Michael Blaugrund
Chief Operating Officer

[redacted]

May 10, 2021

Via E-mail & FedEx

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: File No.4-698

Dear Ms. Countryman:

The Consolidated Audit Trail ("CAT") has been established after years of hard work and investment. The system is available to support securities regulators in a range of inquiries and, after a difficult start, the Plan Participants ("Participants" or "SROs") have worked together under the National Market System Plan Governing the Consolidated Audit Trail (the "CAT NMS Plan" or "Plan") to meet their delivery milestones. Now with the CAT system operational and moving toward completion, it is time to return to the unresolved question of CAT funding.

Cost for the CAT should be shared by the industry and SROs, as expected under the Plan. Unfortunately, the NYSE cannot support this Amendment's cost allocation methodology and failure to adequately disclose the composition of the CAT costs it would socialize to the industry. Below, we offer an idea for an alternative approach.

Summary

- NYSE does not support the Amendment.
- The Amendment does not establish an adequate basis for its allocation methodology, nor does it adequately articulate the composition of the CAT costs it would allocate to the industry.
- We recommend the SROs instead propose a structure that is (1) based on executed volume instead of message traffic and (2) administered like SEC Section 31 fees.
- We recommend establishing a cost allocation model that evenly splits the per share cost three ways: 1/3 to the buyer, 1/3 to the seller, and 1/3 to the Exchange or TRF.

The Amendment's cost allocation methodology lacks sufficient basis

Fundamentally, the proposal consists of a 75/25% split of the CAT costs between the industry (i.e. registered broker-dealers, including Alternative Trading Systems) and Participants (i.e. exchanges and FINRA). Within the industry portion, costs are to be divided based on message traffic volumes, modified by discounts for certain types of participants (e.g. market makers) and certain types of messaging (e.g. options quotes). Some types of message traffic are adjusted by a factor of 1/10000. The resultant pro rata allocation is then further adjusted by applying minimum and maximum fee levels. By contrast, for Participants, cost is to be allocated based on a 60/40% split between equities and options exchanges, then divided among those SROs based on market share. However, the market share metric is to be massaged to assign a minimum value to small exchanges. And there also is a bespoke fee structure for FINRA, which might be based on a percentage of the total equity Participant allocation or 5% more than the highest paying equity Participant.

If this logic sounds tortured, it is because it is. The SROs no doubt intend for the outcomes of this calculation to be fair, but in so doing they have created an incomprehensible, distorted program. The Amendment does not sufficiently justify why 75/25 is an appropriate division between industry and Participants, why some costs should be split by messaging, others by share, or why some SROs have unique treatment. The arbitrariness of the Amendment's methodology may be well-intentioned, but it is impermissible.

<u>The cost structure for the CAT must be transparent</u>

When proposing how a group of people will share in a $115 million dollar expenditure and an ongoing obligation to fund future expenses, NYSE believes more transparency about these costs is warranted. Nevertheless, the Amendment is virtually silent on the use of funds and offers no budget for the CAT's ongoing operation.

The SROs' funding proposal should provide visibility into the composition of the Plan's spending, as well as any relevant technical requirements (e.g. data storage projections). More specifically, the NYSE believes that the SROs' funding proposal should disclose the historical costs and projected annual budget for the following expense categories:

- Plan Operating Expenses
    - Employee, Director or Fiduciary (e.g. CISO, CCO) compensation, if any
    - Professional services (legal, program management, audit, etc)
    - Other
- Plan Processer Expenses
    - Processor Ongoing Support, including any sub-contractors
    - Processor New Development from Participant Change Requests
    - Processor New Development from SEC Change Requests
    - Data Storage
    - Other Vendors
- Other Expenses

The annual budget for subsequent years should also be made public in the future.

<u>Our Alternative Recommendation</u>

NYSE believes that the SROs should propose an alternative cost allocation methodology that is uncomplicated, easily administered, and avoids arbitrary value judgments about what types of CAT recordable activity deserve higher or lower fees. While there may be numerous models that meet these basic constraints, we believe the following proposal would be a starting point that many industry stakeholders could support.

The economics of the US securities industry are based on executions, not on message traffic. Whether it is exchange fees or broker commissions, our industry speaks in terms of "per share" costs and revenues.

We recommend that CAT costs be allocated based on executed share volume,[1] a metric that is already robustly tracked by broker-dealers, investors and execution venues, and administered in a fashion similar to the existing SEC Section 31 fees.[2] Specifically, we recommend that an annual budget be established for the CAT cost base and then a per share or contract fee be established for the upcoming year by dividing the budgeted cost base by the projected total industry volume.

Every transaction has three actors with an economic interest in its consummation: a buyer, a seller and an executing/reporting venue. We propose that the CAT cost allocation methodology reflect that, with the per share fee split evenly three ways:

- 1/3 to the broker-dealer purchasing
- 1/3 to the broker-dealer selling
- 1/3 to the Exchange or TRF reporting the transaction

Splitting the CAT costs for each transaction evenly among the buyer, the seller and the venue is a simple approach and aligns responsibility for funding the market's regulatory infrastructure with receiving economic benefits from participation in the marketplace.

By establishing a per share/contract fee structure, CAT funding costs will be predictable and more easily incorporated into the algorithms, risk models, and billing systems that must account for the charge and, in many cases, pass-thru the fee to the ultimate beneficiary of each trade. The SEC's existing Section 31 fees are a well-established precedent for allocating regulatory costs across the industry in a predictable, transparent fashion, and we think CAT should employ similar mechanics.

OTC Equities do not fit neatly in this paradigm given the extreme share volumes that trade at sub-dollar (and often sub-penny) price levels. We recommend instead that OTC Equities receive a small portion of the overall CAT budget which would also be independently apportioned evenly among the buyer, seller and Over-the-Counter Reporting Facility (ORF) on a per share basis. One potential basis for establishing how much of the CAT costs should be allocated to the OTC Equities pool would be to mirror the percent of total consolidated tape revenue presently attributed to these securities (approximately 2%).[3]

Based on 2020 market volumes and the Amendment's Exhibit B 2021 Total CAT Costs offered for "Illustrative Purposes Only", we anticipate that this alternative model would have resulted in the following CAT fees (see Figure 1 for the calculation):

[1] To normalize for the options contract multiplier, each options contract traded would count as 100 shares.

[2] Section 31 fees are based on dollar volume, not share volume, but our recommendation is structurally similar.

[3] Under Exhibit 1 of the UTP Plan (https://utpplan.com/DOC/Nasdaq-UTPPlan_Composite_as_of_September_17_2020.pdf), FINRA receives 6.25% of UTP Plan revenues as compensation for FINRA OTC Data. Based on the public financial data available on UTPPlan.com and CTAPlan.com, this roughly equals $9MM or 2% of total 2020 SIP net revenues.

Projected fees (per share/contract)		
NMS Equity buyer, per share:	$	0.000012
NMS Equity seller, per share:	$	0.000012
NMS Equity Exchange/TRF, per share:	$	0.000012
Listed option buyer, per contract:	$	0.0012
Listed option seller, per contract:	$	0.0012
Listed option exchange, per contract:	$	0.0012
OTC Equity buyer, per share:	$	0.0000003
OTC Equity seller, per share:	$	0.0000003
OTC Equity ORF, per share:	$	0.0000003

While the Amendment lacks the necessary information for public commenters to understand the cost allocation across broker-dealers trading each asset class, we can nevertheless roughly compare all three models to understand the relative allocations to each market participant type.

% cost allocation by market participant type

	Section 31 Fees	Amendment	NYSE Recommendation
Equity Broker-Dealers	96%	75%	51%
Options Broker-Dealers	4%		14%
OTC Equities Broker-Dealers	0%		1%
FINRA	0%	3%	11%
Equity Exchanges	0%	12%	15%
Options Exchanges	0%	10%	7%

Similarly, it is impossible from the information provided in the Amendment to evaluate how the overall CAT cost will be allocated across the asset classes. However, for comparison we can evaluate the cost incidence of our recommendation versus an estimate of 2020 Section 31 fees[4].

% cost allocation by asset class

	Section 31 Fees	Amendment	NYSE Recommendation
NMS Stocks	93%	?	77%
Listed Options	7%	?	21%
OTC Equities	0%	?	2%

[4] Assumes 2020 covered sales dollar volume of $121T for NMS Equities, $10T for Listed Options, and $429B for OTC Equities.

Conclusion

It is appropriate for broker-dealers to now pay their fair share of the CAT as outlined under Rule 613. But the Amendment offers an unjustified cost allocation methodology and fails to adequately disclose the composition of the CAT costs it would socialize to the industry.

Instead of approving this Amendment, the Commission should ask the SROs to engage with the industry more directly to establish a workable allocation methodology that is simple, predictable and aligns responsibility for funding regulatory infrastructure with receiving economic benefits of the marketplace.

Requiring the buyer, seller and venue active in each transaction to evenly contribute toward funding the CAT would be a reasonable basis for allocating costs that is easily measured and transparent to all market participants. The billing processes established by Section 31 fees are an efficient method to administer an industry-wide regulatory funding program and provide market participants clarity *a priori* of what their trading expenses will be. CAT should adopt something similar.

Undoubtedly there are elements of this recommendation that could be improved and refined with industry feedback. If the Amendment is not approved, or if the SROs choose to withdraw the Amendment, we are hopeful that this recommendation might facilitate productive industry engagement by the Plan.

Respectfully submitted,

Michael Blaugrund

cc: Honorable Gary Gensler, Chair
Honorable Allison Herren Lee, Commissioner
Honorable Elad L. Roisman, Commissioner
Honorable Hester M. Peirce, Commissioner
Honorable Caroline A. Crenshaw, Commissioner
Hugh Beck, Senior Advisor for Regulatory Reporting
Christian Sabella, Acting Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets
David Hsu, Assistant Director, Division of Trading and Markets
Mark Donohue, Senior Policy Advisor, Division of Trading and Markets
Erika Berg, Special Counsel, Division of Trading and Markets

Figure 1: Worksheet to calculate illustrative CAT fees under alternate recommendation

2020 share volumes		
NMS Equity shares executed on exchange (2020)		1,617,193,989,150
NMS Equity shares printed on TRF (2020)		1,146,555,550,000
Options contracted executed on exchange (2020)		7,467,000,000
OTC Equity shares printed on ORF (2020)		2,825,607,343,506
Projected CAT 1 year cost		
2021 estimate:	$	132,522,082
Proposed allocation to OTC equities		
% of Consolidated Tape Revenue attributed to OTC Securities:		2%
If same % applied, OTC Equities CAT costs:	$	2,650,442
Per share OTC Equity cost allocation	$	0.0000009
Proposed allocation to NMS Equities and Listed Options		
Remainder after OTC Securities		98%
NMS Equities and Listed Options CAT costs:	$	129,871,640
NMS Equity shares executed on exchange (2020)		1,617,193,989,150
NMS Equity shares printed on TRF (2020)		1,146,555,550,000
Options contracted executed on exchange (x 100 multiplier)		746,700,000,000
Total share volume (NMS + Options*100)		3,510,449,539,150
Per share NMS Equity cost allocation	$	0.0000370
Per contract Listed Option cost allocation (per share*100)	$	0.0037
% of fee attributed to each actor:		
Buyer:		33.33%
Seller:		33.33%
Venue:		33.33%

Projected fees (per share/contract)		
NMS Equity buyer, per share:	$	0.000012
NMS Equity seller, per share:	$	0.000012
NMS Equity Exchange/TRF, per share:	$	0.000012
Listed option buyer, per contract:	$	0.0012
Listed option seller, per contract:	$	0.0012
Listed option exchange, per contract:	$	0.0012
OTC Equity buyer, per share:	$	0.0000003
OTC Equity seller, per share:	$	0.0000003
OTC Equity ORF, per share:	$	0.0000003

Projected total cost allocation

	Cost		%
NMS Equity Broker-Dealers	$	68,164,620	51%
Options Broker-Dealers	$	18,416,474	14%
OTC Equity Broker-Dealers	$	1,766,961	1%
FINRA	$	15,022,700	11%
Equity Exchanges	$	19,943,090	15%
Options Exchanges	$	9,208,237	7%
Total	$	132,522,082	100%