

March 31, 2023

VIA EMAIL (tradingandmarkets@sec.gov)

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Request for Exemption from Certain Provisions of the National Market System Plan Governing the Consolidated Audit Trail Related to Reporting of Certain Verbal Activity, Floor and Upstairs Activity

Dear Ms. Countryman:

The Participants¹ in the National Market System Plan Governing the Consolidated Audit Trail (“CAT NMS Plan” or “Plan”)² respectfully request that the Securities and Exchange Commission (“Commission” or “SEC”) provide exemptive relief pursuant to the Commission’s authority under Section 36 of the Securities Exchange Act of 1934 (“Exchange Act”)³ and Rule 608(e) of Regulation NMS under the Exchange Act⁴ from enforcing certain reporting requirements of the CAT NMS Plan for Industry Members conducting certain activities on the floor of national securities exchanges as well as certain activities by Industry Members off exchange floors (“upstairs activity”).

Specifically, and for the reasons discussed in detail below, the Participants request that the Commission extend the exemption granted in its order dated November 12, 2020 (the “November 2020 Exemption Order”),⁵ which temporarily exempted each Participant from the requirement in Section 6.4(d) of the CAT NMS Plan that each Participant, through its

¹ The twenty-five Participants of the CAT NMS Plan are: BOX Exchange LLC; Cboe BYX Exchange, Inc., Cboe BZX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., Cboe C2 Exchange, Inc. and Cboe Exchange, Inc.; Financial Industry Regulatory Authority, Inc.; Investors Exchange LLC; Long-Term Stock Exchange, Inc.; MEMX LLC; Miami International Securities Exchange LLC, MIAIX Emerald, LLC, MIAIX PEARL, LLC; NASDAQ BX, Inc., Nasdaq GEMX, LLC, Nasdaq ISE, LLC, Nasdaq MRX, LLC, NASDAQ PHLX LLC, The NASDAQ Stock Market LLC; and New York Stock Exchange LLC, NYSE American LLC, NYSE Arca, Inc., NYSE Chicago, Inc., and NYSE National, Inc.

² The Limited Liability Company Agreement of Consolidated Audit Trail, LLC is the CAT NMS Plan. Unless otherwise noted, capitalized terms are used as defined in Rule 613, in the CAT NMS Plan, or in this letter.

³ See 15 U.S.C. § 78mm(a)(1), which provides, in relevant part, that the “Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title 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 See 17 CFR § 242.608(e), which provides that “[t]he Commission may exempt from the provisions of this section, 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 mechanisms of, a national market system.”

⁵ Exchange Act Release No. 90405 (Nov. 12, 2020), 85 Fed. Reg. 73544 (Nov. 18, 2020), <https://www.sec.gov/rules/exorders/2020/34-90405.pdf>.

Compliance Rule,⁶ require its Industry Members to record and electronically report to the Central Repository the following, 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 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 (e.g., Bloomberg chats, text messages).

As a condition to the November 2020 Exemption Order, the Commission required that the Participants provide 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. On June 3, 2022, the Participants submitted a request for permanent exemptive relief and provided the written status update required by the November 2020 Exemption Order.⁷ This request amends the June 2022 Exemption Request by requesting, in lieu of a permanent exemption, that the Commission extend the existing relief until July 31, 2026. The Participants believe that the requested relief is “necessary or appropriate in the public interest, and is consistent with the protection of investors,” and 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 mechanisms of, a national market system.”⁸

I. Background

A. CAT Reporting Requirements

Under Rule 613(c)(7) of Regulation NMS and Sections 6.3(d) and 6.4(d) of the CAT NMS Plan, reportable events are based on, among other things, the receipt, routing and execution of orders.⁹ Rule 613(j)(8) and the CAT NMS Plan provide that “orders” include: “(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.” An order is defined in Exchange Act Rule 300 as “any *firm* indication of a willingness to buy or sell a security, as either principal or agent,

⁶ Section 1.1 of the CAT NMS Plan defines “Compliance Rule” to mean, “with respect to a Participant, the rule(s) promulgated by such Participant as contemplated by Section 3.11.”

⁷ Letter from Michael Simon, CAT NMS Plan Operating Committee Chair, to Vanessa Countryman, Secretary, Commission, dated June 3, 2022 (the “June 2022 Exemption Request”), <https://catnmsplan.com/sites/default/files/2022-06/06.03.2022-CAT-Exemption-Request-Verbal-Floor-and-Upstairs-Activity-Final.pdf>. As discussed below, the Participants do not believe that the status update provided with the June 2022 Exemption Request negates the need for the Commission to conduct a full economic analysis of the costs and benefits that would be associated with reporting the quote and order events that are the subject of this exemption request.

⁸ 17 CFR § 242.608(e).

⁹ Rule 613(j)(9) provides that “[t]he term *reportable event* shall include, but not be limited to, the original receipt or origination, modification, cancellation, routing, and execution (in whole or in part) of an order, or receipt of a routed order.”

including any bid or offer quotation, market order, limit order, or other priced order.”¹⁰ In addition, a “bid” or “offer” is 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*.¹¹ Because indications of interest and non-firm indications of a willingness to buy or sell a security, are not “orders” or “bids” or “offers” under SEC rules, actions involving them do not constitute reportable events under the CAT NMS Plan.¹² Firm indications of a willingness to buy or sell a security are orders, bids or offers and have certain reportable events associated with them pursuant to the CAT NMS Plan.

B. Current Temporary Exemptive Relief

The Commission issued the November 2020 Exemption Order in response to the Participants’ exemption request dated July 1, 2020.¹³ The November 2020 Exemption Order granted temporary relief until July 31, 2023, 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; (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 (*e.g.*, Bloomberg chats, text messages). As a condition to this relief, the Commission required that the Participants provide 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. The Participants provided this written status update with the June 2022 Exemption Request. In addition, as a condition to this 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.

In granting the temporary exemption, the Commission acknowledged the “current difficulties of implementing reporting of such events,” and 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.”¹⁴ The Commission based its determination to grant the temporary exemptive relief on its belief 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

¹⁰ 17 CFR § 242.300(e) (emphasis added).

¹¹ 17 CFR 242.600(b)(8) (emphasis added).

¹² See FAQ B3 and B38 regarding indications of interest (“IOI”) and requests for quotes (“RFQ”), available at www.catnmsplan.com/faq/index.html.

¹³ Letter from Michael Simon, CAT NMS Plan Operating Committee Chair, to Vanessa Countryman, Secretary, Commission, dated July 1, 2020 (the “July 2020 Exemption Request”), <https://catnmsplan.com/sites/default/files/2020-07/07.01.2020-Exemptive-Request-Re-Verbal-Activity.pdf>.

¹⁴ November 2020 Exemption Order at 11-12.

information, instead of reliance on the manual capture of order information.”¹⁵ In this regard, the Commission reasoned 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.”¹⁶

II. Request for Exemption

A. The Activities Addressed in the November 2020 Exemption Order Were Not Contemplated by Rule 613 or the CAT NMS Plan and Were Not Included in the Cost-Benefit Analysis in the CAT NMS Plan Adopting Release

As an initial matter, and as described in the July 2020 Exemption Request, the Participants reiterate that the verbal floor activity and unstructured verbal and electronic upstairs activity at issue were not previously contemplated by Rule 613 or the CAT NMS Plan.¹⁷ Most notably, there was no cost-benefit analysis by the Commission related to the capture and reporting of this activity in the Rule 613 Adopting Release nor later in the CAT NMS Plan Adopting Release.¹⁸ The Participants nevertheless requested the exemptive relief to provide clarity to market participants.

The Commission disagreed with the Participants’ view in its November 2020 Exemption Order. However, the November 2020 Exemption Order did not cite to any discussion in the CAT NMS Plan or the CAT NMS Plan Adopting Release regarding the activity at issue. Nor did the Commission address the Participants’ assertion that there was no cost-benefit analysis related to the capture and reporting of this activity in the CAT NMS Plan Adopting Release. Rather, the Commission directed the Participants to undertake such analysis by July 31, 2022, as a condition to the relief.

This is a highly unusual circumstance. The CAT NMS Plan Adopting Release did not include any cost-benefit analysis with regard to capturing and reporting verbal floor activity and unstructured verbal and electronic upstairs activity. But the Commission has asserted that such activity is and always has been subject to Rule 613 and the CAT NMS Plan, and has required the Participants to undertake a cost analysis as a condition to exemptive relief. Had the Commission performed a cost-benefit analysis when it approved the CAT NMS Plan, as would have been required if verbal and upstairs activity was in fact reportable pursuant to Rule 613 and the CAT NMS Plan, it would not be necessary for the Participants to do so.

¹⁵ *Id.* at 12.

¹⁶ *Id.*

¹⁷ *See* July 2020 Exemption Request at 5, 9-10.

¹⁸ *See* Joint Industry Plan; Order Approving the National Market System Plan Governing the Consolidated Audit Trail, Exchange Act Release No. 79318 (Nov. 15, 2016), 81 Fed. Reg. 84696 (Nov. 23, 2016) (“CAT NMS Plan Adopting Release”), <https://www.sec.gov/rules/sro/nms/2016/34-79318.pdf>.

B. The Technological Advancements Contemplated by the November 2020 Exemption Order for Capturing Verbal Floor and Upstairs Activities in an Automated Manner Have Not Materialized

The November 2020 Exemption Order is premised on the Commission’s belief that technological or business developments by July 2023, including potential breakthroughs in artificial intelligence, could allow the Participants and Industry Members to capture and report verbal/manual quotes and orders in a cost-effective manner and without manual human intervention.

The technological or business breakthroughs contemplated by the November 2020 Exemption Order have not materialized. Nor do such advancements appear to be on the horizon. It simply is not possible using current technology or business practices to record, analyze and report in an automated manner (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; and (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). Neither natural language processing nor voice recognition technology currently is sophisticated enough to reliably, accurately and consistently capture, parse and analyze and report these interactions in the current trading environments and workflows.¹⁹ Accordingly, the Participants, CAT Advisory Committee members and Industry Member groups, including the Financial Information Forum (FIF), that have considered this issue continue to believe that capturing and interpreting this activity in an automated matter without human intervention is not possible with current technology, nor would it be cost-effective to manually capture this activity.

C. Manually Capturing and Reporting Verbal Activity Would be Costly, Inconsistent, Prone to Error and Disruptive

The alternative—*i.e.*, manually capturing these events by requiring a human being to listen to every verbal interaction of every floor broker, market maker or upstairs trader either live or from tape, and/or to sift through electronic communications to determine if and precisely when a quote was given and whether it was firm—is impracticable and not cost-effective. Determining whether unstructured electronic and verbal activity involves a firm bid or offer

¹⁹ Many commentators have observed that current AI technology is unable to complete tasks involving abstraction and judgment. *See, e.g.*, Isabelle Bousquette, *Mayo Clinic Assessing Google AI Tool as It Seeks More Insights From Patient Records*, WALL ST. J. (Mar. 24, 2022) (“[N]atural language processing . . . has made strides in recent years, say experts, although it remains early days.”); Ann-Marie Alcantara, *AI Customer-Service Startup Netomi Raises \$30 Million*, WALL ST. J. (Nov. 17, 2021) (noting that “conversational artificial intelligence is still in its infancy”); Steve Lohr, *What Ever Happened to IBM’s Watson?*, N.Y. TIMES (July 16, 2021) (reporting that IBM Watson “might well fail a second-grade reading comprehension test”); Jared Council, *Behind Microsoft’s Nuance Deal: Natural Language Processing, Explained*, WALL ST. J. (Apr. 13, 2021) (“NLP systems currently in use are designed for very specific uses, and their performance tends to break down when they encounter something outside of that zone.”); Harry Surden, *Artificial Intelligence and Law: An Overview*, 35 GA. ST. U. L. REV. 1305, 1337 (2019) (explaining that current AI technology “is not very good at dealing with abstractions, understanding meaning, transferring knowledge from one activity to another, and handling completely unstructured or open-ended tasks”).

would be a manual, subjective process that could be highly prone to error resulting in overreporting and/or underreporting to the CAT. As discussed in the written status update provided with the June 2022 Exemption Request, manual review would be cost prohibitive as Industry Members that are floor brokers and market makers—many of which are small firms—will be required to hire additional staff and develop new technology resources to capture and analyze this activity. Such review also would be resource intensive, which could cause a CAT Reporter to miss the requirement to report CAT data by T+1 by 8 am ET.

In addition, due to the inherent subjectivity associated with manual review, capturing this activity manually will likely result in inconsistent or less accurate data across CAT Reporters. For instance, broker-dealers on opposite sides of a negotiation may reach different results with respect to whether and when a firm bid/offer has occurred (*i.e.*, one party may view a discussion of potential pricing as a mere indication, while the recipient may view it as a bid/offer). This ambiguity will cause Industry Members to capture the same activity differently, resulting in a misleading or incomplete view of the transaction. Likewise, this inherent subjectivity will limit regulators' ability to determine compliance with any reporting requirement. Recording the time of verbal interactions either live or from tape would suffer from additional challenges as such conversations involve aspects of negotiations that are not reportable to CAT (*e.g.*, RFQs and IOIs) and that must be distinguished from firm orders that are reportable to CAT. Furthermore, capturing and reporting these events would create significant new recordkeeping requirements; the Participants believe that the Commission should not expand recordkeeping requirements without appropriate rulemaking.

For these reasons, neither floor brokers, exchange market makers nor Industry Members conducting telephone and other verbal discussions or unstructured electronic communications currently have the means to collect the data for these events for purposes of CAT reporting. Attempting to capture these events would significantly disrupt floor trading, current market practices and business models, and could adversely impact the execution quality and efficiencies. The Participants believe that the difficulty and costs that would be associated with reporting verbal and upstairs activity are such that a requirement to do so will change market behavior—to the detriment of customers. Rather than incur the costs and disruption necessary to report such activity, firms and markets are likely to gravitate toward the use of indications of interest (which are clearly not reportable) rather than firm orders/bids and offers. The Participants do not see how that is in the interests of investors. Given the likelihood that reporting will result in such changes, if the Commission believes that it should nonetheless require reporting of verbal floor-based and upstairs activity, the Participants believe that, as a matter of good policy, it should do so through the rulemaking process—not through a CAT reporting requirement that would have the effect of making current market practices impracticable—so that the associated reporting of such activity and the resultant impact on current market practices and related costs can be subject to a full economic analysis of the costs and benefits.

D. Including These Activities in the CAT Would Provide Limited Added Benefit for Regulatory and Surveillance Purposes

The Participants do not believe that adding the events addressed in November 2020 Exemption Order to the CAT would provide meaningful value from a regulatory/surveillance

perspective. As described in the July 2020 Exemption Request, every order that is verbalized on an exchange floor has already been systematized and the systematization (*i.e.*, the origination or receipt of an order) is already reportable to CAT.²⁰ Likewise with respect to upstairs activity, manual orders already are reportable to CAT. Trades, whether occurring on an exchange floor and off-floor, are also already reportable to CAT.

Similarly, the Advisory Committee believes that bilateral negotiations in upstairs activity, such as between asset brokers and broker-dealers, or between two broker-dealers, are currently captured when the broker either creates an order, as in from an asset manager, or accepts an order, as in from another broker-dealer, and when the trade execution occurs. In all of these “event types,” all the necessary information required to fulfill CAT requirements—customer, broker-dealer, time stamps, FDID, etc.—are captured; no additional information, such as the verbal discussion preceding the order and trade, needs to be captured to satisfy CAT requirements.

The ultimate regulatory value of reporting the verbal floor and verbal and unstructured electronic upstairs activities at issue is questionable, given the scope of data that is already available in CAT. Moreover, because they are not widely disseminated, these activities do not lend themselves to the types of market manipulation considered in the adoption of Rule 613.²¹ Any incremental value added for regulatory/surveillance purposes would be significantly outweighed by costs imposed on, and adverse impact to, Industry Members (including their customers) and Participants, as well as the disruption to the market.

III. Request for Exemption

For the reasons discussed above, and to provide clarity to market participants, the Participants request that the Commission extend the exemption granted in the November 2020 Exemption Order until July 31, 2026.

* * * * *

Respectfully submitted,

Brandon Becker
CAT NMS Plan Operating Committee Chair

²⁰ See July 2020 Exemption Request, Exhibit A (providing a detailed description of workflow processes on each exchange floor).

²¹ See, *e.g.*, Exchange Act Release No. 67457 (July 18, 2012), 77 Fed. Reg. 45722 (Aug. 1, 2012) (explaining that the CAT would be useful in investigating frontrunning, spoofing and layering in today’s high-speed electronic markets).

Ms. Vanessa Countryman

March 31, 2023

Page 8

cc: The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
The Hon. Mark T. Uyeda, Commissioner
The Hon. Jaime Lizárraga, Commissioner
Hugh Beck, Senior Advisor for Regulatory Reporting
Haoxiang Zhu, Director, Division of Trading and Markets
David Saltiel, Deputy Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets
David Hsu, Assistant Director, Division of Trading and Markets
Mark Donohue, Senior Policy Advisor, Division of Trading and Markets
Erika Berg, Special Counsel, Division of Trading and Markets