

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90405)

November 12, 2020

Order Granting a Temporary Conditional Exemption Pursuant to Section 36 of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 608(e) of Regulation NMS Under the Exchange Act, Relating to the Reporting of Certain Activities on the Floor of National Securities Exchanges and Certain Activities by Industry Members Off Exchange Floors, as Required by Section 6.4(d) of the National Market System Plan Governing the Consolidated Audit Trail

I. Introduction

By letter dated July 1, 2020, BOX Exchange LLC (“BOX”), Cboe BYX Exchange, Inc., Cboe BZX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., Cboe C2 Exchange, Inc., Cboe Exchange, Inc. (“CBOE”), Financial Industry Regulatory Authority, Inc. (“FINRA”), Investors Exchange LLC, Miami International Securities Exchange LLC, MIAX Emerald, LLC, MIAX PEARL, LLC, NASDAQ BX, LLC, Nasdaq GEMX, LLC, Nasdaq ISE, LLC, Nasdaq MRX, LLC, NASDAQ PHLX LLC (“PHLX”), The NASDAQ Stock Market LLC, New York Stock Exchange LLC (“NYSE”), NYSE American LLC (“NYSE American”), NYSE Arca, Inc. (“NYSE Arca”), NYSE Chicago, Inc., NYSE National, Inc., and Long Term Stock Exchange, Inc. (collectively, the “Participants” or “SROs”) requested that the Securities and Exchange Commission (“Commission” or “SEC”) grant temporary exemptive relief to the Participants from the National Market System Plan Governing the Consolidated Audit Trail (“CAT NMS Plan”),¹ pursuant to its authority under Section 36 of the Securities Exchange Act of 1934 (“Exchange Act”)² and Rule 608(e) of Regulation NMS under the Exchange Act, from

¹ The CAT NMS Plan was approved by the Commission, as modified, on November 15, 2016. See Securities Exchange Act Release No. 79318 (November 15, 2016), 81 FR 84696 (November 23, 2016) (“CAT NMS Plan Approval Order”).

² 15 U.S.C. 78mm(a)(1).

certain reporting requirements in Section 6.4(d) of the CAT NMS Plan relating to certain activities on the floors of national securities exchanges and certain activities by Industry Members off exchange floors.³

Section 36 of the Exchange Act grants the Commission the authority, with certain limitations, to “conditionally or unconditionally exempt any person, security, or transaction . . . from any provision or provisions of [the Exchange Act] or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.”⁴ Under Rule 608(e) of Regulation NMS, the Commission may “exempt from [Rule 608], either unconditionally or on specified terms and conditions, any self-regulatory organization, member thereof, or specified security, if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanism of, a national market system.”⁵

For the reasons set forth below, this Order grants the Participants’ request for a temporary exemption from Section 6.4(d) of the CAT NMS Plan as set forth in the July 1, 2020 Exemption Request, expiring on July 31, 2023.

II. Request for Relief

³ See letter from the Participants to Vanessa Countryman, Secretary, Commission, dated July 1, 2020 (the “July 1, 2020 Exemption Request”). Unless otherwise noted, capitalized terms are used as defined in the CAT NMS Plan. MEMX LLC was added as a Participant to the CAT NMS Plan on June 5, 2020. See Securities Exchange Act Release No. 89306 (July 13, 2020), 85 FR 43626 (July 17, 2020).

⁴ 15 U.S.C. 78mm(a)(1).

⁵ 17 CFR 242.608(e).

In the July 1, 2020 Exemption Request, the Participants request that the Commission exempt each Participant from the requirement in Section 6.4(d) of the CAT NMS Plan that each Participant, through its Compliance Rule, require its Industry Members to record and electronically report to the Central Repository: (1) floor broker verbal announcements of firm bids and offers on an exchange trading floor that are otherwise reported as systematized orders; and (2) market maker verbal announcements of firm quotes on an exchange trading floor, to the extent either are considered orders reportable under Rule 613 of Regulation NMS, the CAT NMS Plan and the Compliance Rules, until July 31, 2023. As a condition to this exemptive relief, the Participants state that they would continue to require that firm verbal interest on an exchange floor (which includes both floor broker verbal announcements of firm bids and offers and market maker verbal announcements of firm quotes) be expressed pursuant to exchange rules approved by the Commission,⁶ and that any such firm verbal interest expressed by a floor broker must be related to a CAT-reportable systematized order, and any resulting trade must be reported to CAT.

In addition, the Participants request that the Commission exempt each Participant from the requirement in Section 6.4(d) of the CAT NMS Plan that each Participant, through its Compliance Rule, require its Industry Members to record and electronically report to the Central Repository the following communications that occur “upstairs,”⁷ to the extent such are

⁶ Exchanges with floors currently have rules that govern the operation of the trading floor, from original receipt and systematization of an order by a floor broker to execution, including rules describing how verbal interest on an exchange floor is to be communicated. See, e.g., July 1, 2020 Exemption Request, Exhibit A (describing the process for relevant exchanges).

⁷ “Upstairs” is a term used to describe the off-exchange market. For example, trading that occurs within a broker-dealer firm or between two broker-dealers in the over-the-counter market would be described as occurring “upstairs.”

considered reportable under Rule 613 of Regulation NMS, the CAT NMS Plan and the Compliance Rules, until July 31, 2023: (1) telephone discussions between an Industry Member and a client that may involve firm bid and offer communications; and (2) unstructured electronic and verbal communications that are not currently captured by Industry Member order management or execution systems (e.g., Bloomberg chats, text messages).

A. Exchange Floor Activity

The Participants state that on all exchanges with floor trading,⁸ each order must be systematized upon receipt by the floor broker on the floor of the exchange.⁹ The Participants further state that an order is considered systematized: (1) when it is sent electronically to the floor broker's system at the exchange; or (2) when the order is manually systematized by the floor broker upon receipt outside of the floor broker's system and prior to representation in the floor trading crowd.¹⁰ To the extent a floor broker is not holding a systematized order, the floor broker is not eligible to represent any firm bid or offer, or to request firm quotes from in-crowd market participants on the floor of an exchange.¹¹ The Participants state that all firm bids or offers represented by a floor broker must be associated with orders that have already been systematized, and that any activity by the floor broker prior to systemization cannot be related to an order, bid or offer pursuant to the CAT NMS Plan.¹² As a result of the systematization

⁸ Currently, these exchanges are NYSE, NYSE American, NYSE Arca, CBOE, PHLX and BOX.

⁹ See July 1, 2020 Exemption Request, supra note 3, at 3.

¹⁰ See id. at 3.

¹¹ See July 1, 2020 Exemption Request, supra note 3, at 3. See also NYSE Rule 7.35B, NYSE Arca Rule 6.67-O, NYSE American Rule 955NY and Cboe Rule 5.91(a)(4).

¹² See July 1, 2020 Exemption Request, supra note 3, at 3. See also NYSE Rule 7.35B, NYSE Arca Rule 6.67-O, NYSE American Rule 955NY and Cboe Rule 5.91(a)(4).

requirements, all orders represented verbally by a floor broker on an exchange floor are required to be captured in exchange systems and, under CAT requirements, the floor broker's receipt of the order, and any modification, electronic route, cancellation, or execution of the order is subject to CAT reporting.¹³ The Participants believe that two verbal events on exchange floors may be CAT-reportable: floor broker announcements of firm orders and market maker announcements of firm quotes.

The Participants state that that reporting of either of these two verbal events were not contemplated when the Commission and the Participants were considering the cost and impact of the CAT NMS Plan.¹⁴ The Participants further state that requiring these elements to be reported to CAT would have a significant and costly impact to exchange floors, to floor broker and market maker business models, and to market structure; and the data being captured would provide minimal added regulatory benefit, likely not justified by the costs that would be required to create systems to capture the activity.¹⁵

The Participants explain that floor brokers and floor market makers will ultimately be required to expend significant effort and funds to provide the data necessary to report verbal orders and quotes to CAT.¹⁶ The Participants state that if verbal floor activity were required to be reported to CAT, Industry Members operating on exchange floors would need to create a process or system to electronically record in real time the firm data being verbally communicated

¹³ See July 1, 2020 Exemption Request, supra note 3, at 3.

¹⁴ See id. at 6-7.

¹⁵ See id. at 6.

¹⁶ See id. at 6.

on exchange floors and to merge that data into the information tracked electronically.¹⁷ The Participants state that neither the exchanges with floors nor Industry Members currently collect or have the means to collect the data for verbal activity on the floor for purposes for CAT reporting and the measures necessary to put such systems in place would significantly disrupt floor trading.¹⁸ The Participants further state that requiring such reporting would likely cause market makers to miss participation in fast-changing markets, and no similar burden would be borne by electronic market makers, whose data collection for CAT reporting will not impact their real-time ability to provide liquidity to the market.¹⁹

B. Unstructured Verbal and Electronic Activity

The Participants believe that much unstructured verbal and electronic activity by Industry Members does not involve firm orders and is thus not subject to CAT reporting.²⁰ However, the Participants believe that two types of verbal and unstructured electronic upstairs activity may involve firm orders that would be subject to CAT reporting: (1) verbal telephone discussions between an Industry Member and a client and (2) unstructured electronic communications that are not currently captured by Industry Member order management or execution systems.

The Participants state that telephonic discussions and unstructured electronic upstairs activities were not contemplated as being CAT reportable at the time the Commission adopted Rule 613 of Regulation NMS and the CAT NMS Plan.²¹ The Participants state that the industry

¹⁷ See id. at 9.

¹⁸ See July 1, 2020 Exemption Request, supra note 3, at 6.

¹⁹ See id. at 8.

²⁰ See id. at 9.

²¹ See id. at 9-10.

has provided the Participants with cost projections for capturing and reporting upstairs negotiations, which are estimated to be approximately \$485 million to \$590 million.²² The Participants further state that these cost projections recognize that Industry Members do not currently collect data for these scenarios, and do not have the means today to collect such data. The Participants also explain that there is uncertainty whether necessary information can be captured with today's technology or personnel in a reliable, accurate and consistent manner.²³ The Participants do not believe this information will add much value to the data available in CAT and any minimal added regulatory benefit would be outweighed by costs imposed on, and adverse impact on, Industry Members.²⁴

The Participants state that the changes required to capture and report verbal and unstructured electronic upstairs activity would cause significant and adverse changes to existing industry practices and business models, which would conflict with one of the underlying principles of the CAT.²⁵ The Participants also state that reporting of this activity may also slow trading processes at certain broker-dealers, and/or may increase the time to initiate a trade, causing clients potentially to receive less advantageous pricing for investors.²⁶ The Participants also believe that if required to be reported, Industry Members may modify their workflows to rely more heavily on indications of interest or similar methods outside the definition of an order,

²² See id. at 10.

²³ See July 1, 2020 Exemption Request, supra note 3, at 10. The Commission understands that this estimation is based on industry cost projections and assumes significant manual intervention is necessary to capture this information.

²⁴ See id.

²⁵ See id.

²⁶ See id.

thereby avoiding CAT reporting requirements for that activity, which could have a negative impact on the price discovery process as well as existing workflows.²⁷

The Participants also state that identifying and reporting of verbal or unstructured electronic communications is difficult and given the subjective nature of determining whether or not a bid or offer is firm, CAT reporting of such communications will be variable and inconsistent.²⁸ The Participants state that Industry Members and different individuals could reach different conclusions about whether or not specific verbal or unstructured electronic communications meet the elements of a CAT Reportable Event and Industry Members on opposite sides of a bid/offer may capture the same activity differently, resulting in a misleading view of the transaction.²⁹

III. Discussion of Participants' Exemption Request

The Commission has carefully considered the information provided by the Participants in support of the Participants' exemption request. The Commission believes that granting temporary exemptive relief is, pursuant to Section 36 of the Exchange Act, appropriate in the public interest and consistent with the protection of investors, and that pursuant to Rule 608(e), this exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of a national market system.

Rule 613(j)(9) of Regulation NMS and Section 1.1 of the CAT NMS Plan defines the term "reportable event" as including, but not limited to, the original receipt or origination,

²⁷ See id.

²⁸ See July 1, 2020 Exemption Request, supra note 3, at 10.

²⁹ See id. at 10.

modification, cancellation, routing, and execution (in whole or in part) of an order, and receipt of a routed order.³⁰ The term “order” is defined in Rule 613(j)(8) of Regulation NMS and Section 1.1 of the CAT NMS Plan as including: (i) any order received by a member of a national securities exchange or national securities association from any person; (ii) any order originated by a member of a national securities exchange or national securities association; or (iii) any bid or offer.³¹ “Bid” and “offer” are defined in Regulation NMS as the bid price or offer price communicated by a member of an exchange or association to any broker-dealer or to any customer, at which it is willing to buy or sell one or more round lots of an NMS security, as principal or agent, but excluding indications of interest.³²

Rule 613 and the CAT NMS Plan both require the capture and reporting of quotes and orders that meet the definition of a CAT reportable event, which includes verbal quotes and orders. The Commission believes that many unstructured verbal or manual communications on exchange floors and “upstairs” are reportable events under Rule 613 and the CAT NMS Plan because firm verbal quotes and orders, whether they occur on an exchange floor or “upstairs,” are reportable to CAT if they are a firm bid or offer. As the Participants note, firm indications of a willingness to buy or sell a security are orders, bids, or offers and have reportable events associated with them pursuant to the CAT NMS Plan.³³ However, indications of interest and other verbal negotiations that do not constitute firm quotes or orders are not reportable to CAT, and many unstructured verbal or manual communications on exchange floors and “upstairs” are not reportable to CAT because they are not firm.

³⁰ See 17 CFR 242.613(j)(9).

³¹ See 17 CFR 242.613(j)(8).

³² See 17 CFR 242.600(b)(8).

³³ See July 1, 2020 Exemption Request, supra note 3, at 3.

The Commission disagrees with the Participants' statement that the verbal announcement of already systematized and reported orders and of firm quotes on exchange floors, firm bid and offer communications in verbal telephone discussions between an Industry Member and a client, and firm orders in unstructured electronic communications that are not currently captured by Industry Member order management or execution systems were not contemplated as being CAT-reportable at the time the Commission adopted Rule 613 and the approval of the CAT NMS Plan. Verbal quotes and orders are a subset of "Manual Order Events," which, as defined by the CAT NMS Plan, are non-electronic communications of order-related information for which CAT Reporters must record and report the time of the event.³⁴ Prior to approval of the CAT NMS Plan, the Participants requested and were granted exemptive relief from the requirement in Rule 613(d)(3) of Regulation NMS that, for Manual Order Events, each CAT Reporter record and report details for reportable events in timestamps to the millisecond.³⁵ In support of the request, the SROs listed examples illustrating reportable events involving the non-electronic communication of order-related information for which CAT Reporters must record and report the time of the event under Rule 613, and, among other things, noted that "a floor broker at an

³⁴ See CAT NMS Plan at Section 1.1 (defining "Manual Order Events" as "a non-electronic communication of order-related information for which CAT Reporters must record and report the time of the event").

³⁵ See Securities Exchange Act Release No. 77265 (March 1, 2016), 81 FR 11856 (March 7, 2016). The Commission granted exemptive relief conditioned upon (1) Manual Order Events being recorded and reported with granularity to the second; (2) Manual Order Events being identified as such in the CAT; and (3) the Electronic Capture of Manual Order Events being recorded and reported to the millisecond. Manual Order Events are defined in the CAT NMS Plan as a non-electronic communication of order-related information for which CAT Reporters must record and report the time of the event.

exchange that represents an order on the floor of the exchange may have to capture the time stamp of order events manually.”³⁶

The Participants state that capturing this verbal activity would be costly, and provide minimal added regulatory benefit likely not justified by the costs. In particular, as noted above, Industry Members have provided Participants with cost projections for capturing and reporting upstairs negotiations, which are estimated to be approximately \$485M to \$590M. The Commission acknowledges the current difficulties of implementing reporting of such events, as described by the Participants in the July 1, 2020 Exemption Request. Currently, the exchanges with floors and Industry Members do not have the means to collect the information necessary for reporting verbal activity on exchange floors or upstairs. At the same time, the Commission believes that the collection of verbal quotes and orders would provide regulatory benefits that do not currently exist today and disagrees with the Participants statement that capturing such data would provide minimal added regulatory benefit.³⁷ Such reporting would help regulators better identify potential violations of securities laws, regulations, and exchange rules, including violations of best execution obligations, firm bid/offer obligations and exchange priority rules. For example, the reporting of firm verbal quotes from floor market makers would allow regulators to determine whether a market maker has “backed away” from a firm quote.

³⁶ See letter from BATS Exchange, Inc., BATS Y-Exchange, Inc., BOX Options Exchange LLC, C2 Options Exchange, Inc., Chicago Board Options Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., International Securities Exchange, LLC, ISE Gemini, LLC, Miami International Securities Exchange LLC, The Nasdaq Stock Market LLC, Nasdaq OMX BX, Inc., Nasdaq OMX PHLX LLC, National Stock Exchange, Inc., NYSE Arca, Inc., New York Stock Exchange LLC, and NYSE MKT LLC to Brent J. Fields, Secretary, Commission, dated January 30, 2015, at 33, [available at: https://www.sec.gov/rules/exorders/2016/finra-incoming-letter-013015.pdf](https://www.sec.gov/rules/exorders/2016/finra-incoming-letter-013015.pdf).

³⁷ See July 1, 2020 Exemption Request, supra note 3, at 6 and 10.

Currently, regulators do not have detailed information relating to most verbal quotes and orders and such information would allow regulators to more capably perform regulatory and surveillance functions, and the Commission does not believe it is appropriate to exclude such quotes and orders from CAT reporting, which often are more complex and/or involve larger-sized orders, particularly on options trading floors and trading floors for proprietary products.

Given the concerns expressed by the Participants, the Commission believes the Participants' request to delay the reporting requirements for verbal quotes and orders is reasonable. While including verbal quotes and orders in the CAT will provide regulatory benefits, the Commission acknowledges that the reporting of such orders and quotes involves complexity and/or costs, especially because capture of this information may require significant manual human intervention. The Commission believes that granting temporary exemptive relief to delay the reporting of verbal quotes and orders could allow Participants and Industry Members time to develop or implement technological changes necessary to capture this information at a lower cost. The Commission further believes that over time, the costs of capturing this CAT reportable information could decline due to technological or business developments, such as through the usage of artificial intelligence or automated processes to capture and report such information, instead of reliance on the manual capture of order information.

Based on the foregoing, pursuant to Section 36 of the Exchange Act, it is appropriate in the public interest and consistent with the protection of investors, and pursuant to Rule 608(e), it is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of a national market system to grant temporary relief for the reporting of: (1) floor broker verbal announcements of firm orders on an exchange that are otherwise reported as systematized orders; (2) market maker

verbal announcements of firm quotes on an exchange trading floor and; (3) telephone discussions between an Industry Member and a client that involve firm bid and offer communications; and (4) unstructured electronic communications that are not currently captured by Industry Member order management or execution systems. Granting temporary exemptive relief until July 31, 2023, which is the date requested by Participants in the July 1, 2020 Exemption Request, and which is approximately one year after the date by which the Participants previously estimated that the CAT would be fully implemented, July 11, 2022,³⁸ would provide CAT Reporters the time to fully consider how to report such events and create the necessary technological and process changes required to capture these required quotes and orders while minimizing potential business disruptions and impacts to existing workflows. As a condition to this relief, the Participants must provide the Commission a written status update on the reporting of these quotes and orders by July 31, 2022, including the estimated costs of reporting these quotes and orders and an implementation plan for the reporting of these quotes and orders.

IV. Conclusion

The Commission believes it is appropriate to grant temporary exemptive relief that exempts each Participant from the requirement in Section 6.4(d) of the CAT NMS Plan for each Participant, through its Compliance Rule, to require its Industry Members to record and electronically report to the Central Repository the following communications, until July 31, 2023: (1) floor broker verbal announcements of firm orders on an exchange that are otherwise reported as systematized orders; (2) market maker verbal announcements of firm quotes on an exchange trading floor; (3) telephone discussions between an Industry Member and a client that

³⁸ See Securities Exchange Act Release No. 88890 (May 15, 2020), 85 FR 31322, 31334 (May 22, 2020).

may involve firm bid and offer communications; and (4) unstructured electronic and verbal communications that are not currently captured by Industry Member order management or execution systems. As a condition to this relief, the Participants must provide the Commission a written status update on the reporting of these quotes and orders by July 31, 2022, including the estimated costs of reporting these quotes and orders and an implementation plan for the reporting of these quotes and orders. Furthermore, as a condition to this exemptive relief, Participants must continue to require that firm verbal interest on an exchange floor be expressed pursuant to exchange rules approved by the Commission and Participants must require that any firm verbal interest expressed by a floor broker must be related to a CAT-reportable systematized order, and any resulting trade must be reported to CAT.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 36(a)(1) of the Exchange Act,³⁹ and Rule 608(e) of the Exchange Act⁴⁰ that the Participants are granted an exemption, until July 31, 2023, from the requirement in Section 6.4(d) of the CAT NMS Plan that requires each Participant, through its Compliance Rule, to require its Industry Members to record and electronically report to the Central Repository: (1) floor broker verbal announcements of firm orders on an exchange that are otherwise reported as systematized orders; (2) market maker verbal announcements of firm quotes on an exchange trading floor; (3) telephone discussions between an Industry Member and a client that may involve firm bid and offer communications;

³⁹ 15 U.S.C. 78mm(a)(1).

⁴⁰ 17 CFR 242.608(e).

(4) unstructured electronic and verbal communications that are not currently captured by Industry Member order management or execution systems (e.g., Bloomberg chats, text messages), subject to the conditions described above.

By the Commission.

J. Matthew DeLesDernier
Assistant Secretary