



BETTER MARKETS

October 28, 2019

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 (Release No. 34-86901; File No. S7-13-19).

Dear Secretary Countryman:

Better Markets¹ appreciates the opportunity to comment on the above-captioned rule proposal (“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 It will finally move the SEC’s inadequate and outdated market surveillance and enforcement capabilities and technology into the 21st Century. 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.² It is as if a police department contracted with predators and criminals to provide the police with a really effective computer to catch them when they engage in future illegal activities.

Those egregious conflicts of interest have led to the problems the Proposal is trying to address. While the Proposal, if strengthened as set forth below, is a good step, the Commission must also use its other enforcement tools and must further amend its rules to end the inexcusable delays and conflicts of interest that are killing the CAT, harming investors and endangering the markets.

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 We recognize that these decisions were made years ago, predating the arrival of the current Chairman, Commissioners and Director of Markets and Trading, who have inherited the consequences of those decisions. We applaud the Chairman and the Director of Markets and Trading, in particular, for their efforts to address these prior failures and get the CAT completed.

Specifically, the Release³ proposes to (1) impose public transparency requirements on the self-regulatory organizations (“SROs” or “Plan Participants”) that are participants to the CAT National Market System Plan (“CAT NMS Plan”); (2) require that the SROs “file with the Commission and publish a complete implementation plan for the CAT and quarterly progress reports, each of which must be approved by a supermajority vote of the Operating Committee of CAT NMS, and; (3) impose certain “financial accountability” measures in the event the CAT NMS fails to meet the new implementation deadlines.⁴ The Commission argues “that increased transparency through formalized and public documentation of the Participants’ implementation progress will increase the Participants’ accountability for the efficient completion of CAT,” and “that modifying the CAT NMS Plan to require additional financial accountability to meet implementation deadlines is appropriate to achieve the CAT’s timely completion.”⁵

Our comments below will address the policy questions in the Release, but we will also offer comments on why the Proposal is woefully inadequate and possibly counterproductive given the significant challenges the CAT is facing.

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.⁶ Now, almost ten years

³ See Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail. Release No. 34–86901; File No. S7–13–19, 84 Fed. Reg. 48458 (September 9, 2019) *available at* <https://www.federalregister.gov/documents/2019/09/13/2019-19852/proposed-amendments-to-the-national-market-system-plan-governing-the-consolidated-audit-trail>.

⁴ See Release at 48458.

⁵ See Release at 48460.

⁶ 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-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

after the Flash Crash, we remain hopeful, but the Commission must quickly take strong, clear action to ensure the CAT is completed and 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. Therefore, we agree with the Commission that imposing transparency requirements upon the CAT NMS should improve the Commission's oversight and public's awareness of the CAT's implementation, or lack thereof. We also agree that imposing financial accountability measures on CAT NMS should increase the likelihood of the CAT's implementation. **However**, we believe the proposed accountability measures must be equally applied to Plan Participants as well as those Industry Members who contribute to any delay.

The failure to complete the CAT and have its capabilities available has significantly impaired the SEC's abilities to police the markets and has resulted in predatory practices going undetected and unpunished. There is no genuine dispute that this failure has harmed investors and our markets. Given this, the SEC should have enforced its rules, in particular Rule 613⁷ (which established the framework within which the CAT was supposed to have been created) and levied substantial fines on the CAT NMS to compel the completion of the CAT, as we previously argued.⁸ Unfortunately, the failure to impose any sanctions or penalties of any kind thus far has perversely rewarded those who have failed their duties, violated the SEC's rules, and victimized investors, in addition to leaving our markets exposed to potential catastrophic crashes.

Ignoring the powers the SEC already has and refuses to use, the Proposal purports to belatedly establish a transparency and accountability mechanism—with sanctions—but it falls far short of resolving the serious deficiencies with the CAT NMS. Therefore, the Commission must further amend Rule 613 to reform how the CAT is governed and controlled to remove some of the thus far unmitigated conflicts of interests that plague the governance of the CAT NMS.

COMMENTS

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

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-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>.

⁷ *See* "Rule 613 (Consolidated Audit Trail)", *available at* <https://www.sec.gov/divisions/marketreg/rule613-info.htm>.

⁸ *See* fn. 6, *ibid*, Better Markets Letter 3.

Better Markets has—for many years—supported the Commission’s efforts to create the CAT.⁹ 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. If completed, the CAT will serve two critical and long-overdue functions: enable the SEC 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 built and provide investment opportunities to savers and retirees. Yet, today, almost ten years after the “Flash Crash,” we remain at grave risk of another one, which will crush confidence of investors and damage our capital formation capability for years to come.

Our markets are moving at the 21st Century speed of milliseconds, but our regulators are too often hopelessly stuck with technology better suited to the horse and buggy era of the 19th Century. 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 and the Plan Processors appear to be taking advantage of inexcusable regulatory inaction.

The CAT NMS Consortium Is Harming Investors and the Commission Has Authority to Hold The CAT NMS Accountable, and Must Do So; Not Doing So Incentivizes The CAT NMS Consortium to Continue to Violate Commission Rules.

Due to the secrecy of the CAT NMS consortium, and SEC’s incomprehensible and inexcusable indecision to not compel transparency thus far, not much is publicly known why the CAT is still not up and running. From the little that is known, the initial Plan Processor, Thesys CAT, a subsidiary of Thesys Technologies, Inc., repeatedly failed to meet deadlines set in CAT NMS Plan and SEC Rule 613. As outlined in the Release, as of this writing, the CAT NMS has missed—**without providing *any* public explanation**—the following deadlines:¹⁰

- The November 15, 2017 milestone completion date for the Plan Processor publishing final technical specifications for the submission of order data for Industry Members;
- The May 15, 2018 milestone completion date for the Plan Processor publishing technical specifications for Industry Member submission of customer data;
- The May 15, 2018 milestone completion date for the Plan Processor making the testing environment available on a voluntary basis and beginning connectivity testing and accepting order data from Industry Members for testing purposes;

⁹ See fn. 6, *ibid*.

¹⁰ Neither the Release nor the three testimonies offered at the recently held U.S. Senate Banking Committee hearing on “Oversight of the Status of the Consolidated Audit Trail” nor *any* other SEC or CAT NMS statements have offered any explanation regarding the reasons for the failure to complete the CAT.

- The August 15, 2018 milestone completion date for Industry Member order submission testing;
- The October 15, 2018 milestone completion date for Industry Member reporting of customer information to the Central Repository;
- The November 15, 2018 deadline for full Industry Member reporting.¹¹

When the CAT NMS requested that the Commission extend the November 15, 2017 deadline for the CAT system to come online and receive data from exchanges and FINRA, the SEC—correctly, in our view¹²—declined to provide the CAT NMS such a “no action” letter which would have in effect blessed their non-compliance with the SEC Rule 613. The public understood from this action that the SEC was signaling that the agency reserved the right to bring enforcement proceedings against the CAT NMS consortium for non-compliance.

However, after those initially promising steps to ensure that the SEC would hold the CAT NMS consortium accountable for their non-compliance with the SEC Rule 613 deadline, the SEC’s oversight of this important issue lapsed. Despite repeatedly, flagrantly and openly violating SEC rules without any valid or compelling reasons (which should not matter anyway), the CAT NMS consortium has never been held accountable or punished in any way.

As we had detailed in a letter to the SEC Chairman in September 2018,¹³ the SEC had ample authority to compel compliance of Rule 613. In addition to the SEC’s general authority to enforce compliances of the securities laws and rules, the specific SEC rule that gave birth to the CAT NMS (SEC Rule 613) itself includes a provision mandating compliance by the industry-members that comprise the CAT NMS and specifies that non-compliance could result in fines. Rule 613 states clearly:

- (h) Compliance by national securities exchanges and national securities associations.*
- (1) Each national securities exchange and national securities association shall comply with the provisions of the national market system plan approved by the Commission.*
 - (2) Any failure by a national securities exchange or national securities association to comply with the provisions of the national market system plan approved by the Commission shall be considered a violation of this section.*
 - (3) The national market system plan submitted pursuant to this section shall include a mechanism to ensure compliance by the sponsors of the plan with the requirements of any approved plan. Such enforcement mechanism may include penalties where appropriate.¹⁴*

Such a requirement was fundamental to the SEC’s decision to outsource this mission-critical system to the private sector in the first place. After all, it has been obvious since the decision was

¹¹ See Release at 48460.

¹² See fn. 6, *ibid.*, Better Markets Letter 2.

¹³ See fn. 6, *ibid.*, Better Markets Letter 3, incorporated as if fully set for herein.

¹⁴ See 17 C.F.R. § 242.613(h).

made to outsource the CAT to the private sector that there were going to be serious conflicts of interest and enormous incentives for at least some industry members to delay, weaken or kill the CAT before it ever came on line (as previously detailed by Better Markets¹⁵).

That is why the Commission specifically armed itself with appropriate and effective regulatory tools to encourage and, if need be, compel the implementation of the CAT according to the approved timelines and standards. In particular, the phrase “may include penalties where appropriate” was a considered decision by the Commission. This phrase was absent in the 2010 Proposed Rule 613 but was specifically included in the 2012 Final Rule 613. In the Adopting Release for the Final Rule 613, the Commission argued—rightly so—

“...that a penalty provision could provide an incentive for each SRO [self-regulatory organization, *i.e.*, stock exchanges that comprise the CAT NMS consortium] to comply with all the provisions of the NMS plan because each SRO will seek to avoid incurring any penalty under the Rule. The incentive to avoid a penalty could also reduce the risk of non-compliance with the Rule.”¹⁶

Thus, the SEC was forearmed, and the industry was specifically forewarned.

It was, however, all for naught. As was predictable and foreseen, the industry-dominated and conflicted consortium failed repeatedly to meet its legal obligations, indefensibly putting investors and markets at risk. Not coincidentally, these actions also simultaneously made sure that the SEC cops on the beat remained unequipped and, therefore, incapable of effectively monitoring and policing their activities. Nevertheless, the SEC has repeatedly failed to use its authority, enforce the law or hold the lawbreakers accountable.

Given the critical nature of the CAT, the specific statutory authorization, and the consortium’s inexcusable conduct, the SEC should have levied substantial daily fines for every day of non-compliance. After all, the industry was on notice and the SEC had already been more than accommodating, but its rule was and remained nonetheless unjustifiably violated. Moreover, every day of delay was another day investors were at risk. This is the precise circumstance anticipated by the SEC and provided for in its rule. The failure of the SEC to act has gutted the rule, nullified the purpose for the provision, removed the risk of a penalty and, therefore, any incentive for compliance.

Transparency Measures Are Vital and Must be Enacted. They Must Apply Not Only to Implementation Phase But Also Upgrades.

We agree with the Commission that requiring the CAT NMS to create and publicize a detailed timeline with concrete deadlines (as set in the Proposal) would prod the consortium and the new Plan Processor, FINRA CAT, to progress towards implementation. We believe this timeline should be prominently publicized on the CAT NMS’s website. It would be beneficial if the SEC also creates a “Spotlight” webpage (as it has for many subjects, such as the Investor

¹⁵ See fn. 6 *ibid.*

¹⁶ See Adopting Release (Release No. 34-67457; File No. S7-11-10), p.235, available at <https://www.sec.gov/rules/final/2012/34-67457.pdf>.

Advisory Committee, Dodd-Frank Implementation, etc.) and host this timeline along with all other CAT related filings, notices, and Commission actions. A one-stop webpage should enable investors, market participants, journalists, Members of Congress, and all other interested parties, to remain informed of the progress, or lack thereof, of the CAT's implementation.

We agree with the Commission that quarterly detailed reporting is appropriate and would provide useful information to all interested parties. These quarterly reports would also provide an early-warning to the Commission and interested-parties about possible upcoming failures to meet any of the regulatory milestones, and enable the Commission to increase its oversight to ensure that the CAT NMS remains on track.

We further urge the Commission to require the same timeline publication and quarterly reports on progress to apply beyond just the implementation phase. The same transparency requirements would be useful when the CAT NMS establishes upgrades schedules. For example, if—and hopefully when—the CAT NMS decides to include futures data, or shortening of the reporting requirements, or increasing the resolution of time granularity, etc., creating a detailed timeline and milestones, accompanied by related quarterly reports would achieve the same public policy benefits as noted above (and discussed in the Release).

The Financial Accountability Measures May Permit Some Industry Members to Strategically Cause Delays So As to Avoid Reimbursing the CAT NMS. Therefore, They Must Be Equally Applied to Both Plan Participants and Industry Members.

The Commission proposes to impose what it calls “financial accountability” measures upon the CAT NMS whenever it fails to meet certain deadlines set in the Proposal. Particularly, the Commission proposes to divide the full implementation of the CAT into four distinct phases:

1. Initial Industry Member Core Equity Reporting: completion deadline, April 30, 2020;¹⁷
2. Full Implementation of Core Equity Reporting Requirements: completion deadline, December 31, 2020;¹⁸
3. Full Availability and Regulatory Utilization of Transaction Database Functionality: completion deadline, December 31, 2021,¹⁹ and;
4. Full Implementation of the CAT NMS Plan Requirements.²⁰

For each of these phases, the Commission proposes a schedule of ratcheting “financial accountability” measures in that the CAT NMS would be unable to recoup some (and up to 100%) of the expenses it has undergone in implementing the particular phase, *if* it fails to implement the required features and modules of the CAT by the dates applicable to the particular phase. For example, if the CAT NMS fails to meet the deadline of April 30, 2020 of Phase 1 by less than 60 days, it will only be able to recoup from Industry Members 75% of expenses it has expended for Phase 1. Similarly, if the CAT NMS fails the deadline by more than 60 but less than 120 days,

¹⁷ See Release at 48466.

¹⁸ See Release at 48467.

¹⁹ See Release at 48468.

²⁰ See Release at 48469.

then it could recoup from Industry Members only 50% of the expenses for Phase 1. Finally, if the CAT NMS fails the deadline by more than 180 days, it cannot recoup **any** expense from Industry Members, therefore, the entirety of the expenses for Phase 1 would be borne by Plan Participants. With slight differences, the same “financial accountability” measure apply to the other phases of the CAT implementation.

We agree with the Commission that this mechanism can serve as an effective tool to compel the Plan Participants to implement the CAT before the new deadlines. However, we nonetheless have serious concerns that the mechanism, as proposed, would be subject to gaming by Industry Members who stand to benefit from delays, but would not suffer the consequences of the delays they cause

As we have argued above, we believe at least some in the industry benefit from the fragmented market structure and lack of regulatory capabilities in detecting manipulation and other predatory behavior. These Industry Members do not have an incentive for the SEC or any regulator to have the revolutionary capabilities of the CAT. These Industry Members’ commercial interests will directly suffer, and some might even face an existential threat, if the CAT is operational and it detects, and the SEC punishes, predatory and illegal conduct. Additionally, even for those Industry Members who do not engage in practices that may be detected and punished by a regulator armed with a powerful tool like the CAT, knowing that they stand to materially benefit from delays to the CAT’s implementation—since they will not fully reimburse the CAT NMS for the expenses—they will have incentives to strategically cause delays.

All these Industry Members, through the formal channels like the Development Advisory Committee or the Industry Advisory Committee, have effective means to delay the implementation by objecting to, for example, specifications and other technical standards set by the CAT NMS. They could also simply coalesce and strategically delay implementation on their end, by claiming, for example, lack of resources or technical capability, inability to install necessary “pipelines” used to report data to the CAT system, or other myriad of seemingly technical or legitimate excuses however pretextual.

As is proposed, the Release does not consider or address **any** of these possible incentives and the resulting strategic maneuvers and gamesmanship that could result. Given the miserable history of the CAT implementation, and the above mentioned obvious economic incentives, the Commission should not take for granted any realistic machinations, and therefore should ensure that the “financial accountability” measures are not placed on the wrong parties. We therefore urge the Commission to amend these provisions so that, in a case of delays, they can be fairly applied upon parties that are in fact responsible for the delay.

For example, if Industry Members have caused or contributed the delay, they should bear the financial penalty, and not the Plan Participants. One potential mechanism by which the Commission could determine which parties to apply the “financial accountability” measures to after the CAT NMS fails to meet a deadline would be to encourage **any** member of the CAT NMS consortium (without the need for a vote by the consortium) to submit to the Commission information regarding who or what caused or contributed to the delay. The Commission could provide for a very short period of time for Industry Member(s) or others to respond to the

information submitted. The Commission, or its designated staff, would then determine the cause(s) of the delay and impose the “financial accountability” measures accordingly.

Importantly, the exact mechanism is less important than the “financial accountability” measures be substantial; the SEC being serious about taking meaningful action quickly; and, the process being transparent and having integrity. That should be sufficient to deter Industry Members or others from secretly sabotaging the CAT. Sunlight is the best disinfectant, but money (in this context) is the best motivator. If investors are ever to benefit from a CAT that lives up to its potential, the SEC simply must take stronger action to correctly identify the problem actors and punish them into compliance.

The Commission Must Further Amend Rule 613 to Improve the Governance of the CAT NMS and Its Technical Capabilities.

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. Moreover, as we noted above, they may actually incentivize inappropriate strategic behavior by some members of the consortium to cause future delays.

The CAT is owned, controlled, and operated by the for-profit industry, which is riddled with conflicts of interest, rather than the SEC which is statutorily required to prioritize the public interest. Under the SEC’s approved plan, the CAT is funded by industry. Its data will be accessible to the Plan Participants that manage the private corporation that will have formal ownership of the CAT. 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.²¹ The SEC will have access to this data for regulatory purposes only. As a threshold matter (and as we have argued through-out this letter and previously²²), 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).

To avoid more years of disappointment, failure and non-compliance, the SEC must promptly reform the Plan’s organizational and governance structure. The SEC may choose to retain the building of the CAT system by an outside entity, such as FINRA CAT, but it must host the system in-house, under its direct and sole control, retaining the prerogative to grant (or deny) access of the data to non-broker-dealer affiliated SROs. If the Commission believes it is necessary and appropriate, the Commission may enlist the already formed Development Advisory Group (DAG) and the Industry Advisory Committee to support and advise the Commission.

²¹ 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.

²² See fn. 6, *ibid*.

In the alternative, the industry's conflicts of interest must be eliminated or mitigated, or failure will be the inevitable outcome. To that end, the SEC must 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 NMS, LLC, specifically—

- The Commission must alter the charter and corporate identity of the CAT NMS, turning it into a not-for-profit organization, and align its mission to that of the SEC. As currently constituted, the CAT 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,²³ companies with independent board members are more innovative,²⁴ and, firms with independent board members more effectively hold CEOs and other executives accountable.²⁵ 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 NMS—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 executive functions of the CAT NMS and to ensure that the leadership of the CAT

²³ 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.

²⁴ 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>.

²⁵ 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>.

NMS 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 NMS. 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 in a position 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 SEC should solely control access and usage of the CAT system. Given the nature of the data and how it can serve a commercial purpose, the profit-seeking exchanges should not have any access to the CAT. If the regulatory arms of the exchanges have a demonstrable regulatory need for access, they should request it on an as needed basis. The SEC may also consider granting permanent access to FINRA to be used to pursue FINRA's mission of investor protection and market integrity.²⁶

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.

²⁶ 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>.

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—because, we submit, there is none—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 microseconds if not nanoseconds.

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.²⁷ 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, but for that to happen, the Commission must bring to bear the full weight of its statutory authority and compel the implementation of the CAT. 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. We hope our comments are helpful to the Commission as it deliberates this proposal and the comment file.

Sincerely,

²⁷ 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).



Dennis M. Kelleher
President & CEO

Lev Bagramian
Senior Securities Policy Advisor

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.com
lbagramian@bettermarkets.com
www.bettermarkets.com