

SEC Rule 613 - Consolidated Audit Trail (CAT)

SRO NMS Plan Industry Event

October 15 and 16, 2012



Agenda

1. Overview of Rule 613 and Key Requirements
2. SRO Action Plan
3. Milestones for NMS Plan Development
4. RFP Scope and Process
5. Development of Requirements
6. “Hot Button” Issues
 - Customer Identifiers/Information
 - Intrafirm Linkages
 - Options
7. Q & A

Overview

- Rule 613 under Regulation NMS requires the exchanges and FINRA (SROs) to submit to the SEC by April 26, 2013 an NMS Plan (Plan) to create, implement, and maintain a consolidated audit trail (CAT).
- As part of the Plan development process, the SROs must consider the feasibility, costs and benefits of alternatives to meet the requirements of Rule 613.

Scope – Covered Securities

- The Plan submitted to the SEC must initially cover all secondary market transactions in NMS stocks and options (NMS securities). In addition, the Plan must examine the feasibility, costs and benefits of including primary market transactions in NMS securities in the initial phase.
- Within 6 months after the effectiveness of the Plan, the SROs must provide an “expansion document” to the SEC outlining how the following securities could be incorporated:
 - Equity securities that are not NMS securities (OTC equity securities), including both primary and secondary market transactions; and
 - Debt securities

Key Requirements

- Creation and maintenance of a central repository accessible by all regulators
 - Will include all events in the lifecycle of an order from receipt or origination through execution or cancellation
 - Requires identity of account holders and persons authorized to trade for an account
 - Establishes reporting deadlines and maximum allowable error rates
- Implementation by SROs of surveillance systems that are reasonably designed to make use of CAT data

SRO Action Plan

- Representatives of each of the national securities exchanges and FINRA are meeting regularly to address our collective obligations under Rule 613.
- SRO working groups have been created to focus on the following aspects of the Plan:
 - Plan Governance
 - Technical
 - Industry Outreach and Input
 - Costs and Funding
 - CAT Expansion `

Milestones for NMS Plan Development

The SROs have identified certain key milestones that they believe must be met to comply with the requirements of Rule 613, including a detailed cost benefit analysis. These milestones include:

- Development of high level requirements and draft RFP

Target Date: In progress

- Communicate to industry general framework of RFP

Target Date: Late November

- Publication of final RFP

Target Date: Mid December

Milestones for NMS Plan Development

- Review of bids and preliminary selection of processor
Target Date: Late January to Mid February 2013
- Publish draft NMS Plan for comment
Target Date: Late February to Mid March 2013
- File NMS Plan with SEC – April 26, 2013

RFP Scope

We anticipate the RFP may include the following:

- How data from reporting entities will be transmitted to, and ingested by, the processor.
- The technology applications and tools that will be used to process and store data.
- How data will be validated and errors corrected, including timeframes that corrected data will be available to regulators.
- How order events will be linked and stored for use by regulators.
- How customer information will be stored and the specific security protocols to be used for such data.

RFP Process

We anticipate the RFP process will include the following steps:

- Publication of RFP on www.catnmsplan.com
- Opportunity for interested parties to ask questions about the RFP prior to bid submission
- Evaluation of submitted bids
- Opportunity for presentations by qualifying bidders

Development of Requirements

Detailed requirements will be developed for key components of the CAT, including:

1. Broker-Dealer Order Information
2. Exchange Data (Quotes, Orders, Trades)
3. CAT Processor and Central Repository

Broker-Dealer Reporting Requirements

1. Customer Identifiers – obtaining the identifiers
2. Detailed Customer Information – both the initial creation of the Customer Database and ongoing reporting, such as when an account is opened and updates to existing information (e.g., address changes)
3. CAT Reporter ID – analyzing how existing market participant identifiers can be used
4. Reporting of Order Information – Linkages within a single firm and across firms

Exchange Reporting Requirements

1. CAT Reporter ID – IDs for the exchange itself as well as capture by the exchange of members' CAT Reporter IDs
2. Linkage between broker-dealers' orders and exchange orders
3. Transmission of data to CAT Processor
4. Consider whether exchanges can report certain data on behalf of their members, such as quotes

CAT Processor and Central Repository

1. Ingestion of Data
2. Processing of data, including validation, linkage and communication back to Reporting Entities
3. Data Storage and Security
4. Provision of data to regulators
5. Reporting Entity Support (e.g., Help Desk, Technical Specifications, Reporting Interpretations)
6. Enforcement of Maximum Reporting Error Requirements

Customer Identification

Each order must identify the customer that originated the order. Rule 613 defines customer as:

- (i) The account holder(s) of the account at the broker-dealer originating the order; AND
- (ii) Any person from whom the broker-dealer is authorized to accept trading instructions for such account, if different from the account holder(s).

Customer Identification

- Each “customer” must have a unique identifier, defined as the “Customer-ID”.
- The Customer-ID must be recorded contemporaneously with the event and then reported as part of the original receipt or origination of the order.
- If there are multiple customers associated with an order, all Customer-IDs must be reported.
- In addition to the Customer-ID, information of sufficient detail to identify the customer must be reported to the CAT.

Customer Identification Implementation Issues

- We anticipate that the responsibility to obtain a unique customer identifier from the CAT processor or other central entity will belong to the broker-dealer with the CAT reporting obligation.
- We are considering whether any existing identifiers, such as Legal Entity Identifiers (LEIs) can be used. However, there are no existing identifiers for retail clients (other than social security number).

Customer Identification Implementation Issues

- We are currently analyzing whether detailed customer information (name, address, etc.) could reside in a separate customer database.
- This information would need to be submitted in order to receive a unique Customer ID.
- The information in the customer database will need to be validated (similar to the LEI validation process) and must facilitate updates to customer information (address changes, etc.).

Customer Identification Implementation Issues

- We are considering whether the Customer ID of the person that placed an order be flagged on each order so that account holders can be distinguished from persons with trading authorization, if those persons are different.
- If such a field were required for each new order event, what kind of issues would that raise for broker-dealers?

Customer Identification Implementation Issues

- How many Customer ID fields should be allowed? What if there are more Customer IDs associated with an order than there are allowed fields?
- Are there other solutions, such as linking account numbers to groups of Customer IDs in the Customer Database? If account numbers were linked to Customer IDs in the Customer Database, would it be possible to only report the account number on the new order event and have the CAT processor extract and associate detail customer information with order events during the order linkage process?

Intrafirm Linkages – Representative Orders

All orders originated by a firm to facilitate the execution of one or more customer orders, regardless of the capacity in which a firm is acting with respect to such order(s), must be reported to the CAT.

Intrafirm Linkages – Representative Orders

Example: Riskless Principal Orders

A proprietary order originated for the purpose of executing a customer order on a riskless principal basis must be reported to the CAT. Additionally, the proprietary order must be linked in the CAT to the underlying customer order.

Intrafirm Linkages – Representative Orders

Example: Agency Orders – “Many to Many”

An order originated for the purpose of executing multiple orders on an agency basis must be reported to the CAT. Additionally, the representative order routed away from the firm (in one or more pieces) must be linked in the CAT to the underlying customer orders.

Options

- The same reporting requirements apply to both options and equities.
- Quotes and orders must be reported to the CAT by both broker-dealers and exchanges.
- We anticipate that related option and equity transactions (e.g., complex orders) would need to be linked in CAT.

Questions?

Feedback and Communication

The SROs have established a dedicated website to provide information to the public on the development of the Reg NMS Plan

www.catnmsplan.com

The SROs have also established a dedicated email address to receive feedback

feedback@catnmsplan.com

We are developing an FAQ section for the catnmsplan.com website. Look for that in the near future.