November 30, 2020

Mrs. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail To Enhance Data Security (Release No. 34–89632; File No. S7–10–20).

Dear Secretary Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned rule proposal[2] ("Release" or "Proposal") regarding the Consolidated Audit Trail ("CAT") published for public comment by the Securities and Exchange Commission ("SEC" or "Commission").

The need for and importance of the CAT for investor protection and market stability cannot be overstated. It will markedly improve the SEC's and self-regulatory organizations ("SROs") disparate and outdated market surveillance and enforcement capabilities and technologies. However, outsourcing the construction and operation of this mission-critical technology to the private sector—and putting some of the very market participants it is supposed to police and punish in charge of its governance structure—were grave mistakes that embedded conflicts of interest into the very core of the CAT.

The Proposal is a step towards implementing the CAT. While we lament the sad fact that the Commission seems to constantly bend backwards in its attempt to accommodate the unending demands of the industry that CAT is supposed to police, we nonetheless agree with most of the proposed amendments to CAT NMS Plan as we believe those changes will strengthen the cybersecurity of the CAT, protect investors' data and the integrity of the CAT system.

While we give due deference to the Commission's claims that—taken together—the Proposal will not diminish the usability, user-friendliness, and usefulness of the CAT system, we

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] *See* Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail To Enhance Data Security. Release No. 34–89632; File No. S7–10–20, 85 Fed. Reg. 65990 (October 16, 2020), *available* at https://www.federalregister.gov/documents/2020/10/16/2020-18801/proposed-amendments-to-the-national-market-system-plan-governing-the-consolidated-audit-trail-to.

still have lingering concerns that adding layers upon layers of limitations can—and likely will—have a chilling effect on both the Commission's staff and SROs regulatory staff's use of the CAT. We fundamentally oppose any usage limits on Commission's staff. We further hope that these new security requirements, and all the new organizational changes required to comply with these new requirements, will not cause further delays and increase conflicts of interest (that already exists in the current SRO-dominated model of CAT governance), in the process leaving investors exposed to predatory practices and endangering the markets.

Description of the Proposal

The Proposal would make significant changes to the CAT NMS Plan to enhance the data- and cybersecurity system of the CAT. These changes would, among other improvements, include, the requirement that the Operating Committee of the Consolidated Audit Trail, LLC ("CAT LLC" a Delaware limited liability company that is jointly owned by Plan Participants) create a permanent data and cybersecurity working group staffed with senior information security personnel of the CAT Participants (the exchanges and FINRA, collectively, SROs). The Proposal would also require the Plan Processor (a wholly-owned subsidiary to FINRA called "FINRA CAT, LLC") to create secure analytical workspaces ("SAWs") and require that Participants use such workspaces to access and analyze PII and CAT data for regulatory purposes. The Proposal would also "set forth requirements for the data extraction, security, implementation and operational controls that will apply to such workspaces, and provide an exception process that will enable Participants to use the user-defined direct query and bulk extract tools in other environments."[3] The Proposal would also set limits on the amount of CAT data that can be exported out of the SAWs, and would also require very strict (in fact, stricter than CAT's own now improved data security environment) monitoring and controls while the data is outside of SAWs.

Importantly, the Proposal would modify and supplement SROs' policies and procedures regarding the confidentiality of CAT data, strengthen the existing requirement that CAT data be used only for regulatory or surveillance purposes, and codify existing practices and enhance the security of connectivity to the CAT infrastructure.

SUMMARY

Because it is so important to investors and our markets, Better Markets has been a stalwart advocate for a robust, comprehensive, real-time CAT from the beginning.[4] Now, more than ten

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3 *See* Release at 66072.

4 *See* Better Markets Newsletter Discussing the Need for a CAT (August 13, 2014), *available* at https://bettermarkets.com/newsroom/financial-reform-newsletter-august-12-2014; *see* also, Better Markets Press Release applauding Senator Mark Warner's efforts on CAT (August 13, 2016), *available* at https://bettermarkets.com/newsroom/better-markets-applauds-sen-mark-warner%E2%80%99s-demand-sec-act-long-overdue-consolidated-audit; *see* also Better Markets Comment Letter in Response to CAT NMS Plan (July 18, 2015), *available* at https://bettermarkets.com/sites/default/files/CL%20-%20SEC%20-%20Consolidated%20Audit%20Trial%207-18-2016.pdf ("**Better Markets Letter 1**"); *see* also Better Markets Press Release raising disappointment on the final CAT Plan Approval (November 15, 2016), *available* at https://bettermarkets.com/newsroom/cat-plan-fails-protect-investors-rid-market-disruptive-and-manipulative-practices; *see* also Better Markets Memo to U.S. Senate Banking Committee Members on the eve of Confirmation Hearing of SEC Commissioners highlighting the need for Senators to ask questions to nominees about the CAT (March 14, 2017), *available* at https://bettermarkets.com/newsroom/critical-

years after the Flash Crash, we remain hopeful, but the Commission must quickly take strong, clear action to ensure the CAT is completed and fully operational as soon as possible.

The CAT has the potential to be a game-changer for the SEC and revolutionize the Commission's capabilities to protect investors, facilitate capital formation and promote fair and orderly capital markets—on which job creators and savers, and indeed all Americans, depend. Strengthening CAT's data and cybersecurity infrastructure, and reducing the real and built-in conflicts of interests that the current CAT NMS Plan has would benefit investors and enable the Commission and SROs to more safely use the CAT.

We urge the Commission to further amend Rule 613 and CAT NMS Plan to reform how the CAT LLC is governed and controlled to remove some of the thus far unmitigated conflicts of interests that plague the governance of the CAT NMS Plan.

COMMENTS

The CAT Has the Potential to Revolutionize SEC's Capabilities to Fulfill Its Tripartite Mission.

Better Markets has—for many years—supported the Commission's efforts to create the CAT.[5] As is well known, the CAT has the potential to be a game-changer for the SEC and revolutionize the Commission's capabilities to protect investors, facilitate capital formation and promote fair and orderly capital markets—on which job creators and savers, and indeed all Americans, depend. Once completed, the CAT will serve two critical and long-overdue functions:

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questions-should-be-asked-senate-banking-committee-confirmation-hearing-sec; *see* also Better Markets letter to U.S. Senate Banking Committee calling on oversight of the SEC to implement CAT (April 14, 2017), *available* at https://bettermarkets.com/sites/default/files/Senate%20Banking%20Committee%20Economic%20Growth%20Proposals.pdf; *see* also Better Markets op-ed in the *American Banker* "Policymakers shouldn't bail on plan to prevent next 'flash crash'" (November 8, 2017), *available* at https://www.americanbanker.com/opinion/policymakers-shouldnt-bail-on-plan-to-prevent-next-flash-crash; *see* also Better Markets letter to SEC Chairman Jay Clayton applauding his decision to not excuse implementation delay (November 15, 2017), *available* at https://bettermarkets.com/sites/default/files/Ltr%20SEC%20Chair%20Clayton%20re%20CAT%2011-15-17.pdf ("**Better Markets Letter 2**"); *see* also Better Markets Blog Post Encouraging the SEC to Stay the Course on CAT and implement it swiftly (January 18, 2018) *available* at https://bettermarkets.com/spotlight-series-investors-and-markets/sec-should-stay-course-cat; *see* also Better Markets Blog Post on "Flash Crash Anniversary a Reminder of Why We Need CAT and Why the SEC Should Flex Its Muscle to End Industry Procrastination" (May 4, 2018), *available* at https://bettermarkets.com/spotlight-series-investors-and-markets/flash-crash-anniversary-reminder-why-we-need-cat-and-why-sec; *see* also Better Markets Letter to SEC Chairman Clayton calling on the SEC to begin levying fines on the industry consortium for lack of compliance implementing CAT (September 24, 2018), *available* at https://bettermarkets.com/sites/default/files/BM%20Ltr%20to%20SEC%20Chair%20Clayton%20On%20CAT.pdf ("**Better Markets Letter 3**"); *see* also Better Markets Letter to the U.S. Senate Banking Committee's 10/22/2019 hearing on "Oversight of the Status of the Consolidated Audit Trail", *available* at https://bettermarkets.com/sites/default/files/Ltr_Senate_Banking_Committee_Hearing_re_CAT_10-19-19_-_Final_%28002%29.pdf (October 22, 2019). For a comprehensive list of Better Markets engagement on CAT, please *see* https://bettermarkets.com/Where-Is-The-CAT.

[5] *See* fn. 5, *ibid.*

enable the SEC and SROs to reduce, manage, and better understand market disruptions and crashes as well as identify, deter, and punish illegal manipulations and other predatory and trading abuses—all for the benefit investors and our markets.

Those functions are vital because investor confidence and trust are the foundations upon which capital markets are build and provide investment opportunities to savers and retirees. If the CAT system was fully operational during the post-COVID period, it would have supported the Commission's mission-critical work and empowered the Commission to better protect investors and understand market disruptions and anomalies—the kinds we witnessed both in the equities and bonds markets in March-April period.

Our markets are moving at the 21st Century speed of milliseconds, but our regulators' tools often are outdated far-short of what is necessary to properly fulfill their missions of investor protection and sustaining of market integrity. The CAT could change all that and catapult investor protection into the 21st Century. However, the CAT is currently bogged down in conflicts of interest at its governance level.

<u>The Commission Must Further Amend Rule 613 to Improve the Governance of the FINRA CAT LLC and Its Technical Capabilities.</u>

While most of the reforms in the Proposal are laudable (and long-overdue), they do nothing to address the foundational flaw that embeds the industry's conflicts of interest throughout the consortium and governance of the CAT LLC.

The CAT LLC is owned, controlled, and operated by the for-profit financial industry. This governance structure is riddled with conflicts of interest. Some of these Plan Participants are affiliated with broker-dealers and some of them have a long rap-sheet for violating SEC rules and securities laws.[6]

As a threshold matter, for-profit businesses should not be put in charge of and in control of the CAT and its data, which will contain information that would have commercial value for any for-profit company seeking to maximize profits (as opposed to the SEC with its mission of upholding the public interest). That said, we welcome the Commission's decision to strengthen the regulatory-purposes-only use requirement with this Proposal, and we also support the Commission's decision to prohibit duel-use cases as well, where an SRO may use certain CAT data both for regulatory and commercial purposes.

The Commission should further reform the CAT NMS Plan's organizational and governance structure. We do not believe any of the below suggestions require any legislative changes, and we believe the Commission has the authority to enact these. The Commission should

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6 *See,* for example, "SEC Charges Direct Edge Exchanges [owned by BATS Exchange] With Failing to Properly Describe Order Types." Penalty: at least $14 million. See, also, "SEC Charges NYSE, NYSE ARCA, and NYSE MKT for Repeated Failures to Operate in Accordance With Exchange Rules." Penalty: at least $4.5 million. See, also, "SEC Charges NASDAQ for Failures During Facebook IPO." Penalty: at least $10 million. See, also, "SEC Charges New York Stock Exchange for Improper Distribution of Market Data." Penalty: at least $5 million.

reconstitute the governance structure to reduce the industry's and SROs' dominance and increase the SEC's and public's representation in the governance of the CAT LLC, specifically—

- The Commission must alter the charter and corporate identity of the CAT LLC, turning it into a not-for-profit organization, and align its mission to that of the SEC and FINRA.[7] As currently constituted, the CAT LLC is a for-profit corporation with no discernable organizational mission. The CAT, as envisioned by the Commission, called for by Members of Congress, and championed by other investor advocates, promises to be a mission-critical tool and database to be used to protect investors and promote market integrity. Its charter must reflect that mission and purpose.

- The not-for-profit then must be led by a Board, the majority of which will be strictly independent directors with impeccable reputations and integrity. The benefits of including independent board members on corporate boards has been extensively studied. Independent board members increase a firm's operating performance,[8] companies with independent board members are more innovative,[9] and, firms with independent board members more effectively hold CEOs and other executives accountable.[10] All firms that issue registered securities in the U.S. (public companies, investment companies, etc.) are required to have some independent board members. Additionally, all quasi-governmental bodies regulating the securities markets have board members that represent the public interest and are independent of the industry they regulate. For example, FINRA, the Municipal Securities Rulemaking Board (MSRB), and the Public Company Accounting Oversight Board (PCAOB) all have majority public, independent board members (in the cases of FINRA and MSRB) and **all** independent board members, in the case of PCAOB. There is no compelling reason why the CAT LLC—responsible for creating and operating the most powerful regulatory tool and repository of information in SEC's history—should not have majority independent board members who pursue investor protection and market integrity.

- The chair of the Board must be a person without past, present or future conflicts who is appointed by the SEC in an open, public process. To avoid industry capture of the

7 *See* "About FINRA" webpage where it succinctly describes its role in the securities markets, "Every investor in America relies on one thing: fair financial markets. To protect investors and ensure the market's integrity, FINRA is a government-authorized not-for-profit organization that oversees U.S. broker-dealers. We work every day to ensure that everyone can participate in the market with confidence," *available* at http://finra.org/about.

8 *See* Knyazeva, Anzhela, Diana Knyazeva, and Ronald W. Masulis. "The supply of corporate directors and board independence." The Review of Financial Studies 26, no. 6 (2013): 1561-1605, *available* at https://www.researchgate.net/profile/Anzhela_Knyazeva/publication/250107467_The_Supply_of_Corporate_Directors_and_Board_Independence/links/02e7e51e95688dff83000000/The-Supply-of-Corporate-Directors-and-Board-Independence.pdf.

9 *See* Chen, Chung-Jen, Bou-Wen Lin, Ya-Hui Lin, and Yung-Chang Hsiao. "Ownership structure, independent board members and innovation performance: A contingency perspective." Journal of Business Research 69, no. 9 (2016): 3371-3379, *available* at https://www.semanticscholar.org/paper/Ownership-structure%2C-independent-board-members-and-Chen-Lin/043a6b0315c70813620e31e7fc280e086a6e12e9.

10 *See* Weisbach, Michael S. "Outside directors and CEO turnover." Journal of financial Economics 20 (1988): 431-460, *available* at https://www.sciencedirect.com/science/article/abs/pii/0304405X88900530.

executive functions of the CAT LLC and to ensure that the leadership of the CAT LLC Board is solely focused on advancing the mission of investor protection and market integrity, the Commission should appoint the Chair of the Board through an open and public nominations process. Importantly, the Commission has extensive experience constituting Advisory Committees tasked with assessing complex, highly technical matters of our securities markets. These Advisory Committees invariably have non-industry yet highly capable, knowledgeable and public-interest-oriented individuals. The Commission has all the contacts and experience necessary to select a conflict-free individual as Chair of the Board.

- The Director of the Division of Trading and Markets must serve on the Board as the permanent sole vice-Chair. One of the significant challenges the SEC is facing with the CAT NMS is that it has no direct involvement in decision-making of the CAT LLC. With a permanent seat at the board table, the Commission would be maximally informed of the undertakings, successes, and failures of the CAT NMS, and be able to quickly react to such developments. The Division of Trading and Markets has the technical expertise to guide the Board and could offer regulatory user's perspectives that could help maintain the CAT user-friendly.

The CAT Needs Upgrades To Be Maximally Effective.

An additional overriding flaw in the CAT system is that the performance specifications of the current CAT Plan indefensibly fall well short of what is necessary and technologically possible. It is as if the SEC wants to get out of 19th Century, but only to the 20th Century and not to the markets and private sector of the 21st Century. Building such a disadvantage into the CAT Plan at the beginning means that the SEC simply will never catch up with the industry and likely never be in a position to fully and properly protect investors and markets.

For example, the CAT Plan currently requires that Participants report data to the Central Repository by 8 a.m. on *the next trading day*. For example, a trade (or any other reportable event) completed at 9:30 a.m. on a Friday on an exchange would not have to be reported into the CAT system until the following Monday at 8 a.m. – 70.5 hours after the trade has occurred. And delays for hours or close to a full day would presumably be commonplace.

In stark contrast, FINRA's TRACE and other systems already require much faster reporting, ranging from 10 seconds to 15 minutes on trade transactions. The CAT Plan offers no convincing justification for the extraordinarily lax reporting time frame, particularly given that market participants have real time access to the information and electronic transmission of it would likely only take.

Real-time, or near real-time would allow for much more robust surveillance and quicker reaction time. As suggested by experts at Lawrence Berkeley National Laboratory, there are reliable measurement methods that can be devised with the help of a high-performance computer system that would provide regulators with early warnings of an impending Flash Crash-like event.[11] These methods might provide as much as an hour of lead time, enabling regulators to intervene to pre-empt or mitigate such crashes (i.e., trading halts, circuit breakers, etc.). However, these would only be possible if the CAT receives real-time or near real-time reporting and is able to consolidate such data for monitoring and surveillance.

Without using the readily available real-time reporting functionality used today by other regulators and the industry itself, the CAT will serve at best as a data archive, not a meaningful surveillance system that could help the SEC detect unstable trading patterns, avert flash crashes, and halt abusive trading practices while they are in progress.

Finally, the CAT will also not include futures data, which is a glaring omission. The SEC and other regulators concluded that the Flash Crash itself was caused by a futures contracts trade. In other words, even if we had a fully operational CAT at the time of the 2010 Flash Crash, the CAT's database would not have included the necessary dataset to enable the SEC and the CFTC to conduct an audit to learn the identity of the trader or the type, timing, and size of the order – basically, what was then thought to be the causes of the crash.

CONCLUSION

There simply is no other tool that could as positively, effectively, and efficiently impact the Commission's abilities to detect, deter and, if necessary, punish predatory market practices as that offered by a robustly implemented and state-of-the-art CAT. This mission-critical tool would indeed become a game-changer. Some market integrity reforms are simply too important to outsource to a conflicted consortium of SROs. This is one of them. The sooner the Commission operationalizes this governing principle, the sooner the investing public, our capital markets, and the job creators and employees who depend on these markets, will realize the benefits of the CAT and the protections it would afford.

Sincerely,

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[11] *See* "Federal Market Information Technology in the Post Flash Crash Era: Roles for Supercomputing." Bethel, E. Wes; David Leinweber; Oliver Rubel; and Keshenq Wu. Lawrence Berkeley National Laboratory (2011).

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