

SEC Publishes Consolidated Audit Trail Plan

The plan would create a single database to enable regulators to track all trading activity in the US equity and options markets.

On April 27, 2016, the Securities and Exchange Commission (SEC) published for public comment a proposed national market system (NMS) plan (the Proposed Plan) to create a consolidated audit trail (CAT) for recording and reporting the complete lifecycle of all orders and transactions in the US equity and options markets.¹ The Proposed Plan, submitted jointly by the national securities exchanges and the Financial Industry Regulatory Authority (FINRA) (collectively, the SROs), would provide for, among other things:

- Creation of a central repository (the Central Repository) that would receive, consolidate, and retain the trade and order data reported as part of the CAT
- Data recording and reporting by the SROs and broker-dealers of NMS securities, as well as over-the-counter equity securities, at the various stages of an order's lifecycle — e.g. origination, routing, modification/cancellation and execution
- Access and use of data in the central repository to the SROs and the SEC for regulatory and oversight purposes
- Data security requirements regarding connectivity and data transfer, encryption, storage, access, breach management and personally identifiable information
- A process to eliminate rules and systems the CAT will render duplicative

The SEC also posed a number of questions to market participants in the release. The comment period for the Proposed Plan will be open for 60 days after publication in Federal Register.²

Background

According to the SEC, the regulatory data infrastructure on which the SROs and the SEC currently rely is outdated and inadequate to effectively oversee a complex, dispersed and highly automated national market system.³ As a result, in performing oversight responsibilities, regulators must attempt to assemble disparate data from a variety of existing systems lacking in completeness, accuracy, accessibility and timeliness. For example, currently FINRA and some of the national securities exchanges maintain their own separate audit trail systems for certain segments of trading activity. These systems vary in scope, required data elements and format, so that, for example, following orders through a transaction's lifecycle is impractical as data may be routed, aggregated, re-routed and disaggregated across multiple markets. Accordingly, to address these shortcomings, the SEC required in Rule 613 of Regulation NMS⁴ that the SROs jointly submit an NMS plan to create, implement and maintain a CAT that would capture — in a

single, consolidated data source — customer and order event information for orders in NMS securities, across all markets, from the time of order inception through routing, cancellation, modification or execution. The SEC outlined the broad framework for the CAT, including the minimum elements the SEC believes are necessary for an effective CAT, while simultaneously permitting the SROs to draw upon their expertise to develop the details.

Plan Processor and Central Repository

Under the Proposed Plan, a “Plan Processor”⁵ would build a Central Repository to receive, consolidate and retain the trade and order data reported as part of the CAT.⁶ The Plan Processor would be responsible for, among other things:

- Operating, maintaining and upgrading the Central Repository
- Ensuring the security and confidentiality of all data reported to the Central Repository
- Publishing technical specifications containing detailed instructions for the SROs’ and broker-dealers’ submission of data to the Central Repository⁷

The Central Repository, under the Plan Processor’s oversight, would receive, consolidate and retain all CAT data, including:

- Information, including the size and condition, on quotes, including the National Best Bid and National Best Offer for each NMS Security
- Last Sale Reports and transaction reports reported under an effective transaction reporting plan filed with the SEC
- Trading halts, limit-up limit-down (LULD) price bands and LULD indicators
- Certain summary data created by securities information processors (SIPs)⁸

The Central Repository would also collect and retain the information SROs and broker-dealers report (discussed below), in a convenient and usable standard electronic data format that is directly available and searchable electronically for a period of not less than six years.⁹

Data Recording and Reporting

The Proposed Plan also sets forth requirements regarding each SRO’s data recording and reporting responsibilities. Each SRO, through the SRO’s compliance rules, will require its members (e.g., broker-dealers) to record and electronically report for each order and each “Reportable Event”¹⁰ the information outlined below, which is referred to collectively in the Proposed Plan as “Participant Data” and “Recorded Industry Member Data.”¹¹

- For original receipt or origination of an order:
 - Firm Designated ID(s) (FDIs) for each customer¹²
 - CAT-Order-ID (as defined in SEC Rule 613(j)(1))¹³
 - SRO-Assigned Market Participant Identifier of the broker-dealer receiving or originating the order
 - Date of order receipt or origination
 - Time of order receipt or origination (using timestamps required by the Proposed Plan)

- Certain material terms of the order¹⁴
- For the routing of an order:
 - CAT-Order-ID
 - Date on which the order is routed
 - Time at which the order is routed (using timestamps required by the Proposed Plan)
 - SRO-Assigned Market Participant Identifier of the broker-dealer routing the order
 - SRO-Assigned Market Participant Identifier of broker-dealer to which the order is being routed
 - If routed internally at the broker-dealer, the identity and nature of the department or desk to which the order is routed
 - Certain material terms of the order
- For the receipt of an order that has been routed:
 - CAT-Order-ID
 - Date on which the order is received
 - Time at which the order is received (using timestamps required by the Proposed Plan)
 - SRO-Assigned Market Participant Identifier of the broker-dealer receiving the order
 - SRO-Assigned Market Participant Identifier of the broker-dealer routing the order
 - Certain material terms of the order
- If the order is modified or cancelled:
 - CAT-Order-ID
 - Date the modification or cancellation is received or originated
 - Time at which the modification or cancellation is received or originated (using timestamps required by the Proposed Plan)
 - Price and remaining size of the order, if modified
 - Other changes in certain material terms, if modified
 - Whether the modification or cancellation instruction was given by the customer, or was initiated by the broker-dealer
- If the order is executed, in whole or in part:
 - CAT-Order-ID
 - Date of execution
 - Time of execution (using timestamps required by the Proposed Plan)
 - Execution capacity (principal, agency or riskless principal)
 - Execution price and size
 - The SRO-Assigned Market Participant Identifier of the broker-dealer executing the order
 - Whether the execution was reported pursuant to an effective transaction reporting plan or the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information

In general, the Proposed Plan requires this data to be recorded contemporaneously with the order event and reported to the Central Repository by 8 a.m. on the day following the event.¹⁵

Exemptive Relief from Certain Requirements of Rule 613 of Regulation NMS

The Proposed Plan also reflects exemptive relief from certain Rule 613 requirements that the SEC granted earlier this year.¹⁶ That exemptive relief provides the SROs with the flexibility to propose

approaches in the Proposed Plan that could potentially be more efficient and cost-effective than those Rule 613 requires, without adversely affecting the reliability or accuracy of CAT data. Specifically, the exemptive relief permits the SROs to propose, in the Proposed Plan, that:

- Only options exchanges — but not options market makers — be required to report information to the Central Repository regarding options market maker quotations
- Instead of requiring broker-dealers to use a universal customer identifier for each customer for all orders, each broker-dealer could assign a unique FDI to each trading account
- Instead of requiring a universal identifier for each broker-dealer reporting data to the CAT, a broker-dealer could use its existing SRO-assigned market participant identifier
- Instead of requiring broker-dealers to link a particular order or execution to an allocation, a broker-dealer could provide an allocation report that focuses on the shares allocated and the applicable accounts' or subaccounts' FDIs
- Instead of requiring manual order receipts to be time-stamped to the millisecond, a time stamp to the nearest second be permitted

Regulatory Access and Use

Under the Proposed Plan, the Plan Processor would be required to provide the SEC and SROs access to the Central Repository for regulatory and oversight purposes pursuant to the federal securities laws, rules and regulations, or any contractual obligations.¹⁷ The Proposed Plan would create a method of accessing CAT data that includes the ability to run complex searches and generate reports.¹⁸ Regulators would have access to the Central Repository by two different methods: (1) an online targeted query tool with pre-defined selection criteria to choose from; and (2) user-defined direct queries and bulk extractions of data via a query tool or language allowing querying of all available attributes and data sources.¹⁹

Data Security and Confidentiality

The Plan Processor would be required to develop and maintain a comprehensive information security program for the Central Repository, which must contain requirements on connectivity and data transfer, encryption, storage, access, breach management and personally identifiable information.²⁰ The Plan Processor would also be responsible for developing a comprehensive information security program, as well as a training program that addresses the security and confidentiality of all information accessible from the CAT.²¹ Finally, the Plan Processor would be required to designate one of its employees as Chief Information Security Officer, who would be responsible for creating and enforcing appropriate policies, procedures and control structures regarding data security.²²

Retirement of Duplicative Rules and Systems

As Rule 613 of Regulation NMS requires, the Proposed Plan contains a method to identify and eliminate rules and systems that may be rendered duplicative (or partially duplicative by CAT), including, for example, FINRA rules that implement its Order Audit Trail System (OATS); option exchange rules that require reporting transactions in the equity underlier for options products listed on the options exchange; and SEC Rule 13h-1 concerning the identification of large traders and their required reporting obligations.

The Proposed Plan estimates that market participants may have duplicative audit trail data reporting responsibilities for a period of up to 2.5 years after industry members begin reporting data to CAT.²³

Implementation Schedule

The terms of the Proposed Plan will be effective immediately upon the SEC's approval of the Plan (the Effective Date). The Plan also sets forth, however, a proposed implementation schedule that phases the Proposed Plan's various aspects over time with respect to different classes of market participants. Upon the Effective Date, within:

- Two months, the SROs would be required to select the Plan Processor from among the remaining bidders
- One year, the SROs would be required to begin reporting data to the Central Repository
- Two years, large broker-dealers would be required to begin reporting data to the central repository — "large broker-dealers" means, in general, a broker-dealer that does not qualify as a "small broker-dealer" under SEC Rule 613
- Three years, "small broker dealers" would be required to begin reporting data to the Central Repository

In her public remarks regarding the Proposed Plan, SEC Chair Mary Jo White stated that implementation of the Proposed Plan is one of the SEC's top priorities and that it is expected that the SEC staff will prepare a recommendation for SEC action later this year.

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Endnotes

- ¹ Joint Industry Plan; Notice of Filing of the National Market System Plan Governing the Consolidated Audit Trail by BATS Exchange, Inc., BATS-Y Exchange, Inc., BOX Options Exchange LLC, C2 Options Exchange, Incorporated, Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., International Securities Exchange, LLC, ISE Gemini, LLC, Miami International Securities Exchange LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The NASDAQ Stock Market LLC, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc; Release No. 34-77724 (April 27, 2016) (Proposed Plan Release), available at: <https://www.sec.gov/rules/sro/nms/2016/34-77724.pdf>
- ² As of the date of this Client Alert, the Proposed Plan has not been published in the Federal Register.
- ³ See Proposed Plan Release. at p. 5
- ⁴ See *id.* at p. 6; see also Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722 (August 1, 2012).
- ⁵ The "Plan Processor" would be selected pursuant to a competitive bidding process set forth in the Proposed Plan.
- ⁶ The activities of the CAT would be conducted through a jointly owned Delaware limited liability company that would be managed by an operating committee.
- ⁷ See Proposed Plan Release. at p. 43-49.
- ⁸ See Proposed Plan Release. at p. 55-56.
- ⁹ See Proposed Plan Release. at p. 56.
- ¹⁰ The Proposed Plan defines "Reportable Event" as "includ[ing], but . . . not limited to, the original receipt or origination, modification, cancellation, routing, execution (in whole or in part) and allocation of an order, and receipt of a routed order."
- ¹¹ See Proposed Plan Release. at p. 61.
- ¹² The Proposed Plan defines a "Firm Designated ID" as "a unique identifier for each trading account designated by Industry Members (e.g., broker-dealers) for purposes of providing data to the Central Repository, where each such identifier is unique among all identifiers from any given Industry Member for each business date."
- ¹³ Rule 613(j)(1) defines a CAT-Order-ID as a unique order identifier or series of unique order identifiers that allows the Central Repository to efficiently and accurately link all reportable events for an order, and all orders that result from the aggregation or disaggregation of such order.
- ¹⁴ "Material terms of the order" include the NMS Security or OTC Equity Security symbol; security type; price (if applicable); size (displayed and non-displayed); side (buy/sell); order type; if a sell order, whether the order is long, short, short exempt; open/close indicator; time in force (if applicable); if the order is for a listed option, option type (put/call), option symbol or root symbol, underlying symbol, strike price, expiration date, and open/close; and any special handling instructions.
- ¹⁵ See Proposed Plan Release. at p. 63.
- ¹⁶ See Securities Exchange Act Release No. 77265 (March 1, 2016), 81 FR 11856 (March 7, 2016).
- ¹⁷ See Proposed Plan Release. at p. 56.
- ¹⁸ See Proposed Plan Release. at p. 159.
- ¹⁹ See Proposed Plan Release. at p. 159.
- ²⁰ See Proposed Plan Release. at p. 168-169.
- ²¹ See Proposed Plan Release. at p. 169.
- ²² See Proposed Plan Release. at p. 169.
- ²³ See Proposed Plan Release. at p. 404.