



Marcia E. Asquith
Corporate Secretary, EVP
Board and External Relations

Direct: (202) 728-8831
Fax: (202) 728-8300

June 22, 2022

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Via Email to rule-comments@sec.gov

**Re: Notice of Filing of Amendment to the National Market System Plan
Governing the Consolidated Audit Trail (File No. 4-698)**

Dear Ms. Countryman:

The Financial Industry Regulatory Authority, Inc. (“FINRA”)¹ appreciates the opportunity to provide comments on the above-captioned proposed amendments to the National Market System Plan Governing the Consolidated Audit Trail (“Plan” or “CAT NMS Plan”). The Operating Committee for the Consolidated Audit Trail, LLC filed the proposed amendments on May 13, 2022, which seek to implement an “executed share” funding model for the CAT (“Executed Share Model”) and to establish a fee schedule for Participant CAT fees based on the Executed Share Model.²

FINRA supports the goal of adopting a transparent funding model that reasonably and fairly allocates CAT costs among Participants and industry members based on objective criteria. The need for reasonable, long-term funding has become increasingly evident as the complexity and cost of the CAT continue to grow well beyond initial

¹ FINRA is submitting this letter solely in its capacity as a participant of the CAT NMS Plan. This letter does not reflect or represent the views of FINRA CAT, LLC, which is a distinct corporate subsidiary of FINRA that acts as the CAT Plan Processor pursuant to an agreement with the self-regulatory organization (“SRO”) participants to the CAT NMS Plan (“Participants” or “Plan Participants”).

² See Securities Exchange Act Release No. 94984 (May 25, 2022), 87 FR 33226 (June 1, 2022) (Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail) (“Proposal”).

estimates. Unfortunately, the Proposal fails to accomplish this goal. In fact, the Executed Share Model—which was approved by the Operating Committee over FINRA’s objections—contains features that are more problematic than the unsuccessful funding model that was withdrawn last year.³

The Proposal would establish a structure whereby the fees charged to Participants and industry members are based on the executed equivalent share volume of transactions in eligible securities. Under the Proposal, for each transaction in an eligible security, the industry member that is the clearing member for the seller in the transaction, the industry member that is the clearing member for the buyer in the transaction, and the applicable Participant for the transaction each would pay a fee calculated by multiplying the number of executed equivalent shares in the transaction and the applicable fee rate, and dividing the product by three⁴—i.e., for each transaction, the buy-side would pay one-third of the fee obligation, the sell-side would pay one-third of the fee obligation, and the relevant Participant for the transaction would pay the remaining one-third of the fee obligation.

As discussed below, the Executed Share Model abandons core cost alignment principles and lacks critical transparency about its true impacts. Accordingly, FINRA believes the Proposal is inconsistent with the Securities Exchange Act of 1934 (“Exchange Act”) and should not be approved by the Securities and Exchange Commission (“SEC” or “Commission”) in its current form.

I. The Proposal Lacks Principled Justification Concerning Cost Alignment

FINRA has been consistent in its view that long-term sustainable CAT funding must be grounded in principle and consistent with the Exchange Act. As FINRA discussed in its comment letter on funding last year,⁵ there were six governing funding principles in the CAT NMS Plan initially approved by the SEC:

- (a) to create transparent, predictable revenue streams for CAT LLC that are aligned with the anticipated costs to build, operate and administer the CAT

³ See Letter from Marcia Asquith, Executive Vice President, FINRA to Vanessa Countryman, Secretary, SEC, dated May 12, 2021 (“FINRA Comment Letter”), discussing Securities Exchange Act Release No. 91555 (April 14, 2021), 86 FR 21050 (April 21, 2021) (“2021 Proposed Funding Model”).

⁴ The applicable Participant for the transaction would be the national securities exchange on which the transaction was executed, or FINRA for each transaction executed otherwise than on an exchange. See Proposal at 33226.

⁵ See FINRA Comment Letter, *supra* note 3, available at <https://www.sec.gov/comments/4-698/4698-8793900-237824.pdf>.

and the other costs of CAT LLC;

- (b) to establish an allocation of the Company's related costs among Participants and Industry Members that is consistent with the Exchange Act, taking into account the timeline for implementation of the CAT and distinctions in the securities trading operations of Participants and Industry Members and their relative impact upon Company resources and operations;
- (c) to establish a tiered fee structure in which the fees charged to: (i) CAT Reporters that are Execution Venues, including ATSS, are based upon the level of market share; (ii) Industry Members' non-ATS activities are based upon message traffic; and (iii) the CAT Reporters with the most CAT-related activity (measured by market share and/or message traffic, as applicable) are generally comparable (where, for these comparability purposes, the tiered fee structure takes into consideration affiliations between or among CAT Reporters, whether Execution Venues and/or Industry Members);
- (d) to provide for ease of billing and other administrative functions;
- (e) to avoid any disincentives such as placing an inappropriate burden on competition and a reduction in market quality; and
- (f) to build financial stability to support CAT LLC as a going concern.⁶

Up to this point, as reflected in the Plan's funding principles, message traffic has been a key proxy for cost-generation in seeking to align CAT fees with CAT costs. Since these funding principles were approved by the SEC, the Participants have attempted to file two different funding models, and both prior models included message traffic components.⁷ In using message traffic to align CAT fees with costs, the Participants previously argued that "message traffic is a key component of the costs of operating the CAT."⁸

The current Proposal departs from utilizing message traffic and instead seeks to establish a cost allocation methodology based on executed share volume entirely. The Proposal describes that the Executed Share Model would equally allocate costs by thirds to the Participant, the buy-side, and the sell side, but it offers no underlying justification as to why this methodology is equitable in the context of the CAT NMS Plan. The

⁶ See CAT NMS Plan, Section 11.2(a) through (f).

⁷ See 2021 Proposed Funding Model, *supra* note 3, and Securities Exchange Act Release No. 82451 (January 5, 2018), 83 FR 1399 (January 11, 2018).

⁸ See FINRA Comment Letter, *supra* note 3, at 6 n.14 (citing letter from CAT NMS Plan Participants to Brent J. Fields, Secretary, SEC (June 29, 2017)).

Proposal also asserts that the Executed Share Model is fair as it operates in a manner that is similar to other fee rules, like the TAF, Section 31, and the options regulatory fee assessed by the options exchanges, which the SEC previously found to be consistent with the Exchange Act. However, the Proposal provides no insight as to why these other fee frameworks, which apply to completely different contexts, should serve as a model here. The Proposal also does not provide adequate support for the overall allocation between Participants and industry members or the allocation of costs between equity and options.

In an acknowledgement that the proposed methodology is incompatible with the cost alignment principle, the Proposal seeks to delete the Plan funding principle language that requires the Participants to take into account “distinctions in the securities trading operations of Participants and Industry Members and their relative impact upon Company resources and operations.”⁹ This principle is clearly grounded in concepts of fairness and equity.

Without offering adequate analysis, the Proposal summarily and erroneously concludes that this cost alignment language “is no longer relevant.”¹⁰ This conclusion appears to be based on yet another unreasoned conclusion that “[i]n light of the many inter-related cost drivers of the CAT (*e.g.*, storage, message traffic, processing), determining the precise cost burden imposed by each individual CAT Reporter on the CAT is not feasible.”¹¹ The Proposal also states that executed share volume “is related to, but not precisely linked to, [a] CAT Reporter’s burden on the CAT.”¹²

Stating that executed share volume—the single measure proposed to be used as the basis for the proposed allocation methodology—is “related to, but not precisely linked to” CAT cost-generation, is inadequate in demonstrating that use of the measure is reasonable and equitable. And while cost drivers may be multifaceted, the Plan, as approved, requires the Participants to seek to achieve cost alignment, because such is consistent with Exchange Act principles. In this regard, the Proposal fails to establish a sufficient nexus between executed share volume and the technology burdens that generate CAT costs and fails to relate each reporter group’s allocation to the burden that each reporter group imposes on CAT.

Rather than propose a funding model that is consistent with the funding principles, the Proposal instead seeks to amend the core funding principles to align with an unjustified allocation methodology. The Proposal must offer a principled justification for why the current principles, which relate to equity and cost alignment, are no longer

⁹ See Proposal, *supra* note 2, at 33238.

¹⁰ See *id.*

¹¹ See *id.* at 33232.

¹² See *id.*

appropriate, consistent with the Plan, or consistent with the Exchange Act.

FINRA, consistent with its prior position, is receptive to modifying the current funding principles where warranted. However, FINRA believes changes to core funding principles must be well-reasoned and transparent and must continue to support the achievement of a fair and equitable outcome. In contrast, the Executed Share Model appears to place the greatest emphasis on the principle relating to the “ease of billing and other administrative functions,” favoring that principle over cost alignment. FINRA recognizes the importance that the ultimate funding model be workable from an administrative perspective and supports that existing principle. It is essential, however, that any such tradeoffs between principles be presented clearly and analyzed fully against their impacts and prevailing Exchange Act requirements. As discussed below, that is not the case with the current Proposal.

II. The Proposal Lacks Fundamental Transparency About Cost Allocation between Participants and the Industry

The Proposal lacks transparency regarding its true impacts. The Proposal claims that it “addresses feedback expressed by some commenters on prior fee filings about the amount allocated to Participants versus Industry Members.”¹³ Specifically, the Proposal states that, in contrast to the previously proposed 75/25 split between industry members and Participants, the current proposal “substantially increases the Participant allocation and substantially reduces the Industry Member allocation from prior proposals.”¹⁴ However, the Proposal does not disclose that the increase in Participants’ share is disproportionately allocated to FINRA rather than equitably allocated amongst the Participants. In fact, under the Proposal, the exchange Participants’ share of total costs would remain almost the same as under the previous proposal. Notably, using trade volumes from 2021, FINRA would pay roughly \$19 million per year under the Proposal, which is \$4 million more than all the options exchanges combined. In percentage terms, as compared to the previous proposal, FINRA’s share would more than double from 4.1% of total costs to 10.8%. In contrast, the options exchanges’ collective share would decrease from 10.4% to 8.9%, the equity exchanges’ share would increase modestly from 10.5% to 13.6%, and the total share for all equity and options exchanges combined would increase only from 20.9% to 21.9%.

Rather than addressing these outcomes transparently so that the public may provide informed feedback, the Proposal touts that the Executed Share Model “substantially increases the Participant allocation and substantially reduces the Industry Member allocation from prior proposals.” Subsumed within an accompanying footnote, the Proposal notes only that “FINRA’s contribution *likely* would increase under the

¹³ See *id.* at 33233.

¹⁴ See *id.*

[current Proposal] in comparison to prior models.”¹⁵ The Proposal adds even further confusion in the single sentence it offers in attempting to justify FINRA’s allocation. According to the Proposal, FINRA’s allocation is appropriate “given FINRA’s responsibility for securities traded in the over-the-counter market.”¹⁶ However, the Proposal is intended to recover the costs of the CAT’s operation as a system, *not* the costs associated with using CAT data for regulatory purposes. FINRA commented on this flawed rationale in connection with a previous proposal, noting that FINRA is not opposed to fees based on regulatory usage, provided such fees are not applied on an unsupported and *ad hoc* basis solely to FINRA.¹⁷ Not only does the current Proposal, which does not seek to amend the funding principles to take into consideration regulatory usage, fail to correct this problematic rationale, but it also dramatically amplifies the problem with an outsized yet opaque increase in FINRA’s allocation.

III. The Proposal Would Result in an Undue Burden

By shifting nearly all of the Participants’ increased share to FINRA, the current Proposal places an undue burden on FINRA, notwithstanding FINRA’s standing among Participants as the only not-for-profit national securities association that relies primarily on regulatory fees from its members for funding and the only Participant not operating a national securities exchange. As FINRA explained in its comment on the previous funding model proposal, given FINRA’s unique nature, FINRA necessarily must seek recovery in turn for the costs it is allocated.¹⁸ Further, as noted above, the costs at issue here concern the operation of CAT as a system, not FINRA’s separate costs to conduct regulation using CAT data. Accordingly, while FINRA recently implemented a plan to increase its regulatory fees to correct a structural deficit in its regulatory funding, FINRA explained in detail that its regulatory fee changes were not designed to cover any costs it is allocated for the operation of the CAT NMS Plan.¹⁹

¹⁵ See *id.* at 33233 n.37. (*emphasis added*).

¹⁶ See *id.*

¹⁷ See FINRA Comment Letter, *supra* note 3.

¹⁸ *Id.*

¹⁹ See Securities Exchange Act Release No. 90176 (October 14, 2020), 85 FR 66592, 66602-03 (October 20, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-032). As FINRA explained (*with emphasis added* below):

In addition to costs associated with its CAT reporting compliance program, FINRA must account for significant costs to integrate CAT data into its regulatory systems. These include one-time costs to migrate regulatory systems into an environment that can interact with CAT data, with

As described in the Proposal, the Executed Share Model would allocate substantial costs to FINRA based on over-the-counter executions reported to FINRA's trade reporting facilities for listed stocks (the "TRFs"). In line with the approach in the instant proposal to assess CAT costs for listed stocks based on TRF volume, FINRA likewise is seeking to recover a corresponding amount of its allocated CAT costs pursuant to its contractual arrangements with the TRF business members.²⁰ Notably, under the TRF contractual arrangements, FINRA has agreed not to retain associated trade reporting or market data revenues. Rather, the business members are entitled to trade reporting fees and market data revenues, and while they then share a percentage of market data revenues with FINRA member TRF participants in the form of transactions credits, they also retain market data revenues from the TRFs. If the Proposal is approved, FINRA will need to fund any costs that are not recovered under these contractual arrangements through increases to FINRA member fees. Unlike the exchanges, who may also seek to pass along all or some portion of their allocated CAT costs, FINRA does not

the potential for greater migration costs as a result of any future regulatory changes, such as under the Commission's recently proposed amendments to the CAT NMS Plan. FINRA also is making significant investments in enhanced surveillance technology to account for and use CAT data in FINRA's oversight of various market integrity rules, as CAT includes expanded audit trail data for options and equities. *Importantly, these costs are separate from and in addition to FINRA's obligation to contribute funding for the development, maintenance, and operation of the CAT system incurred by the CAT Plan Processor.*

And:

As a result, if the CAT NMS Plan Participants file a separate proposal to recover some portion of CAT NMS Plan costs through a direct CAT fee assessment on industry members, the effectiveness of such a filing would not reduce the amount that FINRA projects it needs to raise with this proposal to correct its structural deficit.

²⁰ The FINRA TRFs are facilities of FINRA that are operated by exchange business members. There are two FINRA/Nasdaq TRFs and a FINRA/NYSE TRF. Under agreements with the respective business members, FINRA has sole regulatory responsibility for each TRF and the business member is primarily responsible for the management of TRF business affairs, including establishing pricing for use of the TRF, to the extent those affairs are not inconsistent with the regulatory and oversight functions of FINRA. Additionally, each business member is obligated to pay the cost of regulation and is entitled to the profits and losses, if any, derived from its operation of the TRF.

retain revenue in connection with the TRFs—like TRF market data revenues noted above, or other market data revenues—that could be used to offset its costs. Although the potential downstream industry impacts of FINRA’s allocation were raised by commenters regarding the previously proposed funding model, these impacts are neither acknowledged nor addressed in the current Proposal.²¹

IV. Alternative Models and Process

Like the other Participants, FINRA is strongly invested in the long-term financial sustainability of the CAT. However, FINRA believes a more transparent and fundamentally sound funding model is required, and that such a model requires a fundamentally sound process. In terms of alternatives, following last year’s proposal, FINRA had developed a revised message traffic alternative that was presented publicly in an industry webinar.²² Notably, this alternative sought to address concerns about previous message traffic models by providing for more predictable fees based on prospective (rather than retrospective) rates. FINRA is generally aware that some industry members believe message-traffic models are too complex. Accordingly, as noted above, FINRA is receptive to models that employ workable cost proxy metrics, provided they are principled and consistent with the Exchange Act.

While FINRA is open to other alternatives, FINRA believes a better, more inclusive process involving all parties who will contribute to the costs of the CAT is needed for any alternative to be successful. In addition to its status as the only not-for-profit SRO among the Participants, FINRA also does not control, nor is it under common control with, any other Participant. Because the CAT NMS Plan provides that each Participant shall be entitled to one vote, FINRA is entitled to only one out of 25 votes for purposes of determining the funding model for the CAT, as well as all other decisions regarding the operation of the CAT. In contrast, affiliated exchange groups voting as blocs enjoy substantially greater influence over such decisions. In addition, industry members are not entitled to vote on CAT Plan matters. It was pursuant to this voting structure that the Operating Committee approved a funding model that allocates to FINRA the disproportionate burden of paying a greater share of the costs of the CAT than any other Participant (and a greater share than any group of affiliated Participants).

While FINRA appreciates the challenges of this exercise and recognizes the need for principled tradeoffs, FINRA believes such tradeoffs must be identified and

²¹ See, e.g., Letters from Matthew Price, Chief Operations Officer, Fidelity Investments, to Vanessa A. Countryman, Secretary, SEC, dated May 12, 2021; Ellen Greene, Managing Director, SIFMA, to Vanessa A. Countryman, Secretary, SEC, dated May 12, 2021; and Thomas M. Merritt, Deputy General Counsel, Virtu Financial, to Vanessa A. Countryman, Secretary, SEC, dated May 12, 2021.

²² See CAT Funding Presentation (September 22, 2021), available at <https://catnmsplan.com/sites/default/files/2021-09/09.22.21-CAT-Fee-Model.pdf>.

Ms. Vanessa Countryman

June 22, 2022

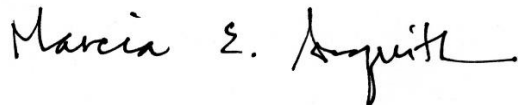
Page 9 of 9

analyzed with meaningful input from various CAT stakeholders. In this respect, FINRA would welcome constructive input from the industry on a reasonable framework, and, importantly, SEC guidance on how the Participants can manage more successfully to develop a funding model consistent with prevailing requirements.

V. Conclusion

FINRA thanks the Commission for its attention to FINRA's comments on the Proposal and looks forward to continued engagement with the Plan Participants, SEC, and market participants to achieve a sustainable solution to CAT's funding needs.

Sincerely,

A handwritten signature in black ink that reads "Marcia E. Asquith". The signature is written in a cursive style with a long horizontal flourish at the end.

Marcia E. Asquith
Corporate Secretary, EVP
Board and External Relations