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October 29, 2020

Via Electronic Mail (rule-comments@sec.gov)

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

Re: File No. SR-FINRA-2020-024; Response to Comments

Dear Ms. Countryman:

On August 14, 2020, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission (the "SEC") proposed rule change SR-FINRA-2020-024, which proposes to eliminate the Order Audit Trail System ("OATS") rules in the FINRA Rule 7400 Series and FINRA Rule 4554 (Alternative Trading Systems — Recording and Reporting Requirements of Order and Execution Information for NMS Stocks) once members are effectively reporting to the consolidated audit trail ("CAT") and the CAT's accuracy and reliability meet certain standards (the "original filing").

FINRA is proposing that, before OATS could be retired, the CAT would generally need to achieve a sustained error rate for Industry Member reporting in five enumerated categories for a period of at least 180 days of 5% or lower on a pre-correction basis, and 2% or lower on a post-correction basis (measured at T+5). In addition to the maximum error rates and matching thresholds, FINRA's use of CAT Data must confirm that (i) there are no material issues that have not been corrected, (ii) the CAT includes all data necessary to allow FINRA to continue to meet its surveillance obligations and (iii) the Plan Processor is sufficiently meeting its obligations under the CAT NMS Plan relating to the reporting and linkage of Phase 2a Industry Member Data. FINRA's review of CAT data and error rates will be based on phase 2a data and linkages, which replicate the data in OATS today and thus are most relevant for OATS retirement purposes.

On September 1, 2020, the SEC published the proposed rule change for comment in the Federal Register.[1] The comment period closed on September 22, 2020. The SEC received three comment letters in response to the Federal Register publication.[2]

Overall, the commenters express support for the proposal to retire OATS and generally agree with the proposed metrics based on error rates. The commenters raise issues primarily relating to timing and transparency and request clarification on several aspects of the proposal. FINRA's responses to the issues raised by the commenters are below.

Timing of OATS Retirement

All three commenters note the need for the "urgent decommissioning of OATS"[3] and for the retirement of OATS in "an efficient and timely manner"[4] and on an "expedited basis"[5] to address the current duplication of firm resources. SIFMA concurs that OATS should be retired in 2021, while FIF comments more specifically on timing, noting its belief that OATS could be retired prior to the commencement of phase 2c reporting on April 26, 2021. In addition, FIF requests clarification as to the earliest date for commencement of the 180-day period and suggests that the period could commence prior to October 26, 2020, because all of the linkage validations are running in production as of September 28, 2020.

FINRA understands the significant technology costs and resources firms have dedicated and continue to dedicate to OATS, including, e.g., relating to system infrastructure, security and maintenance, and regulatory and compliance personnel, as outlined more fully in Refinitiv's letter. As such, FINRA is committed to retiring OATS as efficiently and expeditiously as possible. In that regard, FINRA is fully aligned with the commenters. FINRA notes that the inclusion of OTC Equity Securities in the initial phase of the CAT

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1 See Securities Exchange Act Release No. 89679 (August 26, 2020), 85 FR 54461 (September 1, 2020) (Notice of Filing of File No. SR-FINRA-2020-024).

2 See Letter from William J. Leahey, Head of Regulatory Compliance, Refinitiv Wealth Management, to Vanessa Countryman, Secretary, SEC, dated September 22, 2020 ("Refinitiv"); Letter from Howard Meyerson, Managing Director, Financial Information Forum, to Vanessa Countryman, Secretary, SEC, dated September 22, 2020 ("FIF"); and Letter from Ellen Greene, Managing Director, SIFMA, to Vanessa Countryman, Secretary, SEC, dated September 24, 2020 ("SIFMA").

3 Refinitiv.

4 SIFMA.

5 FIF.

was designed to facilitate the retirement of OATS and reduce costs to the industry.[6] Similarly, the revised Industry Member reporting timeline also was designed, in part, to accelerate the retirement of OATS. The requirement that all firms that report to OATS begin CAT reporting on June 22, 2020 allows the OATS system to be retired up to a year earlier, saving firms the costs of maintaining duplicate reporting systems.

With respect to the 180-day period for evaluating the applicable error rates, FINRA does not believe it would be appropriate for the period to commence as of September 28, 2020. Although the production environment for inter-firm linkage and exchange/TRF/ORF match validations is open for testing as of that date, the compliance date, i.e., the date firms are required to correct all errors for such linkages, is October 26, 2020. FINRA does not believe it would be appropriate to begin evaluating the applicable error rates until firms are required to correct all errors. As such, the earliest date for commencement of the 180-day period is the compliance date for all linkages.

As noted in the original filing, OATS will not be retired prior to commencement of phase 2c reporting on April 26, 2021. However, as further noted in the original filing, FINRA will not take phase 2c error rates into account in determining whether the proposed standards for the retirement of OATS have been met. Although there may be an increase in overall error rates immediately following implementation of the new phase 2c reporting requirements, FINRA does not believe such increase would impact FINRA's ability to assess the accuracy and reliability of phase 2a data. Thus, the timing of OATS retirement will not be negatively impacted by the commencement of phase 2c reporting.

FINRA's Use of CAT Data

All three commenters comment on FINRA's proposal to evaluate and confirm, through incorporation of CAT Data into its automated surveillance program, that the data is accurate and reliable. SIFMA asserts that FINRA should begin this process as soon as possible and requests clarification that FINRA will not wait for industry reporting to achieve the applicable error rates for 180 days before beginning to test its systems. Refinitiv states that the interests of FINRA and the industry are aligned around the goal of FINRA operationalizing CAT Data in its automated surveillances with the confidence necessary for FINRA to decommission OATS; however, this is dependent on factors outside the control of Industry Members. FIF expresses concern about the "open-ended nature" of what they refer to as the "non-error-rate conditions" and asserts that these conditions should not extend the retirement of OATS beyond the 180-day period. FIF also asserts that the "non-error-rate conditions" appear to go beyond the conditions set forth in the CAT NMS Plan, which states, in pertinent part, that:

> it is anticipated that Reporting Members will have to report to both OATS and the Central Repository for some period of time until FINRA can

[6] See CAT NMS Plan, Appendix C, Plan to Eliminate Existing Rules and Systems.

> verify that the data into the Central Repository is of sufficient quality for surveillance purposes and that all reporting requirements meet the established steady state Error Rates set forth in Section A.3(b). Once this is verified, FINRA's goal is to minimize the dual-reporting requirement.[7]

As an initial matter, FINRA believes that the proposed conditions relating to FINRA's use of the CAT Data are entirely consistent with the CAT NMS Plan. The above-quoted provision expressly provides that FINRA must be able to verify that the data is of "sufficient quality for surveillance purposes" (emphasis added).

To make such a determination, and as discussed in the original filing, FINRA must evaluate and confirm through use of the CAT Data that the data is accurate and reliable. Any errors in the CAT Data may manifest themselves only after surveillance patterns and other queries have been run. Thus, while the error rate thresholds may be met over a 180-day period, additional time may be required to reliably establish that usage of the CAT has not revealed material issues that have not been corrected and allow contextual analysis of the data to take place to uncover errors in reporting or processing that may not be apparent from more standardized data validation processes.

FINRA notes that it has already begun the process of transitioning its automated surveillance patterns and testing the CAT Data. Thus, to SIFMA's point, FINRA is not waiting for industry reporting to achieve the applicable error rates for a 180-day period before commencing this process. However, FINRA currently anticipates that this transition, which necessarily includes, among other things, ingestion of all Industry Member and Plan Participant data and linkages in CAT format, will not be complete until the second half of the second quarter of 2021, at the earliest.[8] In that regard, FINRA notes that, as set forth in the Technical Specifications for Plan Participants, equity exchanges will report to CAT via another mechanism until April 2021.[9]

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[7] CAT NMS Plan, Appendix C-102.

[8] As noted in the original filing, the proposed criteria and anticipated timing of OATS retirement are premised on and assume there are no material changes to the current CAT implementation plan, including availability and FINRA's access to CAT Data. Pursuant to amendments to the CAT NMS Plan adopted by the SEC, OATS must be retired by December 31, 2021 for the Plan Participants to meet the Period 3 Financial Accountability Milestone (Full Availability and Regulatory Utilization of Transactional Database Functionality). See CAT NMS Plan, Sections 1.1 and 11.6.

[9] See CAT Reporting Technical Specifications for Plan Participants dated 9/25/2020, available at www.catnmsplan.com/sites/default/files/2020-09/09.25.20-CAT-Reporting-Technical-Specifications-for-Participants-3.2.2_redacted.pdf.

FINRA is reiterating its commitment to retiring OATS as soon as reasonably practicable. However, in addition to retiring OATS in a reasonable timeframe, FINRA also must ensure that it is able to continue to perform its regulatory obligations. The goal of the proposed accuracy and reliability standards is to ensure that the CAT, as the single source of order and trade data, can enable FINRA to conduct accurate and effective market surveillance in accordance with its regulatory obligations.[10]

Transparency and Notice

Two commenters ask that FINRA provide transparency into the process and sufficient notice once the date for the retirement of OATS has been set. Refinitiv requests that FINRA provide transparency relating to its progress in integrating CAT Data into its automated surveillance program and its evaluation for accuracy and reliability. Similarly, FIF requests that FINRA identify and communicate any concerns that FINRA may have about the "non-error-rate conditions" and notify FIF members and other market participants of any determinations relating to these conditions early in the process so that FIF members can plan in advance for the sunsetting of OATS. FIF states that a primary concern is having sufficient advance notice of the OATS retirement date so that firms can plan appropriately.

As an initial matter, FINRA notes the process outlined in the original filing. Once FINRA has determined that the proposed accuracy and reliability standards have been met, FINRA will file for immediate effectiveness a separate rule filing setting forth the basis for its determination and will publish a Regulatory Notice announcing the implementation date of the proposed rule change. FINRA is committed to doing so as far in advance as practicable in order to provide firms with sufficient notice and opportunity to prepare for the retirement of OATS.

In addition, FINRA will provide as much transparency into the process as possible, including, to the extent practicable, providing updates and addressing issues relating to OATS retirement in the course of FINRA's communications with firms. FINRA CAT also provides regular updates to Industry Members regarding CAT implementation and compliance, including statistics on error rates, for example, during FINRA CAT's Weekly Industry Testing Checkpoint and Monthly Implementation calls. Materials for those events

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10 As also discussed in the original filing, OATS was originally proposed to fulfill one of the undertakings in the SEC's order relating to the settlement of an enforcement action against FINRA's predecessor NASD for failure to adequately enforce its rules. FINRA believes that it will continue to be in compliance with the requirements of the SEC's order after retiring OATS, but CAT must prove itself to be a reliable substitute for OATS, and FINRA cannot transition from OATS to CAT until its surveillance program is fully prepared for such transition.

are available on the CAT NMS Plan website.[11] Going forward, FINRA believes that the statistics provided by FINRA CAT will serve as a good proxy for progress toward achieving the requisite error rates for purposes of OATS retirement.

Representative Order Linkages

Two commenters disagree with FINRA's proposal to include phase 2a representative order linkages,[12] which are not required in OATS today, as a threshold for retiring OATS. SIFMA asserts that OATS should be retired immediately once the CAT data replicates the data in OATS today. Refinitiv similarly argues that FINRA should narrowly tailor the evaluation of CAT Data for the purpose of decommissioning OATS to replicating the data quality of OATS.

As discussed in the original filing, linkages for more complex representative order scenarios, such as those involving agency average price trades, net trades and aggregated orders, will not be required until phase 2c. Accordingly, FINRA does not anticipate that the error rates for the "simple" phase 2a representative order linkages in CAT would be significantly higher than the order linkages available in OATS today. Based on available Industry Member reporting statistics, the error rates for intra-firm linkages, in which issues with phase 2a representative order linkages would manifest themselves, appear to be favorable to date.[13] Thus, FINRA continues to believe that the phase 2a representative order linkages should not significantly impact linkage error rates for OATS retirement purposes.

However, as noted in the original filing, in evaluating whether the standards for OATS retirement have been met, FINRA will take into consideration if the error rates for the phase 2a representative order linkages have a significant negative impact on the overall error rates for order linkages. Thus, for example, if the intra-firm linkage error rate deteriorates from current levels and is above 5% over the relevant period, FINRA would evaluate whether the error rate is the result of unlinked representative orders to create an

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11 See www.catnmsplan.com/events.

12 As discussed in the original filing, in phase 2a, linkage is required between the representative street side order and the order being represented when the representative order was originated specifically to represent a single order (received either from a customer or another broker-dealer) and there is: 1) an existing direct electronic link in the firm's system between the order being represented and the representative order, and 2) any resulting executions are immediately and automatically applied to the represented order in the firm's system.

13 See e.g., CAT Monthly Implementation Update dated October 15, 2020, available at www.catnmsplan.com/sites/default/files/2020-10/10.15.20-Monthly-CAT-Implementation-Update.pdf.

apples-to-apples comparison to OATS. If all other proposed criteria have been met, FINRA does not anticipate delaying OATS retirement based on phase 2a representative order linkage error rates alone.

Clarification Relating to Calculation of Error Rates

FIF requests clarification on several specific points relating to the calculation of error rates under the proposed rule change.

First, FIF requests clarification on whether each error-rate category will be evaluated separately or whether all error-rate categories will be evaluated in the aggregate. FIF also asserts that pursuant to the original filing, the required pre-correction rates could be met in each category, while the aggregate pre-correction error rate could potentially exceed 5%. In response, FINRA first is clarifying that the error rates will be evaluated separately for each identified category: (1) rejection rates/data validations, (2) intra-firm linkages, (3) inter-firm linkages, (4) order linkage rates and (5) exchange and TRF/ORF match rates. Thus, FINRA would expect to see a 5% pre-correction and 2% post-correction error rate (aggregated across all firms) in each of these categories over a sustained period of 180 days. Each category represents a key component of FINRA's audit trail and a higher rate in any one of the categories could result in a significant deterioration in the audit trail data available to FINRA to conduct its surveillance. As discussed in the original filing, the proposed error rates are higher than current OATS rates. However, while FINRA believes it is appropriate to retire OATS at the proposed rates, FINRA does not believe that it would be appropriate to allow higher error rates in any one category, even if the overall error rate is at or below the proposed maximum error rate. To do so could result in data that is not reliable enough for FINRA to shift its surveillance from OATS to CAT. Additionally, FINRA notes that pursuant to the original filing, there must be at least a 95% pre-correction and 98% post-correction rate for order linkages that are required in phase 2a.[14] This category essentially combines all of the order-related linkages to capture an overall snapshot of order linkages in the CAT. As such, FINRA believes that it would be unlikely that each of the other categories could achieve the proposed threshold, while this overall category does not.

Second, FIF requests confirmation that FINRA will not consider phase 2c validations in determining compliance with the proposed error rate thresholds. As stated in the original filing and above, FINRA plans to retire OATS based on phase 2a reporting because phase 2a data and linkages replicate what is in OATS today. Since the data and linkages that are

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[14] For example, the original filing states: "In addition to creating linkages within and between broker-dealers, the Plan also includes requirements that the Plan Processor be able to create lifecycles to link various pieces of related orders." See 85 FR 54461, 54464.

not required to be reported until phase 2c are not in OATS today, FINRA will not consider phase 2c validations for purposes of OATS retirement.

Third, FIF requests confirmation that a "named" mismatch in the CAT Reporter Portal would not count as an error, as it would result in the double-counting of errors (since both counterparties receive error feedback). FINRA is clarifying that in instances where a single event, such as a named mismatch, generates two errors, e.g., against both the sending and receiving Industry Member, the error would be counted only once for purposes of the error rate calculations.

Fourth, FIF asserts that certain "false errors," such as unlinked errors where an IPO symbol is not on the Reportable Securities List at the time of the parent event, should not count as errors for purposes of the error-rate thresholds. FINRA believes that these are edge cases that likely will not impact the overall error rates. However, FINRA will take into consideration if it appears that they are having a negative impact on error rates. FINRA does not anticipate delaying the retirement of OATS based on such edge cases.

Finally, FIF requests that FINRA take into consideration a macro event, such as a weather event that impacts market participants overall and clarify that errors or late filings resulting from such a macro event would be excluded in determining compliance with the error rate condition. FINRA will take into consideration if error rates are impacted by a macro event, such as a weather event, that are discrete in nature and not an indicator of fundamental reporting issues; however, such a determination would necessarily depend on the facts and circumstances of any given event.

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FINRA believes that the foregoing responds to the material issues raised by the commenters. If you have any questions, please contact me at [redacted] or [redacted].

Very truly yours,

/s/ Lisa C. Horrigan

Lisa C. Horrigan
Associate General Counsel