MEMORANDUM

To: File Nos. S7-27-18; S7-15-18; S7-14-18; S7-13-18; S7-23-18

From: Eric Diamond, Senior Advisor to Chairman Jay Clayton

Re: Meeting with Representatives of Investment Company Institute

Date: September 23, 2019

On September 23, 2019, Chairman Jay Clayton, Sean Memon (Chief of Staff), Bryan Wood (Deputy Chief of Staff), Sebastian Gomez Abero (Senior Advisor to Chairman Clayton) and Eric Diamond (Senior Advisor to Chairman Clayton) met with the following representatives of the Investment Company Institute (ICI):

- George C. W. Gatch (Chairman)
- Paul Schott Stevens (President and Chief Executive Officer)
- Susan Olson (General Counsel)

The meeting participants discussed, among other things, the SEC's proposed rules relating to fund of funds arrangements; the SEC's proposed rules relating to exchange-traded funds; the proposed rule amendments to rules adopted under section 13 of the Bank Holding Company Act (commonly known as the "Volcker rule"); the SEC's request for comment relating to processing fees charged by intermediaries for distributing materials other than proxy materials to fund investors; the SEC's proposal relating to updated disclosure requirements and a summary prospectus for variable annuity and variable life insurance contracts. At the meeting, the ICI representatives distributed the attached materials.

Investment Company Institute Priorities for SEC Regulation
September 2019

- Ensure Workability of Any New Fund of Funds Regulatory Regime
- Codify and Streamline the Regulatory Treatment of ETFs
- Propose a New Appropriately Tailored Rule for Funds' Use of Derivatives
- Revise the Volcker Rule Implementing Regulations to Avoid Unnecessary Spillover Effects for US Registered Funds and Similar Non-US Funds
- Facilitate More Cost-Effective Distribution of Fund Regulatory Materials
- Reform Fund Proxy Requirements and Do Not Unduly Burden Proxy Advisory Firms
- Modernize Variable Insurance Product Summary Prospectuses
- Ensure that the SEC Actively Promotes a Strong Capital Markets Perspective in its Engagement with FSOC and the FSB
- Defer Collection of CAT Data Until SEC Implements Adequate Information Security Protections

Ensure Workability of Any New Fund of Funds Regulatory Regime

Background:

Funds increasingly invest in other funds as a way to achieve asset allocation, diversification, or other investment objectives. Target date mutual funds ("TDFs") are a popular retirement savings vehicle that often are structured as fund of funds. For example, 95 percent of TDFs are funds of funds, and 43 percent of funds of funds are TDFs.

For the past two decades, a regulatory patchwork of statutes, rules, exemptions, and guidance has governed fund of funds. In December 2018, the Commission proposed Rule 12d1-4 to streamline and enhance the fund of funds regulatory framework. Among other things, the proposed rule would restrict funds of funds that invest more than three percent in another fund from redeeming more than three percent of that underlying fund's total outstanding shares in any 30-day period.

We commend the Commission for its efforts to streamline its regulatory approach and eliminate the need for individual fund of funds exemptive orders. In doing so, however, the Commission must be aware that its proposed approach will disrupt a significant number of existing arrangements and deprive investors of investment opportunities that have served them efficiently and successfully for many years.

ICI surveyed its members about the proposal. Fifty complexes with more than 1,300 fund of funds arrangements and $2.8 trillion in assets responded. A new fund of funds rule would affect nearly 70 percent of these funds with a total of $2.0 trillion in assets.

The proposed redemption restrictions are of utmost concern. They are not only inconsistent with current regulation, but also would prevent fund managers from acting in the best interest of investors and could result in financial harm to shareholders. Indeed, we note that the basis of this rulemaking does not appear related to any specific issue raised by investors in funds of funds.

ICI's Recommendation:

The Commission's proposed rule takes an important step toward streamlining the confusing regulatory regime governing fund of funds, but more work needs to be done to create a final rule that will not cause undue disruption and harm retirement savers.

Additional ICI Materials:

- Letter from Paul Schott Stevens, President & CEO, ICI, to Vanessa Countryman, Secretary, SEC, dated April 30, 2019, available at https://www.ici.org/pdf/19_ltr_fundoffunds.pdf.

Codify and Streamline the Regulatory Treatment of ETFs

Background: An exchange-traded fund (ETF) is a pooled investment vehicle with shares that can be bought or sold throughout the day on a national securities exchange at a market-determined price. For ETFs to trade their shares in the market, they first must obtain permission from the Division of Investment Management and the Division of Trading and Markets.

First, ETFs must receive exemptive relief from the Division of Investment Management from certain provisions of the Investment Company Act. Over the years, this often lengthy and unpredictable process produced uneven treatment among ETFs. ETFs also must comply with the listing and continued listing requirements of the exchange upon which it will list its shares. If a new ETF cannot meet an exchange's preapproved "generic" listing or continued listing standards, even in an immaterial manner, then the exchange must submit an individual proposed rule change to the Division of Trading and Markets to obtain approval to list and trade that product. The process for submitting and obtaining approval of a proposed rule change can take more than one year.

In 2015, the Commission requested comment relating to the listing and trading of ETFs and other exchange-traded products on national securities exchanges.

Last year, the Commission proposed Rule 6c-11 to streamline the ETF approval process, permitting most new ETFs to operate without obtaining exemptive relief orders under specified conditions. The Commission also proposed certain disclosure amendments intended to provide investors who purchase and sell ETF shares in the secondary market with additional information to help them understand ETF trading costs.

ICI's Recommendation: We urge the Commission to adopt Rule 6c-11. It would allow most ETFs to begin operating without first obtaining individual exemptive orders under the Investment Company Act. A more uniform regulatory framework built on Commission experience gained through the exemptive order process would eliminate the current disparate array of exemptive orders that permits some ETF sponsors more flexibility than other ETF sponsors.

We have serious concerns with the proposal to add a series of question and answers with certain historical ETF trading information and trading costs. To demonstrate how costs attributable to bid-ask spreads can affect an investor's total costs of investing in an ETF, we recommended that the Commission add

a hypothetical example using standard inputs, like the current prospectus fee example.

ETFs should not be required to add an interactive calculator on their websites. Not only is historical bid-ask spread data not necessarily predictive of an investor's future spread costs, the proposed bid-ask spread disclosure and the interactive calculator add to a growing list of Commission-mandated disclosures for registered funds that must be licensed or purchased from third-parties. If the Commission still wishes to move forward with an interactive calculator, it should utilize the advanced market metrics available on the Commission's website to avoid imposing unnecessary costs.

We also urge the Commission to consider ways to streamline the exchange listing process and consider ways the two divisions can work together to establish a single process for all ETF approvals that avoids a time-consuming process of multiple, and sometimes conflicting, requirements that many ETFs face today.

Additional ICI Materials

- Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated September 21, 2018, available at https://www.ici.org/pdf/18_ici_sec_etf_ltr.pdf.

Propose a New Appropriately Tailored Rule for Funds' Use of Derivatives

Background:

Funds use derivatives in numerous ways that benefit their shareholders such as hedging risk, managing portfolio duration, enhancing liquidity, gaining exposure to investment opportunities when access through other instruments is difficult or impossible, equitizing cash holdings, and reducing investment costs. Funds currently must look to the statute and an amalgamation of decades-old guidance, staff no-action letters, and staff comments on registration statements.

In 2015, the Commission proposed a rule to modernize regulation in this area and ensure that funds do not have unduly speculative portfolios and hold sufficient assets to meet their derivatives payment obligations.

ICI filed a comment letter supporting the Commission's goal of modernizing regulation and agreed that the proposed derivatives risk management program and aspects of the asset segregation regime would further that objective. We opposed the portfolio limits and the restriction limiting qualifying coverage assets to cash. The Commission never acted on the 2015 proposal.

ICI's Recommendation:

We urge the Commission to issue a new proposed rule that would provide a standardized framework for funds, rationalize asset segregation requirements and provide needed clarity in this area. In particular, we recommend that the proposed rule require: (i) a formalized derivatives risk management program; and (ii) an appropriate asset segregation regime, including an expanded category of assets eligible for segregation. We recommend that the rule not require fund portfolio limits based on arbitrary notional amounts. We encourage the Commission to consider other approaches, for example, risk-based limits which take account of derivatives' impact on a fund's portfolio.

Additional ICI Materials:

ICI submitted or published the following materials in response to the Commission's 2015 proposal:

- Letter from David W. Blass, General Counsel, ICI, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated March 28, 2016, available at www.sec.gov/comments/s7-24-15/s72415-114.pdf

- ICI Viewpoints, "Derivatives—Please Don't Let Them be Misunderstood," Shelly Antoniewicz, February 22, 2016, available at www.ici.org/viewpoints/view_16_derivatives_imf

Revise the Volcker Rule Implementing Regulations to Avoid Unnecessary Spillover Effects for US Registered Funds and Similar Non-US Funds

Background: The Volcker Rule prohibits "banking entities"—defined as banks and their affiliates and subsidiaries—from engaging in proprietary trading and from sponsoring or investing in hedge funds, private equity funds, or other similar funds. The Volcker Rule was not directed at registered funds or at similar non-US funds (collectively, "regulated funds"). But the 2013 regulations implementing the Volcker Rule have resulted in unnecessary spillover effects for regulated funds and their investment advisers. For example:

- The final regulations do not provide a complete carve-out from the banking entity definition for US registered funds or similar funds organized outside the United States. This has caused difficulties for bank-affiliated advisers in launching new regulated funds. Solely because the adviser invested "seed" capital, the fund itself could be subject to the Volcker Rule's trading and investment limits as if it were a bank.

- Although current regulations appropriately exclude "foreign public funds" from the Volcker Rule's restrictions, the regulations place restrictions on US firms and their affiliates that do not apply to foreign firms offering the same types of funds. For example, US firms must ensure that fund interests are sold "predominantly" to third-party retail investors. This creates monitoring and other compliance challenges for US firms that do not apply to their foreign competitors.

- The SEC and the four other agencies (collectively, "Agencies") charged with implementing the Volcker Rule have provided some interpretive guidance for regulated funds, such as staff responses to frequently asked questions and the preamble to the Agencies' July 2018 reform proposal (which was commonly referred to as "Volcker 2.0"). With regard to seeding regulated funds, the Agencies have acknowledged that a period of at least three years may be necessary and that the length of time required may vary (such that the Agencies have not prescribed a maximum seeding period). Despite its usefulness, this guidance does not provide the same certainty or permanence that would be afforded by formal rule changes.

- The Agencies already have indicated their willingness to consider amendments to the implementing regulations that would address the concerns of regulated funds and their investment advisers. In the July 2018 proposal, the Agencies discussed a broad range of regulated fund

issues; they also posed detailed questions about how regulated funds and their advisers have been affected and inquiries about possible solutions. ICI has engaged extensively with Division of Investment Management staff and staffs from the other Agencies, and we were pleased to see that the proposal sought comment on the full range of our members' Volcker Rule concerns.

The package of Volcker Rule reforms recently adopted by some of the Agencies (and expected to be adopted by the others) did not address issues related to the treatment of investment funds under the implementing regulations. According to the preamble to that release, the Agencies intend to tackle those issues in an additional notice of proposed rulemaking.

ICI's Recommendation: We recommend that the Commission prioritize efforts to conduct a second rulemaking to reform the Volcker Rule implementing regulations and that it encourage the other Agencies to do the same. We further recommend that the Commission and its staff take the lead in the interagency process with respect to crafting provisions that will avoid inappropriate application of the Volcker Rule to regulated funds and their advisers.

Additional ICI Materials: ICI's response to the Agencies' July 2018 Volcker reform proposal:

- Letter from Susan M. Olson, General Counsel, ICI, to the Agencies, dated October 17, 2018, at https://www.ici.org/pdf/31448a.pdf.

Facilitate More Cost-Effective Distribution of Fund Regulatory Materials

Background: When an investor holds fund shares with an intermediary (*e.g.,* a broker-dealer), fund records only identify the intermediary as the record owner, and the fund has limited information about the underlying beneficial shareholders. Funds therefore rely on intermediaries to deliver fund materials to these shareholders. A significant portion of mutual fund assets are held in this manner.

When an investor holds shares directly with its fund as a registered or "record" owner, the fund's transfer agent maintains the name and address in its records and delivers fund materials to the investors either itself or through a third-party hired for that purpose.

Securities Exchange Act rules require funds to reimburse intermediaries for "reasonable expenses" incurred in forwarding fund materials to fund shareholders. Intermediaries generally outsource forwarding of fund materials to a fulfillment vendor, which then invoices the fund to pay the expenses. These are fund expenses that fund shareholders pay.

This reimbursement system creates a disconnect between the party that negotiates the vendor fees (*i.e.,* the intermediary) and the party that pays the bill (*i.e.,* the fund shareholder). To make matters worse, the lack of properly aligned incentives prevents competition and has created a near-monopoly for the predominant vendor, which now has a financial stake in keeping the status quo.

For many years, the SEC has relied on self-regulatory organizations, such as the NYSE, to establish the fees that issuers must pay to reimburse intermediaries for distributing regulatory materials. The NYSE fee schedule sets maximum rates for what constitutes "reasonable" delivery expenses (*i.e.,* "processing fees") that funds must reimburse, in addition to actual out-of-pocket costs such as printing and mailing.

We gathered data from ICI members to compare the amount that funds pay in NYSE processing fees for shareholder report delivery per intermediary-held account against the amount per direct-held account. Respondents represent close to three thousand mutual funds that total $7.3 trillion in assets under management as of August 2018. ICI's survey found:

- The median fund pays ***3 times more*** in processing fees for mailing the shareholder report to an intermediary account than to a direct account.

- The median fund pays ***5 times more*** in processing fees for emailing the shareholder report to an intermediary account than to a direct account.

Our analysis raises real concern about whether the fee schedule represents reasonable expenses for delivering fund materials.

The SEC requested comment in June of 2018 on the framework regulating fees that intermediaries charge funds for distributing certain regulatory materials to fund shareholders, such as shareholder reports and prospectuses.

ICI's Recommendation: We urge the SEC to facilitate greater competition by permitting funds to select the fulfillment vendor and negotiate the price for distribution of fund materials. This will realign incentives and reintroduce market competition, eliminating the need for a regulator-set fee schedule.

The Commission could do so by interpreting its rules so that funds may, but are not required to, select a fulfillment vendor and negotiate the fee rate. This approach aligns with how funds select the vendor to deliver materials to their direct accounts.

Alternatively, the Commission could: (i) allow funds to choose how to deliver fund regulatory materials by not applying the objecting beneficial owner (OBO)/nonobjecting beneficial owner (NOBO) distinction for the purpose of delivering fund regulatory materials; or (ii) reform the NYSE fee schedule to actually reflect reasonable expenses and periodically review the continued reasonableness of those fees.

It is critical for the Commission to act to resolve the longstanding problems with the current framework that has cost fund shareholders millions of dollars.

Additional ICI Materials:

- Letter from Shelly Antoniewicz and Joanne Kane to Brent J. Fields, Secretary, SEC, dated January 17, 2019, available at https://www.sec.gov/comments/s7-13-18/s71318-4844298-177198.pdf

- *Fund Shareholders Have to Receive Reports. They Don't Have to Pay So Much for Them*, dated November 1, 2018, available at https://www.ici.org/viewpoints/view_18_delivery_processing_fees

- Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated October 31, 2018, available at www.sec.gov/comments/s7-08-15/s70815-315.pdf

- Letter from Paul Schott Stevens, President and CEO, ICI, to Brent J. Fields, Secretary, SEC, dated March 14, 2016, available at www.sec.gov/comments/s7-08-15/s70815-581.pdf

- *ICI Survey: Flawed Fee System Doubles Costs to Fund Shareholders for Broker Delivery of Fund Reports*, ICI Viewpoints (July 14, 2016), available at www.ici.org/policy/regulation/disclosure/16_news_fund_report_cost

- *Let's Make Disclosure Reform Serve Shareholders*, ICI Viewpoints (October 25, 2017), available at https://www.ici.org/viewpoints/view_17_disclosure

Reform Fund Proxy Requirements and Do Not Unduly Burden Proxy Advisory Firms

Background: Proxy voting is important to funds in their dual roles as issuers and institutional investors.

Funds as Issuers. Funds' challenges in seeking shareholder approvals are even more severe than those of operating companies. This is due to their heavily retail shareholder bases, differences in voting behavior (retail investors are far less likely to vote than institutional investors), and the intermediated nature of fund ownership (funds often cannot communicate directly with large percentages of their shareholders because of the highly intermediated nature of fund ownership and the Commission's objecting beneficial owner (OBO) rules).

In addition, when funds seek shareholder approval for certain matters, such as fundamental policy changes or approvals of new investment advisory agreements, the Investment Company Act of 1940 has an onerous shareholder approval requirement. It provides that funds must achieve: (i) a minimum quorum of greater than 50 percent and the affirmative vote of at least 67 percent of shares present; or (ii) more than 50 per centum of the outstanding voting securities of such company. These "majority vote" approval standards typically far exceed what state law or funds' organizational documents generally require.

Finally, the Commission-required disclosure in fund proxy statements makes them very lengthy and dissuades shareholders from reading them, while also making them very expensive to produce and disseminate.

We surveyed our fund members in 2018 to quantify the effect of these requirements and found that: (i) five proxy campaigns exceeded $10 million, with the largest exceeding $100 million; (ii) 37 percent of respondents adjourned a meeting at least once for lack of quorum; and (iii) 93 percent hired a proxy solicitation firm to assist with achieving quorums and approvals.

Funds as Investors. The Commission's proxy rules and proxy-related guidance also affect funds as institutional investors. Many funds use proxy advisory firms' administrative and research services, and, therefore, any new requirements imposed on proxy advisory firm also could affect funds and potentially increase fund shareholder costs.

ICI's Recommendations:

- Reduce quorum requirements to facilitate funds' ability to reach the 1940 Act's "majority vote" standard.
- Permit funds to change certain fundamental policies with board approval and advance shareholder notice.
- Revise proxy disclosure requirements to permit greater use of layering and linking.

- Permit funds to deliver proxy materials to, and communicate with, their beneficial shareholders directly.
- Consider the financial impact on fund shareholders of imposing additional obligations on proxy advisory firms.

Additional ICI Materials:

ICI has addressed "funds as issuers" proxy matters in the following letter:

- Letter from Paul Schott Stevens, President and CEO, ICI, to Vanessa Countryman, Secretary, SEC, dated June 11, 2019, available at: www.sec.gov/comments/4-725/4725-5658296-185774.pdf.

ICI has addressed "funds as investors" proxy matters in the following materials:

- Letter from Paul Schott Stevens, President and CEO, ICI, to Vanessa Countryman, Acting Secretary, SEC, dated March 15, 2019, available at www.sec.gov/comments/4-725/4725-5124158-183336.pdf.

- Letter from Paul Schott Stevens, President and CEO, ICI, to Brent J. Fields, Secretary, SEC, dated November 14, 2018, available at www.sec.gov/comments/4-725/4725-4702049-176465.pdf.

- *Proxy Voting by Registered Investment Companies, 2017*, ICI Research Perspective (July 2019), available at www.sec.gov/comments/4-725/4725-5948672-189130.pdf.

- *Trends in Proxy Voting by Registered Investment Companies, 2007–2009*, ICI Research Perspective (Nov. 2010), available at www.sec.gov/comments/4-725/4725-5948677-189131.pdf.

Modernize Variable Insurance Product Summary Prospectuses

Background:

ICI members include mutual funds that serve as the investments underlying variable insurance products. These funds are an essential part of variable insurance products as the funds' performance affects the value of the insurance products.

Prospectuses for variable insurance products are long, technical documents that many investors have difficulty digesting. Reducing key information to a plain-English summary prospectus would enhance an investor's understanding of these products.

The Commission proposed permitting variable insurance product issuers to use a summary prospectus. The Commission also proposed permitting an optional online delivery method for underlying fund prospectuses.

ICI's Recommendation:

We support the Commission's proposal. Simplified disclosure requirements will promote the ability of investors to make more informed investment decisions. Allowing investors to choose how they access information would benefit retail investors and our environment.

Additional ICI Materials:

- Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated February 15, 2019, available at https://www.sec.gov/comments/s7-23-18/s72318-4940428-178488.pdf

Ensure that the SEC Actively Promotes a Strong Capital Markets Perspective in its Engagements with the FSOC and the FSB

Background: As major participants in US and global financial markets, ICI members support appropriate regulation to ensure the resiliency and vibrancy of those markets. For the same reason, ICI and its members have supported efforts to improve regulators' capability to monitor and mitigate excessive risk taking across the financial system—including through the establishment of the US Financial Stability Oversight Council, which brings together diverse perspectives and expertise from across the spectrum of financial services to consider emerging risks.

Over the years, ICI has been deeply concerned with the way in which asset management generally, and regulated funds in particular, have been viewed not only by FSOC but also by the global Financial Stability Board. The membership of both bodies is weighted toward central bankers, and early work by FSOC and the FSB on asset management was firmly rooted in concerns with "distress" and "disorderly failure" derived from the experience of banks. ICI and its members were particularly alarmed that the FSOC would hold open the possibility of, and the FSB would actively pursue, the potential designation of individual regulated funds and their managers as systemically important and in need of prudential regulation and supervision.

Some helpful developments have occurred, giving us reason to expect more thoughtful and constructive policymaking from these bodies. Both FSOC and the FSB have correctly recognized that activities-based regulation is the appropriate way to address any potential risks to financial stability in asset management. Indeed, FSOC has proposed to take an activities-based approach more generally and only use its designation authority as a tool of last resort—an approach that will elevate the role of the SEC and other primary regulators with frontline expertise. On the global front, the FSB has given greater responsibility over asset management-related policy to the International Organization of Securities Commissions and, under Chairman Randal Quarles, is placing greater emphasis on empirical analysis and engagement with stakeholders.

Nevertheless, there is still cause for concern. Attention to asset management will continue, given its size and importance to the financial system in the United States and globally. With this comes the prospect of central bankers viewing an asset management issue with their banking expertise and experience in mind—in particular, the "safety and soundness" goals of bank regulation, the inherent riskiness of the highly-leveraged bank model and its propensity for "runs," the significant problems that banks experienced during the global financial crisis, the unprecedented level of government intervention needed to

safeguard the banking system, and the various regulatory tools that have been employed to strengthen individual banks and the overall banking sector. Some global policy bodies that are also FSB members—including in particular the International Monetary Fund, Bank for International Settlements, and the Basel Committee on Banking Supervision—continue to posit scenarios involving mass redemptions by open-end funds that will lead to destabilizing "fire sales" of assets. ICI continues to push back against misinformed narratives about financial stability risks posed by regulated funds and to educate policymakers about the strong regulation and actual experience of regulated funds.

ICI's Recommendation: We recommend that the Commission and its staff—both directly and through IOSCO—continue to be deeply engaged in the work of FSOC and the FSB. It is vitally important that the Commission's expertise with respect to the capital markets, asset management, and regulated funds be shared within these important policymaking forums. We ask that the Commission and its staff actively promote a strong capital markets perspective in policy discussions as appropriate to foster sound policy outcomes. A related suggestion is to consider seconding Commission staff to the FSB.

Additional ICI Materials:

- Letter from Paul Schott Stevens, President & CEO, ICI, to FSOC, dated May 13, 2019, at https://www.ici.org/pdf/19_ltr_fsoc.pdf (commenting on FSOC's proposed interpretive guidance).

- Testimony of Paul Schott Stevens, President & CEO, ICI, Before the Committee on Financial Services, United States House of Representatives, on The Financial Stability Board's Implications for US Growth and Competitiveness (Sept. 23, 2016), at https://www.ici.org/pdf/16_house_fsc_fsb.pdf.

Defer Collection of CAT Data Until SEC Implements Adequate Information Security Protections

Background: The consolidated audit trail (CAT) will contain a vast amount of order and trade information for US exchange-listed equities and options. ICI supports the Commission's efforts to develop a comprehensive record of activity in the equity and options markets, but we urge the Commission to ensure there are adequate protections for CAT data.

The CAT will contain information concerning the positions and trading strategy for all registered funds and other entities that hold or trade exchange-listed equities or options. This information will be reported to the CAT on a T+1 basis, and trades will be linked with account information. As a result, CAT users will know, for example, the identity of a registered fund that makes a stock trade.

This customer-level trade information will make the CAT a trove of sensitive market data with enormous commercial value that will attract the attention of cyber criminals. A breach of CAT data could expose thousands of funds to predatory trading practices, harm fund shareholders, cause great reputational damage to the Commission, and damage confidence in the capital markets.

Protecting this critical information is of paramount importance.

ICI's Recommendation: The Commission must ensure that CAT data will be appropriately protected. The Commission should require the plan processor—a FINRA subsidiary that will receive and store all CAT data—and all third parties with access to CAT data establish rigorous information security measures. The Commission should not allow the CAT to accept additional data until it is fully satisfied with the CAT's information security program.

The Commission should pay close attention to the four key areas set forth below and encourage the CAT operating committee and plan processor to collaborate with chief information security officers from the buyside and other industry participants, as appropriate, to design a sufficient information security program.

- **Breach notification.** The Commission should require the plan processor to notify market participants of cyber incidents that compromise their data. Market participants need to know if a cyber incident affects the security of their data and should be informed if there is suspicion that their data may have been used for unauthorized purposes. Only then can they take necessary steps to protect their interests or the interests of their clients. For example, if a mutual fund adviser learns that a cyber incident has exposed details about recent

trade data, the adviser could adjust its trading strategies to attempt to protect future trades from predatory traders that might have material information about the fund's intentions.

- **Relationship between the plan processor and vendors.** The Commission should ensure that the FINRA subsidiary that will operate the CAT conducts a continuous independent review of its own information security controls. The FINRA subsidiary similarly should review the controls of any critical third-party vendors, including, potentially, FINRA. An independent continuous audit is a standard practice for assessing and monitoring the proper function of critical security controls.
- **Key threats to CAT data.** The Commission should ensure that the plan processor has considered all relevant threat scenarios, including threats of attacks against privileged individuals or threats of misuse of CAT data for frontrunning or competitive purposes.
- **Data extraction.** CAT data should remain in the CAT. If the Commission intends to permit self-regulatory organizations to extract data from the CAT, it should ensure that the plan processor has adopted appropriate access controls and limits on data extraction, tagging protocols for extracted data, monitoring/auditing of extractions, data lineage tracking, data leakage prevention measures, remote/interconnected systems approval, disposition of extracted data over time, and incident response for extracted data sets.

Additional ICI Materials:

- Letter from David W. Blass, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated July 18, 2016, available at https://www.sec.gov/comments/4-698/4698-8.pdf