

## Consolidated Audit Trail

### FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT

#### Summary

FINRA is issuing this *Regulatory Notice* as part of its continuing efforts to provide members with guidance on requirements relating to the Consolidated Audit Trail (CAT), and FINRA Rule 6800 Series (the “CAT Rules”). In particular, FINRA is reminding members of their supervisory responsibilities under the CAT Rules and FINRA’s Supervision Rule (Rule 3110). Members may wish to consider whether the practices and recommended steps described below are applicable to their own circumstances and would enhance their supervisory systems and compliance programs.<sup>1</sup>

Questions concerning this *Notice* should be directed to:

- ▶ Dave Chapman, Vice President, Market Regulation, at (240) 386-4995 or [dave.chapman@finra.org](mailto:dave.chapman@finra.org); or
- ▶ Lisa Horrigan, Associate General Counsel, Office of General Counsel, at (202) 728-8190 or [lisa.horrigan@finra.org](mailto:lisa.horrigan@finra.org).

Questions relating to CAT industry member registration or reporting, interpretive guidance, or technical specifications should be directed to the FINRA CAT Help Desk at (888) 696-3348 or [help@finracat.com](mailto:help@finracat.com).

#### Background

FINRA and the national securities exchanges (each an “SRO” or “Participant”) have adopted rules requiring their members to comply with Rule 613 of the Securities Exchange Act of 1934 and the CAT NMS Plan.<sup>2</sup> These rules generally cover reporting to the CAT, clock synchronization, time stamps, connectivity and data transmission, development and testing, recordkeeping, the timeliness, accuracy and completeness of data and compliance dates. See, e.g., the FINRA Rule 6800 Series.<sup>3</sup>

August 31, 2020

#### Notice Type

- ▶ Reminder

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management
- ▶ Systems
- ▶ Trading

#### Key Topics

- ▶ Consolidated Audit Trail (CAT)
- ▶ NMS Securities
- ▶ OTC Equity Securities

#### Referenced Rules & Notices

- ▶ FINRA Rule 3110
- ▶ FINRA Rule 6800 Series
- ▶ Notice to Members 99-45
- ▶ Notice to Members 02-29
- ▶ Notice to Members 05-48
- ▶ Securities Exchange Act Rule 613

## CAT Reporting

FINRA is reminding all members that receive or originate orders in NMS stocks, OTC equity securities or listed options that they will be required to report to CAT. All proprietary trading activity, including market making activity, is subject to CAT reporting. There are no exclusions or exemptions of any kind for size or type of firm or type of trading activity. Member CAT reporting is being phased in over several time periods, starting with “phase 2a” equities reporting for large and small industry members that currently report to OATS, which commenced on June 22, 2020, and “phase 2b” options reporting for large industry members, which commenced on July 20, 2020.<sup>4</sup> Small industry members that do not currently report to OATS are required to report to CAT commencing on December 13, 2021.

There are a variety of ways in which members may comply with the CAT Rules. For example, a member may develop or purchase a proprietary system for CAT reporting or it may enter into a reporting agent agreement with another member or other party to report on its behalf under Rule 6870(c).<sup>5</sup> In any case, the member receiving or originating the order for an NMS stock, OTC equity security or a listed option is responsible for complying with the CAT Rules, and cannot contract away or otherwise shift this responsibility to a third party.

## CAT Supervisory Systems and Procedures

In accordance with Rule 3110(a), all members must establish and maintain a supervisory system that is reasonably designed to achieve compliance with the CAT Rules. A well designed and implemented supervisory system is particularly important when a member is using a reporting agent to comply with the CAT Rules to ensure that such third party is conducting CAT activities as agreed upon and in compliance with the CAT Rules. In addition, Rule 3110(b) requires each member to establish, maintain, and enforce written supervisory procedures that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with other applicable FINRA rules.<sup>6</sup>

FINRA reminds members that reasonably designed supervisory procedures should document the steps that an appropriately registered firm principal<sup>7</sup> for the reporting member should take to achieve compliance with the FINRA rules, including the CAT Rules. See, e.g., *Notice to Members 99-45*, as well as *Notice to Members 02-29*, regarding the Order Audit Trail System (OATS), for general guidance on supervisory obligations of member firms in this context.

Given the different business models of members and that members can achieve compliance with Rule 3110 through a variety of methods and systems, this *Notice* only addresses some of the general elements members should consider in assessing the reasonableness of their supervisory systems and written supervisory procedures regarding the CAT Rules. FINRA is not mandating any particular type or method of supervision, nor is

it intending to provide a checklist of steps that if followed would constitute a reasonably designed supervisory system. FINRA will examine members' supervisory systems and written supervisory procedures and, where appropriate, initiate disciplinary action for failure to adopt, implement and enforce reasonably designed supervisory procedures.

## Specific Considerations for CAT Supervisory Systems and Procedures

Reasonably designed written supervisory procedures should address the CAT Rules and, at a minimum: (1) identify the individual, by name or title, responsible for the review of CAT reporting; (2) describe specifically what type of review(s) will be conducted; (3) specify how often the review(s) will be conducted; and (4) describe how the review(s) will be evidenced. These procedures should incorporate frequent reviews by the firm of the data posted on the CAT Reporter Portal.<sup>8</sup> A firm's written supervisory procedures also should address clock synchronization and CAT reporting. The clock synchronization section should cover, at a minimum, how and when clocks are synchronized, who is responsible for clock synchronization, how the firm evidences that clocks have been synchronized, and how the firm will self-report clock synchronization violations, consistent with the clock synchronization guidance available on the CAT NMS Plan website.<sup>9</sup>

Members' written supervisory procedures also must be reasonably designed to ensure that the data reported by them or on their behalf is transmitted in a timely fashion and that it is complete and accurate. Among other things, firms should review this data to verify that: (1) the data is sent to CAT by 0800 (8:00 a.m. Eastern Time) the following Trading Day; (2) the data is complete with no missing events; and (3) the data is accurate with all of the appropriate data fields reported correctly. It will not be sufficient for firms to only review rejected data.

Provided below are recommended steps that members should consider incorporating into their CAT supervisory systems and written supervisory procedures:

- ▶ Daily clock synchronization each business day before market open (and re-synchronization as necessary throughout the day) to ensure that their business clocks are synchronized to within 50 milliseconds of the National Institute of Standards and Technology's (NIST) atomic clock, with the exception of business clocks used solely for manual order events or the time of allocation on Allocation Reports, which must be synchronized to within one second of the NIST atomic clock.<sup>10</sup>
- ▶ Daily review of the CAT Reporter Portal to:
  - ▶ review file status to ensure file(s) sent by the member or by their reporting agent was accepted by CAT and to identify/address any file submission or integrity errors;
  - ▶ identify late records;

- ▶ identify and repair any data ingestion errors (syntax/semantic rejections);<sup>11</sup>
- ▶ identify and repair any linkage errors;
- ▶ review reporting statistics and compare them to firm record counts to ensure the member firm or its reporting agent has reported all required records;
- ▶ receive communications from FINRA CAT regarding CAT availability, announcements, software releases, etc.;<sup>12</sup> and
- ▶ update and maintain firm contact information.

Periodic comparative reviews of accepted CAT data against order and trade records and the [CAT Reporting Technical Specifications](#) to ensure:<sup>13</sup>

- ▶ all reportable records are submitted to CAT;
  - ▶ data fields contain accurate information;
  - ▶ records are submitted in the correct time sequence (*e.g.*, executions are not time-stamped prior to the receipt of a new order);
  - ▶ “Handling Instructions” are correctly populated;
  - ▶ “Account Holder Type” values are populated correctly;
  - ▶ the “Manual Flag” field is populated correctly; and
  - ▶ data is properly reported under the member’s “Industry Member Identifier” (IMID).
- ▶ Ongoing steps:
- ▶ If applicable, communicate regularly with your CAT reporting agent to ensure data is being properly submitted.
  - ▶ Review [CAT Announcements](#) and [CAT Frequently Asked Questions](#) pages.
  - ▶ Review the [CAT Reporter Portal User Guide](#), [CAT Technical Specifications](#), and [Industry Member Reporting Scenarios](#) as they are updated.
  - ▶ Use the FINRA CAT Help Desk at (888) 696-3348 or [help@finracat.com](mailto:help@finracat.com).
  - ▶ Report reporting issues to the FINRA CAT Help Desk.

Members that use a reporting agent to assist with their reporting obligations should also review their Reporting Agent agreements regarding any supervisory activities that the reporting agent may monitor or surveil for on behalf of the member.<sup>14</sup> Members are reminded that they may never contract their supervisory and compliance activities away from their direct control, and that they remain ultimately responsible for all supervisory activities.<sup>15</sup> Therefore, members should periodically review and assess the effectiveness of the reporting agent’s activities.

## Common OATS Supervisory Deficiencies Noted During Reviews

To assist members in developing adequate CAT supervisory systems and written supervisory procedures, FINRA staff has compiled below examples of supervisory deficiencies that we have found most frequently during the course of OATS compliance reviews. Members should consider the following as instructive for purposes of CAT supervision, including with respect to overseeing their reporting agent's activities, as applicable:

- ▶ The written supervisory procedures merely recite the applicable rules.
- ▶ Failure to designate responsible supervisory personnel in the procedures.
- ▶ Failure to describe the review process adequately in the procedures.
- ▶ Failure to specify the frequency of reviews in the procedures.
- ▶ Failure to document supervisory systems in the written supervisory procedures.
- ▶ Failure to update procedures within a reasonable period to reflect new regulatory requirements or procedures.
- ▶ Failure to document reviews or take remedial steps, if necessary, following a review.
- ▶ Failure to monitor adequately the performance of reporting agents to which the member has delegated its reporting responsibilities.

## Conclusion

FINRA encourages firms to review their supervisory systems and written supervisory procedures in the context of this guidance to ensure that they are reasonably designed to achieve compliance with the CAT Rules.

## Endnotes

1. This *Notice* is not intended to create new obligations, nor does it relieve firms of any existing obligations under federal securities laws and regulations.
2. Rule 613 of the Securities Exchange Act of 1934 requires national securities exchanges and national securities associations to submit a national market system plan to the SEC to create, implement, and maintain the CAT. Pursuant to Rule 613, the Participants filed with the SEC the CAT NMS Plan, which was approved by the SEC on November 15, 2016. The SROs jointly own and operate CAT NMS, LLC, which was formed by the SROs to arrange for and oversee the creation, implementation and maintenance of the CAT, as required under Rule 613. For more information, see the [CAT NMS Plan website](#), which includes CAT FAQs and Alerts, and the [CAT section of the FINRA Key Topics website](#). Capitalized terms used but not otherwise defined herein have the meaning ascribed to them under the CAT Rules.
3. As mandated under Rule 613, the CAT NMS Plan requires each Participant to adopt rules requiring its members to comply with Rule 613 and the CAT NMS Plan, and to agree to enforce compliance by its members in that regard. FINRA is coordinating with other Participants to promote harmonized and consistent regulation of all Participants' CAT compliance rules. The SEC approved a Rule 17d-2 Plan under which the regulation of CAT compliance rules will be allocated among Participants to reduce regulatory duplication for Industry Members that are members of more than one Participant. See Securities Exchange Act Release No. 88366 (March 12, 2020), 85 FR 15238 (March 17, 2020). Under the Rule 17d-2 Plan, the regulation of CAT compliance rules with respect to common members that are members of FINRA is allocated to FINRA.
4. See the [CAT NMS Plan](#) website for detailed information on the reporting timelines.
5. Under FINRA Rule 6870(c), member firms that use a reporting agent to record and transmit their CAT data must have an executed copy of the written agreement with that entity that specifically outlines the functions and responsibilities of each party. (See [OATS Report - February 10, 2004](#), which discusses firm best practices for reporting agent agreements.) Each Reporting Member, however, is ultimately responsible for its own data, notwithstanding the existence of such an agreement. Also, it is imperative that FINRA member firms determine in which CAT Phase they are required to report and that this determination is clearly and accurately communicated to the reporting agent to ensure that order information is submitted accordingly.
6. See *Notice to Members 99-45*, NASD Provides Guidance On Supervisory Responsibilities (June 1999). If a firm utilizes a reporting agent to record and transmit CAT data on its behalf, the member firm is still required to have written supervisory procedures to ensure compliance with the CAT Rules. As noted, a contractual arrangement, no matter how comprehensive, will not relieve a member of its responsibilities under the CAT Rules.
7. See FINRA Rule 1200 Series (Registration and Qualification).
8. The Industry Member CAT Reporter Portal ("CAT Reporter Portal") is a web-based tool that allows CAT Reporters to monitor and manage data submissions to CAT. The CAT Reporter Portal includes end-to-end capability for providing complete and accurate data to CAT, including the ability to manually enter and upload data, monitor submissions, and review and correct errors.

Additionally, the CAT Reporter Portal provides access to reporting statistics including information on an Industry Member's submissions and error rates as well as its performance compared to that of its peers. Users can also access other CAT related information including system announcements, system status, and additional resources. See the CAT Reporter Portal User Guide and CAT Connectivity Supplement for Industry Members at the [CAT Transaction Registration & Onboarding](#) section of the CAT NMS Plan website.

9. See Section R of the CAT FAQs, available at <https://catnmsplan.com/faq>.
10. For more detailed guidance on clock synchronization requirements and procedures, see Section R of the CAT FAQs. See also Standards for Self-Reporting Deviations of Clock Synchronization Standards to FINRA CAT, [CAT Alert 2020-02](#).
11. Members should review closely any reporting agent agreements into which it has entered to establish whether the member or its reporting agent is responsible for the repair and resubmission of any rejected data.
12. To ensure they receive all updates regarding the CAT NMS Plan, the [www.catnmsplan.com](http://www.catnmsplan.com) website, and other CAT updates, members should subscribe to receive [FINRA CAT e-mail notifications](#).
13. If a reporting agent is submitting data on a member's behalf, it is the member's responsibility to periodically obtain from its reporting agent a complete set of CAT data submitted on its behalf, in order to perform the reviews outlined above or to validate that its reporting agent is monitoring the accuracy of data submitted on its behalf.
14. See *Notice to Members 05-48* (July 2005) relating to members' responsibilities when outsourcing activities to third-party service providers.
15. See *Notice to Members 05-48*. Specific guidance on oversight of third party service providers with respect to clock synchronization is provided in CAT FAQ R2.