

November 29, 2021

By electronic mail to rule-comments@sec.gov

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

Re: Joint Industry Plan; Order Instituting Proceedings to Determine Whether to Approve or Disapprove an Amendment to the National Market System Plan Governing the Consolidated Audit Trail (July 20, 2021)(Release No. 34-92451; File No. 4-698)

Dear Ms. Countryman:

Modern Markets Initiative (“MMI”), the education and advocacy organization devoted to the role of technological innovation in creating the world’s best markets, appreciates the opportunity to provide written comments to the SEC in connection with the “Joint Industry Plan; Order Instituting Proceedings to Determine Whether to Approve or Disapprove an Amendment to the National Market System Plan Governing the Consolidated Audit Trail” (the “Proposed Funding Model”).^[1]

By way of background, MMI members collectively employ more than 1600 people in over 50 markets globally and account for approximately twenty percent of daily trading volume. MMI’s members are routinely engaged in building out automated trading technology systems and have expertise in data storage and collection, and experience with vendors and general industry standard costs associated with the provision of data collection and storage services.

MMI urges the SEC to not approve the Proposed Funding Model and consider ways it could take on more direct oversight of the CAT, leveraging the Commission’s un-conflicted regulatory position and its unique rule-making authority. MMI understands that FINRA and the exchanges have been placed in a difficult position by the structure of the Operating Committee. However, it is also our view that the exchanges and FINRA have fallen short in working with the broader broker-dealer community to find a transparent, workable, and equitable alternative that mitigates inherent conflicts of interest. This is manifest in the fee proposal: it seeks to protect certain parties at the expense of others; and fails to ground the costs in a way that resembles real-world, market costs of goods and services. MMI, therefore, urges the SEC to take more control over CAT governance, and particularly the finances, in order to override these conflicts of interest and add the benefit of its extensive regulatory expertise and rule-making authority to the process.

MMI's material concerns center around these key areas:

- Poor governance and abdication of responsibility to leverage industry feedback for the fees proposal. Notably, since the SEC's extension for comments was filed, it is not apparent that the CAT Operating Committee has leveraged its Advisory Committee in any meaningful collaboration to identify alternative fee proposals. Nor, to our knowledge, has the Operating Committee engaged any other industry representatives or working groups.^[2]
- Lack of accountability regarding project budget overruns, which are now ten times more than the original estimates.
- Unfair and inequitable proposed fee structure that subsidizes the activities of registered market makers and the options exchanges, asking other participants to pay for the CAT processing of their activity.
- Absence of transparency regarding budget and expenses over the past decade of implementation.
- General failure to use industry expertise in estimating, designing, building, and managing the CAT. Rather than seeking and using industry experience upfront, the Operating Committee and FINRA CAT have taken the approach that they will design the system and the reporting specifications, poorly, on their own; and then let industry working groups spend tens of thousands of man-hours trying to clean it all up. This is notoriously frustrated by the need to have every edit approved by the Operating Committee -- which, again, lacks the trading and trading system's expertise to opine on many of the issues at all. This whole debacle began with the SROs' decision to assign staff to the Committee who have no experience trading or trading systems.
- The financial incentives that the SEC established have, perversely, worked against the project. Rather than take time to get the system and the specifications right, the Operating Committee instead pushes back on industry-requested changes that they deem "too hard to get done before the next deadline." This dynamic has real-world consequences and costs: poor data quality, excessive processing by the CAT system, many man-hours spent rehashing issues, and ultimately code rework by CAT reporters.
- Meanwhile, the SROs have given themselves the luxury of not being required to report their own data using the same specifications that brokers are required to use. There is no moral justification for this exemption; the SROs simply wanted an easier specification than the one they have forced on brokers -- and there is no oversight to stop them from making such exemptions.

Discussion

The following is MMI's feedback as requested in the Commission's extension filing:

B- 7. Commenters' views on whether a Section 31 fee-like cost allocation framework (i.e., a transaction-based fee framework) would benefit or harm efficiency, competition, and capital formation, and any views of whether there are other benefits or costs of adopting such an approach;

On the recommendation of administering the funding similar to Section 31 fee-like cost allocation, MMI notes this type of process would lend simplicity to the payments process (rather than creating a new billing and receivables process for CAT, as is suggested in the filing). However, based on the limited information that the Operating Committee has shared regarding the cost drivers of CAT, MMI believes that "message traffic" is a more appropriate basis for calculating fee structure, as opposed to "executed trades."

In addition, MMI would like to call to regulators' attention the very poor state of accounting with respect to Section 31 fees in general. Brokers and clearing firms have absolutely no transparency regarding which trades are charged, and no ability to reconcile the charges. The SROs are collectively unwilling or unable to provide any data to brokers to support those fees. Should CAT fees also be collected via clearing firm direct-debit, MMI urges the Commission to require SROs to provide detailed accounting to every fee payer, contemporaneously with every month's fee assessment. Such data should be detailed enough that the end-payer (not just the clearing firm, but the introducing/executing broker) can reconcile the fees down to the end account. Any end-broker should be able to automatically download this data and automatically reconcile the charges with the broker's knowledge of shares traded. MMI members will happily contribute to the research and design required to execute this request.

Further, and most importantly, MMI objects to the idea that the SROs might be allowed to pass through the 100% of building and operating the CAT to brokers and end-customers, which is what happens today with Section 31 fees. The decade of delays and wasted work on CAT has been solely due to mismanagement by the SROs. The SROs were solely responsible for the original selection process that led to awarding the project to Thesys and were solely responsible for the management and ultimate failure of that first attempt to build CAT. If there is a notion that the failure was the fault of Thesys, MMI objects to this narrative. No vendor can succeed at a project of this scope without a very high degree of expertise and collaboration from a dedicated and intimately involved client.

Re-awarding the project to FINRA CAT has not significantly improved these dynamics. The project continues to be extremely expensive, poorly managed, and of questionable quality. The Operating Committee continues to fail to add meaningful direction or expertise. The SROs should be responsible to bear the costs of the buildout and not be allowed to pass those costs on to the rest of the industry, who had no ability to help reduce them along the way. A full accounting should be rendered to arrive at the costs for buildout based on the SEC's initial timeline for the project and further review and consideration of the allocation of cost between SROs and industry.

A-13. Commenters' views on whether other Industry Members (including those that do not transact in options) would subsidize the activity of Options Market Makers under the proposal; any views on

whether Section 6.4(d)(iii)437 of the CAT NMS Plan effectively reduces the message traffic of Options Market Makers relative to what it would be otherwise, and thus ultimately reduce the CAT fees they would be assigned under the Participants' proposal; views on how this subsidization would benefit or harm efficiency, competition, and capital formation; views on whether there are other benefits or costs of adopting such an approach; views (in detail) on whether there is an alternative approach that would be more beneficial to efficiency, competition, or capital formation;

MMI expresses concern that the Proposed Funding Model creates a potential for equities industry members to, in effect, subsidize activity of Options market makers. Of the Industry Member CAT reportable events, 89% originate from Options Market Makers, according to the CAT Committee's Comment Letter of May 5, 2021. However, the proposal gives options market makers a 99% discount in counting their fee-eligible reported events; this effectively shifts 94% of Industry Members' CAT fee pool to equities activity in non-market maker accounts.^[3]

This subsidy is unfair at face value. A robust explanation of the goal, and a study of the expected effects of such a subsidy must be provided to satisfy the Exchange Act. Neither has been provided. This is one of many examples of work by the SROs that fails to provide the transparency, sophistication, or market-wide input that should be a baseline requirement for setting the CAT funding model. The fee model should avoid an arbitrary selection of winners and losers that could impact efficiency and competition in the markets. Ultimately, the responsibility for funding cost of the CAT should be borne by the parties generating the message traffic -- including the exchanges as well as brokers on an equal footing.

Notably, MMI observes the proliferation of securities exchanges (often noted to create excessive fragmentation), is also a potential factor driving outsized "messaging" costs. It is worth the SEC evaluating the commercial incentives related to market fragmentation and to conduct an evaluation of the impact of such fragmentation on costs associated with the CAT -- and then consider this impact when approving or disapproving any CAT fee allocations plan.

B- 13. Commenters' views on how any inherent conflicts of interest may be addressed in the proposal;

Unfortunately, the inherent conflicts of interest in the CAT governance framework lead to a number of structural gaps, including:

- Top-level control is given to a committee of SROs who have no incentive to perform their duties well. They have nothing tangible to gain if CAT succeeds, and they have acted accordingly, failing to use their best resources to ensure its success. In fact, the "Financial Accountability Milestones" have done just the opposite of what was intended: MMI members have observed when the Processor and/or Committee sacrificed "doing the right thing" in the reporting specifications (which are still terrible), and instead laser-focused on "meeting the date" in order to avoid financial penalties.
- The governance structure of the Operation Committee, where only the SRO representatives have a voice, and where the SROs expect to have unilateral control to propose the fees structure, disincentivizes accountability and transparency and contains no inherent cost controls.
- No evidence or transparency regarding self-imposed cost controls.

- Lack of communication between the Operating Committee and Advisory Committee, without meaningful discussion before decisions are final or public.
- “Blank check” moral hazard of allowing the costs to reach at least ten times the initial estimate, with no intermediary notifications or accountability.

To illustrate these points, please consider the original CAT Plan^[4] filed by the SROs, which includes the original cost estimates. It was not clear at the time of the filing, but has become clear in the years since, that the authors clearly did not understand what data CAT was meant to capture. The assumption at that time, evident in many ways since, was that CAT would capture “order tickets” in the same way that OATS did; and the original estimates for the number and of events to be reported were based in part on that paradigm. However, *years* later, through countless working group meetings and back-and-forth iterations with the FINRA CAT staff, industry members came to understand that the SROs have re-interpreted Rule 613 to say that “every customer instruction” must be captured. “Every customer instruction” is now understood to include many events that were never considered in OATS, nor are they required to be captured in brokers’ books and records: for example, a request to cancel an order, or a request to modify an order, or a rejection of such requests by the venue holding the open order. None of these things were understood, even in concept, when the Plan was filed, nor when the first several sets of reporting specifications were published. Yet, these requirements *significantly* expand the scope of data and the number of events required to be reported. In the Operating Committee’s webinars (September 21/22), they attempted to relate the explosion of costs to a vague notion of “more data in the marketplace” -- but this hardly explains the scale of the cost differences or the failure to estimate them properly.

FINRA CAT and the Operating Committee are without an overall plan, in changing that reporting paradigm. Rather than capturing “order tickets”, we are nearing the point where CAT is actually capturing “every message that industry traders and trading systems send back and forth to each other. But the Plan Processor and the Operating Committee have failed to recognize this shift that they are making. Rather, they are forcing the industry toward this end in a haphazard way, costing millions in working group time, and code rewrites for reporters with each change in the specifications. We suspect that this stuck-between-two-paradigms state costs the CAT system a lot of extra processing power (and therefore costs) that could have been avoided, had the whole plan been robust from the start.[5]

The *very poor* quality of the various “specifications” documents reflects a lack of expertise, and lack of direction, on the part of both the Plan Processor and the Operating Committee. The expansive set of document requests include: (1) the Participant (SRO) reporting requirements; (2) the Industry Member (broker) reporting requirements; (3) the Industry Member “scenarios” document; and (4) an ever-growing list of “Frequently Asked Questions” posted to the CAT website.[6]

So, the Processor and the Committee issue vague, poorly written documents, without industry input, and then industry member working groups spend tens of thousands of man-hours poring over them and responding with hundreds (thousands?) of questions and corrections. The Plan Processor consistently responds that they do not have the authority to make any decisions about most of these things and must get approvals from the Committee. This process takes months, and the answers are often poorly understood.[7]

As far as how these conflicts may be addressed, it is important that (1) the structural gaps and conflicts of interest must be disclosed and acknowledged; and (2) that the Operating Committee adheres to a governance process that addresses the conflicts of interest, potentially mirroring the SIP governance process as an example of a decision-making process that incorporates industry feedback and transparency of record-keeping.

MMI specifically recommends that the roles of the Operating Committee and the Advisory Committee should be re-examined. The Operating Committee should be required to have an industry observer(s) present in its deliberations; and the brokerage industry should have a more meaningful role, including potentially a veto power, in discussion and decision making before the Operating Committee's major decisions are final or public. Finally, the SEC should have a direct observer in every meeting between the SROs, so that decisions to bury problems for the sake of "meeting deadlines" cannot be made in the dark.

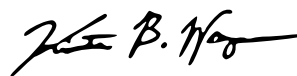
Finally, the Operating Committee and Plan Processor should be tasked to employ the trading expertise, and trading systems expertise, that they so obviously lack to date. The entire project suffers from this gap, and it has weighed upon the "historical costs" as well as the apparent budget projections; and continues to weigh on the massive investment of time and resources for industry members. This knowledge gap is obvious, shocking, and inexcusable.^[8]

Conclusion

MMI supports the overall objectives of the CAT and provides the comment above in an effort to move the process to completion while ensuring a fair and equitable funding model. To that end, we believe that an appropriate next step in the CAT process is for the SEC to call a meeting of the exchanges, FINRA, and industry members, where the agency can provide much-needed leadership to this initiative by facilitating a transparent conversation about building a thoughtful, resilient governance and funding model for the CAT. Given the enormity of this project and the length of time it has been in development, it is worth the time of all interested parties to find reasonable solutions to these questions rather than pressing forward with the failed model currently under consideration.

Thank you for your consideration.

Very truly yours,



Kirsten Wegner
Chief Executive Officer
Modern Markets Initiative

cc: Mr. Michael Simon, CAT NMS Plan Operating Committee Chair

[1] Joint Industry Plan; Order Instituting Proceedings to Determine Whether to Approve or Disapprove an Amendment to the National Market System Plan Governing the Consolidated Audit Trail (July 20, 2021) at <https://www.sec.gov/rules/sro/nms/2021/34-92451.pdf>.

[2] The Operating Committee held two public webinars on 9/21/2021 and 9/22/2021 regarding the fees proposal. Both webinars were essentially unilateral. Any questions from the community were required to be submitted in advance, in writing. There was no attempt to collaborate during these presentations.

[3] <https://www.sec.gov/comments/4-698/4698-8793895-237841.pdf>

[4] On September 30, 2014, the CAT participants published their [original CAT NMS Plan](#), providing the following estimated costs: (1) A range of build costs from about \$ 30 million to \$92 million, with an average of \$53 million (See [Appendix C, Page 54](#): “the six shortlisted bidders provided estimates ranging from a low of \$30,000,000 to a high of \$91,623,000, with an average one-time cost of \$53,002,915.27.”); and (2) a range of 5-year operating costs from \$135 million to \$465 million, with an average \$255 million, or \$51 million annually spread over five years (See [Appendix C, Page 54](#)).

[5] Further questions worth exploring include: Why does “Linker” require so much processing power and time? Are the underlying data structures (as reflected by the reporting specifications documents that we can see) wrong, or unnecessarily complex?

[6] Further inquiry should be explored on the extent of the disparate collection of documents, and whether reporting requirements are clearly envisioned, well understood, or clearly written? MMI notes there are four different sets of documents, which invites questions on whether this common practice? It is worth questioning whether the “Scenarios” and “FAQs” for CAT are essentially a band-aid for underlying problems with the requirements gathering and very poor documentation. It is worth questioning whether the SRO appointees to the Operating Committee, although well-intentioned, may not have had the skills and experience for the undertaking.

[7] MMI notes anecdotal responses from SROs and Plan Processor centering around not being able to fix problems because of pressure to hit deadlines; or responses noting that CAT systems cannot accommodate certain workflows due to incompatibilities with the underlying data model of CAT, which differs from the industry standards and “ground truth” of industry trading protocols.

[8] An illustration of the point: as of this writing, industry groups are still trying to get the Plan Processor and Operating Committee to understand, and to properly model, what happens when orders are canceled. The reporting specifications for industry members still evidence a near-total lack of understanding of these processes, and industry members continue to receive false “errors” from CAT in their reporting as a result. Failure to understand and correctly model such a basic concept, after ten years of CAT, is beyond comprehension.