



January 22, 2013

**Via Electronic Mail**

BATS Exchange, Inc.  
BATS Y-Exchange, Inc.  
BOX Options Exchange LLC  
C2 Options Exchange, Incorporated  
Chicago Board Options Exchange,  
Incorporated  
Chicago Stock Exchange, Inc.  
EDGA Exchange, Inc.  
EDGX Exchange, Inc.  
Financial Industry Regulatory  
Authority, Inc.

International Securities Exchange, LLC  
Miami International Securities  
Exchange, LLC  
NASDAQ OMX BX, Inc.  
NASDAQ OMX PHLX, LLC  
The NASDAQ Stock Market LLC  
National Stock Exchange, Inc.  
New York Stock Exchange LLC  
NYSE Arca, Inc.  
NYSE MKT LLC

Elizabeth M. Murphy  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: SRO Request for Comment on Proposed CAT RFP Concepts Document  
SEC File No. S7-11-10

Dear SRO Representatives and Ms. Murphy:

The Securities Industry and Financial Markets Association (“**SIFMA**”)<sup>1</sup> appreciates the opportunity to comment on important issues associated with the process by which the self-regulatory organizations (the “**SROs**”) are proposing to move forward with a request for proposal (“**RFP**”) relating to the creation and implementation of the consolidated audit trail (the “**CAT**”) under Rule 613 of the Securities and Exchange Act of 1934 (the “**Exchange Act**”). We also provide comments, in the attached Concepts Document Feedback Summary, regarding the specific technical and operational elements

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<sup>1</sup> SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit [www.sifma.org](http://www.sifma.org).

of the CAT contained in the SROs' proposed outline of concepts to be included in an RFP, dated December 5, 2012 (the "**Concepts Document**").<sup>2</sup>

## **I. Executive Summary**

SIFMA supports the development of a national market system plan (the "**NMS Plan**") for the CAT that fully meets the requirements of Rule 613 in an efficient and expeditious manner. SIFMA acknowledges the enormity of the task that the SROs face and applauds the SROs for their significant efforts to come together and quickly advance the project. We believe that the CAT process provides an invaluable opportunity to enhance and consolidate the information capture and reporting structure that exists today. However, the process that the SROs have undertaken thus far, and indications of their plans for continued development of the CAT, raise several concerns from a process and policy perspective. In particular, SIFMA believes there are a number of steps that the SROs should take at this stage to improve the process and ensure the best possible outcome:

- *Defer Issuing an RFP.* The SROs' planned imminent issuance of an RFP is premature; an RFP should be deferred until the contours of the NMS Plan for which proposals are requested have become clearer and the industry has had an opportunity to consider and provide comment on the proposed NMS Plan.
- *Provide Transparency and Form the Advisory Committee.* The SROs should provide greater transparency into their CAT development activities and form a CAT Advisory Committee, at this stage of the process, that includes representation from several SRO member firms.
- *Address SRO Conflicts of Interest.* The SROs should take steps to address the potential conflicts of interest that they face in this process, particularly where an SRO is considering submitting a proposal to act as CAT processor.
- *Propose Funding Models and Cost Allocation.* How the CAT will be funded and how its costs will be allocated is a critical issue that should be addressed early in this process and before an RFP is published. Existing regulatory fees relating to trading activity that are designed to fund regulatory functions should be a primary source of funding, with any additional costs borne equitably among all stakeholders.

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<sup>2</sup> In addition to outlining the proposed RFP, the Concepts Document indicates that the SROs plan to seek exemptive relief from the Securities and Exchange Commission (the "**Commission**") in order to obtain an extension of time within which to file the NMS Plan until December 2013. SIFMA supports such an extension, which will allow more time for industry consideration and feedback, and encourages the Commission to grant the extension.

- *Determine Governance and Ownership Structure.* The SROs should propose a governance structure for the CAT and the proposed role of the CAT processor within that structure before requesting proposals from parties to act as the CAT processor.
- *Establish Single SRO Point of Contact.* A “Lead SRO” should be designated as the single point of contact during the development of the CAT and as the single SRO that interprets and enforces the CAT’s requirements on member firms going forward. This SRO should be selected based on its experience in all products that the CAT will eventually process, not only exchange-listed equities.
- *Plan for Elimination of Legacy Systems.* Any RFP should seek proposals to develop and implement the CAT assuming that it must be capable of fully replacing the Order Audit Trail System (“OATS”) and Electronic Blue Sheets (“EBS”) from the CAT’s inception, and seek proposals for the integration of other reporting systems’ functionalities.

SIFMA is also pleased to provide an outline of its comments and suggestions on the proposed technical and operational aspects of the CAT discussed in the Concepts Document. These comments can be found in the Concepts Document Feedback Summary, attached to this letter.

## **II. Defer Issuing an RFP Until NMS Plan is Further Developed**

The Concepts Document indicates that, as soon as February 2013, the SROs will issue an RFP to select a CAT processor to perform or oversee the functions described in the Concepts Document and the eventual NMS Plan. SIFMA believes that the CAT’s development is not yet far enough along for the selection of a CAT processor or even the publication of an RFP for this purpose. The solicitation of bids to act as processor for an unwritten NMS Plan puts the proverbial “cart before the horse.” The SROs should focus on preparing the NMS Plan, rather than considering proposals to act as plan processor for a plan that has not yet been developed. The SROs should defer publishing an RFP until the details of the actual NMS Plan becomes clearer.

SIFMA acknowledges that it may be important for the SROs to work closely with a technology expert as it develops the NMS Plan, for example, to obtain input as to what types of functionality are technologically feasible. However, bringing in a provider at this point to satisfy that role does not require issuing an RFP for the ultimate role of CAT processor for a system that has not yet been designed. Representatives of SRO member firms may provide assistance to the SROs in this capacity through the Advisory Committee (as suggested below). If the SROs prefer to also retain an outside vendor to provide additional technological assistance, we would suggest a two-step process. The SROs could publish a request for information, and engage a technological advisor now to

address design and technical challenges, and then wait until the NMS Plan has been prepared before publishing an RFP to hire the ultimate CAT processor.<sup>3</sup>

Rule 613 requires the SROs to select a CAT processor within two months *after* the NMS Plan becomes effective.<sup>4</sup> This is because the CAT processor will be hired to act as the processor for the NMS Plan actually *approved* by the Commission. As no plan has yet been proposed and the Concepts Document only sets forth a limited set of broad concepts for how the CAT will operate (including in some cases, multiple alternatives), how can responses to an RFP be fully evaluated?

At the December 10, 2012 industry event sponsored by the SROs (the “**December Event**”), SRO representatives acknowledged that many details of how the CAT would operate (including many issues not addressed in the Concepts Document) are still under discussion and yet to be resolved. Yet the SROs have indicated that they will make final decisions on these issues and publish the resulting RFP after they receive industry input on the limited scope of the Concepts Document. Such a process does not provide the industry with an appropriate opportunity to consider and comment on those issues not addressed in detail in the Concepts Document. If the SROs intend to take the industry’s views into account, it is likely that the SROs’ current visions for the CAT may need to change once the industry has a chance to consider their more detailed proposals. For example, the Concepts Document does not address:

- How the CAT would track internal allocations and sub-allocations;
- Maximum error rate to be tolerated;
- Elimination of other redundant reporting systems;
- Governance and payment structure of the CAT processor; or
- Funding and cost allocation of the CAT.

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<sup>3</sup> On January 16, 2012, the SROs released a document titled “Information for CAT Bidders.” The stated purpose of the document is to provide information on the anticipated content and structure of the RFP to be published in February. Among other things, the document explains that the SROs are seeking bids “to create, implement and maintain the CAT so that all possible technology alternatives can be identified and the costs and benefits of each analyzed.” Because of the late publication of this document and the pending deadline for submitting comments on the Concepts Document, SIFMA has not yet had an opportunity to fully consider and prepare comments on this document. SIFMA may provide supplemental comments based on the information contained in this document, if appropriate. As a preliminary matter, SIFMA agrees that it will be beneficial for the SROs to obtain information about various potential technological alternatives and their estimated costs in order to analyze the costs and benefits of each alternative. However, as noted above, SIFMA continues to believe that the SROs should only be requesting information regarding proposals for alternative CAT structures and estimated costs, not seeking competing bids to build a system, the structure of which that has not yet been decided.

<sup>4</sup> Rule 613(a)(3)(i).

Additionally, the Concepts Document in some cases provides several alternatives,<sup>5</sup> or contemplates “potential data sources”<sup>6</sup> which, depending on the SROs’ decision to incorporate or not, would have a major impact on the CAT’s structure. With so much potential for change, the SROs should wait until at least filing the NMS Plan with the Commission before publishing an RFP.

Distributing an RFP at this stage misses fundamental steps in the process, and risks short-circuiting the broad role of the public input that the Commission contemplated in Rule 613. Setting out the structure of the CAT in an RFP would effectively finalize critical structural components of the NMS Plan and operation of the CAT before the industry has had an opportunity to provide detailed consideration and comment.

Publishing an RFP based on an incomplete and highly tentative plan is also unfair to potential bidders. The SROs will be asking vendors to place bids without knowing the critical elements of the CAT structure, including the governance structure or funding models under which it will operate. Vendors cannot submit fully considered proposals under these circumstances.<sup>7</sup> For example, while vendors may assume that the eventual NMS Plan will include a funding model that will raise sufficient funds to pay the expenses of the CAT, vendors might craft different proposals for the structure and timing of their compensation depending on the structure and timing of the funds raised to support the CAT. The CAT processor will likely face significant upfront costs in building the CAT with costs leveling out for its continued operation. Bidders would therefore likely propose different compensation structures depending on whether the source of funds used to compensate them would utilize existing revenue sources (*e.g.*, market data fees, FINRA Trading Activity Fees and OTC Reporting Facility fees) or only future fees to be received once the CAT is operational.

### **III. Policy and Process of the CAT Development**

SIFMA believes that the process of developing the CAT, the policies surrounding the governance of the CAT, how the CAT is funded, and what systems the CAT replaces,

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<sup>5</sup> For example, two alternative approaches are provided for each of how to assign CAT Customer IDs and how to assign CAT Order IDs. *See* Concepts Document at 21–27.

<sup>6</sup> *See* Concepts Document at 14 (noting that the Options Clearing Corporation and the Depository Trust & Clearing Corporation are “potential” data sources for the CAT).

<sup>7</sup> At the December Event, a representative of the SROs indicated that, where the Concepts Document contains alternative proposed structures, the SROs would select their preferred approach prior to issuing an RFP and seek proposals only for the selected structure. While SIFMA does not believe that an RFP should be published with a large number of elements of the CAT undecided, it believes that there would be merit in having bidders provide bids where a limited number of elements are proposed as alternatives. This could inform the SROs’ consideration of structural alternatives from regulatory, effectiveness, and cost-benefit perspectives.

are critical gating issues that should be addressed at the outset, either along with, or prior to, the resolution of the important technical issues outlined in the Concepts Document.

#### **A. Improvements to Transparency and Industry Involvement**

The development and implementation of the CAT is an enormous undertaking for the SROs and their member firms, with great implications for their businesses. Moreover, for the CAT to function as intended, the CAT rules, the operation of the CAT processor, and broker-dealer systems, operations and business processes must all operate in a seamless, hand-in-glove fashion. Therefore, it is imperative that the process through which the CAT is developed and implemented by the SROs (including the selection of the CAT processor) be open and transparent, and entail the deep involvement and meaningful participation of representatives of the SROs' member firms. The Commission itself envisioned close collaboration between the SROs and the industry, with the SROs benefiting from "draw[ing] on the knowledge and experience of [their] members."<sup>8</sup> It is important to ensure that the process achieves this degree of collaboration.

SIFMA appreciates the efforts the SROs have taken to hold public events to inform the industry about their progress in developing the proposed NMS Plan. The programs have been very educational and have greatly aided member firms' understanding of Rule 613's requirements and the SROs' planning and progress. However, the events have not allowed for substantive collaboration. The discussions at these events have been at a very high level and mainly one-directional, with the SROs informing the public and answering questions as to the decisions that the SROs have already made. As the programs necessarily involved a very large group of participants, they have also not provided a forum conducive to substantive industry input and close collaboration. While these types of programs are beneficial to the industry, SIFMA does not believe they alone provide the type of collaboration necessary for the successful development of the CAT envisioned by the Commission. Given the great scope and anticipated cost of the CAT, the industry should be allowed to actively participate in the CAT's development, rather than only having the opportunity to react to proposals that the SROs separately develop.

To enable a better forum for industry input and encourage more meaningful discussion, the SROs should (i) establish a CAT Advisory Committee at this time with several industry representatives and a mandate for active involvement in all phases of the design of the CAT; (ii) provide more information about their activities and meetings to the public through their [catnmsplan.com](http://catnmsplan.com) website; and (iii) make all RFP responses public.

#### **1. Establish the CAT Advisory Committee and Increase Direct Industry Participation**

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<sup>8</sup> Exchange Act Release No. 67457 (July 18, 2012) (the "CAT Adopting Release") at 245.

SIFMA believes that the CAT Advisory Committee envisioned by Rule 613 should be established at this time.<sup>9</sup> Such a committee is an invaluable tool for encouraging and enabling industry input into the SROs' decisionmaking in relation to the development and formation of the CAT. Delaying the formation of the Advisory Committee until the NMS Plan is effective could limit its value, since the effective NMS Plan and the CAT structure will have already definitively set forth all the details of how the CAT will operate. Such a delay will also deprive the SROs of the industry's important expertise that the Commission believed would facilitate the CAT's development. Experience with existing audit trails demonstrates much of the complexity arises in relation to the activities taking place within and between member firms, as opposed to between the members and SROs. SIFMA believes that member firms have unique expertise, insight and experience that differ from, but strongly complement, the knowledge of the SROs on these matters. An Advisory Committee is a much more effective forum for member firms to provide valuable input in a real-time manner. Without this type of deep industry involvement during the vital planning and development process, the SROs will not have an opportunity to fully consider the insights and interests of the industry until the comment period, at which point any major changes could introduce costs, and delay the CAT's implementation.

SIFMA acknowledges that, as self-regulatory organizations, the SROs at times engage in regulatory activities that involve sensitive information and require confidentiality. However, SIFMA does not believe that most of the discussions surrounding the CAT development possess are of this nature. Rather, the CAT will be an industry utility and technology system. What information the CAT is required to capture is publicly known and spelled out in Rule 613. How the CAT will operate to capture the data will become publicly known when the SROs file and the Commission approves the NMS Plan. In any case, member firms will require a detailed understanding of the CAT's operation in order to connect to the CAT system and report information. While the data that will eventually be processed by the CAT will be used by SROs for confidential market surveillance and enforcement activities, those functions will not be part of their joint NMS Plan development. If truly confidential information is to be discussed during a particular development meeting (which SIFMA believes would be unlikely and rare), the SROs could enter executive session and exclude the Advisory Committee.

## **2. Expand Information on SROs' CAT Website**

To further aid in transparency and foster industry involvement and public input, the SROs should also expand the scope of information that they publish on their [catnmsplan.com](http://catnmsplan.com) website. The website has been a valuable tool for providing the public with information about the general CAT framework and the SROs' planned events.

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<sup>9</sup> In adopting Rule 613, the Commission noted that the Advisory Committee is intended to "afford SRO members ... the opportunity to have input on the *creation, implementation, and maintenance*" of the CAT. CAT Adopting Release at 79 (emphasis added).

However, the materials published have been at a high level, and generally reflect only those decisions the SROs have already made, providing little insight into the SROs' decisionmaking process. The SROs should instead use the website as a tool to provide greater transparency and post more detailed information. This should include, at a minimum:

- Details on each of the SROs' CAT development committees, such as the committee's role and membership,
- Schedules of planned meetings, including discussion topics and agendas, and
- Minutes of meetings (redacted if confidential information is discussed).

SIFMA believes this level of transparency into the SROs' CAT development process will improve the opportunities for collaboration and improve the efficiency of the process and overall outcome.

### **3. Make All RFP Responses Public**

Transparency is also crucial in the RFP selection process. At the December Event, a representative of the SROs indicated that, after publishing the RFP and obtaining bids, the SROs will select the winning bidder. Responses to the RFP that the SROs considered will not be made public. It is SIFMA's understanding that the industry will have no opportunity to provide input into the selection of the CAT processor—or even see bidders' proposals. SIFMA urges the SROs to reject this secretive approach in favor of a transparent process that will better inform the public discussion by making all RFP responses public.

SIFMA expects that the responses to the RFP will set forth each bidder's proposal for how the CAT processor will function and reflect significant differences in approach. Each of these proposed structures may impose different costs, provide different benefits, and allocate the costs and burdens differently. These different visions should be available to the public to inform the discussion regarding the costs and benefits of various CAT features and the technological feasibility of different solutions. The RFP responses that are *not* selected, along with the SROs' rationale for their elimination from consideration, will be important for the industry to consider in commenting on the ultimate NMS Plan filed with the Commission. For example, an RFP response may propose a lower cost alternative to the proposal selected by the SRO, but may be judged by the SROs to nonetheless be inferior to the higher cost proposal. The public and the Commission would have an interest in seeing each RFP response so it can better understand the SROs' choice.

Of course, to the extent that information contained in an RFP response is sensitive or proprietary, and its exclusion does not detract from the ability to evaluate the response, SIFMA would not object to aspects of the responses being redacted before public dissemination.



## **B. SRO Conflicts of Interest in Designing RFP and Selection of CAT Processor**

SIFMA understands that certain of the SROs themselves are considering responding to the RFP and bidding to become the CAT processor. If this is the case, an SRO that is, at the same time, involved in designing and preparing the RFP, bidding to become the CAT processor, considering the RFP responses and selecting the winning bidder, faces an inherent conflict of interest. For example, an SRO that is itself interested in responding to the RFP could have an incentive to design the RFP in a manner that better aligns with its own qualifications and abilities than competitors or third parties. An SRO (many of which are for-profit enterprises) that intends to itself submit an RFP response may have difficulty acting as an impartial participant in designing the RFP or considering the responses of its competition.

Notwithstanding the conflict of interest it will cause, SIFMA believes that the development of the CAT will benefit from a broad pool of RFP responses submitted by a range of qualified parties, including any SRO that believes it may fill this role. However, if any SRO were to prepare and submit a bid, SIFMA believes that certain specific protections should be implemented in order to manage the conflict that would arise from an SRO bidding, including the following:

- Establish information barriers between any SRO employee working on the CAT development project as part of the joint SRO working group, on one side, and any person involved in the preparation of an SRO's bid on the other side. The walls would need to prevent collaboration between individuals engaged in designing the RFP and those preparing a response to the RFP on behalf of a bidding SRO.
- Any SRO that is itself submitting a bid to act as CAT processor should be obligated to recuse itself from the consideration of all RFP responses, and the ultimate CAT processor selection.
- As discussed above, all RFP responses should be made public. If an SRO's bid is ultimately selected, public disclosure of other rejected responses would mitigate potential claims that the SRO was favored over a qualified third-party bidder with a superior response and bid.

The adoption of these policies would enhance the CAT processor selection process, and ultimately contribute to the CAT's success, by ensuring that an SRO may bid on the RFP, while dispelling the conflict of interest that arises from the same SRO effectively "sitting on both sides of the table."<sup>10</sup>

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<sup>10</sup> Additionally, if a for-profit SRO is ultimately selected as the CAT processor, SIFMA believes adequate controls and conflict-of-interest policies will need to be implemented, for example, to prevent any (...continued)

### C. Funding Models and Allocation of CAT Costs

The SROs have not yet made public any proposals for the manner in which the CAT would be funded and how its costs would be allocated. Given the large anticipated cost of developing and operating the CAT, the manner in which these costs will be allocated and recovered is an integral issue that should be addressed early in the process. Rule 613 requires the SROs to consider the costs and benefits of their choices between reasonable alternative approaches to creating and implementing the CAT.<sup>11</sup> But this consideration cannot take place in a vacuum—each reasonable approach may not only impose greater or lesser costs, but may impose costs differently on different parties. The costs to each group should be considered and analyzed independently. Because the allocation of costs between SROs and their members places SROs and their member firms in direct financial conflict, it is important that this area in particular have transparent deliberation and public input from the early stages.

SIFMA believes that these costs should be borne in an equitable manner among the SROs, their members, users of the CAT data, and the industry as a whole. SIFMA suggests the following guiding principles:

- The cost of building and operating the CAT is an industry-wide cost, and should not be shouldered by member firms alone. Most of the SROs operate as profit-making enterprises and have revenue directly attributable to the order lifecycle events occurring on their exchange. The burden of the costs of the CAT should not be borne entirely by members; SROs, investors, and potentially other stakeholders should also contribute their equitable share.
- Costs allocated to the SROs should actually be borne by the SROs themselves from their own independent sources of revenue, rather than simply being further passed through to member firms.
- The SROs already receive significant fees attributable to the order lifecycle activity occurring on their trading venue, such as revenue from the sale of market data. The Commission has long contemplated that the market data fees the SROs receive are primarily intended to fund the costs of SROs' regulatory functions, particularly those relating to the SROs' market surveillance activities.<sup>12</sup> As the CAT will, in large part, be used by SROs to

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(continued...)

appearance of potential misuse of information that the SRO gains access to through its role as CAT processor.

<sup>11</sup> Rule 613(a)(1)(xii).

<sup>12</sup> See Concept Release: Regulation of Market Information Fees and Revenue, Exchange Act Release No. 42208 (Dec. 9, 1999).

enhance their market regulation and surveillance activities, market data fees and other fees the SROs already receive to fund regulatory activities (such as FINRA's Trading Activity Fee and the options exchanges' Options Regulatory Fee) are a particularly appropriate source of CAT funding.<sup>13</sup>

- As the Commission detailed in the CAT Adopting Release, the Commission currently faces numerous challenges and inefficiencies in conducting market surveillance, investigations, enforcement and market reconstructions—as it must obtain audit trail information from numerous disparate sources. The CAT will not only significantly improve the quality of the information available to the Commission, but reduce the cost and burdens the Commission currently faces in obtaining the data and performing these functions. As the Commission will be a significant user of the CAT and the CAT will likely bring significant cost savings to the Commission, SIFMA believes that the SROs should consult with the Commission to determine whether the Commission should potentially contribute part of the cost of the development and ongoing maintenance of the CAT.
- To help defray the costs of the CAT, the SROs should also consider creative and alternative funding mechanisms, such as allowing for the future sale of portions of the data collected by the CAT. For example, market participants, issuers, academics and others may have an interest in purchasing aggregated and non-individually identifying trading data in order to study market and trading trends. While appropriate privacy controls would need to be implemented, the sale of CAT data for limited purposes may be an opportunity to offset part of the cost of the CAT and reduce the costs that need to be allocated between the SROs and their members.

In addition, the SROs and SEC should examine if there are any cost and funding efficiencies to be gained from the existing technical and administrative infrastructures of other plans, such as the Consolidated Tape Plan, the Consolidated Quotation Plan, the Nasdaq UTP Plan, and the Options Price Reporting Authority Plan. Because these plans similarly involve the collection and reporting of trading data and maintain a supporting fee structure, there may be ways to leverage these existing mechanisms rather than creating redundancies and additional industry costs.

#### **D. Governance and Ownership of the CAT**

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<sup>13</sup> In this regard, we note that as the CAT will replace other legacy reporting and audit trail systems, the costs that the SROs currently expend on maintaining and operating these systems can be reallocated toward CAT expenses. The consolidated nature of the CAT should also allow the SROs to conduct their market surveillance activities more efficiently, allowing for additional cost savings that can also be allocated toward CAT expenses.

The Concepts Document outlines certain specific CAT functions for which the SROs are considering publishing an RFP to obtain bids to act as the CAT processor. However, the Concepts Document does not describe *what* the role of the CAT processor will be, its placement in the overall CAT structure, or address several important CAT governance features. A potential bidder would likely need to understand these and other unanswered questions surrounding the role of CAT processor before it could reasonably bid to take on that role. The resolution of these questions also closely tie in with and will impact other unresolved issues, such as determining an appropriate funding model, the nature of the Advisory Committee's participation, and the manner in which SRO members may interact through a single SRO point of contact (discussed in Section III.E below).

As a result, SIFMA believes that the SROs should publish their proposals on the following points for public comment, and consider the responses, before any RFP is published:

- *Structure of the CAT Processor.* What will be the structure of the CAT processor and how does it fit into the overall CAT governance structure? With whom will the CAT processor be contracting? Will the SROs jointly form an entity, such as an LLC, that will administer the CAT and hire a vendor to act as the CAT processor? Or, will the CAT processor itself administer the CAT? Will the CAT processor be a single-purpose entity formed to fill this role, or an existing vendor operating under a contractual arrangement?
- *Payment Structure.* Under what type of payment structure will the CAT processor operate? Cost of operation-plus an agreed-upon profit margin? A set contractual rate for the entire project per month? A specified dollar amount per CAT record received and processed?
- *Data Ownership.* Who will own the data received and processed by the CAT? The CAT processor? The SROs? What rights will the CAT processor have to the data?
- *Portability of CAT Processor Role.* How will the SROs ensure that the role of CAT processor is portable, such that the CAT processor can be replaced in the future (*e.g.*, if contract renewal terms cannot be reached, the processor ceases doing business, or otherwise)? Once built, who will own the intellectual property and systems that the initial CAT processor builds or contributes to the development of? If the CAT processor owns this intellectual property, how will the CAT processor be replaceable?
- *CAT Processor Financial Responsibility.* How will potential liability of the CAT processor (*e.g.*, in the case of a security breach) be assured? What level of insurance coverage will be required?

Any interested bidder would need to understand the responses to these questions in order to consider whether they are interested in bidding to be the CAT processor, and what their costs and potential profits might be. Proposing answers to these questions will also provide the necessary context for addressing several other important unresolved issues.

#### **E. Single SRO Point of Contact**

With 18 SROs involved in the development and administration of the CAT, member firms need a single SRO as their point of contact during both the development and operation of the CAT. With respect to the development stage, a single Lead SRO would allow SRO members (particularly those not directly participating in the Advisory Committee) a more streamlined ability to communicate with the SROs and engage in the process.

With respect to the ongoing operation of the CAT, SIFMA is concerned that different SROs may interpret the CAT's requirements differently, impose different compliance requirements, and subject firms to duplicative enforcement. Such a situation would, of course, be inefficient and unworkable for firms that are members of several of the SROs. Designating a Lead SRO would avoid this unnecessary complexity.

The Concepts Document contemplates the CAT processor will perform certain "administrative" functions, including functions with regulatory compliance implications. For example, under the Concepts Document, the CAT processor would provide CAT reporters with "data and reporting interpretations," as well as "monitor reporting compliance" and "develop compliance reports" regarding member firms. SIFMA supports the centralization of these functions within one entity, but questions whether these would be appropriate functions for the CAT processor if the CAT processor is not itself one of the SROs. SIFMA therefore believes that these functions should be performed by the CAT processor only if one of the SROs is ultimately selected as the CAT processor. Otherwise, a Lead SRO should be designated by the remaining SROs to provide these interpretations and perform compliance monitoring and reporting *on an exclusive basis*. Only the Lead SRO (or if a firm is not a member of the Lead SRO, another designated SRO) should have authority and responsibility to enforce CAT reporting obligations. Consolidating these functions within one SRO (whether or not it is the CAT processor) will create efficiencies and avoid regulatory duplication, potential inconsistent interpretations, and unnecessary compliance costs.

Additionally, because the CAT processor (or the Lead SRO) will be tasked with these regulatory functions, SIFMA suggests that the selection of the CAT processor should consider both immediate and potential future product coverage. In selecting a CAT processor, the SROs should therefore consider its knowledge and experience not only with respect to exchange-listed equities, but with respect to other products (*e.g.*, new issues and fixed-income securities) likely to eventually be reported through the CAT.

#### **F. Elimination of Legacy Systems**

In adopting Rule 613, the Commission recognized that the CAT could create efficiencies by eliminating redundant reporting systems and required the SROs to consider and describe a plan for the retirement of systems rendered duplicative.<sup>14</sup> Additionally, a key factor in the development of the CAT and the consideration of its costs and benefits will be its scalability and extensibility, particularly regarding what other existing systems the CAT will be able to replace and which products it will be able to support. The Concepts Document, however, does not address these issues, which are important questions of scope that bidders will need to consider.

SIFMA believes that the CAT should be designed to replace as many existing reporting systems as possible from its earliest stages. SIFMA acknowledges that expanding the CAT in a way that would allow for the elimination of legacy reporting systems may mean that the CAT must include information, products or functionality not absolutely necessary to meet the minimum initial CAT requirements under Rule 613—thus increasing its start-up costs. However, the overall cost reductions of expanding the CAT at the outset to eliminate redundant systems may justify the cost. The SROs should therefore seek responses in its RFP regarding the ability and costs of incorporating other reporting requirements into the CAT, and eliminating those systems. The SROs and public could then consider whether the additional start-up costs are justified by the savings of eliminating the legacy reporting system.

At very least, it is critical that OATS and EBS be entirely replaced and eliminated at the time that the CAT is implemented. SIFMA will not support, and will urge that the Commission not approve, an NMS Plan that does not result in the elimination of both OATS and EBS. It would be cost prohibitive to the industry to operate the CAT along with either additional system. Rather than CAT being an entirely new and additional cost, replacing OATS and EBS would allow firms to reallocate the costs currently spent on those systems to the CAT. While retiring OATS and EBS may mean additional upfront work to incorporate other features and functionality into the CAT (*e.g.*, to cover OTC equities—which are included in OATS, but not initially covered by the CAT, and information on cleared trades), the cost savings of eliminating OATS and EBS and preventing the operation of three side-by-side systems would justify the expansion from the outset. Further, to maximize costs savings and other efficiencies from shifting these and other reporting systems into the CAT and eliminate duplicative efforts, the SROs should avoid making any significant changes to these reporting systems during any interim period.

Any RFP should therefore request bids that assume that all OATS and EBS functionality will be incorporated into CAT, and request that responders also provide bids that would reflect the costs of including features in the CAT that could lead to the elimination of other systems, such as large trader reporting, large options position reports,

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<sup>14</sup> See, *e.g.*, CAT Adopting Release at 285; Rule 613(a)(1)(ix).

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Consolidated Options Audit Trail System (COATS), and FINRA's Trade Reporting and Compliance Engine (TRACE) system.

#### **IV. RFP Concepts Proposal**

##### **A. Technical Operation of the CAT**

Please refer to the Concepts Document Feedback Summary, attached to this letter, for an outline of SIFMA's comments and suggestions with respect to the technical operation of the CAT proposed in the Concepts Document.

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January 22, 2013

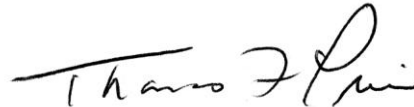
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SIFMA greatly appreciates the SROs' consideration of SIFMA's comments in connection with the Concepts Document. SIFMA would be pleased to discuss these comments in greater detail with the staff of the SROs. If you have any questions, please contact T.R. Lazo at (202) 962-7383 or tlazo@sifma.org, or Tom Price at (212) 313-1260 or tprice@sifma.org.

Sincerely,



Theodore R. Lazo  
Managing Director and  
Associate General Counsel



Thomas Price  
Managing Director  
Operations, Technology and BCP

cc: Elisse B. Walter, Chairman  
Luis A. Aguilar, Commissioner  
Troy A. Paredes, Commissioner  
Daniel J. Gallagher, Commissioner

John Ramsay, Acting Director, Division of Trading and Markets  
James R. Burns, Deputy Director, Division of Trading and Markets  
David S. Shillman, Associate Director, Division of Trading and Markets

Joe Ratterman, President and Chief Executive Officer, BATS Global Markets  
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William J. Brodsky, Chairman and Chief Executive Officer, Chicago Board  
Options Exchange  
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William O'Brien, Chief Executive Officer, Direct Edge  
Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA  
Gary Katz, President and Chief Executive Officer, International Securities  
Exchange  
Thomas P. Gallagher, Chairman and Chief Executive Officer, Miami International  
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Robert Greifeld, Chief Executive Officer, Nasdaq OMX  
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## Concepts Document Feedback Summary

This document is designed to provide SIFMA's high-level recommendations on the technical and operational considerations in connection with the design of the CAT. SIFMA appreciates the complexity of the issues that the CAT presents to both the SROs and the industry, and appreciates the opportunity to provide its membership's views. In order to develop consensus views on various aspects of the CAT, SIFMA has undergone a rigorous process with our members in which we have undertaken a diligent, comprehensive and thoughtful review and consideration of the proposals laid out in the Concepts Document. While this document includes an outline of our high-level themes, we expect to provide the SROs with a more comprehensive blueprint of our vision for the technical operation of the CAT within the next 30 to 60 days.

### **I. General**

1. At its core, the CAT is a consolidated audit trail of *existing* business activity. The manner in which the CAT is implemented should support *all* existing permissible trading behavior. Current business practices should not be required to change solely to conform to CAT technical specifications and requirements. A mechanism to support permissible but unmodelled activities (similar to exception codes in OATS) should be part of the specification and RFP.
2. Reporting to the CAT should be unidirectional, with the exception of error correction (discussed below). A business model requiring frequent or complex bilateral intraday communications with the CAT processor would be undesirable due to the tax on systems and processes that this would entail.

### **II. Linkages (including Order ID)**

1. The CAT should be designed in a manner to minimize disruption to current market practice, processing and systems. While changes will be required to provide a consistent cross market approach to the CAT, these changes should augment existing processes and facilities and not attempt to introduce a completely reengineered marketplace.
2. The model for linking transactions together should follow the "daisy chain" model proposed by the SROs on pages 24 and 26 of the Concepts Document. Additionally, SIFMA believes that constructing the audit trail from information provided by various CAT Reporters should be the responsibility of the CAT processor. The linkages model should leverage the linkage methodology of FINRA's Order Audit Trail System (OATS) with any applicable modifications to fully support the Rule 613 requirements. For example, the CAT should replicate the manner in which OATS handles linking unique order IDs for both intra- and inter-firm through the use of "Firm Order IDs" and "Routed Order IDs" to establish bi-directional links between data submitted by multiple firms (or between firms and exchanges).
3. The CAT data model should reflect linkages originating in the middle office which may be created subsequent to order and execution processing. Brokers can provide

customer orders and the (full or partial) executions related to those orders. They can also provide a set of allocations and orders (or in lieu of allocation, a step-out transaction to other brokers). There should be no expectation that an allocation will be linked to individual executions or individual orders.

4. The CAT data model should represent post-execution events relevant to the lifecycle of a reportable event. Post-execution events, such as allocations and CMTA transfers, will need to be added to the inventory of reportable transactions to support the CAT. In many cases an executing firm will not have a view of the post-execution lifecycle events necessary to reconstruct the life of an order for CAT reporting purposes. While the Concepts Document proposes that the CAT will not permit order event linking through any form of “fuzzy matching,” SIFMA believes a level of “fuzzy matching” logic will be required; for example, give-ups may require linking based on information on terms and conditions of orders as opposed to explicit linkages.
5. SIFMA recommends that the SROs create an inventory of all reportable fields in EBS that clearing firms or prime brokerage firms are responsible for, in order to prevent duplicative reporting and allow EBS to be retired in a timely manner.
6. When one firm steps out to another, the attributes of the reported post-trade allocations should be sufficient for the CAT to tie the event back to the original order.
7. SIFMA notes that manual orders will require submission to the CAT and acknowledges that these orders differ from electronic transactions. Manual orders lack the long chains of data that can be linked together using a daisy chain approach, and will require linking through “fuzzy matching” where explicit linkages are not available.

### **III. Customer ID**

SIFMA strongly supports the alternative approach for Customer IDs outlined by the SROs in their Concepts Document on page 22. This favored approach would not require that broker-dealers obtain and store a unique Customer ID from the CAT. SIFMA does not support the SROs’ initial recommendation for Customer ID, described on page 21 of the Concepts Document, which would establish two-way intraday communications to establish Customer IDs for new customers. This approach would require that broker-dealers change systems to capture a CAT-assigned Customer ID, contravening the guiding principle that the CAT fit into preexisting business practices wherever possible and that reporting to the CAT be unidirectional.

1. As noted above, reporting to the CAT should be unidirectional. SIFMA’s recommended model for interaction is to send customer and account information to the CAT, as well as subsequent account and transaction data, with all transformation and linking necessary to construct an audit trail within the CAT processor.

2. The CAT should be responsible for identifying and linking natural persons and legal entities across different reporting members from the account and customer information stored within the CAT processor. The ability to accept a CAT-generated Customer ID from the CAT and include it on all transmissions would require substantial infrastructure investments in systems and processes and is not a desirable model.
3. SRO members view their “customer” as the party that routed the order to the member, which may or may not be the end-user or ultimate beneficiary of the transaction. In many cases, such as with an interdealer broker, the SRO member may not know the identity of the end-client, or the role in which they are acting, and would therefore not be able to report this information to the CAT. Because members are often many levels removed from the ultimate beneficial owner, the CAT itself should be able to link each segment of the order back to the original ultimate customer under the daisy chain model, rather than relying on each CAT Reporter to report the identity of the ultimate customer.
4. To identify natural persons (*i.e.*, retail customers), date of birth and social security number / tax identification number should be used. Firms should also send an account number unique to the customer and other identifying information regarding the account and the CAT processor should generate a Customer ID number for the CAT’s internal purposes that can be linked to other accounts owned by the individual through the unique combination of social security number and date of birth.
5. Legal Entity Identifier (LEI) or Tax ID Number (TIN) should be the identifying attributes for non-natural persons that own brokerage accounts. The same methodology should be applied as stated above for retail customers.
6. CAT Reporters should send the CAT an initial file with all of a firm’s customer information (for both natural and non-natural person holders) as an initial, one-time population mechanism. Each business day, the CAT should accept one or more delta file(s) from the firm that includes additions and changes to their customer list.
7. The CAT should be responsible for mapping individual natural persons and legal entities to transactions by cross-referencing information stored within the CAT.

#### **IV. CAT Reporter ID**

1. SIFMA recommends that a CAT Reporter’s Legal Entity Identifier (LEI) be used as its CAT Reporter ID, and does not support the SROs’ proposal to use CRD numbers for the CAT Reporter ID discussed on page 19 of the Concepts Document. SIFMA’s membership supports LEI as the CAT Reporter ID given its new prominent role in the global financial markets and transaction reporting. Additionally, SIFMA’s members do not believe the SROs should introduce new protocols like CRD, which are not used in this capacity today. The use of LEI will allow the regulators to distinguish the exact legal entity engaged in activity.

The use of LEI also avoids any confusion between multiple CRDs utilized by member firms or single MPIDs used across multiple entities by the same firm. Support for existing identifiers would need to continue in the interim. However, the SROs' proposed approach of supporting a host of legacy SRO-issued identifiers in each market tied to a single CAT Reporter IDs within the CAT is both rational, and required for situations in which a Reporter does not have or has not yet transitioned to LEI.

## **V. Error Correction**

1. The Concepts Document proposes that error repairs will be required on a one-day turnaround timeframe. SIFMA believes that this is insufficient and recommends that the error correction timeframe mirror the existing standards used today for OATS, which allows repairs to be resubmitted within five days from the date the reject error is reported back to the firm (rather than the trade or reporting date).
2. CAT Reporters should be informed of any CAT system-detected errors within 24-48 hours.
3. SIFMA recommends that the CAT should be able to perform catch-up and re-run its analysis through a continuous or repeating match process to resolve rejects and mismatches, unlike OATS today.
4. The CAT processor may, at times, be in a better position than SRO members to detect the existence and source of an error since the processor will see activity on both sides of every transaction. While the members will strive to ensure all data is correct, the processor should be able to inform a CAT Reporter of a potential error and make suggestions for remediation based on its knowledge.
5. The CAT should give each party to a transaction an opportunity to repair information without penalizing their counterparty, which may not have been a source of the error. Today, the OATS process penalizes both firms on an OATS mismatch, rather than only targeting the offending firm that submitted the mismatch.
6. If a daisy chain is broken at one link, the CAT should not invalidate the entire order chain. This is particularly evident in the case of a GTC Order where activity may occur across multiple days. The CAT should be able to acknowledge the missing link and direct the associated error and penalties to the proper correcting firm.
7. The CAT should preserve child events and be able to reconstruct them upon correction of a parent order. Similarly, the CAT should provide the ability to amend previously submitted data that has not yet resulted in an error.

## **VI. Options**

SIFMA believes that the CAT framework for options should generally align as closely as possible to that being designed for the broader securities markets. That being said, the nature of the options market that exists today present certain unique challenges

that must be considered and addressed in the requirements for the CAT. Below are several key issues in options markets which are part of a broader list and discussion which will be shared with the SROs and SEC at a later date.

1. Notwithstanding the general expectation that both the SROs and the members will report each event, the options exchanges are in the best position to report option quotes to the CAT, given the market structure of the options market and the exchanges' existing infrastructure. This would avoid duplication of millions or billions of messages per day, ensure consistency in the data, and reduce the large number of broker-dealers required to report options quotes, thereby reducing excessive expenses to submit data that would provide no additional value over what can be reported directly by the exchanges.
2. SIFMA believes that the CAT should support OSI symbology as opposed to exchange symbology.
3. CAT Reporters should not need to transmit certain transaction details already implicit in the OSI Symbology or daily OCC files. Additionally, all transactions in listed options occur on an exchange, and each exchange submits a match trade file to the OCC. Therefore, SIFMA believes that SRO members should not have to report certain elements inherent to an options order, such as strike price, expiration date, the underlying symbol and whether the exercise is American or European style, since the CAT already will be receiving this data from an alternative source.
4. Exchanges are in the best position to report options orders entered directly into exchange-provided front ends, such as the ISE's Precise system. SIFMA acknowledges that broker-dealers may have to submit additional information to supplement the data reported by exchanges, such as the Customer ID.
5. The CAT will need to capture unique attributes and order types specific to the options market. This includes the open/close, and origin code describing the nature of market participant, *e.g.*, customer, firm or market maker.
6. Certain activities unique to the options market should be excluded from CAT reporting requirements. This includes exercise and assignments and representation of implicit strategies.
7. The CAT has to provide a sufficiently sophisticated model for representing net priced orders. SIFMA believes that the CAT requirements focus on two basic order types: regular, simple orders (a single order representing a single buy or sell or a call or put on an underlying) and "net priced" orders (a catchall for strategies in which a single order is placed for execution of two or more separate products at a differential price). SIFMA believes that the reporting should be reflective of the way the orders are received by and sent from the broker-dealer.

8. In order to address Rule 613's linking requirements, the CAT will need to deliver to the options market similar functionality as is provided by OATS with respect to linkages. Like equities, an options order can follow multiple systemic and non-systemic (telephone) paths through the layer of interdealer brokers before reaching an exchange. Because options transactions are not currently reportable through OATS, there is no simple way to reconstruct how the order has changed hands. The CAT linkage requirement utilized in options should mirror the one used in the equities market.
9. SIFMA recommends that the SROs leverage the COATS system to help facilitate the CAT reporting requirements, which will need to encompass manual trades that occur on an exchange trading floor.

## **VII. Infrastructure**

1. Transmission requirements
  - a. The initial format selected for the CAT should be designed with product expansion in mind, so as to eliminate the need for future enhancements to the CAT is expanded to include non-NMS securities in the future. SIFMA recommends the use of a standard record layout to be used for all reporting. The CAT should support multiple transport mechanisms for submission, such as FTP, FIX, web-based access and others.
  - b. CAT Reporters require the ability to transmit in either real time or batch. Additionally, CAT Reporters will need the ability to submit corrections either through a "batch with repairs" approach or as a manual correction to individual transactions.
2. Security Requirements
  - a. CAT Reporters will need the ability to specify and configure their own authorized users and their associated entitlements within whatever data access facilities are provided by the CAT.
  - b. SIFMA members recommend that security of the CAT should include both physical and logical access controls for both data centers and access points utilized by regulators.
  - c. CAT Reporters should have the ability to access an audit trail of what user accounts or processes from within their firms have altered or accessed their CAT-reported data, along with a change log and timestamp.
  - d. SIFMA members believe that the CAT should support file and disk-based encryption in order to safeguard their confidential information and that of their customers. This includes the encryption of data on all backup or removable media.

- e. SIFMA members believe there should be different levels of access provided to users with access to the system including write, read-only, create, modify; as well as compartmentalization of access by firm, business unit, reporter, or end “client,” for both individual firm users, operations personnel, and regulators.
- f. The CAT should ensure that appropriate standards are in place for protecting nonpublic information of any kind, including personally identifiable information.
- g. CAT Reporters will want to be informed of any security breaches occurring within the CAT.

### **VIII. Replacement of Regulatory Reporting Systems with the Consolidated Audit Trail**

1. OTC equity securities should be phased into the CAT on day one so that OATS and EBS can be retired at that time, eliminating the need for the industry to maintain redundant reporting systems.
2. Over time, the CAT should obviate the need for other separate regulatory reporting systems, and its initial design should allow for the future consolidation or retirement of these systems, such as Large Trader Reporting, Large Options Position Reporting (LOPR), Consolidated Options Audit Trail (COATS), Regulatory Filing Applications and Equity Cleared Reports.
3. A timeline and additional data fields should be proposed by the SROs in the NMS Plan to eliminate rules and reporting system that can be replaced with the CAT.

### **IX. Other**

1. OMS vendors and other third parties should be permitted to submit CAT reports on behalf of their client CAT Reporters.
2. SIFMA recommends that the SROs use the CAT as an opportunity to strategically migrate to a common symbology. Although SIFMA’s members strongly support generally minimizing changes to established business practices, longer term, SIFMA believes that it is desirable to move to a common symbology in order to reduce confusion and minimize trading errors, and that this migration may be efficiently managed as part of the CAT implementation.
3. SIFMA recommends that when an exchange plays a meaningful role in the technical generation of quotes on behalf of a broker-dealer, either through a proprietary API, or a specialist whose quotes are supported with exchange systems, then the exchange should submit the quotes to the CAT on behalf of members.