THE SEC APPROVES NEW CONSOLIDATED AUDIT TRAIL RULE

The Securities and Exchange Commission (the “SEC”) has approved Rule 613 under the Securities Exchange Act of 1934 (the “Exchange Act”) to require FINRA and the national securities exchanges (together “SROs”) to jointly submit to the SEC a national market system plan (“NMS Plan”) to create, implement, and maintain a consolidated order tracking system, or Consolidated Audit Trail (“CAT”). The CAT will be required to capture customer and order event information for orders in NMS Securities, across all securities markets, from the time of the inception of the order through its routing, cancellation, modification, or execution.

Citing the shortcomings in the completeness, accuracy, accessibility, and timeliness of various existing SRO audit trail systems, on May 26, 2010 the SEC proposed Rule 613, which required the SROs to jointly submit an NMS Plan that would govern the creation of a consolidated audit trail and control reporting of audit trail data. The SEC received a number of comments on proposed Rule 613, including many suggesting alternative approaches to various aspects of the proposal. After a two-year consideration of those comments, the SEC adopted Rule 613 with a number of modifications to the original proposal.

The SEC believes that the implementation of a CAT will improve surveillance of the equity markets and will significantly augment the ability of regulators to monitor overall market structure and assess how SEC rules are affecting the markets.

Rule 613 is effective October 1, 2012, and requires the SROs to submit for approval to the SEC an NMS Plan within 270 days of the August 1, 2012 publication of the Adopting Release in the Federal Register. The NMS Plan will be published for public comment, after which modifications may be made. The SEC then must approve the NMS Plan for it to become effective. Once the SEC approves the NMS Plan, the SROs are required to report the required data to a newly created central repository within one year of the effectiveness of the Plan.

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2 Generally, exchange-listed equities and equity options. “NMS security” is defined in Rule 600(a)(46) of Regulation NMS to mean “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.” A listed option is defined in Rule 600(a)(35) of Regulation NMS to mean “any option traded on a registered national securities exchange or automated facility of a national securities association.”


4 See Rule 613(e). The NMS Plan must provide for the creation and maintenance of a central repository that will be responsible for the receipt, consolidation, and retention of all information reported under Rule 613(c)(7). The central repository will be jointly owned, and be a facility of, each SRO and thus subject to SEC oversight.
Members of the SROs are required to report within two years of effectiveness and small broker-dealers\(^5\) will have up to three years to report. This implementation schedule will likely result in the deadline for most firms to comply with the CAT requirements being three to four years in the future.

**Key Highlights**

Rule 613 mandates that the NMS Plan submitted by the SROs for SEC approval must require:

- The SROs and their respective members to provide certain detailed information\(^6\) to a central repository regarding each quote, order and reportable event\(^7\) in an NMS Security.\(^8\)

- Such information to be reported by 8:00 a.m. on the trading day following the day it was recorded by the SRO or the member firm, and be subsequently available in an aggregated format to regulators for their analysis.\(^9\) This is an important change from the original CAT rule proposal, which contemplated reporting by member firms on a real-time basis.

- All reportable events to be tagged and stored by the central repository in a linked fashion to allow regulators to accurately follow an order through its entire life cycle from generation through routing, modification, cancellation, and execution.\(^10\)

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\(^5\) Rule 613(a)(3)(vi) looks to the definition of “small broker dealer” in Rule 240.0-10(c) under the Exchange Act.

\(^6\) See Rule 613(c)(7)(i) through (viii). Such data varies depending on where in process the order is, and generally includes: (1) the Customer-ID(s) for each customer, including the person giving a modification or cancellation instruction; (2) the CAT-Order-ID; (3) the CAT-Reporter-ID of the broker-dealer, national securities exchange, or national securities association receiving, originating, routing, modifying, cancelling, or executing an order and to which an order is being routed; (4) the identity and nature of the department or desk to which an order is routed, if routed internally at the broker-dealer; (5) the date an order was received, originated, routed, modified, cancelled, or executed; (6) the time an order was received, originated, routed, modified, cancelled, or executed; (7) material terms of an order and any changes of such terms, if modified; (8) the price and remaining size of an order, if modified; (9) execution capacity (principal, agency, riskless principal); (10) execution price and size; and (11) 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 (“OPRA”).

\(^7\) Rule 613(j)(9) defines “reportable event” to include, but not be limited to, the original receipt or origination, modification, cancellation, routing, and execution (in whole or in part) of an order, or receipt of a routed order.

\(^8\) Rule 613(c)(1).

\(^9\) Rule 613(c)(3) and (4). As proposed, Rule 613 would have required real-time reporting of such data.

\(^10\) Rule 613(c)(2). Proposed Rule 613 had required a “Unique Order Identifier” to be attached to each order reported to the central repository that would be the same throughout the order’s entire life cycle. Rule 613 as adopted has a more general requirement that once all the events are transmitted to the central repository, the repository must be able to efficiently and accurately link all the life cycle events for the same order and make the data available to regulators.
• Each broker-dealer and SRO to be assigned a unique, cross-market identifier to be reported to the central repository along with every reportable event.

• Each customer, as well as any person that is authorized to have trading discretion over a customer’s account to be assigned a unique, cross-market customer identifier to be reported to the central repository for every order originated.

• SROs and their members to synchronize the business clocks they use to record the date and time of any reportable event, and that there be time stamps reported to the central repository for each event, in millisecond or shorter increments.  

Rule 613 also requires an NMS Plan submitted to the SEC to discuss not only how the CAT would be created but any reasonable alternative approaches considered by the SROs, and why a particular approach was chosen. The NMS Plan must also discuss how the SROs solicited the views of their members, what those views were and how they were taken into account. The NMS Plan should also describe the costs of creating, implementing and maintaining the CAT and provide an analysis of its impact on competition, efficiency, and capital formation. The NMS Plan should also discuss whether any other reporting systems (or parts thereof) could be eliminated in light of the CAT.

Rule 613 provides that information furnished pursuant to the CAT will be kept confidential by the SEC and the SROs. Recognizing that some of the information may reveal customers’ and broker-dealers’ proprietary trading strategies and positions, the SEC states in the Adopting Release that it will assert all appropriate exemptions to disclosure under the Freedom of Information Act. It is unclear, however, whether confidentiality can be maintained if the records are subpoenaed in private litigation.

Several important issues will have to be addressed by the SROs in designing the NMS Plan. First, what will be the role of the large trader reporting system upon implementation of the CAT? The SROs will have to determine if the large trader system will remain independent, be integrated with the CAT, or be ended once the CAT is effective. Second, the SROs will have to decide if the CAT will build off the operational aspects of FINRA’s OATS system or will be a completely different reporting system. Third, the time-stamping requirement likely will prove expensive for the industry as most broker-dealers will have to adjust their time-stamping clocks. It will be interesting to see if the SROs and the SEC back away from this requirement in light of industry comment on the NMS Plan.

11 Rule 613(d).

12 Rule 613(d)(e)(4)(i); Adopting Release in text after footnote 689.

13 See Rule 240.13h-1 under the Exchange Act, which provides for large trader reporting. Please also see our client memorandum “SEC Adopts Large Trader Reporting System”, August 4, 2011.
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