Follow-Up Response to SEC Questions Regarding the Joint Industry Plan; Notice of Filing of the National Market System Plan Governing the Consolidated Audit Trail by;

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File Number 4-698

This is a follow-up to our previous response regarding the current proposal from the exchanges/SROs for the Consolidated Audit Trail ("CAT") system concept.[1]

In our initial response, we said it appears that FINRA is the proper entity to enact an audit trail because it already has the technology mostly in place to accomplish what the proposed CAT system is designed to achieve, deals with most of the required data and it has the regulatory authority over the exchanges, broker-dealers, alternative trading systems ("ATSs") and clearing firms required to submit data to the CAT.

As we discussed, reporting compliance will be very important in order for any audit trail to be effective. In the past, FINRA has had difficulties with reporting non-compliance to its' systems. There are a significant number of cases in which FINRA has found non-compliance with its' reporting requirements and there are repeat offenders that continued to ignore previous FINRA actions against them.

As an example, in a recent FINRA disciplinary action released August 3, 2016, Barclays was fined $1.3 million for systemic FINRA Order Audit Trail System ("OATS") violations spanning from 2008 through 2016. FINRA summarized:[2]

> "The staff of FINRA's Department of Market Regulation (the "staff") identified **15 systems issues** at the firm that gave rise to approximately **3.6 billion OATS reporting violations** from ***September 2008 through the present***. The 15 systems issues impacted up to 3% of all reportable order events ("ROEs") the firm was required to transmit to OATS during the relevant period. Specifically, the systems issues caused the firm to report to OATS approximately 3.3 billion inaccurate or incomplete ROEs and to fail to report to OATS approximately 332 million ROEs."

This FINRA action was finalized *8 years* after the violations began, despite at least 4 relevant FINRA examinations into Barclays' OATS reporting from 2013 to 2016.

Moreover, since 2013 Barclays was fined by FINRA on **5 separate occasions** for reporting violations, with *two of them specifically for other OATS violations* (including inaccurate and incomplete reporting of more than 124 million reportable order events from 2008 through 2011).

[1] *Response to SEC Questions Regarding the CAT File Number 4-698 071816*, dated July 18, 2016 https://www.sec.gov/comments/4-698/4698-12.pdf

[2] FINRA Letter of Acceptance, Waiver and Consent No. 20140417499-01, Re: Barclays Capital Inc., August 3, 2016 http://www.finra.org/sites/default/files/Barclays_AWC_080316.pdf

The list of firms with repeated OATS reporting violations is lengthy and in some of the FINRA disciplinary actions the amount and value of misreporting are disturbingly large and covered many years.

As another example, Wedbush Securities has been fined by FINRA 8 times from 2007 through 2015 for inaccurate, incomplete and failure to file reportable order events to FINRA's OATS starting in 2004. FINRA's Disciplinary Proceeding number 20070077690 filed **March 30, 2012**, stated during just the examination period **<u>January 1, 2005 through July 7, 2006</u>** Wedbush only reported ***<u>.08%</u>*** of its' **<u>required order reporting obligations</u>** to OATS. For this reporting obligation Wedbush essentially did not report ***<u>1.6 billion</u>*** or ***<u>99.92%</u>*** of its orders to FINRA. FINRA did not finalize this action until 7 years after the reporting violations began.

Current FINRA Audit Trail Deficiencies

The Barclays and Wedbush examples show FINRA either; a) is not using algorithms to compare the data received from OATS reports to other data sources to uncover red flags of problematic reporting, b) has not programmed its' algorithms to look for appropriate red flags, or c) has no other records to reconcile against the OATS data in order to determine the accuracy of the data coming into its' system.

With the OATS data, FINRA is relying on the participants to accurately file the data without an apparent way to verify the accuracy. If FINRA could or was analyzing this data for discrepancies, reporting problems would be discovered early and could be rectified without multiple investigations, a lengthy review and a disciplinary process that is finalized years after the violations begin.

Without correct data, how can FINRA monitor the markets for other potentially illegal behavior? As FINRA stated:

> "Because FINRA uses OATS data as an **integral part of its automated market surveillance program <u>to detect customer harm, manipulative activity and other potential violations</u>** of FINRA rules and the federal securities laws, a failure to transmit ROEs or the transmission of **inaccurate or incomplete ROEs can hamper FINRA's ability** to detect potentially violative conduct and/or create false positive alerts requiring the expenditure of unnecessary resources to resolve the alerts. Moreover, these **<u>failures also caused the Audit Trail to be inaccurate</u>**."

If this is how a current audit trail is operated by a sophisticated SRO, what changes will be made to promote accurate reporting to the CAT and speed up enforcement actions against those that violate the requirements? Why have these changes not already been made by FINRA to gain cooperation from its members and obtain correct OATS data?

If the CAT operators are unable to eliminate inaccurate/problematic reporting to the CAT, we believe it will fail to provide a useful tool for investigations as the SEC has envisioned.

As we suggested in our prior comment letter on this subject, the CAT system should be a complete audit trail that has various metrics available to be able to compare and reconcile not only for the accuracy of the data (which is vitally important), but also to use as a tool for regulatory investigation and enforcement purposes. A true audit trail should be designed to encompass trade activity from pre-execution through clearance and settlement.