Public Statement

Statement at an Open Meeting on a Notice of the Consolidated Audit Trail National Market System Plan

Chair Mary Jo White

April 27, 2016

Good morning. This is an open meeting of the U.S. Securities and Exchange Commission on April 27, 2016, under the Government in the Sunshine Act. The Commission today will be considering a major milestone forward in the creation of the consolidated audit trail (CAT), a critical initiative that will greatly advance the ability of regulators to oversee the modern, constantly evolving securities markets. Specifically, the Commission will consider a staff recommendation to publish for public comment a proposed national market system plan submitted jointly by the self-regulatory organizations (SROs) to create, implement and maintain the consolidated audit trail.

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The U.S. capital markets are the most robust and reliable in the world. In recent years, technology has transformed our markets, with sophisticated market participants – including brokers, proprietary traders, institutional investors, and many others – now using computer algorithms to generate large numbers of orders to be executed at great speed. While we are constantly seeking ways to optimize our markets for investors and issuers, these developments, in general, have significantly improved the marketplace for retail and institutional investors, as well as supporting the capital needs of small and large issuers.

The consolidated audit trail will greatly strengthen our ongoing efforts – through regulation, examination, and enforcement – to ensure that the U.S. equity markets remain the most robust and reliable in the world. Working with the SROs, we have put in place new measures to support the operational integrity of the critical infrastructure that stands at the center of the modern marketplace. We have advanced rules to enhance the regulation of active proprietary traders and to give investors better information about how their orders are handled. We have brought significant enforcement cases against exchanges, alternative trading systems, and other major market participants. And we have considered and will continue to consider foundational market structure issues through new data analyses and engagement with stakeholders, including through the Equity Market Structure Advisory Committee that just met yesterday.

The effectiveness of these initiatives and future ones depends on the Commission having the tools and the resources to keep pace with quickening developments in the marketplace. Simply put, the benefits that technology has created for trading in our markets must also be fully realized in the Commission’s regulation and oversight of those markets.
Regulators today face a variety of challenges in effectively overseeing today's highly automated, complex and dispersed securities markets. While FINRA and the exchanges currently maintain their own separate audit trail systems, and have worked diligently to improve them, these systems do not provide ready access to all of the data points necessary for effective oversight, such as customer identity and post-allocation information. Nor do these systems provide a mechanism to easily track activity across multiple equities and options markets. Regulators today thus do not have ready access to a comprehensive database of timely and accurate information about orders entered and trades executed across the U.S. securities markets – access that is increasingly necessary for us to effectively do our jobs to safeguard investors and the markets.

The consolidated audit trail is critical to achieving this objective, and it will generate enormous benefits for the SEC's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. Once completed, it will be one of the world's most comprehensive and sophisticated financial databases, providing the complete lifecycle of all orders and transactions in the U.S. equity and options markets. It will enable us to more quickly analyze and reconstruct market events like the Flash Crash and the volatility of last August 24th. It will enable us to more efficiently identify and investigate potential misconduct in high-volume, technology-driven markets. And it will enhance the ability of regulators to conduct research and monitor behavior throughout the equity markets.

The creation of a completely new system of this scale is a huge undertaking, requiring care in its development to ensure that the system ultimately built fully meets the regulatory needs and is designed in a cost-effective and efficient manner. Careful consideration of the alternatives and the full range of perspectives is imperative, as the creation of a well-designed database and its ongoing utility requires the close coordination and cooperation of all affected stakeholders. Every segment of our market infrastructure and every type of market participant, including investors, exchanges, FINRA, other trading venues, broker-dealers, clearing organizations, and technology providers, are impacted by this initiative. All of their perspectives should be fully heard and inform the collective effort.

I would like to take a moment to express my gratitude to the exchanges and FINRA, to whom our rule assigned responsibility for developing the consolidated audit trail. Their immense efforts, which have led to the proposed NMS Plan that is being considered by the Commission today, have included close consultation with a range of market participants, as well as with bidders seeking to build the central repository. I am also grateful for the significant contributions by the other members of the Development Advisory Group (DAG), which represents a diverse range of perspectives that have been critical to the construction of this proposal. The DAG includes some 24 firms, representing large, medium, and small broker-dealers, as well as three industry associations: STA, SIFMA, and FIF.

As required by Rule 613, the proposed NMS Plan includes details on the operation of the consolidated audit trail, including how data would be reported by the exchanges and broker-dealers and how that data will be made available to regulators. The plan also describes a variety of procedures to assure the timeliness, accuracy, and security of the data. An extensive economic analysis and discussion of alternatives also is included, as well as provisions relating to the
governance of the Plan, the selection of a Plan processor, books and records and financial matters, including a description of how the SROs intend to structure the fees associated with the consolidated audit trail.

In addition to the NMS Plan submitted by the SROs, the proposal being considered today contains a detailed preliminary, independent economic analysis prepared by Commission staff. This analysis includes a discussion of the economic effects, including the benefits and costs, of the creation, implementation and maintenance of the consolidated audit trail as set forth in the proposed NMS Plan, the likely effects on competition, efficiency and capital formation, as well as potential alternatives. We solicit comment on all aspects of this analysis to assist the Commission and market participants in understanding and evaluating the proposed NMS Plan.

More generally, the public comment process on the NMS Plan proposed by the exchanges and FINRA will be extremely important in ensuring the ultimate success of this undertaking. I encourage all interested parties to provide the Commission their views and analysis. The Commission’s notice highlights a number of areas where public comment would be particularly beneficial, and I want to very briefly underscore three of those.

First, the accuracy of the data submitted to and maintained by the consolidated audit trail will obviously be critical to its effectiveness. The proposal sets forth a maximum initial error rate of five percent for reporting data, and the expectations for how that initial rate will be lowered over time to one percent. I am very interested in the views of commenters on the reasonableness of the proposed maximum error rate, and its impact on both the usefulness of the consolidated audit trail and the timetable for retiring existing systems.

The NMS Plan also proposes that the initial clock synchronization standard be within 50 milliseconds of the time maintained by the National Institute of Standards and Technology, and that it be reviewed annually to determine whether it remains appropriate. There is concern about whether 50 milliseconds is the optimal standard or whether the offset should be more precisely calibrated, as the precision of synchronization may affect the accuracy of the sequencing of events recorded in the consolidated audit trail. This element of the proposal is also a significant cost driver that must be carefully considered. Opinions on the rigor and practicality of various clock synchronization standards and their impacts on our regulatory objectives are of keen interest.

Finally, I should note that, while the data contained in the consolidated audit trail is essential for regulators, it is highly sensitive information that includes unique customer-level information that needs to be secured. While the exchanges and FINRA fully recognize this, and the NMS Plan contains a variety of specific proposals relating to data security, I would ask commenters – particularly those with expert knowledge of information security processes and controls – to provide detailed feedback on this aspect of the proposal.

Implementation of the consolidated audit trail is one of the Commission’s top priorities, and today’s recommendation is a critical milestone toward its realization. The comments we receive will be assessed carefully as the staff prepares a recommendation for Commission action later this year, consistent with the time frames set out in Rule 608.
The implementation timetables set forth in Rule 613 would be triggered upon approval of the Plan, and executing on this timetable must be a top priority for us all. Under Rule 613, within two months after Commission approval, the exchanges and FINRA would select the Processor to build, operate and maintain the consolidated audit trail. Data would begin to be reported by the exchanges and FINRA within one year of Commission approval, by large broker-dealers within two years, and by small broker-dealers within three years, at which time implementation of the consolidated audit trail would be complete.

Of course, our work will not stop with the implementation of a consolidated audit trail. We will need to continuously work to enhance its operation and its utility, including by coordinating with other regulators to improve oversight of cross-market activities that involve securities and futures, as well as potentially other products.

Before I ask Steve Luparello, Director of the Division of Trading and Markets, to discuss the proposed NMS Plan, and Mark Flannery to discuss the preliminary economic analysis, I would like to thank Steve and his Deputy Director, Gary Goldsholle, for their leadership on this rulemaking, as well as their counsel, Carl Emigholz. I also would like to commend the Trading and Markets rulemaking team: David Shillman, David Hsu, Mark Donohue, Steve Samson, Rebekah Liu, Jennifer Colihan, Leigh Duffy, John Lee, and Ted Uliassi. From the Division of Economic and Risk Analysis, I would like to thank Mark Flannery, Jennifer Marietta-Westberg, Vanessa Countryman, Amy Edwards, Christopher Meeks, Laura Tuttle, Claire O'Sullivan, and Adam Bloomfield.

Many thanks as well to Annie Small, Meridith Mitchell, Lori Price, Tracy Hardin, Donna Chambers, Cynthia Ginsberg, and Maureen Johansen from the Office of General Counsel.

There are many other staff throughout the agency to thank for their contributions, including Steve Cohen, Mandy Sturmfelz, Rosemary Filou, and Wendy Kong from the Division of Enforcement.

Finally, I would like to express my gratitude to my fellow Commissioners and their counsel for their continuing hard work and dedication to bringing the consolidated audit trail to completion.

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