BETTER MARKETS

November 15, 2017

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Consolidated Audit Trail (CAT) Is a Vital Tool that Must be Implemented ASAP

Dear Chairman Clayton,

I write on behalf of Better Markets[1] to support and applaud your decision **not to delay** data-reporting for the Consolidated Audit Trail (CAT), a vital, long-overdue market surveillance tool, and we urge you and your fellow Commissioners to continue to insist that the CAT get completed and up-and-running as soon as possible. As you know, the CAT will allow regulators like the Securities and Exchange Commission (SEC) to monitor our ever-evolving markets, detect market abuses, identify wrong-doers, and gain a deeper understanding of how modern markets work and why they sometimes crash.

It is simply unacceptable that today the SEC remains blindfolded in its market surveillance activities, lacking the most basic data and analytics to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. The CAT is specifically designed to correct that gross deficiency and it must be completed and become fully operational on time, if not sooner. As discussed below, attempts to justify delays in the activation of this critically important surveillance tool are baseless.

The Confidence Crushing Flash Crash Revealed Gaping Holes in SEC Capabilities

While the May 6, 2010 "Flash Crash" revealed gaping holes in our market surveillance capabilities and the urgent need for a CAT-like tool, the years-long debate since then about the details has obscured the shock and severity of that confidence-crushing market crash. It was really more of a bungee-jump than a crash because the 10-minute $1 trillion plummet down was quickly erased with a ten minute $1 trillion bounce-back up. However, during that time, a single share of stock for Accenture, CenterPoint Energy, and Exelon dropped to $0.01 while one share of Apple, HP and Sotheby's skyrocketed up to $100,000.00. Those dizzying market moves only took about 18 minutes or so to unfold, but it took many months for regulators just to reconstruct

[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, one that protects and promotes Americans' jobs, savings, retirements, and more.

the events and, even now more than seven years later, no one really knows what happened, as the arrest of a London trader contradicted previous studies, conclusions and beliefs from years earlier.

The Flash Crash bounce back up to almost top-line net-zero losses has obscured the damage and danger to our markets and investors. But, as our opaque and fragmented markets move to nanosecond speed, it is only a matter of time before we see a repeat of the Flash Crash -- or more likely something much worse. For example, imagine if the Flash Crash happened just ten minutes before the close and there was no time for the market to bounce back. U.S. markets would have closed down about $1 trillion, which would have almost certainly triggered an historic global selloff with likely catastrophic consequences.

Moreover, it is critical to remember that, while the Flash Crash may have been unique thus far in its severity, it wasn't a one-off. There have been numerous other significant "mini" flash crashes since. For example, on October 15, 2014, we saw extreme volatility in Treasury markets and, on August 24, 2014, another market "bungee-jump" resulted in the Dow falling by more than 1,000 points before snapping back quickly.

<u>The Consolidated Audit Trail Is a Vital Tool That Must Be Completed on Time</u>

As you know, after the Flash Crash, many in and out of Congress demanded that the SEC get better tools to analyze and, if possible, prevent such destabilizing events, which would also fulfill its central mandates of protecting investors and maintaining the integrity of the markets. Hearings were held; speeches were delivered; blame was cast; reports were issued; and, promises were made. Ultimately, it took six years for the SEC to approve a final rule which, while far from perfect,[2] did set in motion the building of a computerized CAT able to capture most activities in the securities markets, which will enable roughly real-time analysis of market disruptions and anomalies like the Flash Crash.

Now, after being hired in January 2017, a CAT contractor has nearly completed the initial build according to the highest security standards. If the SEC-approved timeline remains intact as you maintained yesterday, exchanges will begin to report some data to the CAT starting today. As you know, other data and other market participants will have to begin reporting in phases over the coming months and years. For example, broker-dealers will have to begin reporting in the next two years. This timeline is critical if the SEC is ever going to have even minimally adequate tools to protect our markets and investors.

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[2] See, e.g., Comment Letter from Better Markets to the SEC on the "National Market System Plan Governing the Consolidated Audit Trail," Release No. 34- 77724, File No. 4-698 (July 18, 2016), *available at* https://bettermarkets.com/sites/default/files/CL%20-%20SEC%20-%20Consolidated%20Audit%20Trial%207-18-2016.pdf.

Objections to the CAT Are Baseless and Should Continue to be Rejected

But now many in the industry, including the for-profit exchanges, other trading venues, broker-dealers and high-frequency traders, are using the recent hack of the decades-old SEC computer system, EDGAR, as an excuse to kill the CAT. They argue that the SEC, which is statutorily charged to protect investors and make our securities markets fairer and less prone to manipulation, cannot be trusted with the vital data it needs to conduct audits or monitor the markets, and go after those who manipulate markets or defraud investors. In meetings with policymakers, they say that unless and until the securities regulators build an unrealistically impregnable system to house personally identifiable information (PII) that is critical to the workings of the CAT, the SEC should not have access to the CAT.

In an even more disturbing move, the industry is pushing for legislation that will bar the operator of CAT from collecting **any** market data until the SEC builds those hacker-proof systems. That would have the effect of killing the CAT, since such system cannot be built and such a delay would render the system obsolete before it is ever turned on. It is important to note and consider that the industry is loath to impose similarly high IT security standards on itself before collecting PII from its clients and investors. The SEC should not be held to impossibly high standards of security that the industry does not **first** impose on itself.

Like all Americans, we too are concerned about potential cyberattacks and violations of personal privacy – whether it is stolen from regulators or, as is much more often the case, from corporations, including financial firms. However, we think it is utterly shortsighted and disastrously unwise to kill a potentially game-changing tool under the pretext of "protecting PII." If the industry and their allies are truly concerned about PII and market stability (and getting rid of bad actors from their ranks, as they claim), they should embrace and advocate for other solutions that enable the CAT to work and appropriately protect PII. In short, they should help improve the CAT, not try to kill it.

A Simple CAT-Based Solution to Protecting PII

If one is genuinely concerned about protecting PII in a system already built according to the highest security standards, as the CAT is reported to be, then we would suggest a simple solution to prevent PII exposure. The SEC could require the CAT operator to create a special regulator-only access point to its system. This would be a protected regulatory safe zone: a secure, firewalled-space within the confines of the CAT system where only regulators have access to its analytical capabilities and data.

This regulatory safe zone would allow only regulators to log into the CAT system, plug-in their own data and other analytical tools to conduct their regulatory business without ever needing to export the data (PII or otherwise) to their in-house systems. Obviously, the regulators' activities in the CAT would need to be fully secure from everyone else, i.e., no auditing or audit trail of the regulators.

As a result, the regulators would not need to build an impossible-to-achieve high security capability around the PII data. The SEC and other regulators do not need to protect what it does not have in the first place.

<u>Conclusion: The CAT Is Essential To Protecting Markets and Investors</u>

It is simply a gross disserve to our markets and investors that our cops on the Wall Street beat – more than seven years after the Flash Crash -- still lack the most minimal and basic tools to understand market abnormalities, to quickly determine their causes, and, if appropriate, identify and punish manipulators and wrongdoers. It took more than five years for the government to bring a case against the person who allegedly caused the Flash Crash. That was years after an exhaustive study by regulators that failed to identify any perpetrators or find any wrongdoing by anyone.

As regulators and policymakers mandated to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation, an effective CAT is essential and long overdue. You are right to insist that the CAT be completed on time (and, we would argue, improved, but that's a discussion for another day).

Finally, while your reported "constructive" talks with the industry certainly should continue, it appears that there might be some degree of noncompliance. Make no mistake about it: whether intended or not, this is a very high profile, public test of the SEC. If such noncompliance is any more than minimal or for an incredibly short period of time, then the SEC must use its enforcement authority against those who knowingly and intentionally defy the law. The industry has had more than ample time to comply and the SEC simply must continue to insist that it do so. Any attempts to sabotage the CAT, disobey the rules or undermine the SEC must be quickly met with a direct, forceful and clear response that meaningfully punishes the violators. Anything less will send a horrible message that will undermine the mission, authority and integrity of the SEC.

Sincerely,

Dennis M. Kelleher
President and CEO

Cc: Commissioner Kara M. Stein
Commissioner Michael S. Piwowar