



February 14, 2019

Via Electronic Mail (kimmelm@sec.gov)

Ms. Manisha Kimmel, Senior Policy Advisor  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: Consolidated Audit Trail Implementation

Dear Ms. Kimmel:

The Healthy Markets Association<sup>1</sup> appreciates the opportunity to welcome you to the Securities and Exchange Commission. You have an incredibly important and complex task: overseeing the creation and implementation of the Consolidated Audit Trail (CAT).

The CAT has become a disappointment to investors, other market participants, regulators, and lawmakers. After more than eight and a half years of planning and building, we are still years away from realizing the CAT's potential.<sup>2</sup> As you approach your new position, we urge you to focus on three key areas:

1. the benefits of effectively utilizing FINRA's experience and resources,
2. the risks attendant with permitting access by for-profit exchanges, and
3. the need to dramatically improve and expand the content of the CAT.

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<sup>1</sup> The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets. To learn more about Healthy Markets, please see our website at <http://www.healthymarkets.org>.

<sup>2</sup> Our Executive Director, while serving as a senior US Senate aide, first pressed the Commission for what would become the CAT in 2009. We know that you are acutely aware of the need for the CAT, and so we will not further address those issues here. If you wish to review a history of the CAT and its importance, we refer you to our testimony before the House Financial Services Committee. Testimony of Tyler Gellasch, Executive Director of the Healthy Markets Association, Hearing on *Implementation and Cybersecurity Protocols on the Consolidated Audit Trail* Before the House Financial Services Committee, Subcommittee on Capital Markets, Securities and Investment, 115th Cong. (2017), available at [https://financialservices.house.gov/uploadedfiles/11.30.2017\\_tyler\\_gellasch\\_testimony.pdf](https://financialservices.house.gov/uploadedfiles/11.30.2017_tyler_gellasch_testimony.pdf).

## **FINRA Experience and Resources**

Just two years ago, the exchanges, through the NMS Plan process, selected Thesys as the winning bidder to build and maintain the CAT. Yet, it has been reported that the exchanges will be replacing Thesys with FINRA.<sup>3</sup> Some are arguing that this change in operators means that the Commission should again delay the CAT's implementation. We disagree. To the contrary, we believe that the switch to FINRA will allow the project to better leverage the experience and expertise of FINRA.

At the time Thesys was selected, FINRA and the NMS Plan Participants had gone quite far down the road of developing the necessary processes to build and implement the CAT. FINRA is not starting from scratch.

But most importantly, FINRA has spent decades working with broker-dealers on developing processes for submission of data for its Order Audit Trail System (OATS). That experience and existing infrastructure should be leveraged as the CAT project moves to the next key stage--taking data from broker-dealers.

Obtaining reliable data from a large and diverse group of broker-dealers is a complex task that FINRA has been doing for decades. We urge you to leverage their experience and resources to continue that process as seamlessly as possible.

## **Risks Posed by Exchange Access**

The CAT Plan permits the exchanges to access to CAT data for regulatory purposes. We are deeply concerned with the exchanges' access to the database, which we believe poses significant risks. We urge you to work with the NMS Plan Participants and the Commission to remove the exchanges from having access to the CAT data.

The for-profit exchanges' incentives and conflicts of interest pose significant challenges for them to provide consistent, high-quality surveillance and enforcement over the long term. Further, FINRA already performs the vast majority of the surveillance functions for the for-profit exchanges. FINRA has spent decades and millions of dollars developing technology and systems to process data and identify areas of concern across various venues. In general, the exchanges have not developed similar capabilities.

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<sup>3</sup> Dave Michaels, *Stock Exchanges to Fire Company Building Stock-Market Supercomputer*, Wall. St. J., Jan. 31, 2019, available at <https://www.wsj.com/articles/stock-exchanges-to-fire-company-building-stock-market-supercomputer-11548956486>.

Additionally, while the CAT Plan provides exchanges access for “regulatory” purposes, it is unclear what this access will mean, in practice. For example, can an exchange use it to determine how market participants are taking advantage of trading on its exchange? Can an exchange use the information from the CAT to tweak its rules for trading so as to gain market share or advantage or disadvantage particular market participants, including competitors? This seems to exacerbate the exchanges’ fundamental conflicts of interest as “for profit market participants” and “regulators”. Brokers submitting data should not be worried that the exchanges are going to use their access to the CAT data in a manner that could disadvantage their trading strategies, intellectual property, or customers. Similarly, ATSS should not be concerned that exchanges may misappropriate their CAT data access to disadvantage their operations. For-profit exchanges should not be in the position of being able to utilize their enforcement authority to negatively impact their competitors.

Finally, data security is a significant concern for the CAT. For any such concern, one of the primary security vulnerabilities is typically the points of access. Providing more than a dozen for-profit market participants (each with an unknown number of employees, contractors, or agents) with access to some or all of the CAT introduces significant risk for unauthorized or unintended access.

Ultimately, we believe -- strongly -- that access to the CAT data should be either public (on a time-delayed, anonymized bases) or limited to the Commission and FINRA only. The in-between ground where just some for-profit market participants have access, while others do not, is a recipe for disaster. We urge you to work with the exchanges and the Commission to dramatically alter the structure of the CAT Plan.

In particular, we urge you to work with the Commission to revise the Final Rule to extricate the CAT from the NMS Plan process entirely.<sup>4</sup> The Commission should take direct ownership of the CAT process and work with FINRA directly to implement it.

### **Need for Further CAT Enhancements**

The CAT was initially envisioned as a “real time” monitoring and surveillance tool that would provide regulators with a comprehensive view of who was doing what in our fragmented markets. The CAT Plan does not implement that vision. It is not real time. The time precision leaves significant variations. The CAT Plan does not require the use

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<sup>4</sup> The NMS Plan process, which was created by Congress when exchanges were predominantly mutually-owned organizations, is fraught with conflicts of interest and should be retired in its entirety. Testimony of Tyler Gellasch (2017).

of legal entity identifiers (LEIs), despite the widespread adoption of LEIs around the world. Nor does the CAT include broad-based futures markets--even though the Flash Crash that provided the primary impetus for the CAT's creation started with trading in broad-based futures markets.

We recognize these improvements will take time to implement, but we urge you to work with the Commission, FINRA, other regulators, and other stakeholders to work towards these significant enhancements in the months and years ahead.

### **Conclusion**

We look forward to helping you implement this important regulatory tool. We are thrilled that Chairman Clayton has tasked you with this important mission. Good luck, investors are depending upon you.

Sincerely,



Tyler Gellasch  
Executive Director

Cc: Brett Redfearn, Director, Division of Trading and Markets