FIA PTG
PRINCIPAL TRADERS GROUP

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July 14, 2023

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Order Instituting Proceedings to Determine Whether to Approve or Disapprove an Amendment to the National Market System Plan Governing the Consolidated Audit Trail
Release No. 34-97750; File No. 4-698

Dear Ms. Countryman:

The FIA Principal Traders Group ("FIA PTG")[1] appreciates the opportunity to submit this letter to the Securities and Exchange Commission ("SEC" or the "Commission") in response to the Order Instituting Proceedings[2] on a proposed amendment to the CAT NMS Plan ("Proposed Amendment" or "Proposal") to implement a revised funding model (the "Funding Model") for the consolidated audit trail ("CAT"). Over the past six years, FIA PTG has filed four comment letters[3] on prior funding proposals filed by the Participants. As costs continue to spiral seemingly without constraint, instead of addressing concerns identified in our prior letters and seeking to reach a compromise with Industry Members, we have yet another slightly modified iteration of the same Proposal.

[1] FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy.

[2] *See* Order Instituting Proceedings to Determine Whether to Approve or Disapprove an Amendment to the National Market System Plan Governing the Consolidated Audit Trail Release No. 34-97750; File No. 4-698.

[3] *See* Letter from Joanna Mallers, Secretary, FIA PTG, to Brett J. Fields, Secretary, SEC, dated June 22, 2017 ("FIA PTG CAT Funding Letter #1"); Letter from Joanna Mallers, Secretary, FIA PTG, to Brett J. Fields, Secretary, SEC, dated Jul 28, 2017 ("FIA PTG CAT Funding Letter #2"); Letter from Joanna Mallers, Secretary, FIA PTG, to Brett J. Fields, Secretary, SEC, dated January 12, 2018 ("FIA PTG CAT Funding Letter #3"); Letter from Joanna Mallers, Secretary, FIA PTG to Vanessa Countryman, Secretary, SEC, dated May 12, 2021 ("FIA PTG CAT Funding Letter #4).

Since it was originally approved, the scope of the CAT has grown significantly and no longer resembles the database originally approved. The costs associated with the increased scope, both ongoing and historical, have grown substantially from those originally projected. These scope and cost changes were not subject to public notice and comment or cost/benefit analysis and Industry Members did not have meaningful representation to challenge or limit the expansion and associated expense, yet, the proposed Funding Model allocates the majority of the cost to Industry Members. The CAT requires a fundamental change to its governance and transparency model. Either it should become a Commission initiative that is subject to public notice and comment and cost/benefit analysis, or Industry Members deserve representation commensurate with their proposed share of the financial burden. Accordingly, once again, we urge the Commission not to approve this Proposal.

1. The Cost Allocation Methodology Violates the Exchange Act.

The Participants continue to attempt to allocate a majority of costs to Industry Members. We note that the principal terms set forth in the Funding Model, including the allocation costs to the Participants, have remained virtually unchanged for several years.[4] Despite the Participants' attempt to allocate massive historical costs, and many more billions going forward, the current Proposal and allocation methodology is supported only by cursory statements and no meaningful economic analysis. As discussed below, even the assumption that the Participants will bear 22% of CAT costs is questionable, given that the Proposal specifically contemplates that exchanges may pass-through their CAT related costs to Industry Members.

Industry Members will bear significantly more costs than the Proposal suggests. While the Funding Model purports to allocate 67% of CAT costs to Industry Members, it also allocates a separate 11% of costs to FINRA. However, as FINRA has made clear, the proposed allocation to FINRA should be expected to fall directly on Industry Members given that as a not-for-profit national securities association FINRA relies on member fees for funding.[5] Thus, at minimum, Industry Members should be expected to bear approximately 78% of CAT costs.

The Proposal's allocation of 22% of CAT costs to Participants is similarly problematic and unsupported by meaningful analysis. In particular, the Participants' statements that they may pass on their 22% of costs to their members (the same Industry Members) further calls into question the entire Funding Model. Specifically, we note that the Proposal states that "each Participant may determine to charge their members fees to fund their share of CAT fees."[6] If the Participants were to do this, it would render the entire Funding Model meaningless, ***with Industry Members bearing 100% of CAT costs***.

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4 Release No. 34-91555 (Apr. 14, 2021), available at: https://www.sec.gov/rules/sro/nms/2021/34-91555.pdf.

5 Letter from Marcia Ascquith, FINRA (June 22, 2022) available at: https://www.sec.gov/comments/4-698/4698-20132717-303208.pdf.

6 Proposal at 17107.

With little to no skin-in-the-game, the Participants will not be incentivized to control costs. These concerns are exacerbated by the general lack of transparency coming from the CAT Operating Committee. Despite continued requests for information about key drivers of the rapidly growing CAT costs, the CAT Operating Committee points to high-level financial and operating budgets published by the Committee that merely provide broad categories of costs and expenses.

Likewise, in the current structure, the SEC staff also have no incentive to control costs. The Staff continue to dictate various interpretations and requirements to the CAT Operating Committee outside of formal rulemakings. This process does not afford industry members with appropriate notice of, and opportunity to comment on, material changes to the CAT. Nor does it adhere to the requirements under the Exchange Act to weigh the costs and benefits of proposed changes to the NMS plan. This lack of formal process for material changes to the CAT has surely contributed to the significant growth in costs.

More broadly, the fundamental structure of the CAT and associated Funding Model raise important separation of power questions under the U.S. Constitution. The Commission has directed the development of CAT to supplement the government's surveillance program. At the same time, under the Funding Proposal, all or most of the costs of developing the CAT would be borne by Industry Members, who have no voice in its control or development. The power of any government agency to essentially levy such a tax on the industry should require Congressional oversight; yet in this case the SEC has avoided that requirement by directing CAT through Rule 613.

At minimum, any proposed allocation of prospective costs must properly incentivize the Participants to control CAT costs and establish appropriate controls to ensure they do so. Any future funding proposal should consider the exclusive right the Participants have to build and operate the CAT, without any substantive input from Industry Members — including making any proposals about how to allocate the costs. This creates a "blank check" moral hazard that has existed from the beginning and continues to contribute to the CAT Operating Committee's behavior. In this regard, FIA PTG would support the establishment of a mechanism akin to Section 31 under the Exchange Act. We note Section 31, unlike this Proposal, establishes a mechanism for Congressional oversight of the Commission's budget, which keeps the Commission's spending within certain parameters. Additionally, there are already established mechanisms for allocating Section 31 fees to the party originating an order. These critical components are absent from the Funding Model, and thus the SEC should reject the Proposal.

2. The Proposed Allocation of Historical Costs Violates the Exchange Act.

There are additional problems related to the Funding Proposal's allocation of historical costs. The Proposal fails to take into account the substantial and outsized implementation costs placed on Industry Members. Industry Members have invested substantial sums in developing sophisticated reporting technologies designed to comply with the CAT technical specifications. Because of the "moving target" that is CAT implementation, firms have had to devote significant time and resources to develop and then re-develop these systems to comply with ever-changing specifications.

Furthermore, it is inappropriate for Industry Members to bear *any* costs related to the CAT Operating Committee's failed engagement of Thesys as the Plan Processor, including any costs associated with engaging and transitioning to the new processor. The CAT Operating Committee on their own and with no input from the industry originally selected Thesys to build the CAT. Industry Members had no control over the selection or management of Thesys, which ultimately was unable to meet its obligations. There are no circumstances where it would be fair or reasonable for the Industry Members to pay any portion of costs related to this failed engagement over which they had no control. Similarly, there were likely substantial costs arising from the transition of a project of this size and complexity. Again, the industry had no decision-making authority over how expenses were managed for the transition to FINRA, and it is unreasonable for Industry Members to be expected to cover those costs.

Despite acknowledging that approximately 40% of Industry Members registered at the onset of this process are no longer registered and subject to the jurisdiction of the Plan Participants and the Commission, the proposed model seeks to allocate all historical costs to current Industry Members based on their current market activity. This is patently unfair. FIA PTG understands the challenge faced by the Company in reallocating costs incurred over the past decade but does not agree with the methodology proposed. Current Industry Members had no control over the stops and starts incurred in the development of CAT and the related funding model and simply cannot be left to pay the price.

3. The Governance Structure Continues to Lack Industry Participation.

From the start FIA PTG has raised concerns over the lack of industry participation in the development, operation and cost allocation processes of the CAT. If the Proposal is approved, we are concerned that under the current governance structure there will be little-to-no incentive for aggressive cost management since Industry Members will be footing the vast majority of the expenses. Accordingly, we believe that at a minimum, the CAT Operating Committee should be reconfigured, with Industry Members comprising the percentage of the Committee equivalent to whatever cost allocation percentage is eventually allocated to them.

4. The Overall Scope and Budget Have No Checks and Balances.

The CAT Operating Committee continues to fail to provide the public and the industry with material information about the source of spiraling CAT costs. Instead, the CAT Operating Committee publishes high-level budgets, with costs assigned to overly broad and unhelpful categories. As currently proposed, despite bearing most of the costs, there will be no opportunity for the public, including Industry Members, to review and provide commentary on the development of the annual CAT budget in advance of its implementation. Under this Proposal, we are left asking the same question we have asked before: What incentives do Plan Participants have to ensure these costs are aggressively managed going forward when historically there has been no accountability and most of the costs are being passed on to Industry Members? We join the Securities Industry and Financial Markets Association ("SIFMA") in calling for an "independent cost review mechanism."[7] The scope of the CAT must not be allowed to continue to expand and related costs to grow unfettered.

We also understand that a major driver of CAT costs is the addition of various new system features and reporting requirements that were established as the result of discussion between Commission staff and the CAT Operating Committee. Many of these requirements have been driven by informal reinterpretations of the 2016 Plan requirements and have resulted in material changes to the CAT without proper weighing of costs and benefits associated with such changes. Before finalizing a funding proposal, the Plan Participants should confirm that the existing CAT system meets the requirements of the Plan, and that any future changes will require filings with the Commission that afford industry members with notice of the change and an opportunity to comment.

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Requiring Industry Members, including FIA PTG members, to incur most of the costs, both ongoing and historical, of a system over which they have no control and data of which they have no access to, is unfair and therefore the Proposal should not be approved. If you have any questions, please do not hesitate to contact Joanna Mallers at jmallers@fia.org.

Respectfully,

FIA Principal Traders Group

Joanna Mallers

Joanna Mallers
Secretary

cc: Gary Gensler, Chair
Hester M. Peirce, Commissioner
Caroline A. Crenshaw, Commissioner
Mark T. Uyeda, Commissioner
Jaime Lizárraga, Commissioner

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[7] *See* Letter from Ellen Greene, Managing Director, SIFMA, to Vanessa Countryman, Secretary, SEC, dated May 2, 2023.