspective. The Operating Committee believes that this approach to OTC Equity Share volume addresses comments about prior fee proposals regarding the different trading characteristics of NMS Stocks and OTC Equity Securities.[61]

E. Maximum Equities Participant Fee

The Operating Committee proposes to establish a maximum fee to be paid by a national securities association that is a Participant. Currently, FINRA is the only national securities

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[57] *See* Section 11.3(a) of the CAT NMS Plan.
[58] *See* Prior Fee Proposal at 1408.
[59] Data Boiler Letter at 8.
[60] Prior Fee Proposal at 1406.
[61] Suspension Order at 31664-5.

association that is a Participant in the CAT NMS Plan. Under the Proposed Funding Model, FINRA would pay a CAT fee based on its proportionate market share in NMS Stocks, subject to a maximum fee. The maximum fee allocated to FINRA would be the greater of (x) 20% of the Equities Participant Allocation or (y) the highest CAT fee required to be paid by any other Equities Participant plus 5% of such highest CAT fee (the "Maximum Equities Participant Fee"). Certain commenters objected to the Maximum Equities Participant Fee or questioned the justification for the Maximum Equities Participant Fee.[62]

The imposition of the Maximum Equities Participant Fee serves as a method to institute a cap on fees in order to fairly allocate costs to FINRA given that a market share approach potentially may result in FINRA having a significant allocation given the large volume of NMS Stock activity that is subject to trade reporting on FINRA facilities, and potentially may not accurately reflect a fair allocation of costs to FINRA. In this way, the proposed Maximum Equities Participant Fee would address the potential for outsized fees that were previously addressed via the tiering and comparability provisions set forth in the Original Funding Model and the Prior Fee Proposal. These provisions sought to impose similar levels of fees on comparable CAT Reporters. Finally, along with the other components of the calculation of the Participant CAT fee, the Operating Committee believes the use of market share is a fair and reasonable basis for assessing regulatory usage, expense and burden among the Participants. FINRA is expected to be one of the largest regulatory users of the CAT and it would be fair and reasonable for the FINRA to pay a proportionate percentage of the CAT fees commensurate with FINRA's comparable market share, which is subject to the Maximum Equities Participant Fee and also not subject to any fee for OTC Equity Security market share.

F. Minimum Participant Fee

The Operating Committee proposes to require each Participant to pay at least a minimum CAT fee, regardless of its market share. Specifically, the Operating Committee proposes to require each Participant to pay a minimum CAT fee of 0.75% of the Participant Allocation, referred to as the Minimum Participant Fee. Commenters indicated that there was inadequate justification for use of the Minimum Participant Fee.[63]

This Minimum Participant Fee is intended to ensure that all Participants provide a meaningful contribution to the funding of the CAT, as the CAT is intended to assist all market participants by creating enhanced oversight of the markets.[64] All Participants, regardless of their market share, are required to regulate their markets and members, and they may do so using the CAT. Therefore, all Participants receive benefits from the CAT and should pay a meaningful portion of the CAT costs. However, the size of the minimum fee is not so large as to be overly burdensome to Participants with a smaller market share.

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62 Data Boiler Letter at 9; FINRA Letter at 7-9; LTSE Letter at 5; and NYSE Letter at 2.
63 LTSE Letter at 4-5; NYSE Letter at 2.
64 CAT NMS Plan Approval Order at 84698.

IV. Illustrative Example

In response to the illustrative example of the Proposed Funding Model provided in the Proposing Release, commenters requested additional information used in the fee calculation.[65] In response to these requests, the Operating Committee provided a variety of additional data regarding the Proposed Funding Model, including the 2021 operating budget for the CAT as well as the total Industry Member message traffic count and total message traffic counts for Options Market Makers and Equity Market Makers used in the illustrative example.[66] In addition, the Operating Committee offered to provide to each Industry Member, upon request, the Industry Member's total message traffic, and the Industry Member's market maker message traffic.[67]

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Respectfully submitted,

Michael Simon
CAT NMS Plan Operating Committee Chair

cc: The Hon. Gary Gensler, Chair
The Hon. Allison Herren Lee, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
Mr. Hugh Beck, Senior Advisor for Regulatory Reporting
Mr. David Saltiel, Acting Director, Division of Trading and Markets
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Mr. David Hsu, Assistant Director, Division of Trading and Markets
Mr. Mark Donohue, Senior Policy Advisor, Division of Trading and Markets
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CAT NMS Plan Participants

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65 Letter from Howard Meyerson, Managing Director, Financial Information Forum, to Vanessa Countryman, Secretary, SEC re: re: File No. 4-698 (April 29, 2021) at 1-2; Letter from Howard Meyerson, Managing Director, Financial Information Forum, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 21, 2021) at 2-3; Joanna Mallers, Secretary, FIA Principal Traders Group, to Vanessa Countryman, Secretary, SEC re: File No. 4-698 (May 7, 2021) at 2; Tower Research Letter at 3.

66 CAT Letter at 2-3.

67 *Id.* at 2.