SEC Seeks Public Comment on Plan to Create A Consolidated Audit Trail

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Washington D.C., April 27, 2016 — The Securities and Exchange Commission today voted to publish for public comment a proposed national market system (NMS) plan to create a single, comprehensive database that would enable regulators to efficiently track all trading activity in the U.S. equity and options market. The plan for the database, known as the consolidated audit trail (CAT), was submitted jointly by the self-regulatory organizations (SROs) as required by Rule 613 of Regulation NMS.

“The Commission’s action to approve the proposed CAT plan for public comment is a major market structure milestone. CAT will enable regulators to harness today’s technology to enhance the regulation and oversight of today’s trading markets,” said SEC Chair Mary Jo White. “It will significantly increase the ability of regulators to conduct research, reconstruct market events, monitor market behavior, and identify and investigate misconduct.”

The proposed NMS plan details the methods by which SROs and broker-dealers would record and report information, including the identity of the customer, resulting in a range of data elements that together provide the complete lifecycle of all orders and transactions in the U.S. equity and options markets. The proposed NMS plan also sets forth how the data in the CAT would be maintained to ensure its accuracy, integrity and security.

In seeking public comment on the NMS plan, the Commission also prepared a detailed preliminary economic analysis of the proposal, which includes a discussion of the economic effects, including costs of the creation, implementation and maintenance of the CAT as proposed by the SROs.

Public comments on the proposal should be received by the Commission within 60 days of its publication in the Federal Register.

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FACT SHEET

SEC Seeks Public Comment on National Market System Plan to Create a Consolidated Audit Trail

SEC Open Meeting
April 27, 2016

Action
The Securities and Exchange Commission voted to publish for public comment a national market system (NMS) plan to create a single, comprehensive database—a consolidated audit trail (CAT)—that would enable regulators to more efficiently and accurately track trading in equity and option securities throughout the U.S. markets. The proposed plan would increase the effectiveness of market research and monitoring, event re-construction, and the ability to identify and investigate market misconduct. The plan is being submitted jointly by the national securities exchanges and the Financial Industry Regulatory Authority (FINRA) to the Commission.

**Highlights of the Plan**

**Plan Processor and Central Repository**

The CAT NMS plan provides that a plan processor will build a central repository that would receive, consolidate, and retain the trade and order data reported as part of the CAT. Among other things, the plan processor would be responsible for:

- Operating, maintaining, and upgrading the central repository
- Ensuring the security and confidentiality of all data reported to the central repository
- Publishing technical specifications containing detailed instructions for the submission of data by the self-regulatory organizations (SROs) and broker-dealers to the central repository

**Data Recording and Reporting**

The CAT NMS plan applies to NMS securities as well as to over-the-counter equity securities. At the various stages in the lifecycle of an order—e.g., origination, routing, modification/cancellation, and execution—the SROs and broker-dealers would be required to submit certain information about the order to the central repository, such as:

- A unique identifier, provided by the broker-dealer, for the customer submitting the order
- An identifier, provided by the SRO, for the broker-dealer receiving, originating, routing, or executing the order
- The date and time of the order event
- The security symbol, price, size, order type, and other material terms of the order

Generally, the CAT NMS plan requires this data to be recorded contemporaneously with the order event and reported to the central repository by 8 a.m. on the day following the event. The CAT NMS plan also requires CAT data to be time-stamped in increments as granular as those utilized by the SROs and broker-dealers, but with a minimum time stamp granularity of one millisecond for all order events except manual order events (in which case, the time stamp granularity must be a minimum of one second). Further, the CAT NMS plan requires the SROs and broker-dealers to synchronize their business clocks to within 50 milliseconds of the time maintained by the National Institute of Standards and Technology.

The CAT NMS plan sets an initial maximum error rate of five percent for data reported to the central repository, subject to quality assurance testing, adjustments at each initial launch date for CAT reporters and periodic review by the operating committee. The CAT NMS plan also discusses a
phased approach to lowering the maximum error rate with the ultimate goal of one percent for data reported to the central repository.

To assist in reducing the error rate, the SROs propose that the plan processor, among other things, measure and report errors, provide reports to the SROs and other reporters, define educational and support programs, and provide error correction tools.

The CAT NMS plan also reflects exemptive relief from certain requirements of Rule 613 that the Commission previously granted. This exemptive relief provides the SROs with the flexibility to propose approaches in the CAT NMS plan that could potentially be more efficient and cost-effective than those required by Rule 613 without adversely affecting the reliability or accuracy of CAT data. Specifically, the exemptive relief permits the SROs to propose, in the CAT NMS plan, that:

· Only options exchanges—but not options market makers—be required to report information to the central repository regarding options market maker quotations

· Instead of requiring a universal customer identifier for each customer to be used by broker-dealers for all orders, each broker-dealer could assign a unique firm-designated identifier (FDI) to each trading account. Under this approach, broker-dealers would be permitted to use an account number or any other identifier defined by the firm as the FDI, provided each identifier is unique across the firm for each business date. The plan processor would then assign a unique customer identifier for each customer.

· Instead of requiring a universal identifier for each broker-dealer reporting data to the CAT, a broker-dealer could use its existing SRO-assigned market participant identifier. The plan processor would then assign a unique identifier for each reporting broker-dealer.

· Instead of requiring broker-dealers to link a particular order or execution to an allocation, a broker-dealer could provide an allocation report that focuses on the shares allocated and the FDI of the applicable accounts or subaccounts

· Instead of requiring the receipt of manual orders to be time-stamped to the millisecond, a time stamp to the nearest second be permitted

**Governance**

The SROs propose to conduct the activities of the CAT through a Delaware limited liability company, which they would jointly own. An operating committee comprised of all the SROs—each with one vote—would manage the company. In addition, an advisory committee consisting of, among others, broker-dealers of various sizes and specialties, investors, and a person with significant regulatory experience, would provide input to the operating committee.

**Regulatory Access and Use**

The CAT NMS plan provides that the SROs and the Commission would have access to the data contained in the central repository for regulatory and oversight purposes. The CAT NMS plan provides that CAT data would be stored in a way that allows regulators to perform complex queries,
such as reconstructing market events and the status of order books at various time intervals. Regulators would have access to CAT data through both an online targeted query tool and user-defined direct queries and bulk extracts.

Data Security and Confidentiality

The CAT NMS plan establishes data security requirements regarding connectivity and data transfer, encryption, storage, access, breach management, and personally identifiable information (PII). In addition, the plan processor would be responsible for:

· Requiring individuals with access to the central repository to agree to use CAT data only for appropriate surveillance and regulatory activities and to employ safeguards to protect the confidentiality of CAT data

· Developing a comprehensive information security program as well as a training program that addresses the security and confidentiality of all information accessible from the CAT

· Designating one of its employees as Chief Information Security Officer, who would be responsible for creating and enforcing appropriate policies, procedures, and control structures regarding data security

Retirement of Duplicative Rules and Systems

As required by Rule 613, the CAT NMS plan contains a method to eliminate rules and systems that will be rendered duplicative by CAT, including identification of such rules and systems.

The CAT NMS plan estimates that market participants would have duplicative audit trail data reporting responsibilities for a period of up to 2.5 years after industry members begin reporting data to CAT.

Implementation Schedule

The CAT NMS plan provides for the following implementation schedule:

· Within two months of Commission approval of the CAT NMS plan, the SROs would be required to select the plan processor from among the remaining bidders through a two-round voting process in which each SRO has one vote

· Within one year of Commission approval of the CAT NMS plan, the SROs would be required to begin reporting data to the central repository

· Within two years of Commission approval of the CAT NMS plan, large broker-dealers would be required to begin reporting data to the central repository

· Within three years of Commission approval of the CAT NMS plan, small broker dealers would be required to begin reporting data to the central repository

Background

On July 11, 2012, the Commission adopted Rule 613 of Regulation NMS under the Securities Exchange Act of 1934. Rule 613 requires the SROs to jointly submit a national market system plan to create, implement, and maintain a CAT that would capture—in a single, consolidated data source—
customer and order event information for orders in NMS securities, across all markets, from the
time of order inception through routing, cancellation, modification, or execution. Rule 613 outlines a
broad framework for the CAT, including the minimum elements the Commission believes are
necessary for an effective CAT, while allowing the SROs to draw upon their expertise to develop the
details of the CAT.

What's Next?

The notice of the CAT NMS plan will be published on the Commission’s website and in the Federal
Register. Comments should be received within 60 days of publication in the Federal Register.
Consistent with Rule 608, if the Commission makes the necessary findings, the Commission must
approve the CAT NMS plan within 180 days.

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