

SEC Adopts Consolidated Audit Trail Rule

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Yesterday, the U.S. Securities and Exchange Commission (“SEC”) adopted new Rule 613 under Section 11A of the Securities Exchange Act of 1934, which directs the development and implementation of a consolidated audit trail (“CAT”) with respect to the trading of NMS securities (exchange-listed equities and equity options). Under the rule, national securities exchanges and the Financial Industry Regulatory Authority (“FINRA”) (self-regulatory organizations or “SROs”) are required to submit a national market system (“NMS”) plan to the Commission to create, implement, and maintain a CAT. The NMS plan will capture order event information for orders in NMS securities across all U.S. markets, throughout the life cycle of each order. As discussed in greater detail below, the adopted rule does not require reporting in real time — perhaps the most contentious aspect of the rule as proposed.

The SEC adopted the new Rule with a 3-2 vote, with Commissioners Walter and Aguilar dissenting. Rule 613 becomes effective 60 days after publication in the Federal Register. SROs are required to submit the NMS plan within 270 days of that same date. SROs will begin reporting information to the central repository within one year after approval of the NMS plan by the Commission; and, subject to an extended reporting requirement for small broker-dealers, broker-dealers generally will be required to begin reporting within two years of approval of the plan.

This summary is based on statements at the open meeting; we will provide additional detail when the adopting release for the rule becomes available.

Key Requirements of Rule 613

Report data to a central repository. SROs and their members will be required to provide to a central repository detailed data on each quote and order in an NMS security, including the order’s origination, modification, cancellation, routing and execution. Information regarding broker-dealer’s proprietary quotes is included in the reporting requirements.

Unique identifier for broker-dealers and exchanges. Reportable order information must include a unique, cross-market identifier for each broker-dealer and national securities exchange.

Customer/account holder identifiers. The SEC’s press release regarding the adopted rule states that “each customer as well as any customer adviser who has trading discretion over a customer’s account [will] be assigned a unique, cross-market customer identifier” that must accompany all order information reported to the central repository. This is a controversial point.

Commissioner Walter stated as one of the reasons for her dissent the fact that the rule as adopted requires only identification of the “account holder,” rather than of the actual beneficial owner of the account. Precisely how the final rule release will define this customer identifier, then, remains to be seen.

~~C~~*lock synchronization and timestamps.* SROs and broker-dealers will be required to synchronize the clocks used to record the date and time of any reportable event, and timestamps must be reported in milliseconds or smaller increments.

Changes from Proposed Rule

~~N~~*o real-time reporting.* As originally proposed, Rule 613 would have required real-time reporting of audit trail information. By contrast, as adopted Rule 613 *prohibits* SROs from requiring that data be reported prior to 8:00 a.m. ET on the following trading day.

~~N~~*o mandate to record and report information in uniform format.* The SROs are given flexibility to determine the manner in which the required data must be reported to the central repository, but the central repository must be able to provide the data to the SEC in a uniform format.

~~N~~*o unique order identifier.* There is no requirement to tag orders with unique order identifiers, but the central repository must have sufficient data to link all order events in the life cycle of the order.

~~E~~*ffective date for smaller broker-dealers.* Smaller broker-dealers will have three years (instead of two) to begin reporting.

~~U~~*se of account identifiers rather than customer specific identifiers.* The original proposal would have required unique customer identifiers to accompany all order data reported to the repository; as discussed above, the Rule as adopted instead requires account-level identifiers.

New Requirements

The final rule also includes several requirements that were not contained in the original proposal:

~~P~~*rivacy of customer information.* The rule requires policies and procedures designed to ensure the protection of confidential customer information collected and retained by the central repository.

~~E~~*rror rate and correction.* The NMS plan must provide detailed information regarding anticipated error rates as well as the plan’s proposed error correction process.

~~A~~*dvisory Committee.* To ensure that interested parties have a voice in the development of the NMS plan, the plan must establish an Advisory Committee to advise the plan sponsors on the implementation, operation, and administration of the central repository.

~~C~~*entral Repository’s Chief Compliance Officer.* The central repository’s Chief Compliance Officer must regularly review the operations of the CAT and recommend enhancements to ensure that the central repository remains an effective regulatory tool.

Disclosure of Estimated Costs. The NMS plan must describe the estimated costs of the CAT, as well as any reasonable alternative approaches considered by the SROs and why the plan was chosen from among those alternatives.

Eliminate other reporting systems. The NMS plan must include a plan to eliminate other reporting requirements that will be rendered duplicative by the CAT

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