

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90535; File No. SR-FINRA-2020-024)

November 30, 2020

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1 to Delete the FINRA Order Audit Trail System (OATS)

I. Introduction

On August 14, 2020, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² proposed rule changes to delete the Order Audit Trail System (“OATS”) rules in the FINRA Rule 7400 Series and FINRA Rule 4554 (the “OATS Rules”) once members are effectively reporting to the Consolidated Audit Trail (“CAT”). On September 1, 2020, the proposed rule change was published for comment in the Federal Register.³ On October 8, 2020, the Commission extended the time period for Commission action on the proposed rule change to November 30, 2020.⁴ The Commission received three comment letters on the Notice.⁵ On October 29, 2020, FINRA

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 89679 (August 26, 2020), 85 FR 54461 (the “Notice”).

⁴ See Securities Exchange Act Release No. 90129, 85 FR 65113 (October 14, 2020).

⁵ See Letters from William J. Leahey, Head of Regulatory Compliance, Refinitiv, to Vanessa Countryman, Secretary, Commission, dated September 22, 2020 (“Refinitiv Letter”); Howard Meyerson, Managing Director, Financial Information Forum, to Vanessa Countryman, Secretary, Commission, dated September 22, 2020 (“FIF Letter”); Ellen Greene, Managing Director, Equity & Options Market Structure, to Vanessa Countryman, Secretary, Commission, dated September 24, 2020.

responded to the comment letters,⁶ and filed Amendment No. 1 to the proposed rule change (“Amendment No. 1”). The Commission is publishing this notice to solicit comments on Amendment No. 1 to the proposed rule change from interested parties and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Background

Pursuant to Section 11A of the Exchange Act⁷ and Rule 608 of Regulation NMS thereunder,⁸ FINRA and other self-regulatory organizations filed with the Commission a National Market System Plan Governing the Consolidated Audit Trail (the “CAT NMS Plan” or “Plan”)⁹ to comply with Rule 613 of Regulation NMS under the Exchange Act.¹⁰ The Plan was published for comment in the Federal Register on May 17, 2016,¹¹ and approved by the Commission, as modified, on November 15, 2016.¹² On March 15, 2017, the Commission approved rule change proposals submitted by the by all the national securities exchanges and

⁶ See Letter from Lisa C. Horrigan, Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission, dated October 29, 2020 (“Response Letter”). In Amendment No. 1, FINRA proposes to modify the proposal to provide that it will calculate the match rate in the aggregate across all equity exchanges instead of calculating the equity exchange match rate on a per exchange basis.

⁷ 15 U.S.C. 78k-1.

⁸ 17 CFR 242.608.

⁹ See Letter from Participants to Brent J. Fields, Secretary, Commission, dated February 8, 2016. Prior versions of the CAT NMS Plan were submitted to the Commission on September 30, 2014; February 27, 2015; and December 23, 2015.

¹⁰ 17 CFR 242.613.

¹¹ Securities Exchange Act Release No. 77724 (April 27, 2016), 81 FR 30614 (May 17, 2016).

¹² Securities Exchange Act Release No. 79318 (November 15, 2016), 81 FR 84696 (November 23, 2016) (“CAT Approval Order”).

association that are party to the CAT NMS Plan (“Participants”) that implement provisions of the CAT NMS Plan applicable to their members (the “CAT Compliance Rules”).¹³

The CAT NMS Plan is designed to create, implement, and maintain a consolidated audit trail that will capture in a single consolidated data source customer and order event information for orders in NMS Securities and OTC Equity Securities (together, “CAT-Eligible Securities”), across all markets, from the time of order inception through routing, cancellation, modification, or execution. Section C.9 of Appendix C to the Plan requires each Participant to “file with the SEC the relevant rule change filing to eliminate or modify its duplicative rules within six (6) months of the SEC’s approval of the CAT NMS Plan” and states that “the elimination of such rules and the retirement of such systems [will] be effective at such time as CAT Data meets minimum standards of accuracy and reliability.” FINRA submitted a proposed rule change that was substantively similar to the instant filing on May 15, 2017.¹⁴ FINRA subsequently withdrew the filing on January 12, 2018.¹⁵

Section C.9 of Appendix C to the Plan also requires these rule filings to discuss the following:

(i) specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate should determine when a system duplicative of the CAT can be retired;

¹³ Securities Exchange Act Release Nos. 80255 (March 15, 2017), 82 FR 14563 (March 21, 2017); 80256 (March 15, 2017), 82 FR 14526 (March 21, 2017).

¹⁴ See Securities Exchange Act 80783 (May 26, 2017), 82 FR 25423 (June 1, 2017)(SR-FINRA-2017-13).

¹⁵ See Securities Exchange Act Release No. 82524 (January 17, 2018), 83 FR 3230 (January 23, 2018).

(ii) whether the availability of certain data from Small Industry Members would facilitate a more expeditious retirement of duplicative systems; and

(iii) whether individual Industry Members can be exempted from reporting to duplicative systems once their CAT reporting meets specified accuracy and reliability standards, including, but not limited to, ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.¹⁶

In response to these requirements, FINRA submitted the instant filing (the “Proposal”), which is described below.

III. Description of the Proposed Rule Changes

As required by the CAT NMS Plan, the Proposal discusses: (1) the specific standards that will govern when OATS will be eliminated; (2) whether the availability of data from Small Industry Members would facilitate duplicative systems retirement; and (3) the feasibility of granting exemptions from reporting to duplicative systems to individual Industry Members whose CAT reporting meets certain accuracy and reliability thresholds.

A. Specific Accuracy and Reliability Standards

1. OATS

The OATS rules require certain FINRA members to report a variety of data regarding transactions in OTC equity securities and NMS stocks to OATS on a daily basis.¹⁷ In the proposal, FINRA proposes to delete its OATS rules from its rulebook once CAT Data achieves certain pre- and post-correction error rates and certain qualitative criteria have been met.

¹⁶ See id.

¹⁷ See FINRA Rule 7400.

FINRA stated that it believes that relevant error rates are the primary, but not the sole, metric by which to determine the CAT's accuracy and reliability and will serve as the baseline requirement needed for OATS to be retired.¹⁸ FINRA stated that the Participants established an initial Error Rate, as defined in the Plan, of 5% on initially submitted data (i.e., data as submitted by a CAT Reporter before any required corrections are performed).¹⁹ The Participants based this Error Rate on their consideration of "current and historical OATS Error Rates, the magnitude of new reporting requirements on the CAT Reporters and the fact that many CAT Reporters may have never been obligated to report data to an audit trail."²⁰

In the Proposal, FINRA expressed agreement with the Participants' conclusion that a 5% pre-correction threshold "strikes the balance of adapting to a new reporting regime, while ensuring that the data provided to regulators will be capable of being used to conduct surveillance and market reconstruction, as well as having a sufficient level of accuracy to facilitate the retirement of existing regulatory reports and systems where possible."²¹ However, FINRA believed that, when assessing the accuracy and reliability of the data for the purposes of retiring OATS, the error thresholds should be measured in more granular ways and should also include minimum error rates of post-correction data, which represents the data most likely to be used by FINRA to conduct surveillance. Although FINRA is proposing to measure the appropriate error rates in the aggregate rather than firm-by-firm, FINRA expressed the belief that

¹⁸ See Notice, supra note 3 at 54463.

¹⁹ See CAT NMS Plan, Appendix B, Section A.3(b).

²⁰ See CAT NMS Plan, Appendix C, Section A.3(b).

²¹ Id.

the error rates for equity securities should be measured separately from options since options orders are not currently reported regularly or included in OATS.²²

FINRA also proposes that, before OATS is retired, the CAT would generally need to achieve a sustained error rate for Industry Member reporting in each of the categories below:

- Rejection Rates and Data Validations. FINRA has reviewed the data validations for the CAT, which are set forth in the Industry Member Technical Specifications published by the Plan Processor,²³ and confirmed that they are substantially similar to OATS. While not required to be designed the same as OATS, data validations must be functionally equivalent to OATS in accordance with the CAT NMS Plan (i.e., the same types of basic data validations must be performed by the Plan Processor to comply with the CAT NMS Plan requirements). Appendix D of the Plan, for example, requires that certain file validations²⁴ and syntax and context checks be performed on all submitted records.²⁵ If a

²² See Notice, supra note 3 at 54463

²³ See, e.g., Industry Member Technical Specifications (2a/2b) version 2.2.1 r6, dated June 22, 2020, available at www.catnmsplan.com/sites/default/files/2020-06/CAT_Reporting_Technical_Specifications_for_Industry%20Members_v2.2.1r6_CLEAN.pdf.

²⁴ See CAT NMS Plan, Appendix D, Section 7.2. The Plan requires the Plan Processor to confirm that file transmission and receipt are in the correct formats, including validation of header and trailers on the submitted report, confirmation of a valid SRO-Assigned Market Participant Identifier, and verification of the number of records in the file. Id.

²⁵ See id. The Plan provides that syntax and context checks would include format checks (i.e., that data is entered in the specified format); data type checks (i.e., that the data type of each attribute conforms to the specifications); consistency checks (i.e., that all attributes for a record of a specified type are consistent); range/logic checks (i.e., that each attribute for every record has a value within specified limits and the values provided are associated with the event type they represent); data validity checks (i.e., that each attribute for every record has an acceptable value); completeness checks (i.e., that each mandatory attribute for every record is not null); and timeliness checks (i.e., that the records were submitted within the submission timelines). Id.

record does not pass these basic data validations, it must be rejected and returned to the CAT Reporter to be corrected and resubmitted.²⁶ The Plan also requires the Plan Processor to provide daily statistics on rejection rates after the data has been processed, including the number of files rejected and accepted, the number of order events accepted and rejected, and the number of each type of report rejected.²⁷ FINRA is proposing that, over the 180-day period, aggregate rejection rates (measured separately for equities and options) must be no more than 5% pre-correction or 2% post-correction across all CAT Reporters.²⁸

- Intra-Firm Linkages. The Plan requires that “the Plan Processor must be able to link all related order events from all CAT Reporters involved in the lifecycle of an order.”²⁹ At a minimum, this requirement includes the creation of an order lifecycle between “[a]ll order events handled within an individual CAT Reporter, including orders routed to internal desks or departments with different functions (e.g., an internal ATS).”³⁰ FINRA is proposing that aggregate intra-firm linkage rates across all Industry Member Reporters must be at least 95% pre-correction and 98% post-correction.

²⁶ See id.

²⁷ See id.

²⁸ CAT NMS Plan, Appendix C, Section A.3(b), at n. 102. FINRA stated that while error rates after reprocessing of error corrections are ultimately expected to be de minimis for the CAT, it does not believe that post-correction errors need to be de minimis before OATS can be retired and is not suggesting, with this proposal, that 2% would meet the ultimate objective of de minimis error rates for CAT. In other words, the Proposal does not change the standard under the CAT NMS Plan that post-correction errors must be de minimis. See Notice, supra note 3 at n. 24.

²⁹ CAT NMS Plan, Appendix D, Section 3.

³⁰ Id.

- Inter-Firm Linkages. The order linkage requirements in the Plan also require that the Plan Processor be able to create the lifecycle between orders routed between broker-dealers.³¹ FINRA is proposing that at least a 95% pre-correction and 98% post-correction aggregate match rate be achieved for orders routed between two Industry Member Reporters.³²
- Order Linkage Rates. 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.³³ For example, the Plan requires linkages between customer orders and “representative” orders created in firm accounts for the purpose of facilitating a customer order, riskless principal orders, and orders worked through average price accounts.³⁴ Pursuant to the phased approach for Industry Member reporting certain of these order linkages will not be required in the initial phase of reporting (or “Phase 2a”), which commenced on June 22, 2020.³⁵ FINRA is proposing that there be at least a 95% pre-correction and 98% post-correction linkage rate for orders that are required in Phase 2a.

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Id.

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This assumes linkage statistics will include both unlinked route reports and new orders where no related route report could be found.

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See CAT NMS Plan, Appendix D, Section 3.

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See id.

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See CAT Reporting Timelines at www.catnmsplan.com/timelines/. See also Securities Exchange Act Release No. 88702 (April 20, 2020), 85 FR 23075 (April 24, 2020) (Order Granting Conditional Exemptive Relief from Sections 6.4, 6.7(a)(v) and 6.7(a)(vi) of the CAT NMS Plan) (“Phased Industry Member Reporting Exemptive Order”) and FINRA Rule 6895. Linkages for representative order scenarios involving agency average price trades, net trades and aggregated orders will not be required until the third phase of reporting (or “Phase 2c”) is implemented in April 2021; such linkages are not required in OATS today.

While such linkages are not required in OATS today, FINRA believes that it is appropriate to evaluate them for purposes of retiring OATS. These linkages represent a significant enhancement to the data currently available in OATS and will enhance the quality of the equity audit trail. FINRA does not anticipate that the error rates for the Phase 2a representative order linkages in CAT would be significantly higher than the order linkages available in OATS today. Nonetheless, in evaluating whether the standards for OATS retirement have been met, FINRA has stated that it 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.

- Exchange and TRF/ORF Match Rates. The Plan requires that an order lifecycle be created to link “[o]rders routed from broker-dealers to exchanges” and “[e]xecuted orders and trade reports.”³⁶ FINRA is proposing at least a 95% pre-correction and 98% post-correction aggregate match rate across all equity exchange for orders routed from Industry Members to an exchange and, for over-the-counter executions, the same match rate for orders linked to trade reports.³⁷

FINRA has stated that it intends to commence its review of CAT data and error rates based on Phase 2a data and linkages, which would replicate the data in OATS today, and will not wait for implementation of Phase 2c reporting (and the attendant linkages) to do so. Large Industry Members and Small Industry Members that currently are reporting to OATS (“Small Industry OATS Reporters”) are required to submit data to the CAT for these same events and scenarios during Phase 2a. Accordingly, FINRA believes that Phase 2a Industry Member Data is

³⁶ Id.

³⁷ See Amendment No. 1, supra note 6.

the most relevant for OATS retirement purposes. FINRA anticipates that it will retire OATS based solely on Phase 2a reporting, assuming the threshold pre- and post-correction error rates are achieved and FINRA's use of the data confirms that the data is accurate and reliable, as discussed below.

Once these error rate thresholds are met, FINRA has stated that it must also evaluate and confirm through incorporation of CAT Data into its automated surveillance program that the data is accurate and reliable.³⁸ Thus, in addition to the maximum error rates and matching thresholds proposed above, FINRA's proposal requires that use of CAT Data must confirm that (i) there are no material issues that have not been corrected (e.g., delays in the processing of data, issues with query functions, etc.), (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 believes that any errors in the CAT Data may manifest themselves only after surveillance patterns and other queries have been run. Thus, FINRA believes that while 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 processes.

In order to alert members of the status of the OATS Rules, if the Commission approves the proposed rule change, FINRA is proposing to add introductory language to Rule 4554 and the Rule 7400 Series that will state that the SEC has approved a proposed rule change (SR-

³⁸ For example, FINRA will need to transition all or substantially all of its automated surveillance patterns to CAT Data in order to evaluate the accuracy and reliability of the data.

FINRA-2020-024) to remove Rule 4554 and the Rule 7400 Series from the FINRA rulebook; however, by its terms, SR-FINRA-2020-024 will not be implemented until FINRA has determined that the CAT has achieved a level of accuracy and reliability sufficient to replace OATS. FINRA has stated that once it has determined that such standards have been met, FINRA will file for immediate effectiveness a rule filing setting forth the basis for its determination and will publish a Regulatory Notice announcing the implementation date of SR-FINRA-2020-024.

2. Small Industry Member Data Availability

The second issue the Plan requires the proposed rule change to address is “whether the availability of certain data from Small Industry Members two years after the Effective Date would facilitate a more expeditious retirement of duplicative systems.”³⁹ FINRA believes that there is no effective way to retire OATS until all current OATS reporters are reporting to the CAT. Pursuant to the phased reporting approach, Small Industry OATS Reporters and Large Industry Members were required to begin reporting to the CAT on the same date, June 22, 2020. Thus, at this time, all current OATS reporters are required to report to the CAT.⁴⁰ Small Industry Members that are not currently required to record and report information to OATS are required to begin reporting to the CAT in December 2021.⁴¹

3. Individual Industry Member Exemptions

The final issue the Plan requires the proposed rule change to address is “whether individual Industry Members can be exempted from reporting to duplicative systems once their

³⁹ See CAT NMS Plan, Appendix C, Section C.9.

⁴⁰ The 180-day timeframes discussed above with respect to usage of the data and calculation of error rates will apply to data reported to the CAT by Small Industry OATS Reporters.

⁴¹ See supra note 36.

CAT reporting meets specified accuracy and reliability standards, including, but not limited to, ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.”⁴²

FINRA has stated that it believes that a single cut-over from OATS to CAT is highly preferable to a firm-by-firm approach and is not proposing to exempt members from the OATS requirements on a firm-by-firm basis.⁴³ FINRA explained that the primary benefit to a firm-by-firm exemptive approach would be to reduce the amount of time an individual firm is required to report to a legacy system (e.g., OATS) if it is also accurately and reliably reporting to the CAT. FINRA believes that the overall accuracy and reliability thresholds for the CAT described above would need to be met under any conditions before firms could stop reporting to OATS. In addition, a firm-by-firm approach would require that OATS and CAT data be combined and integrated in order for FINRA to conduct surveillance in accordance with SEC rules and SRO obligations. Moreover, as discussed above, Small Industry OATS Reporters are required to report to the CAT on the same timeframe as all other OATS Reporters (i.e., Large Industry Members). Thus, FINRA believes there is no need to exempt members from OATS requirements on a firm-by-firm basis.

IV. Discussion and Commission Findings

After carefully considering the Proposal, the comments submitted, and FINRA’s response to the comments, the Commission finds that the proposed rule change, as modified by Amendment No., 1 is consistent with the requirements of the Act and the rules and regulations

⁴² See CAT NMS Plan, Appendix C, Section C.9.

⁴³ See Notice, supra note 3, at 54465.

thereunder applicable to national securities exchanges and associations.⁴⁴ Specifically, the Commission finds that the Proposal is consistent with Section 15A(b)(6) of the Act,⁴⁵ which requires, among other things, that the rules of an association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and are not designed to permit unfair discrimination between customers, issuers, brokers or dealers. In addition, the Commission finds the Proposal is consistent with Section 15A(b)(9) of the Act,⁴⁶ which requires that the rules of an association not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

The Commission also finds that the proposed rule change is consistent with Section 11A of the Act,⁴⁷ and the CAT NMS Plan. Section 11A of the Act directs the Commission, with due regard for the public interest, the protection of investors, and the maintenance of fair and orderly markets, to use its authority to facilitate the establishment of a national market system for securities, including by authorizing or requiring SROs to act jointly to plan, develop, operate, or regulate a national market system. As discussed above, the Plan requires the proposal to discuss the specific accuracy and reliability standards that would determine when duplicative systems would be retired, whether the availability of certain data from Small Industry Members would facilitate a more expeditious retirement of duplicative systems, and whether individual Industry

⁴⁴ In approving these proposed rule changes, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴⁵ 15 U.S.C. 78o-3(b)(6).

⁴⁶ 15 U.S.C. 78o-3(b)(9).

⁴⁷ 15 U.S.C. 78k-1.

Members could be exempted from reporting to duplicative systems once their CAT reporting meets specified accuracy and reliability standards.⁴⁸ Accordingly, FINRA filed the Proposal to indicate when the OATS Rules would be eliminated once CAT is sufficiently accurate and reliable and to explain how they intend to assess CAT's accuracy and reliability. As discussed below, the Commission believes that the Proposal is consistent with the above-noted provisions of the CAT NMS Plan and consistent with the Act because it is reasonably designed to assist the SROs in meeting their regulatory obligations pursuant to Rule 613 and the Plan.

The Commission finds that FINRA's proposal to delete its OATS rules is consistent with the Act. While OATS has provided an important resource for surveillance of the OTC market for equity securities, CAT is designed to be a more robust tool for market surveillance. Unlike OATS, the CAT will include order and transaction information from the Exchanges and will enable regulators to trace the complete life cycle of every order, regardless of whether it is routed or executed OTC or on an exchange.

FINRA's proposed approach to the timing of retiring OATS is appropriate. Three commenters stated the need for the "urgent decommissioning of OATS",⁴⁹ and for the retirement of OATS in "an efficient and timely manner"⁵⁰ and on an "expedited basis"⁵¹ to address the current duplication of firm resources. In its Response Letter, FINRA stated that it understands the technology costs and resources firms have dedicated and continue to dedicate to OATS, and that FINRA is committed to retiring OATS as efficiently and expeditiously as possible. The

⁴⁸ See CAT NMS Plan, Appendix C, Section C.9. See Phased Industry Member Reporting Exemptive Order, supra note 34.

⁴⁹ See Refinitiv Letter, supra note 5.

⁵⁰ See SIFMA Letter, supra note 5.

⁵¹ See FIF Letter, supra note 5.

commenters also believed that OATS could be retired prior to the commencement of Phase 2c reporting on April 26, 2021. They expressed concern that Phase 2c error rate reporting would negatively impact the timing for the retirement of OATS.⁵² However, the retirement of OATS is independent of Phase 2c reporting. The earliest OATS can be retired is April 26, 2021 because error rate thresholds must be met over a 180-day period. In addition, as discussed in greater detail below, Phase 2c error rates are not part of the OATS retirement error rate calculation and therefore should not delay the retirement of OATS. In finding that the proposed timing for retiring OATS, after commencement of Phase 2c reporting on April 26, 2021, is consistent with the Act, the Commission considered FINRA's representation that it will not take Phase 2c error rates into account in determining whether the proposed standards for the retirement of OATS have been met. Thus, the Commission believes that the commencement of Phase 2c reporting does not impact the timing of OATS retirement.

All three commenters commented on FINRA's proposal to evaluate and confirm, through incorporation of CAT Data into its automated surveillance program, that CAT Data is accurate and reliable.⁵³ One of these commenters argued that the process for incorporating CAT Data into FINRA's surveillance program should begin as soon as possible and asked FINRA to clarify that it will not wait for industry reporting to achieve the applicable error rates for 180 days before beginning to test its systems.⁵⁴ Another commenter stated that while it agrees with FINRA's goal of operationalizing CAT Data in its automated surveillances with the confidence necessary for FINRA to eliminate OATS, this is dependent on factors outside the control of Industry

⁵² See FIF Letter, Refinitiv Letter, and SIFMA Letter, supra note 5.

⁵³ See FIF Letter, Refinitiv Letter, and SIFMA Letter, supra note 5.

⁵⁴ See SIFMA Letter, supra note 5.

Members.⁵⁵ In addition, the third stated that the “open-ended nature” of the non-error-rate conditions should not extend the retirement of OATS beyond the 180-day period.⁵⁶ The Commission believes that the proposed conditions relating to FINRA’s use of the CAT Data are consistent with the CAT NMS Plan. The CAT NMS Plan provides that FINRA must be able to verify that the data is of “sufficient quality for surveillance purposes.”

In any event, FINRA stated that it has already begun the process of transitioning its automated surveillance patterns and testing the CAT Data, addressing commenters’ concerns that FINRA is not waiting for industry reporting to achieve the applicable error rates for a 180-day period before commencing this process. However, as FINRA explained, the errors in the CAT Data may not be apparent until surveillance patterns and other queries have been run.⁵⁷ Error rate thresholds may be met over a 180-day period, however, additional time may be required to reliably 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. For these reasons, the Commission concludes that FINRA’s proposal to evaluate and confirm that CAT Data is accurate and reliable is reasonable.

The Commission concludes that FINRA’s proposed approach to review CAT data and error rates to determine if the OATS Rules can be deleted based on Phase 2a Industry Member data and linkages is appropriate as this is the data reported in OATS today, and thus is the most

⁵⁵ See Refinitiv Letter, supra note 5.

⁵⁶ See FIF Letter, supra note 5.

⁵⁷ See Response Letter, supra note 6, at 4.

relevant for determining if OATS should be retired.⁵⁸ Two commenters objected to FINRA including error rates for Phase 2a representative order linkages, arguing that such linkages are not required in OATS and therefore should be not considered in determining whether OATS can be retired.⁵⁹ The representative order linkages required in Phase 2a are “simple” linkages,⁶⁰ and do not include more complex representative order scenarios, such as those involving agency average price trades, net trades and aggregated orders, which will not be required until Phase 2c. Statistics provided by FINRA CAT show that firms are performing these linkages with error rates well under those FINRA is proposing to require for retirement of OATS.⁶¹ Based on these statistics, the Phase 2a representative order linkages should not significantly impact linkage error rates for OATS retirement purposes.⁶² In addition, in evaluating whether the standards for

⁵⁸ All Industry Members that currently are reporting to OATS are required to the submit data to the CAT during Phase 2a. See Phased Industry Member Reporting Exemptive Order, supra note 35.

⁵⁹ See Refinitiv Letter and SIFMA Letter, supra note 5.

⁶⁰ 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. See Response Letter, supra note 6, at n. 7.

⁶¹ See <https://catnmsplan.com/sites/default/files/2020-11/11.19.20-Monthly-CAT-Implementation-Update.pdf>, at p. 5.

⁶² See Response Letter, supra note 6, at 6.

OATS retirement have been met, FINRA will evaluate whether the error rate is the result of unlinked representative orders to create an apples-to-apples comparison to OATS.⁶³

FINRA has committed to retiring OATS as soon as reasonably practicable,⁶⁴ and has stated that if all other proposed criteria have been met, it does not anticipate delaying OATS retirement based on Phase 2a representative order linkage error rates alone.⁶⁵ The Commission believes that including error rates for Phase 2a representative order linkages is reasonable, as they will be included by FINRA’s automated surveillance program and are not impacting error rates to date.⁶⁶ Actual data provided by FINRA CAT is consistent with FINRA’s representation in its Response Letter that it is unlikely that the error rates for the Phase 2a representative order linkages in CAT will be significantly higher than the order linkages available in OATS today,⁶⁷ and FINRA does not anticipate delaying OATS retirement based solely on Phase 2a representative order linkage error rates.⁶⁸

The Commission also finds that FINRA’s proposed framework for assessing the accuracy and reliability of CAT Data for purposes of retiring OATS—including the “single cut-over” approach; and the scope, commencement, timeframe, and methodology of the assessment—is consistent with the Act. The Plan states that the elimination or modification of the SROs’ duplicative rules and the retirement of the related systems will be “effective at such time as CAT

⁶³ Id. at 7.

⁶⁴ Id. at 5.

⁶⁵ Id. at 6-7.

⁶⁶ See supra note 61.

⁶⁷ Id.

⁶⁸ See Response Letter, supra note 3, at 6-7.

Data meets minimum standards of accuracy and reliability.”⁶⁹ “CAT Data” is defined broadly⁷⁰ and includes customer information and order and transaction records pertaining to NMS stocks, OTC Equity Securities, and listed options submitted by both Participants and Industry Members. The Commission finds that the assessment mechanism proposed by FINRA is consistent with both the Act and the CAT NMS Plan, because it is reasonably designed to ensure that, before OATS is retired and OATS reporting requirements are eliminated, CAT is operating with sufficient accuracy and reliability for regulatory purposes, including by assessing whether compliance with key requirements of the CAT NMS Plan has been attained.

Although FINRA generally intends to limit its assessment of error rates to Industry Member Data and to focus its assessment on fields and securities that are currently in OATS, some information that is outside the scope of OATS could be relevant to the consideration of the overall accuracy and reliability of the CAT and the performance of the Plan Processor. The Commission believes that while consideration must be given to the overall accuracy and reliability of CAT Data more broadly, it is appropriate for FINRA to focus their assessment of whether CAT is performing with a sufficient degree of accuracy and reliability to permit OATS retirement on data related to OATS-eligible securities by the same types of entities (*i.e.*, broker-dealers) that are required to submit OATS reports. An assessment of the quality of broker-dealer reporting to CAT could be skewed by consideration of Participant reporting, particularly considering that Participants are required to report one year sooner than Industry Members and, all things being equal, can be expected to attain higher level of accuracy before Industry Members. Furthermore, focusing on Industry Member records will help identify any issues

⁶⁹ CAT NMS Plan, Appendix C, Section C.9.

⁷⁰ See CAT NMS Plan, Section 1.1.

specific to this class of CAT Reporters and facilitate quicker improvements. This in turn could provide regulators with better oversight capability more quickly and help minimize the costs associated with duplicative reporting.

In addition, the Commission believes that FINRA’s assessment of the data quality of specific categories of errors—i.e., rejection rates, intra-firm linkages, inter-firm linkages, order linkage rates, exchange and TRF/ORF match rates—are appropriate. The categories identified by FINRA are categories of errors calculated by OATS today and reflect key aspects of data quality that affect the ability of regulators to effectively access and use CAT Data to perform their regulatory functions. Thus, Commission believes it is reasonable for FINRA to examine these aspects of the data to confirm that they are exhibiting accuracy levels consistent with the required pre- and post-correction accuracy levels of CAT Data overall. In particular one of the significant limitations of existing audit trail systems is the deficiency of linkages between the various events in the order life cycle—and the lack of linkage to specific customers—which results in regulators attempting to link these events together themselves from various sources through ad hoc and cumbersome processes that can introduce errors.⁷¹ Therefore, the Commission concludes that it is appropriate for FINRA’s assessment to include various aspects of order and transaction linkages.

⁷¹ See, e.g., CAT Approval Order, 81 FR at 84814-15 (“cross-market examinations require the cumbersome and time-consuming task of linking many different data sources . . . regulators that are determining whether rule violations have occurred will combine trading data from sources such as public feeds, SRO audit trails, EBS data, and trade blotters”); Securities Exchange Act Release No. 77724 (April 27, 2016), 81 FR 30614, 30685 (May 17, 2016) (notice of CAT NMS Plan) (“data is currently stored in multiple formats, is difficult to merge, and results in errors during the merging process”).

Moreover, the Commission concludes that it is appropriate for FINRA to allow retirement of OATS only when the 5% pre-correction and 2% post-correction thresholds are met in each category. The 5% pre-correction threshold is the same as the initial maximum pre-correction error rate set forth in the CAT NMS Plan, and the 2% post-correction threshold is a reasonable quantification of the “de minimis” post-correction error rate contemplated by the CAT NMS Plan for the purposes of OATS retirement.⁷² Thus, the Commission believes it is reasonable to not require accuracy rates in CAT to equal or surpass the accuracy rates in OATS before allowing for OATS retirement.

The Commission also concludes that the calculation methodologies proposed by FINRA for these metrics—specifically that the inter-firm linkage quality metric will be measured in the aggregate across all Industry Members rather than on a per-firm basis and that post-correction error rates will be measured as the number of errors in a particular category divided by the total number of records received in that category—are appropriate as this is how the CAT NMS Plan defines the calculation of these error rates.⁷³ Further, the Commission concludes that FINRA’s approach of measuring post-correction error rates at T+5 is appropriate, as this is consistent with the requirements of the CAT NMS Plan.⁷⁴ It is appropriate to apply the data processing cycles and standards set forth in the CAT NMS Plan—such as regulatory access to corrected data on T+5—rather than standards associated with OATS or other existing systems to ensure that

⁷² See CAT NMS Plan, Section 6.5(d)(i); Appendix C, Section A.3(b); Appendix C, Section A.3(b), n. 102.

⁷³ See CAT NMS Plan, Section 1.1. See also 17 CFR 242.613(j)(6). “The term *error rate* shall mean the percentage of reportable events collected by the central repository in which the data reported does not fully and accurately reflect the order event that occurred in the market.” Id.

⁷⁴ See CAT NMS Plan, Appendix C, Section A.2(a); Appendix D, Section 6.

FINRA CAT's surveillances are adequate based on the data that will be reported. An assessment of the adequacy of FINRA CAT's processing based on OATS' or other systems' standards would not provide assurance that these systems would be sufficient under the applicable CAT NMS Plan requirements.

In addition to these assessment criteria and error rates, under FINRA's proposal, it must be able to confirm that (1) usage over the assessment period has not revealed material issues that have not been corrected; (2) the CAT includes all data necessary to allow FINRA to continue to meet its surveillance obligations; and (3) the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan. One commenter argued that these qualitative factors, which they referred to as "non-error-rate conditions," appear to go beyond the conditions set forth in the CAT NMS Plan, and they have concerns about the open-ended nature of the non-error-rate conditions.⁷⁵ The CAT NMS Plan requires that a system retirement proposal discuss "specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate should determine when a system duplicative of CAT can be retired" (emphasis added).⁷⁶ The Commission believes that the qualitative factors identified by FINRA in addition to quantitative metrics such as error rates are consistent with this requirement. For example, even if CAT Reporters are reporting accurate data to the Central Repository, as measured by error rates, regulators might not be able to use CAT as intended if the Plan Processor is not adequately performing its functions, such as linking reportable events together to create a complete order

⁷⁵ See FIF Letter, supra note 5.

⁷⁶ CAT NMS Plan, Appendix C, Section C.9.

life cycle and providing access and querying functionality to regulators. The Commission therefore concludes that it is appropriate for FINRA to consider these qualitative factors.

The transparency regarding the assessment process and communication with Industry Members regarding any issues identified during that process will be beneficial. FINRA has committed to provide the industry with information and updates directly and through FINRA CAT regarding CAT implementation issues by holding periodic industry outreach events.⁷⁷ These opportunities for regular and ongoing feedback about any issues identified will facilitate the correction of such issues and reduce the potential for delays in systems retirement.

The Commission finds that FINRA's proposal with respect to the length of the assessment are consistent with the Act. Before a crucial regulatory tool such as OATS can be retired, it is prudent to ensure that error rates in the replacement audit trail system have reached stable, consistent levels. FINRA has represented that, based on past experience, 180 days represents the minimum time needed to fully test the accuracy and reliability of trade and order data and system functionality to ensure that FINRA is able to carry out its surveillances and other regulatory functions without a loss of quality. The Commission concludes that a 180-day period strikes a reasonable balance between ensuring that high accuracy and reliability levels are sustainable and minimizing the duplicative reporting period as much as practicable.

Two commenters requested that FINRA provide transparency and sufficient notice once the date for the retirement of OATS has been set.⁷⁸ As an initial matter, the process for retiring OATS is outlined in the Proposal. And, the Commission believes that FINRA is incented to

⁷⁷ FINRA hosts a number of industry outreach events. For the list of upcoming FINRA events, see <https://www.finra.org/events-training>. Separately, FINRA CAT also hosts a number of industry update calls and events. For a list of upcoming industry outreach events, see <https://catnmsplan.com/events>.

⁷⁸ See FIF Letter and Refinitiv Letter, supra note 5.

make the requisite filing as far in advance as practicable in order to provide firms with sufficient notice and opportunity to prepare for the retirement of OATS to promote an orderly retirement of OATS. In addition, FINRA will provide as much transparency into the process as possible regarding issues relating to OATS retirement in its communications with firms.⁷⁹ The Plan Processor is required to provide a variety of error rate data to CAT Reporters and the Operating Committee under the CAT NMS Plan including daily statistics on rejection rates after the data has been processed.⁸⁰ During the 180-day assessment period, the Commission believes that it is appropriate for the SROs and the Plan Processor to provide this error rate data, as it will help Industry Members identify any problem areas and improve the accuracy of their CAT reporting. FINRA CAT currently provides regular updates to Industry Members regarding CAT implementation and compliance during FINRA CAT's Weekly Industry Testing Checkpoint and Monthly Implementation calls.⁸¹ Also, the statistics provided by FINRA CAT will serve as a good proxy for progress toward achieving the requisite error rates for the purposes of OATS retirement.⁸² Further, once FINRA has determined that such standards have been met, it has committed to file a rule filing for immediate effectiveness setting forth the basis for its determination and to publish a Regulatory Notice announcing the implementation date of SR-FINRA-2020-024.

⁷⁹ See Response Letter, supra note 6.

⁸⁰ See CAT NMS Plan, Section 6.1(o)(v); CAT NMS Plan, Appendix C, Section A.3(b); CAT NMS Plan, Appendix D, Section 10.4.

⁸¹ See Response Letter, supra note 6.

⁸² Id.

V. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2020-024 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2020-024. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the

principal office of the Exchange and on its Internet website. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-024 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change As Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the 30th day after the date of publication of notice of the filing of Amendment No. 1 in the Federal Register. As discussed above, the proposed rule change, as modified by Amendment No. 1, would eliminate the OATS Rules as duplicative systems of the CAT, after Industry Members are able to demonstrate reliable and accurate reporting to the CAT with a reasonable rate of errors, and after FINRA is able to ascertain that (1) usage of CAT Data over the assessment period has not revealed material issues that have not been corrected; (2) the CAT includes all data necessary to allow FINRA to continue to meet its surveillance obligations; and (3) the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan. The Commission believes that the proposal is consistent with these provisions of the CAT NMS Plan and consistent with the Act because they are reasonably designed to assist the SROs in meeting their regulatory obligations pursuant to Rule 613 and the Plan.

In Amendment No. 1, FINRA modified the method by which the equity exchange match rate would be calculated. Specifically, FINRA proposed that instead of calculating the equity exchange match rate on a per exchange basis, it would calculate the match rate in the aggregate across all exchanges. The Commission believes that such a calculation is consistent with the

current reporting published by FINRA CAT and as such will be easier for industry members to understand. The Commission believes Amendment No. 1 does not materially modify the substance of the proposed rule change as it was initially filed, but merely provides for a more straightforward method for calculating the equity exchange match rates.

Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act, to approve the proposed rule change, SR-FINRA-2020-024, as modified by Amendment No. 1, on an accelerated basis.⁸³

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-FINRA-2020-024), as modified by Amendment No. 1, be and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸⁴

J. Matthew DeLesDernier
Assistant Secretary

⁸³ 15 U.S.C. 78s(b)(2).

⁸⁴ 17 CFR 200.30-3(a)(12).