

November 27, 2019

VIA EMAIL

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 50549

RE: Consolidated Audit Trail – Liability and Access Issues

Dear Chairman Clayton:

The Participants¹ of the CAT NMS Plan write in response to the letter sent to you by the Securities Industry and Financial Markets Association (“SIFMA”) dated November 11, 2019, regarding certain liability and access issues related to the Consolidated Audit Trail.² The SIFMA Letter expresses concern about the terms under which broker-dealers are required to report data to CAT. In particular, SIFMA objects to any limitations of liability by the Participants with respect to the reporting of data by Industry Members. SIFMA also raises issues with the use of CAT Data by regulators (i.e., the Participants and SEC) for regulatory purposes. In sum, the letter re-raises numerous issues that were previously addressed by the Commission and the Participants throughout the course of the proposal and adoption of the CAT NMS Plan.³ The Participants would like to respond to various aspects of the SIFMA Letter, as discussed further below.

I. Personally Identifiable Information

At the outset, the Participants greatly appreciate SIFMA’s continued interest in preparing its members for Consolidated Audit Trail (“CAT”) reporting as well as its concerns over protecting personally identifiable information (“PII”). In particular, the Participants appreciate SIFMA’s assistance with, and support for, the Operating Committee’s request for exemptive relief from certain requirements in the CAT NMS Plan regarding the collection of PII.⁴ However, the Participants would like to clarify that the PII Exemptive Request seeks an

¹ The twenty-four Participants of the CAT NMS Plan are: BOX Exchange LLC; Cboe BYX Exchange, Inc., Cboe BZX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., Cboe C2 Exchange, Inc. and Cboe Exchange, Inc., Financial Industry Regulatory Authority, Inc., Investors Exchange LLC, Long-Term Stock Exchange, Inc., Miami International Securities Exchange LLC, MIAX Emerald, LLC, MIAX PEARL, LLC, Nasdaq BX, Inc., Nasdaq GEMX, LLC, Nasdaq ISE, LLC, Nasdaq MRX, LLC, Nasdaq PHLX LLC, The NASDAQ Stock Market LLC; and New York Stock Exchange LLC, NYSE American LLC, NYSE Arca, Inc., NYSE Chicago, Inc. and NYSE National, Inc. Each Participant is a self-regulatory organization (“SRO”) under the Securities Exchange Act of 1934 (“Exchange Act”).

² Letter from Kenneth E. Bentsen, Jr., President and CEO, SIFMA, to The Honorable Jay Clayton, Chairman, U.S. Securities and Exchange Commission (“SEC”) (Nov. 11, 2019) (the “SIFMA Letter”).

³ See Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA, and Ellen Greene, Managing Director Financial Services Operations, SIFMA, to Brent J. Fields, Secretary, SEC (July 18, 2016); see also Letter from SROs to Brent J. Fields, Secretary, SEC (Sep. 23, 2016) (responding to public comments regarding the proposed CAT NMS Plan); Letter from SROs to Brent J. Fields, Secretary, SEC (Sep. 2, 2016) (responding to public comments regarding the proposed CAT NMS Plan).

⁴ See Letter from Michael Simon, Chair, CAT NMS Plan Operating committee, to Vanessa Countryman, Secretary, SEC (Oct. 16, 2019) (the “PII Exemptive Request”).

exemption from the CAT NMS Plan requirements that the CAT collect and retain social security numbers, dates of birth and account numbers for individuals; the request is not intended to and does not limit the definition of PII to include only customer name, address and year of birth.

II. CAT Reporter Agreement

Regarding SIFMA's objections to the CAT Reporter Agreement, the Participants have discussed the CAT Reporter Agreement on multiple occasions with SIFMA and have noted that the CAT Reporter Agreement is not a commercial contract. Instead, the CAT Reporter Agreement was prepared to facilitate compliance with a regulatory requirement (i.e., Industry Members reporting to CAT) pursuant to Rule 613, the CAT NMS Plan and each Participants' CAT compliance rules. Subjecting the CAT Reporter Agreement to the conditions proposed by SIFMA is both unprecedented and would undermine the viability of the SRO model that has been a feature of the federal securities laws since 1934. The SRO model requires the Participants to regulate their members, while the SEC, in turn, regulates the Participants. The Participants, as SROs, are held to very strict standards under the federal securities laws. For instance, each Participant must establish and enforce rules to regulate the conduct of its members, and each Participant also is subject to regular examination by the SEC.

The Participants continue to believe that the CAT Reporter Agreement is not substantively different from other regulatory reporting agreements with similar liability provisions (such as the FINRA Order Audit Trail System ("OATS") reporting agreement) that Industry Members have entered into with SROs. While CAT will collect more information than is collected by OATS, the Participants fail to see how that difference in scale affects what are similar liability provisions. Moreover, the Participants understand that Industry Members regularly enter into agreements with their customers that include broad limitations of liability that would cover claims related to theft or unauthorized access of a customer's PII held by an Industry Member.⁵ The Participants continue to believe that the most practical way to address SIFMA's concerns related to PII is to limit the amount of PII collected by CAT in the first instance, which the Participants are seeking to do through the PII Exemptive Request.

One of the stated objections to the CAT Reporter Agreement in the SIFMA Letter is that firms are not permitted to conduct extensive due diligence of the Plan Processor, which SIFMA claims firms would do in other circumstances.⁶ The Participants believe that SIFMA's concerns

⁵ See, e.g., E*TRADE Customer Agreement at Section 14 (disclaiming liability for security, among other things), available at <https://us.etrade.com/e/t/estation/contexthelp?id=1209031000>; Goldman, Sachs & Co. New Account Application and Agreement for Entities at Section 22 (disclaiming liability for any losses or damages of any kind, among other things), available at <https://www.goldmansachs.com/s/gspb/GSPrimeServices-GSCoNewAccountApplicationandAgreementforEntitiesStandardFormv32014.pdf>; Schwab Account Agreement, Electronic Services Agreement at Section 5 (disclaiming liability for unauthorized access, among other things), available at https://www.schwab.com/public/schwab/nn/agreements/schwab_brokerage_acct_agreement.html; TD Ameritrade Client Agreement at Section 7(c) (disclaiming liability for losses or damages of any kind, among other things), available at https://www.tdameritrade.com/retail-en_us/resources/pdf/AMTD182.pdf; Vanguard Brokerage Account Agreement at Section 19 and Electronic Services Agreement at Section 14 (disclaiming liability for unauthorized access and theft, among other things), available at <https://personal.vanguard.com/pdf/v718.pdf>.

⁶ As noted, the Participants are not aware of broker-dealers conducting due diligence with respect to other regulatory reporting agreements. In fact, members of the CAT Advisory Committee have previously mentioned that Industry Members do not conduct the same level of due diligence on SRO systems that they would otherwise.

over the inability to conduct extensive due diligence over the Plan Processor are misplaced. As previously discussed, the SRO model and the CAT NMS Plan adopted pursuant to Rule 613 vests the due diligence obligations with respect to the Plan Processor in the Participants, with strict oversight by the SEC. Much in the same way the Participants are not permitted to conduct due diligence of how their regulator, the SEC, uses CAT Data, broker-dealers must not be permitted to conduct due diligence of how the Participants, which regulate broker-dealers, comply with the CAT NMS Plan.⁷

Moreover, the Participants' view, as previously discussed, is that the CAT Reporter Agreement is not unique; it is similar to other regulatory reporting agreements that Industry Members execute with SROs. Regulatory reporting agreements are commonly used to govern the receipt of data by Participants and include limitations on liability. While extensive due diligence can be a negotiated term between parties in commercial situations, when both parties can choose whether to enter into an agreement or when a party can choose not to fulfill the terms of an agreement if due diligence reveals certain information, due diligence is not appropriate, in this case, where the Participants are required by law to establish a CAT that allows Industry Members to report data and Industry Members are required to report data into the CAT, which is subject to SEC oversight. Participants cannot condition the implementation of a requirement under the federal securities laws on due diligence requests of regulated member firms.

Separately, SIFMA's suggestion that the Commission should direct the Participants to allow firms to set up connectivity and testing without an agreement, or with a streamlined agreement that addresses the necessities of connectivity, without limiting the reporting firms' liability protections, is not a viable solution. As an initial matter, the Participants wish to clarify that Industry Members are not required to execute a CAT Reporter Agreement for the limited purpose of setting up and testing connectivity that will be used to report data to the CAT (i.e., "ping testing").⁸ However, the Participants do not believe that it would be prudent to permit Industry Members to engage in more extensive testing of their ability to report data to CAT by transmitting actual data without an agreement in place or to introduce a new, second agreement that addresses only connectivity. All firms with CAT reporting obligations in Phases 2a and 2b must complete production readiness testing by April 6, 2020 for Phase 2a and May 4, 2020 for Phase 2b. All such firms also must be certified with the Plan Processor prior to reporting to the production environment on April 20, 2020.

⁷ See Joint Industry Plan; Order Approving the National Market System Plan Governing the Consolidated Audit Trail, Exchange Act Release No. 79318 (Nov. 15, 2016), 81 Fed. Reg. 84696, 84764-5 (Nov. 23, 2016) (the "CAT NMS Plan Adopting Release") ("By statute, the Commission is the regulator of the Participants, and the Commission will oversee and enforce their compliance with the Plan. To impose obligations on the Commission under the Plan would invert this structure, raising questions about the Participants monitoring their own regulator's compliance with the Plan.").

⁸ On November 20, 2019, FINRA CAT sent a notice to Industry Members and CAT Reporting Agents that stated: "FINRA CAT, LLC reminds Industry Members and CAT Reporting Agents that private line connectivity to CAT needs to be established and a connectivity ping test completed as soon as possible. Firms and reporting agents should note that the ping test may be completed prior to signing the CAT Reporter Agreement and obtaining CAT Reporter Portal entitlements. For more information related to CAT Connectivity, please review the FINRA CAT Connectivity Supplement for Industry Members." See Email from FINRA CAT to Industry Members and CAT Reporting Agents (Nov. 20, 2019) ("CAT Connectivity Reminder").

III. Use of CAT Data by Regulators for Regulatory Purposes

a. Bulk Extracts

In the context of liability, SIFMA is attempting to reopen the issue of how Participants *and presumably the Commission* are permitted to access and use CAT Data. The reintroduction of well-settled aspects of the design and functionality of the CAT will only delay Industry Members from connecting to and testing with the Plan Processor and could jeopardize progress made to date and adherence to the implementation milestones.⁹ The Participants remain committed to a constructive and productive dialogue with SIFMA regarding CAT implementation, but revisiting settled issues will not lead to a timely implementation.

At this point in the evolution of the CAT, SIFMA is well aware of the ability of regulators to extract and use CAT Data. Those issues were discussed in the CAT NMS Plan Adopting Release:

In response to the commenters that expressed concern about allowing any entity to extract or download CAT Data, the Commission notes that it believes that regulators need access to CAT Data outside the Central Repository to perform their duties effectively.¹⁰

Thus, the CAT NMS Plan, as approved by the Commission, expressly requires that the Participants and the SEC have the ability to extract transactional CAT Data from the CAT System for surveillance and regulatory purposes. Section 6.10(c)(1) of the CAT NMS Plan provides that “Regulators will have access to processed CAT Data through two different methods; an online targeted query tool, and user-defined direct queries and bulk extracts.”¹¹ Section 8.2.2 of Appendix D of the CAT NMS Plan further provides:

The Central Repository must provide for direct queries, bulk extraction, and download of data for all regulatory users. Both the user-defined direct queries and bulk extracts will be used by regulators to deliver large sets of data that can then be used in internal surveillance or market analysis applications.

Though not required by the CAT NMS Plan, the Participants recently authorized FINRA CAT, LLC (“FINRA CAT”) to develop and implement a secure analytics workspace (“SAW”)

⁹ Note that delays caused by Industry Members – whether intentional or not – could punitively affect Participants under the Commission’s recent CAT NMS Plan amendment proposal. *See* Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail, Exchange Act Release 86901 (Sep. 9, 2019), 84 Fed. Reg. 48458 (Sep. 13, 2019); *see also* Letter from Michael Simon, Chair, CAT NMS Plan Operating Committee, to Vanessa Countryman, Secretary, SEC (Oct. 28, 2019).

¹⁰ CAT NMS Plan Adopting Release at 84876. *See also* CAT NMS Plan Adopting Release at 84767 (“The Commission notes that the Plan and the Participants’ response affirms that access to PII data will only be provided to a limited set of authorized individuals, and only for the limited purpose of conducting regulatory and surveillance activities. The Plan also contains an explicit prohibition on the ability to bulk download sensitive information such as PII, and this protection must be reinforced through the Plan Processor’s controls, policies and procedures.”).

¹¹ *See also* CAT NMS Plan, Appendix C at C-18 (“The Participants and other regulators will need the ability to do bulk extraction and download of data, based on a specified date or time range, market, security, and Customer-ID.”); CAT NMS Plan, Appendix D at D-25 (“Regulators will have access to processed CAT Data through two different methods, an online-targeted query tool and user-defined direct queries and bulk extracts.”).

that will give the Participants and the SEC an option to connect a workspace to the Central Repository to analyze CAT Data and run their surveillance protocols. The SAW will provide regulators with another means of accessing and analyzing CAT Data in a secure workspace, but regulators will not be limited to accessing and analyzing CAT Data only in the SAW. In addition, SIFMA's Letter suggests that FINRA CAT will manage and control the SAW; however, unlike the Central Repository, the SAW will not be within the sole control of FINRA CAT. Instead, each regulator will administer its own SAW account, including, the implementation of its own security controls.

Because the SAW is an enhancement that is not specifically required by the CAT NMS Plan, it is not scheduled to be implemented until the fall of 2020. Thus, until the SAW is implemented, the Participants' use of CAT Data must take place within CAT or outside of the SAW, consistent with the permitted uses in the CAT NMS Plan, which, like the Participants' other operations, is subject to SEC oversight. Accordingly, SIFMA's request to limit access by the Participants and the SEC only to a SAW-like environment and to prohibit the Participants and SEC from extracting CAT Data into their own systems, provided it is for surveillance and regulatory purposes, is inconsistent with the CAT NMS Plan and the regulatory obligations imposed on the Participants as SROs.¹²

b. Surveillance and Regulatory Purposes

The SIFMA Letter also requests that the Commission clarify the meaning of the term "surveillance and regulatory purposes" for purposes of the CAT and to clearly prohibit Participants from using CAT Data for any commercial purposes. Both Rule 613 and the CAT NMS Plan include various provisions limiting the Participants' use of CAT Data for only surveillance and regulatory purposes.¹³ Notably, these provisions do not expressly define "surveillance and regulatory purposes." Efforts by the industry to define these terms could, under the pretext of data protection, limit the ability of the Participants to perform their SRO market oversight responsibilities.

Rule 613(a)(1)(ii) provides that CAT Data shall be available to regulators "to perform surveillance or analyses, or for other purposes as part of their regulatory and oversight responsibilities." The CAT NMS Plan provides further clarification by requiring: "The Plan Processor must provide Participants' regulatory staff and the SEC with access to all CAT Data for regulatory purposes only. Participants' regulatory staff and the SEC will access CAT Data to

¹² Separately, the Participants note that regulators currently access OATS data without the use of a SAW or similar environment, and the contemplated approach with respect to CAT Data would be consistent with this approach. The Participants appreciate that OATS data only includes transactional data rather than customer identifying information. However, the SIFMA Letter draws no distinction between the two types of data in demanding that regulators' access be limited to a secure analytics environment.

¹³ However, the CAT NMS Plan expressly permits a Participant to use Raw Data that it reports to the CAT for commercial or other purposes in accordance with applicable law, rule or regulation. *See* CAT NMS Plan, Section 6.5(h) ("A Participant may use the Raw Data it reports to the Central Repository for regulatory, surveillance, commercial or other purposes as otherwise not prohibited by applicable law, rule or regulation."); *see also* CAT NMS Plan Section 1.1 (defining "Raw Data" as "Participant Data and Industry Member Data that has not been through any validation or otherwise checked by the CAT System.").

perform functions, including economic analyses, market structure analyses, market surveillance, investigations, and examinations.”¹⁴

The manner in which Participants may efficiently satisfy their regulatory obligations as SROs under the Exchange Act has been a subject analyzed by the SEC many times. The SROs have similar concerns about how they can meet their statutory obligations while avoiding unnecessary duplication. As SIFMA and the SEC are aware, there are myriad Rule 17d-2 and other agreements and arrangements to promote efficiencies in the SRO regulatory scheme. Although the SROs are still discussing this topic, they have no desire to delay progress on CAT given the strict development and implementation milestones.¹⁵

Further, the SIFMA Letter requests that the Commission restrict each exchange’s access to CAT Data to only trading activity conducted on that exchange and designate a single Participant to perform cross-market surveillance. The Participants believe that both of these requests are inconsistent with the Participants’ obligations under the federal securities laws and CAT NMS Plan, and are at odds with the regulatory purpose of the CAT. As an SRO, each Participant has an obligation to enforce its members’ compliance with the requirements of the Exchange Act, the rules and regulations thereunder, and the rules of the particular Participant.¹⁶ These obligations have never been limited to a Participant’s members’ activities on a particular exchange. In fact, Section 6.10 of the CAT NMS Plan requires each Participant to use CAT Data in its surveillance.¹⁷

Finally, and more fundamentally, the Participants are bound to use the CAT as required in the CAT NMS Plan and Rule 613. The Participants cannot agree to impose restrictions on their use, or the Commission’s use, of CAT Data beyond the surveillance and regulatory limitations currently set forth in the CAT NMS Plan. Rule 613 and the CAT were designed to significantly enhance oversight of the U.S. securities markets by improving regulators’ ability to meet their regulatory and surveillance obligations under the Exchange Act by significantly improving the market information available to regulators. Any restrictions such as those requested by SIFMA are inappropriate given the regulatory purpose of the CAT and the requirements of Rule 613 and the CAT NMS Plan, and could impede market surveillance and investigations, to the detriment of the markets and the public generally.

¹⁴ CAT NMS Plan, Appendix D at D-25.

¹⁵ The Participants formed a Cross-Market Regulation Working Group (“CMRWG”) under the Intermarket Surveillance Group (“ISG”) that is comprised of representatives of the regulatory staff of the Participants. The CMRWG was formed so that Participants’ regulatory staff have a forum to discuss regulatory coordination and potential methods of reducing duplicative regulatory efforts. These discussions are ongoing.

¹⁶ See Exchange Act Sections 6(b)(1) and 15A(b)(2).

¹⁷ See CAT NMS Plan, Section 6.10(a) (“Using the tools provided for in Appendix D, Functionality of the CAT System, each Participant shall develop and implement a surveillance system, or enhance existing surveillance systems, reasonably designed to make use of the consolidated information contained in the Central Repository.”); see also Rule 613(a)(1)(ii) and (e)(2). Note that Section 1.1 of the CAT NMS Plan broadly defines “CAT Data” to include information regarding transactions on all of the Participants’ markets. Moreover, as previously discussed, Participants must use CAT Data only for surveillance and regulatory purposes.

IV. Regulatory Immunity

Finally, the Participants respectfully disagree with SIFMA's view that the CAT NMS Plan should be amended to waive SROs' regulatory immunity for data breach claims. Immunity is a judicially created and administered doctrine and courts have held consistently that an SRO has immunity for actions that it takes in its role as an SRO, such as regulation of its members.¹⁸ Actions taken by the Participants, as SROs, pursuant to the CAT NMS Plan and Rule 613 are actions that the SEC is requiring the SROs to take. Thus, The CAT NMS Plan, which was implemented in accordance with a regulatory obligation imposed by Rule 613, and its requirements regarding the collection of CAT Data from Industry Members (and Participants) for surveillance and regulatory purposes falls squarely within the types of actions for which immunity is appropriate.

¹⁸ See *City of Providence v. BATS Global Markets, Inc.*, 878 F.3d 36, 46-7 (2d Cir. 2017) (explaining that SROs acting as regulators are afforded absolute immunity and noting "Absolute immunity is available to an SRO therefore only when it carries out regulatory functions."); *D'Alessio v. New York Stock Exchange, Inc.*, 258 F.3d 93, 105 (2d Cir. 2001) ("NYSE, as SRO, stands in the shoes of the SEC in interpreting the securities laws for its members and in monitoring compliance with those laws . . . "[i]t follows that the NYSE should be entitled to the same immunity enjoyed by the SEC when it is performing functions delegated to it under the SEC's broad oversight authority."). See also *Santos-Buch v. FINRA*, 591 Fed. Appx. 32 (2d Cir. 2015) (immunity to FINRA); *In re Series 7 Broker Qualification Exam Scoring Litig.*, 548 F.3d 110 (D.C. Cir. 2008) (immunity NASD); *In re NYSE Specialists Litigation*, 503 F.3d 89 (2d Cir. 2007) (immunity to NYSE); *DL Capital Group, LLC v. Nasdaq Stock Market, Inc.*, 409 F.3d 93 (2d Cir. 2005) (immunity to Nasdaq); *Sparta Surgical Corp. v. Nat'l Ass'n of Sec. Dealers, Inc.*, 159 F.3d 1209 (9th Cir. 1998) (immunity to NASD).

The Honorable Jay Clayton

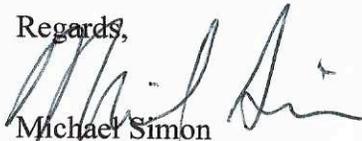
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Thank you for your continued attention to this project. Please contact me at (212) 229-2455 if you have any questions or comments.

Regards,



Michael Simon

CAT NMS Plan Operating Committee Chair

cc: The Hon. Robert J. Jackson, Jr., Commissioner
The Hon. Allison Herren Lee, Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
Mr. Brett Redfearn, Director, Division of Trading and Markets
Mr. David S. Shillman, Associate Director, Division of Trading and Markets
Mr. David Hsu, Assistant Director, Division of Trading and Markets
Mr. Mark Donohue, Senior Policy Advisor, Division of Trading and Markets
Ms. Manisha Kimmel, Senior Policy Advisor, Regulatory Reporting to Chairman Clayton
CAT NMS Plan Participants
Kenneth E. Bentsen, Jr., President and CEO, SIFMA