



SENT VIA EMAIL TO RULE-COMMENTS@SEC.GOV

September 25, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: National Market System Plan Governing the Consolidated Audit Trail (Release No. 34-77724; File No. 4-698)

Dear Mr. Fields:

On September 24, 2018, Better Markets sent a letter to the Chairman of the Securities and Exchange Commission, Mr. Jay Clayton, which is attached below, directly related to the implementation of the Consolidated Audit Trail NMS Plan referenced above. We kindly request our September 24, 2018 letter to be included in the comment file under Release No. 34-77724; File No. 4-698.

Thank you.

Sincerely,

A handwritten signature in blue ink that reads "Dennis M. Kelleher".

Dennis M. Kelleher
President & CEO

Lev Bagramian
Senior Securities Policy Advisor

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464



www.bettermarkets.com



BETTER MARKETS

September 24, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: The SEC Must End Its Self-inflicted Blindness to Predatory Actions in the Equity Markets and Get the Years-Overdue Consolidated Audit Trail Implemented ASAP.

Dear Chairman Clayton:

It is not an exaggeration to say that our sprawling, fragmented, nanosecond-moving equity markets live on a knife's edge every day: will today be the day when the next “flash crash” occurs and trillions of dollars disappear for no known reason? Will the next “flash crash” bounce back bungee-jump style like it did more than eight years ago on May 6, 2010? Or, will the next one ignite a global chain reaction that causes markets worldwide to plummet, vaporizes tens of trillions of dollars, undermines market confidence and reveal regulators to be – once again – impotent if not incompetent? Or will it, as some have speculated, trigger the next catastrophic global financial crash?¹

That is what is at stake in the completion and implementation of the Consolidated Audit Trail (CAT). While we recognize you inherited a suboptimal situation not of your making or desire, the failure to get this mission-critical investor protection system up and running needlessly and irresponsibly places investors, markets and the financial system at grave risk.

As you know from prior meetings and communications,² we have very much appreciated your past leadership regarding the implementation of the CAT. However, we are compelled to

¹ “The next financial crash won’t come from a ‘known unknown,’” Robin Wigglesworth, *The Financial Times*, September 8, 2018, available at <https://www.ft.com/content/946fe48e-b1ec-11e8-8d14-6f049d06439c>.

² *See, e.g.*, Better Markets Letter to Chairman Jay Clayton (November 15, 2017). Available at <https://bettermarkets.com/sites/default/files/Ltr%20SEC%20Chair%20Clayton%20re%20CAT%2011-15-17.pdf>.

write to express our deep concern with the latest decision to *de facto* delay the implementation of the CAT. Instead of holding the nearly exclusively-industry consortium, known as the CAT NMS, LLC, accountable for not completing the creation of the CAT and for repeatedly and unjustifiably violating the deadlines that were set forth in the Securities and Exchange Commission's (SEC) 2016 rule,³ the Commission has *de facto* approved – without prior notice or providing opportunity for public to comment – an amendment to its rule and granted years of extension to the industry to create and operate the CAT.⁴ Moreover, the Commission or Commission staff appears to have agreed to a heretofore secret “Master Plan”⁵ between the CAT NMS consortium and the Commission that seems to have established new deadlines and timelines in direct contravention of the 2016 CAT NMS Plan and in clear conflict of SEC Rule 613.

In addition to violating the rule and the Administrative Procedures Act (APA), this action conflicts with the position you took on CAT last year,⁶ when you rejected a similar request for extension. We wrote to you then applauding that decision, and we urged you to stay the course and see through the implementation of this long-overdue, irreplaceable tool and database.⁷ The decision now to allow for the delay of the CAT would mean the SEC would remain largely in the dark regarding what is actually happening in our equity markets, including the all-to-common disruptive, manipulative, predatory and dangerous activities of some in the financial industry. The ongoing harm to investors and markets cannot be overstated and the risks to the financial system are simply unacceptable. In delaying the CAT and not requiring its immediate implementation, the SEC is failing to fulfill its missions of investor protection and promotion of fair and orderly markets.

As you know, the CAT system promises to be game-changer for the SEC and would revolutionize your capabilities to protect investors, facilitate capital formation and promote fair and orderly capital markets – on which job creators and savers, and indeed all Americans, depend. The CAT system will be the world's largest data repository for securities transactions, tracking billions of orders, executions, and quotes in all of the equities and options markets every day. More specifically, the CAT will collect order, cancellation, modification, and trade execution information for every trade (someday, it is hoped, in real time). That information will serve two vital functions: enabling the SEC not only to reduce, manage, and better understand market

³ See Release No. 34-79318 “Joint Industry Plan; Order Approving the National Market System Plan Governing the Consolidated Audit Trail.” (November 15, 2016). Available at <https://www.sec.gov/rules/sro/nms/2016/34-79318.pdf>

⁴ See “Statement on Status of the Consolidated Audit Trail” by Brett Redfearn, Director of SEC's Division of Trading and Markets. (August 27, 2018). Available at https://www.sec.gov/news/public-statement/tm-status-consolidated-audit-trail#_ftn1.

⁵ For a cryptic mention of this “Master Plan,” see Director Redfearn's statement referenced in Note 4 *supra*.

⁶ See Chairman Jay Clayton's Statement on Status of the Consolidated Audit Trail. (November 14, 2017). Available at <https://www.sec.gov/news/public-statement/statement-status-consolidated-audit-trail-chairman-jay-clayton>.

⁷ See *supra* note 2.

disruptions and crashes, but also to identify, deter, and punish illegal manipulations and other trading abuses – all for the benefit investors and our markets.

As you also know, by no later than November 15, 2017, the CAT was supposed to be up and running, at least partially. But, it is still paralyzed by the conflicted industry-group governance structure⁸ which is unwilling to commit to critical decisions that would bring CAT online. Instead of holding them accountable **as only the SEC can do** – using all of the traditional and reasonable means available to the Commission, including bringing enforcement cases against the CAT NMS, LLC or individual members of the consortium – you apparently have decided to accommodate their latest unreasonable requests for extension. This is particularly inappropriate when that request comes from an industry-dominated entity where many of the representatives are more interested in maintaining *status quo*, maximizing profits and minimizing regulatory scrutiny than ensuring that the SEC has the tools and ability to monitor and police **their** activities in the markets. At a minimum, this decision should only have been after notice and solicitation of public comments.

We find this decision particularly troubling given that the SEC has all the authority it needs to hold CAT NMS accountable for the ongoing lack of compliance. As you know, in addition to the SEC’s general authority to enforce compliances of the securities laws and rules, the specific SEC rule that gave birth to CAT NMS (SEC Rule 613)⁹ itself includes a provision mandating compliance by the industry-members that comprise the CAT NMS and specifies that non-compliance could result in fines. Rule 613 states clearly:

(h) Compliance by national securities exchanges and national securities associations.

(1) Each national securities exchange and national securities association shall comply with the provisions of the national market system plan approved by the Commission.

(2) Any failure by a national securities exchange or national securities association to comply with the provisions of the national market system plan approved by the Commission shall be considered a violation of this section.

(3) The national market system plan submitted pursuant to this section shall include a mechanism to ensure compliance by the sponsors of the plan with the requirements of any approved plan. Such enforcement mechanism may include penalties where appropriate.¹⁰

Such a requirement was fundamental to the SEC’s decision to outsource this mission-critical system to the private sector in the first place. After all, it has been obvious since the decision was

⁸ For more detailed discussion about the problems with the governance structure of CAT and the conflicts of interest that this structure would create, *see* Better Markets’ comment letter in response to the CAT NMS Plan (Release No. 34-77734; File No. 4-698). (July 18, 2016). Available at <https://www.sec.gov/comments/4-698/4698-17.pdf>.

⁹ *See* “Rule 613 (Consolidated Audit Trail).” Available at <https://www.sec.gov/divisions/marketreg/rule613-info.htm>.

¹⁰ *See* 17 C.F.R. § 242.613(h).

made to outsource the CAT to the private sector that there were going to be serious conflicts of interest and enormous incentives for at least some industry members to delay, weaken or kill the CAT before it ever came on line (as previously detailed by Better Markets).¹¹

The Commission knew that as well when it was making the decision to outsource CAT to the industry and specifically armed itself with appropriate and effective regulatory tools to encourage and, if need be, compel the implementation of CAT according to the approved timelines and standards. In particular, the phrase “may include penalties where appropriate” was a considered decision by the Commission. This phrase was absent in the 2010 Proposed Rule 613 but was specifically included in the 2012 Final Rule 613. In the Adopting Release for the Final Rule 613, the Commission argued – rightly so –

“...that a penalty provision could provide an incentive for each SRO [self-regulatory organization, *i.e.*, stock exchanges that comprise the CAT NMS consortium] to comply with all the provisions of the NMS plan because each SRO will seek to avoid incurring any penalty under the Rule. The incentive to avoid a penalty could also reduce the risk of non-compliance with the Rule.”¹²

Given this specific reasoning and authorization, the SEC should have levied substantial daily fines for every day of non-compliance after notice and appropriate opportunity to cure. After all, the SEC had already been more than understanding and accommodating, but its rule is nonetheless being unjustifiably violated. This is the precise circumstance anticipated by the SEC and provided for in its rule. The failure of the SEC to act guts the rule, nullifies the purpose for the provision, removes the risk of a penalty and, therefore, any incentive for compliance. Given the upcoming November 15, 2018 deadline for the self-regulatory organizations (*i.e.*, the stock exchanges and FINRA) to begin reporting to the CAT, the SEC should announce now that it will enforce its rule and levy heavy fines on the CAT NMS consortium if they fail to have the CAT system fully ready on or before November 15, 2018.

The SEC must recognize and appreciate that failure to comply with its rule is a direct, public challenge to the power and authority of the SEC. Accepting that should be intolerable under any circumstance, but it is even worse here because it rewards past violations and encourages future violations. After all, if they simply break the rules without penalty, indeed with the reward of the extension they have been trying to bully the SEC into giving them, why would anyone ever comply? Think about the message that is being sent here. For example, if the SEC will not hold accountable those who flaunt the CAT NMS rule, why would these same industry-members comply with other SEC rules like the Transaction Fee Pilot or other upcoming market structure-related rules and projects?

It is unacceptable to us, as we know it is for you, that more than eight years after the “Flash Crash,” the CAT system remains unfinished and unimplemented. Such crashes will certainly happen again, likely much worse than they have in the past, and it is in the interest of regulators,

¹¹ See *supra* note 8.

¹² See Adopting Release (Release No. 34-67457; File No. S7-11-10), p.235. Available at <https://www.sec.gov/rules/final/2012/34-67457.pdf>.

policymakers and all responsible industry participants to ensure regulators have effective tools to respond to such eventualities. Until the CAT is operating, the SEC will remain blindfolded in its market surveillance and enforcement activities.

This self-inflicted blindness will leave Main Street consumers, tens of millions of investors – importantly, including Mr. and Mrs. 401(k) – and financial markets at grave risk of a run-a-way crisis if not a full-blown meltdown. No one should want that as their legacy. The time to act is now, without delay.

Thank you for considering these issues.



Dennis M. Kelleher
President and CEO

Lev Bagramian
Senior Securities Policy Advisor

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

[REDACTED]
[REDACTED]

www.bettermarkets.com

CC: Commissioners Kara M. Stein
Commissioner Robert J. Jackson Jr.
Commissioner Hester Pierce
Commissioner Elad Roisman
Brett Redfearn, Director, Division of Trading and Markets