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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80813; File No. SR-NASDAQ-2017-055]

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Eliminate Requirements That Will Be Duplicative of CAT

May 30, 2017

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 26, 2017, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend the Rule 7000A series relating to the Order Audit Trail System, Rule 8211 and Chapter IX, Section IV relating to Electronic Blue Sheets, Chapter VII, Section VII relating to account identification, and Chapter V, Section VII relating to the Consolidated Options Audit Trail System to reflect changes to these rules once members are

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

effectively reporting to the Consolidated Audit Trail (“CAT”) and the CAT’s accuracy and reliability meets certain standards as described below.

The text of the proposed rule change is available on the Exchange’s website at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend the Rule 7000A series relating to the Order Audit Trail System (“OATS”), Rule 8211 and Chapter IX, Section IV relating to Electronic Blue Sheets (“EBS”), Chapter VII, Section VII relating to account identification, and Chapter V, Section VII relating to the Consolidated Options Audit Trail System (“COATS”) to reflect changes to these rules once members are effectively reporting to the CAT, and the CAT’s accuracy and reliability meets certain standards as described below.<sup>3</sup>

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<sup>3</sup> The Exchange initially filed the proposed rule change on May 15, 2017 (SR-NASDAQ-2017-050). On May 26, 2017, the Exchange withdrew that filing and submitted this filing.

## Background

Bats BYX Exchange, Inc.; Bats BZX Exchange, Inc.; Bats EDGA Exchange, Inc.; Bats EDGX Exchange, Inc.; BOX Options Exchange LLC; C2 Options Exchange, Incorporated; Chicago Board Options Exchange, Incorporated; Chicago Stock Exchange, Inc.; FINRA; International Securities Exchange, LLC; Investors' Exchange LLC; ISE Gemini, LLC; ISE Mercury, LLC; Miami International Securities Exchange LLC; MIAX PEARL, LLC; NASDAQ BX, Inc.; NASDAQ PHLX LLC; The NASDAQ Stock Market LLC; National Stock Exchange, Inc.; New York Stock Exchange LLC; NYSE MKT LLC; and NYSE Arca, Inc. (collectively, the “Participants”) filed with the Commission, pursuant to Section 11A of the Exchange Act<sup>4</sup> and Rule 608 of Regulation NMS thereunder,<sup>5</sup> the National Market System Plan Governing the Consolidated Audit Trail (the “CAT NMS Plan” or “Plan”).<sup>6</sup> The Participants filed the Plan to comply with Rule 613 of Regulation NMS under the Exchange Act.<sup>7</sup> The Plan was published for

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<sup>4</sup> 15 U.S.C. 78k-1.

<sup>5</sup> 17 CFR 242.608.

<sup>6</sup> See Letter from the Participants to Brent J. Fields, Secretary, Commission, dated September 30, 2014; and Letter from Participants to Brent J. Fields, Secretary, Commission, dated February 27, 2015. On December 24, 2015, the Participants submitted an amendment to the CAT NMS Plan. See Letter from Participants to Brent J. Fields, Secretary, Commission, dated December 23, 2015.

ISE Gemini, LLC, ISE Mercury, LLC and International Securities Exchange, LLC have been renamed Nasdaq GEMX, LLC, Nasdaq MRX, LLC, and Nasdaq ISE, LLC, respectively. See Securities Exchange Act Release No. 80248 (March 15, 2017), 82 FR 14547 (March 21, 2017); Securities Exchange Act Release No. 80326 (March 29, 2017), 82 FR 16460 (April 4, 2017); and Securities Exchange Act Release No. 80325 (March 29, 2017), 82 FR 16445 (April 4, 2017).

National Stock Exchange, Inc. has been renamed NYSE National, Inc. See Securities Exchange Act Release No. 79902 (Jan. 30, 2017), 82 FR 9258 (February 3, 2017).

<sup>7</sup> 17 CFR 242.613.

comment in the Federal Register on May 17, 2016,<sup>8</sup> and approved by the Commission, as modified, on November 15, 2016.<sup>9</sup> On March 15, 2017, the Commission approved the new Nasdaq Rule 6800 Series and Chapter IX, Section 8 to implement provisions of the CAT NMS Plan that are applicable to Nasdaq members.<sup>10</sup>

The CAT NMS Plan is designed to create, implement, and maintain a consolidated audit trail that will capture in a single consolidated data source customer and order event information for orders in NMS Securities and OTC Equity Securities, across all markets, from the time of order inception through routing, cancellation, modification, or execution. Among other things, Section C.9. of Appendix C to the Plan, as modified by the Commission, requires each Participant to “file with the SEC the relevant rule change filing to eliminate or modify its duplicative rules within six (6) months of the SEC’s approval of the CAT NMS Plan.”<sup>11</sup> The Plan notes that “the elimination of such rules and the retirement of such systems [will] be effective at such time as CAT Data meets minimum standards of accuracy and reliability.”<sup>12</sup> Finally, the Plan requires the rule filing to discuss the following:

(i) specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate should determine when a system duplicative of the CAT can be retired;

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<sup>8</sup> Securities Exchange Act Release No. 77724 (April 27, 2016), 81 FR 30614 (May 17, 2016).

<sup>9</sup> Securities Exchange Act Release No. 79318 (November 15, 2016), 81 FR 84696 (November 23, 2016) (“Approval Order”).

<sup>10</sup> See Securities Exchange Act Release No. 80256 (March 15, 2017), 82 FR 14526 (March 21, 2017) (SR-NASDAQ-2017-008).

<sup>11</sup> CAT NMS Plan, Appendix C, Section C.9.

<sup>12</sup> See id.

(ii) whether the availability of certain data from Small Industry Members two years after the Effective Date would facilitate a more expeditious retirement of duplicative systems; and

(iii) whether individual Industry Members can be exempted from reporting to duplicative systems once their CAT reporting meets specified accuracy and reliability standards, including, but not limited to, ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.<sup>13</sup>

#### Changes to OATS

In response to these requirements, Nasdaq is proposing to delete the Rule 7000A Series (the “OATS Rules”) from the Nasdaq rulebook once the CAT achieves the specific accuracy and reliability standards described below, and Nasdaq has determined that its usage of the CAT Data has not revealed material issues that have not been corrected, confirmed that the CAT includes all data necessary to allow Nasdaq to continue to meet its surveillance obligations,<sup>14</sup> and confirmed that the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan.<sup>15</sup>

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<sup>13</sup> See id.

<sup>14</sup> As noted in the Participants’ September 23, 2016 response to comment letters on the Plan, the Participants “worked to keep [the CAT] gap analyses up-to-date by including newly-added data fields in these duplicative systems, such as the new OATS data fields related to the tick size pilot and ATS order book changes, in the gap analyses.” See Letter from Participants to Brent J. Fields, Secretary, Commission, dated September 23, 2016, at 21. The Participants noted that they “will work with the Plan Processor and the industry to develop detailed Technical Specifications to ensure that by the time Industry Members are required to report to the CAT, the CAT will include all data elements necessary to facilitate the rapid retirement of duplicative systems.” Id.

<sup>15</sup> Nasdaq notes that the OATS Rules were originally proposed to fulfill one of the undertakings contained in an order issued by the Commission relating to the settlement of an enforcement action against the National Association of Securities Dealers, Inc. for failure to adequately enforce its rules. See Securities Exchange Act Release No. 39729 (March 6, 1998), 63 FR 12559 (March 13, 1998). In approving the OATS Rules, the

## Specific Accuracy and Reliability Standards

The first issue the Plan requires the proposed rule change to discuss is “specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate should determine when a system duplicative of the CAT can be retired.”<sup>16</sup> Nasdaq believes that relevant error rates are the primary, but not the sole, metric by which to determine the CAT’s accuracy and reliability and will serve as the baseline requirement needed before OATS can be retired to account for information being available in the CAT.

As discussed in Section A.3.(b) of Appendix C to the CAT NMS Plan, the Participants established an initial Error Rate, as defined in the Plan, of 5% on initially submitted data (i.e., data as submitted by a CAT Reporter before any required corrections are performed). The Participants noted in the Plan that their expectation was that “error rates after reprocessing of error corrections will be de minimis.”<sup>17</sup> The Participants based this Error Rate on their consideration of “current and historical OATS Error Rates, the magnitude of new reporting requirements on the CAT Reporters and the fact that many CAT Reporters may have never been obligated to report data to an audit trail.”<sup>18</sup>

Nasdaq agrees with the Participants’ conclusion that a 5% pre-correction threshold “strikes the balance of adapting to a new reporting regime, while ensuring that the data provided to regulators will be capable of being used to conduct surveillance and market reconstruction, as well as having a sufficient level of accuracy to facilitate the retirement of existing regulatory

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Commission concluded that OATS satisfied the conditions of the SEC’s order and was consistent with the Exchange Act. See id. at 12566-67.

<sup>16</sup> See id. [sic]

<sup>17</sup> See CAT NMS Plan, Appendix C, Section A.3(b), at n.102.

<sup>18</sup> Id.

reports and systems where possible.”<sup>19</sup> However, Nasdaq believes that, when assessing the accuracy and reliability of the data for the purposes of retiring OATS, the error thresholds should be measured in more granular ways and should also include minimum error rates of post-correction data, which represents the data most likely to be used by Nasdaq to conduct surveillance. Although Nasdaq is proposing to measure the appropriate error rates in the aggregate, rather than firm-by-firm, Nasdaq believes that the error rates for equity securities should be measured separately from options since options orders are not currently reported regularly or included in OATS.

To ensure the CAT’s accuracy and reliability, Nasdaq is proposing that, before OATS could be retired, the CAT would generally need to achieve a sustained error rate for Industry Member reporting in each of the categories below for a period of at least 180 days of 5% or lower, measured on a pre-correction or as-submitted basis and 2% or lower on a post-correction basis (measured at T+5).<sup>20</sup> Nasdaq is proposing to measure the 5% pre-correction and 2% post-correction thresholds by averaging the error rate across the period, not require a 5% pre-correction and 2% post-correction maximum each day for 180 consecutive days. Nasdaq believes that measuring each of the thresholds over the course of 180 days will ensure that the CAT consistently meets minimum accuracy and reliability thresholds for Industry Member reporting while also ensuring that single-day measurements do not unduly affect the overall measurements.

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<sup>19</sup> Id.

<sup>20</sup> The Plan requires that the Plan Processor must ensure that regulators have access to corrected and linked order and Customer data by 8:00 a.m. Eastern Time on T+5. See CAT NMS Plan, Appendix C, Section A.2(a).

Nasdaq is proposing to use error rates in each the following categories, measured separately for options and for equities, to assess whether the threshold pre- and post-correction error rates are being met:

- Rejection Rates and Data Validations. Data validations for the CAT, while not expected to be designed the same as OATS, must be functionally equivalent to OATS in accordance with the CAT NMS Plan (i.e., the same types of basic data validations must be performed by the Plan Processor to comply with the CAT NMS Plan requirements). Appendix D of the Plan, for example, requires that certain file validations<sup>21</sup> and syntax and context checks be performed on all submitted records.<sup>22</sup> If a record does not pass these basic data validations, it must be rejected and returned to the CAT Reporter to be corrected and resubmitted.<sup>23</sup> The specific validations can be determined only after the Plan Processor has finalized the Industry Member Technical Specifications; however, the Plan also requires the Plan Processor to provide daily statistics on rejection rates after the data has been processed, including the number of files rejected and accepted, the number

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<sup>21</sup> See CAT NMS Plan, Appendix D, Section 7.2. The Plan requires the Plan Processor to confirm that file transmission and receipt are in the correct formats, including validation of header and trailers on the submitted report, confirmation of a valid Exchange[sic]-Assigned Market Participant Identifier, and verification of the number of records in the file. Id.

<sup>22</sup> See id. The Plan notes that syntax and context checks would include format checks (i.e., that data is entered in the specified format); data type checks (i.e., that the data type of each attribute conforms to the specifications); consistency checks (i.e., that all attributes for a record of a specified type are consistent); range/logic checks (i.e., that each attribute for every record has a value within specified limits and the values provided are associated with the event type they represent); data validity checks (i.e., that each attribute for every record has an acceptable value); completeness checks (i.e., that each mandatory attribute for every record is not null); and timeliness checks (i.e., that the records were submitted within the submission timelines). Id.

<sup>23</sup> See id.

of order events accepted and rejected, and the number of each type of report rejected.<sup>24</sup>

Nasdaq is proposing that, over the 180-day period, aggregate rejection rates (measured separately for equities and options) must be no more than 5% pre-correction or 2% post-correction across all CAT Reporters.

- Intra-Firm Linkages. The Plan requires that “the Plan Processor must be able to link all related order events from all CAT Reporters involved in the lifecycle of an order.”<sup>25</sup> At a minimum, this requirement includes the creation of an order lifecycle between “[a]ll order events handled within an individual CAT Reporter, including orders routed to internal desks or departments with different functions (e.g., an internal ATS).”<sup>26</sup> Nasdaq is proposing that aggregate intra-firm linkage rates across all Industry Member Reporters must be at least 95% pre-correction and 98% post-correction.
- Inter-Firm Linkages. The order linkage requirements in the Plan also require that the Plan Processor be able to create the lifecycle between orders routed between broker-dealers.<sup>27</sup> Nasdaq is proposing that at least a 95% pre-correction and 98% post-correction aggregate match rate be achieved for orders routed between two Industry Member Reporters.<sup>28</sup>
- Order Linkage Rates. In addition to creating linkages within and between broker-dealers, the Plan also includes requirements that the Plan Processor be able to create lifecycles to

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<sup>24</sup> See id.

<sup>25</sup> CAT NMS Plan, Appendix D, Section 3.

<sup>26</sup> Id.

<sup>27</sup> Id.

<sup>28</sup> This assumes linkage statistics will include both unlinked route reports and new orders where no related route report could be found.

link various pieces of related orders.<sup>29</sup> For example, the Plan requires linkages between customer orders and “representative” orders created in firm accounts for the purpose of facilitating a customer order, various legs of option/equity complex orders, riskless principal orders, and orders worked through average price accounts.<sup>30</sup> Nasdaq is proposing that there be at least a 95% pre-correction and 98% post-correction linkage rate for multi-legged orders (e.g., related equity/options orders, VWAP orders, riskless principal transactions).

- Exchange and TRF/ORF Match Rates. The Plan requires that an order lifecycle be created to link “[o]rders routed from broker-dealers to exchanges” and “[e]xecuted orders and trade reports.”<sup>31</sup> Nasdaq is proposing at least a 95% pre-correction and 98% post-correction aggregate match rate to each equity exchange for orders routed from Industry Members to an exchange and, for over-the-counter executions, the same match rate for orders linked to trade reports.

In addition to these minimum error rates and matching thresholds that generally must be met before OATS can be retired, Nasdaq believes that during the minimum 180-day period during which the thresholds are calculated, Nasdaq’s use of the data in the CAT must confirm that (i) usage over that time period has not revealed material issues that have not been corrected, (ii) the CAT includes all data necessary to allow Nasdaq to continue to meet its surveillance obligations, and (iii) the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan. Nasdaq believes this time period to use the CAT Data is necessary to reveal any errors that may manifest themselves only after surveillance patterns and other queries have

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<sup>29</sup> See CAT NMS Plan, Appendix D, Section 3.

<sup>30</sup> See id.

<sup>31</sup> Id.

been run and to confirm that the Plan Processor is meeting its obligations and performing its functions adequately.

#### Small Industry Member Data Availability

The second issue the Plan requires the proposed rule change to address is “whether the availability of certain data from Small Industry Members two years after the Effective Date would facilitate a more expeditious retirement of duplicative systems.”

Nasdaq believes that there is no effective way to retire OATS until all current OATS reporters are reporting to the CAT. Although Technical Specifications for Industry Members are not yet available, Nasdaq believes it would be inefficient, less reliable, and more costly to attempt to marry the OATS and CAT databases for a temporary period to allow some Nasdaq members to report to CAT while others continue to report to OATS. Consequently, Nasdaq has concluded at this time that having data from those Small Industry Members currently reporting to OATS available two years after the Effective Date would substantially facilitate a more expeditious retirement of OATS. For this reason, Nasdaq supports an amendment to the Plan that would require current OATS Reporters that are “Small Industry Members” to report two years after the Effective Date (instead of three). Nasdaq intends to work with the other Participants to submit a proposed amendment to the Plan to require Small Industry Members that are OATS Reporters to report two years after the Effective Date.

Nasdaq has identified approximately 300 member firms that currently report to OATS and meet the definition of “Small Industry Member;” however, only ten of these firms submit information to OATS on their own behalf, and eight of the ten firms report very few orders to

OATS.<sup>32</sup> The vast majority of these 300 firms use third parties to fulfill their reporting obligations, and many of these third parties will begin reporting to CAT in November 2018. Consequently, Nasdaq believes that the burden on current OATS Reporters that are “Small Industry Members” would not be significant if those firms are required to report to CAT beginning in November 2018 rather than November 2019. The burdens, however, are significantly greater for those firms that are not reporting to OATS currently; therefore, Nasdaq does not believe it would be necessary or appropriate to accelerate CAT reporting for “Small Industry Members” that are not currently reporting to OATS, and Nasdaq would not support an amendment to the Plan to accelerate CAT reporting for “Small Industry Members” that are not currently OATS Reporters.

#### Individual Industry Member Exemptions

The final issue the Plan requires the proposed rule change to address is “whether individual Industry Members can be exempted from reporting to duplicative systems once their CAT reporting meets specified accuracy and reliability standards, including, but not limited to, ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.”

As described above, Nasdaq believes that a single cut-over from OATS to CAT is highly preferable to a firm-by-firm approach and is not proposing to exempt members from the OATS requirements on a firm-by-firm basis. The primary benefit to a firm-by-firm exemptive approach would be to reduce the amount of time an individual firm is required to report to a legacy system (e.g., OATS) if it is also accurately and reliably reporting to the CAT. Nasdaq believes that the overall accuracy and reliability thresholds for the CAT described above would need to be met

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<sup>32</sup> For example, in one recent month, eight of the ten firms submitted fewer than 100 reports during the month, with four firms submitting fewer than 50.

under any conditions before firms could stop reporting to OATS. Moreover, as discussed above, Nasdaq supports amending the Plan to accelerate the reporting requirements for Small Industry Members that are OATS Reporters to report on the same timeframe as all other OATS Reporters. If such an amendment were approved by the Commission, there would be no need to exempt members from OATS requirements on a firm-by-firm basis.

#### Changes to EBS and Account Identification Rules

The EBS rule is Nasdaq's rule regarding the automated submission of specific trading data to Nasdaq upon request using the Electronic Blue Sheet system. Rule 8211 applies to EBS reporting for equity securities, while Chapter IX, Section 4 applies EBS reporting to options. Rule 8211 and Chapter IX, Section 4 require members to submit certain trade information as prescribed by Nasdaq Regulation, including, for proprietary transactions, the clearing house number or alpha symbol of the member submitting the data, the identifying symbol assigned to the security, and the date the transaction was executed.

Chapter VII, Section VII imposes certain account identification requirements on Market Makers. Specifically, Chapter VII, Section VII requires, among other things, that each Market Maker shall file with Nasdaq Regulation and keep current a list identifying all accounts for stock, options and related securities trading in which the Market Maker may, directly or indirectly, engage in trading activities or over which it exercises investment discretion. The rule also prohibits a Market Maker from engaging in stock, options or related securities trading in an account which has not been reported pursuant to this rule.

Once broker-dealer reporting to the CAT has begun, the CAT will contain the data the Participants would otherwise have requested via the EBS system for purposes of NMS Securities and OTC Equity Securities. Consequently, Nasdaq will not need to use the EBS system or

request information pursuant to these rules for NMS Securities or OTC Equity Securities for time periods after CAT reporting has begun if the appropriate accuracy and reliability thresholds are achieved, including an acceptable accuracy rate for customer and account information.

However, these rules cannot be completely eliminated immediately upon the CAT achieving the appropriate thresholds because Nasdaq Regulation staff may still need to request information pursuant to these rules for trading activity occurring before a member was reporting to the CAT.<sup>33</sup> In addition, these rules apply to information regarding transactions involving securities that will not be reportable to the CAT, such as fixed-income securities; thus, these rules must remain in effect with respect to those transactions indefinitely or until those transactions are captured in the CAT.

The proposed rule change proposes to add new Supplementary Material to Rule 8211, Chapter VII, Section VII and Chapter IX, Section 4 to clarify how Nasdaq will request data under these rules after members are reporting to the CAT. Specifically, the proposed Supplementary Material to these rules will note that Nasdaq Regulation will request information under these rules only if the information is not available in the CAT because, for example, the transactions in question occurred before the firm was reporting information to the CAT or involved securities that are not reportable to the CAT. In essence, under the new Supplementary Material, Nasdaq Regulation will make requests under these rules if and only if the information is not otherwise available through the CAT.

The CAT NMS Plan states, however, that the elimination of rules that are duplicative of the requirements of the CAT and the retirement of the related systems should be effective at such

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<sup>33</sup> Firms are required to maintain the trade information for pre-CAT transactions in equities and options pursuant to applicable rules, such as books and records retention requirements, for the relevant time period, which is generally three or six years depending upon the record. See 17 CFR 240.17a-3(a), 240.17a-4.

time as CAT Data meets minimum standards of accuracy and reliability.<sup>34</sup> Accordingly, as discussed in more detail below, Nasdaq believes that the EBS data may be replaced by CAT Data at a date after all Industry Members are reporting to the CAT when the proposed error rate thresholds have been met, and Nasdaq has determined that its usage of the CAT Data has not revealed material issues that have not been corrected, confirmed that the CAT includes all data necessary to allow Nasdaq to continue to meet its surveillance obligations, and confirmed that the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan.

Nasdaq believes CAT Data should not be used in place of EBS data until all Participants and Industry Members are reporting data to CAT. In this way, Nasdaq will continue to have access to the necessary data to perform its regulatory duties.

The CAT NMS Plan requires that a rule filing to eliminate a duplicative rule address whether “the availability of certain data from Small Industry Members two years after the Effective Date would facilitate a more expeditious retirement of duplicative systems.”<sup>35</sup> Nasdaq believes that the submission of data to the CAT by Small Industry Members a year earlier than is required in the CAT NMS Plan, at the same time as the other Industry Members, would expedite the replacement of EBS data with CAT Data, as Nasdaq believes that the CAT would then have all necessary data from the Industry Members for Nasdaq to perform the regulatory surveillance that currently is performed via EBS. For this reason, Nasdaq supports amending the CAT NMS Plan to require Small Industry Members to report data to the CAT two years after the Effective Date (instead of three), and intends to work with other Participants toward that end.

The CAT NMS Plan requires that this rule filing address “whether individual Industry Members can be exempted from reporting to duplicative systems once their CAT reporting meets

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<sup>34</sup> Id. [sic]

<sup>35</sup> Id.

specified accuracy and reliability standards, including, but not limited to, ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.”<sup>36</sup> Nasdaq believes that a single cut-over from EBS to CAT is highly preferable to a firm-by-firm approach and is not proposing to exempt members from the EBS requirements on a firm-by-firm basis. Nasdaq believes that providing such individual exemptions to Industry Members would be inefficient, more costly, and less reliable than the single cut-over. Providing individual exemptions would require the exchanges to create, for a brief temporary period, a cross-system regulatory function and to integrate data from EBS and the CAT to avoid creating any regulatory gaps as a result of such exemptions. Such a function would be costly to create and would give rise to a greater likelihood of data errors or other issues. Given the limited time in which such exemptions would be necessary, Nasdaq does not believe that such exemptions would be an appropriate use of limited resources. Moreover, the primary benefit to a firm-by-firm exemptive approach would be to reduce the amount of time an individual firm is required to comply with EBS if it is also accurately and reliably reporting to the CAT. Nasdaq believes that the overall accuracy and reliability thresholds for the CAT described above would need to be met under any conditions before firms could stop reporting to EBS, and as discussed above, by accelerating Small Industry Members to report on the same timeframe as all other Industry Members, there is no need to exempt members from EBS requirements on a firm-by-firm basis.

The CAT NMS Plan also requires that a rule filing to eliminate a duplicative rule to provide “specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate

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<sup>36</sup> Id.

should determine when a system duplicative of the CAT can be retired.<sup>37</sup> Nasdaq believes that it is critical that the CAT Data be sufficiently accurate and reliable for Nasdaq to perform the regulatory functions that it now performs via EBS. Accordingly, Nasdaq believes that the CAT Data should meet specific quantitative error rates, as well as certain qualitative requirements.

Nasdaq believes that, before CAT Data may be used in place of EBS data, the CAT would need to achieve a sustained error rate for a period of at least 180 days of 5% or lower measured on a pre-correction or as-submitted basis, and 2% or lower on a post-correction basis (measured at T+5).<sup>38</sup> Nasdaq proposes to measure the 5% pre-correction and 2% post-correction thresholds by averaging the error rate across the period, not require a 5% pre-correction and 2% post-correction maximum each day for 180 consecutive days. Nasdaq believes that measuring each of the thresholds over the course of 180 days will ensure that the CAT consistently meets minimum accuracy and reliability thresholds while also ensuring that single-day measurements do not unduly affect the overall measurements. Nasdaq proposes to measure the appropriate error rates in the aggregate, rather than firm-by-firm. The 2% and 5% error rates are in line with the proposed retirement threshold for other systems, such as OATS and COATS.

In addition to these minimum error rates before using CAT Data instead of EBS data, Nasdaq believes that during the minimum 180-day period during which the thresholds are calculated, Nasdaq's use of the data in the CAT must confirm that (i) usage over that time period has not revealed material issues that have not been corrected, (ii) the CAT includes all data necessary to allow Nasdaq to continue to meet its surveillance obligations, and (iii) the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan. Nasdaq

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<sup>37</sup> Id.

<sup>38</sup> The Plan requires that the Plan Processor must ensure that regulators have access to corrected and linked order and Customer data by 8:00 a.m. Eastern Time on T+5. See CAT NMS Plan, at C-15.

believes this time period to use the CAT Data is necessary to reveal any errors that may manifest themselves only after surveillance patterns and other queries have been run and to confirm that the Plan Processor is meeting its obligations and performing its functions adequately.

#### Changes to COATS

The options exchanges utilize COATS to collect and review data regarding options orders, quotes and transactions. The Participants have provided COATS technical specifications to the Plan Processor for the CAT for use in developing the Technical Specifications for the CAT, and the Participants are working with the Plan Processor to include the necessary COATS data elements in the CAT Technical Specifications. Accordingly, although the Technical Specifications for the CAT have not yet been finalized, Nasdaq and the other options exchanges propose to eliminate COATS in accordance with the proposed timeline discussed below.

Nasdaq adopted Chapter V, Section 7 to implement certain reporting requirements related to COATS, and therefore proposes to eliminate the information reporting requirements of that rule and replacing those requirements with a requirement that members report information pursuant to this rule as required by the Exchange's CAT compliance rule, Chapter IX, Section 8.<sup>39</sup> Among other things, Chapter V, Section 7 requires an Options Participant to ensure that

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<sup>39</sup> COATS was developed to comply with an order of the Commission requiring the then-options exchanges to “design and implement” a consolidated audit trail to “enable the options exchanges to reconstruct markets promptly, effectively surveil them and enforce order handling, firm quote, trade reporting and other rules.” See Section IV.B.e.(v) of the Commission’s Order Instituting Public Administrative Proceedings Pursuant to Sections 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions (the “Order”). See Securities Exchange Act Release No. 43268 (September 11, 2000) and Administrative Proceeding File No. 3-10282. As noted, the Plan is designed to create, implement and maintain a CAT that would capture customer and order event information for orders in NMS Securities and OTC Equity Securities, across all markets, from the time of order inception through routing, cancellation, modification, or execution in a single consolidated data source. Nasdaq has already adopted rules to enforce compliance by its Industry Members, as applicable, with the

each options order received from a Customer for execution on the Nasdaq Options Market is recorded and time-stamped immediately, and also at the time of any modification or cancellation of the order. The rule also specifies the information that must be contained at a minimum, including a unique order identification, the underlying security, opening/closing designation, the identity of the Clearing Participant, and the Options Participant identification.

The CAT NMS Plan states that the elimination of rules that are duplicative of the requirements of the CAT and the retirement of the related systems should be effective at such time as CAT Data meets minimum standards of accuracy and reliability.<sup>40</sup> As discussed in more detail below, Nasdaq and the other options exchanges believe that COATS may be retired at a date after all Industry Members are reporting to the CAT when the proposed error rate thresholds have been met, and Nasdaq has determined that its usage of the CAT Data has not revealed material issues that have not been corrected, confirmed that the CAT includes all data necessary to allow Nasdaq to continue to meet its surveillance obligations, and confirmed that the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan.

Nasdaq believes COATS should not be retired until all Participants and Industry Members that report data to COATS are reporting comparable data to the CAT. In this way, Nasdaq will continue to have access to the necessary data to perform its regulatory duties.

The CAT NMS Plan requires that a rule filing to eliminate a duplicative rule address whether “the availability of certain data from Small Industry Members two years after the

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provisions of the Plan. Once the CAT is fully operational, it will be appropriate to delete Nasdaq’s rules implemented to comply with the Order as duplicative of the CAT. Accordingly, Nasdaq believes that it would continue to be in compliance with the requirements of the Order once the CAT is fully operational and the COATS rules are deleted.

<sup>40</sup> Id. [sic]

Effective Date would facilitate a more expeditious retirement of duplicative systems.”<sup>41</sup> The Exchange believes COATS should not be retired until all Participants and Industry Members that report data to COATS are reporting comparable data to the CAT. While the early submission of options data to the CAT by Small Industry Members could expedite the retirement of COATS, the Exchange believes that it premature to consider such a change and that additional analysis would be necessary to determine whether such early reporting by Small Industry Members would be feasible.

The CAT NMS Plan requires that this rule filing address “whether individual Industry Members can be exempted from reporting to duplicative systems once their CAT reporting meets specified accuracy and reliability standards, including, but not limited to, ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.”<sup>42</sup> Nasdaq believes that a single cut-over from COATS to CAT is highly preferable to a firm-by-firm approach and is not proposing to exempt members from the COATS requirements on a firm-by-firm basis. Nasdaq and the other options exchanges believe that providing such individual exemptions to Industry Members would be inefficient, more costly, and less reliable than the single cut-over. Providing individual exemptions would require the options exchanges to create, for a brief temporary period, a cross-system regulatory function and to integrate data from COATS and the CAT to avoid creating any regulatory gaps as a result of such exemptions. Such a function would be costly to create and would give rise to a greater likelihood of data errors or other issues. Given the limited time in which such exemptions would be necessary, Nasdaq and the other options exchanges do not believe that such exemptions would be an appropriate use of limited resources.

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<sup>41</sup> Id.

<sup>42</sup> Id.

The CAT NMS Plan also requires that a rule filing to eliminate a duplicative rule to provide “specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate should determine when a system duplicative of the CAT can be retired.”<sup>43</sup> Nasdaq believes that it is critical that the CAT Data be sufficiently accurate and reliable for the Exchange to perform the regulatory functions that it now performs via COATS. Accordingly, Nasdaq believes that the CAT Data should meet specific quantitative error rates, as well as certain qualitative requirements.

Nasdaq and the other options exchanges believe that, before COATS may be retired, the CAT would need to achieve a sustained error rate for a period of at least 180 days of 5% or lower measured on a pre-correction or as-submitted basis, and 2% or lower on a post-correction basis (measured at T+5).<sup>44</sup> Nasdaq proposes to measure the 5% pre-correction and 2% post-correction thresholds by averaging the error rate across the period, not require a 5% pre-correction and 2% post-correction maximum each day for 180 consecutive days. Nasdaq believes that measuring each of the thresholds over the course of 180 days will ensure that the CAT consistently meets minimum accuracy and reliability thresholds while also ensuring that single-day measurements do not unduly affect the overall measurements. Nasdaq proposes to measure the appropriate error rates in the aggregate, rather than firm-by-firm. In addition, Nasdaq proposes to measure the error rates for options only, not equity securities, as only options are subject to COATS. The 2% and 5% error rates are in line with the proposed retirement threshold for OATS.

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<sup>43</sup> Id.

<sup>44</sup> The Plan requires that the Plan Processor must ensure that regulators have access to corrected and linked order and Customer data by 8:00 a.m. Eastern Time on T+5. See CAT NMS Plan, at C-15.

In addition to these minimum error rates before COATS can be retired, Nasdaq believes that during the minimum 180-day period during which the thresholds are calculated, Nasdaq's use of the data in the CAT must confirm that (i) usage over that time period has not revealed material issues that have not been corrected, (ii) the CAT includes all data necessary to allow Nasdaq to continue to meet its surveillance obligations, and (iii) the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan. Nasdaq believes this time period to use the CAT Data is necessary to reveal any errors that may manifest themselves only after surveillance patterns and other queries have been run and to confirm that the Plan Processor is meeting its obligations and performing its functions adequately.

If the Commission approves the proposed rule change, Nasdaq will announce the implementation date of the proposed rule change in a Regulatory Notice that will be published once Nasdaq concludes the thresholds for accuracy and reliability described above have been met and that the Plan Processor is sufficiently meeting all of its obligations under the CAT NMS Plan.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>45</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>46</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest.

Nasdaq believes that the proposed rule change fulfills the obligation in the CAT NMS Plan for Nasdaq to submit a proposed rule change to eliminate or modify duplicative rules. In

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<sup>45</sup> 15 U.S.C. 78f(b).

<sup>46</sup> 15 U.S.C. 78f(b)(5).

approving the Plan, the SEC noted that the Plan “is necessary and appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanism of a national market system, or is otherwise in furtherance of the purposes of the Act.”<sup>47</sup> As this proposal implements the Plan, Nasdaq believes that this proposal furthers the objectives of the Plan, as identified by the SEC, and is therefore consistent with the Exchange Act.

Moreover, the purpose of the proposed rule change is to eliminate rules that require the submission of duplicative data to the exchange. The elimination of such duplicative requirements will reduce unnecessary costs and other compliance burdens for Nasdaq and its members, and therefore, will enhance the efficiency of the securities markets. Furthermore, Nasdaq believes that the approach set forth in the proposed rule change strikes the appropriate balance between ensuring that Nasdaq is able to continue to fulfill its statutory obligation to protect investors and the public interest by ensuring its surveillance of market activity remains accurate and effective while also establishing a reasonable timeframe for elimination or modification of its rules that will be rendered duplicative after implementation of the CAT.

B. Self-Regulatory Organization’s Statement on Burden on Competition

Section 6(b)(8) of the Exchange Act<sup>48</sup> requires that the Exchange’s rules not impose any burden on competition that is not necessary or appropriate. Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. Nasdaq notes that the proposed rule change implements the requirements of the CAT NMS Plan approved by the Commission regarding the elimination of rules and systems that are duplicative the CAT, and is designed to

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<sup>47</sup> Approval Order at 84697.

<sup>48</sup> 15 U.S.C. 78f(b)(8).

assist Nasdaq in meeting its regulatory obligations pursuant to the Plan. Similarly, all exchanges and FINRA are proposing the elimination of their rules related to OATS, EBS and COATS to implement the requirements of the CAT NMS Plan. Therefore, this is not a competitive rule filing and, therefore, it does not raise competition issues between and among the self-regulatory organizations and/or their members.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Although written comments on the proposed rule change were not solicited, two commenters, the Financial Information Forum (“FIF”) and the Securities Industry and Financial Markets Association (“SIFMA”), submitted letters to the Participants regarding the retirement of systems related to the CAT.<sup>49</sup> In its comment letter, with regard to the retirement of duplicative systems more generally, FIF recommends that the Participants continue the effort to incorporate current reporting obligations into the CAT in order to replace existing reportable systems with the CAT. In addition, FIF further recommends that, once a CAT Reporter achieves satisfactory reporting data quality, the CAT Reporter should be exempt from reporting to any duplicative reporting systems. FIF believes that these recommendations “would serve both an underlying regulatory objective of more immediate and accurate access to data as well as an industry objective of reduced costs and burdens of regulatory oversight.”<sup>50</sup> In its comments about EBS specifically, FIF states that the retirement of the EBS requirements should be a high priority, and that the CAT should be designed to include the requisite data elements to permit the rapid

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<sup>49</sup> Letter from William H. Hebert, FIF, to Participants re: Milestone for Participants’ rule change filings to eliminate/modify duplicative rules, dated April 12, 2017 (“FIF Letter”); Letter from Kenneth E. Bentsen, Jr., SIFMA, to Participants re: Selection of Thesys as CAT Processor, dated April 4, 2017 (“SIFMA Letter”), at 2.

<sup>50</sup> FIF Letter at 2.

retirement of the EBS system.<sup>51</sup> Similarly, SIFMA states that “the establishment of the CAT must be accompanied by the prompt elimination of duplicative systems,” and “recommend[ed] that the initial technical specifications be designed to facilitate the immediate retirement of . . . duplicative reporting systems.”<sup>52</sup>

As discussed above, Nasdaq agrees with the commenters that the OATS, EBS and COATS reporting requirements should be replaced by the CAT reporting requirements as soon as accurate and reliable CAT Data is available. To this end, Nasdaq anticipates that the CAT will be designed to collect the data necessary to permit the retirement of OATS, EBS and COATS. As discussed above, Nasdaq disagrees with the recommendation to provide individual exemptions to those CAT Reporters who obtain satisfactory data reporting quality; however, Nasdaq supports amendments to the CAT NMS Plan that would accelerate reporting for Small Industry Members that are currently reporting to OATS to facilitate the retirement of that system.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

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<sup>51</sup> Id.

<sup>52</sup> SIFMA Letter at 2.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### **Electronic Comments:**

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2017-055 on the subject line.

##### **Paper Comments:**

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2017-055. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the

principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2017-055 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>53</sup>

Eduardo A. Aleman,  
Assistant Secretary.

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<sup>53</sup> 17 CFR 200.30-3(a)(12).

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