

MEMO# 35624

February 20, 2024

ICI and Other Industry Participants File Amicus Brief in CAT Funding Litigation

[35624]

February 20, 2024

TO: ICI Members

Equity Markets Advisory Committee SUBJECTS: Trading and Markets RE: ICI and Other Industry Participants File Amicus Brief in CAT Funding Litigation

On February 15, ICI joined several other industry participants in filing the attached amicus curiae ("friend of the court") brief in support of the petition filed by the American Securities Association (ASA) and Citadel Securities in the US Court of Appeals for the 11th Circuit to vacate the SEC's approval of the Consolidated Audit Trail (CAT) funding model.^[1] In September 2023, the SEC approved the revised CAT funding model—the Executed Share Model—that allocates approximately two-thirds of the CAT operating costs, including the legacy costs already incurred, to executing brokers (one-third to a buyer's executing broker and one-third to a seller's executing broker) based on the number of executed shares in a transaction and a fee rate based in part on budgeted CAT costs.

The brief argues that:

- The SEC acted in an "arbitrary and capricious"^[2] manner by approving the funding model, which would impose "massive" costs on broker-dealers and investors without giving them a genuine role in establishing the CAT's budget and failing to adequately consider alternative funding approaches with cost control measures.^[3] The brief notes that the creation of the CAT as an NMS plan has allowed the SROs to operate with "virtually unlimited and unchecked flexibility" that has enabled costly, "unchecked decision-making."
- The two-thirds cost allocation to broker-dealers, with potentially even more costs to be allocated from FINRA's pass-through of its share, is inequitable and unreasonable, and therefore arbitrary and capricious. Specifically, the brief argues that the SEC's characterization that allocating the costs between three parties as "reasonable" is "entirely superficial and unsupported."^[4]

The brief further emphasizes that the SEC's approval order expressly acknowledges that broker-dealers may, and some likely will, pass through their share of CAT costs to their customers. It characterizes such a pass-through to customers as contrary to the goal of "protect[ing] investors and support[ing] fair, efficient capital markets."^[5]

Nhan Nguyen
Associate General Counsel, Securities Regulation

Notes

[1] American Securities Association, Citadel Securities LLC v. U.S. Securities and Exchange Commission, The Nasdaq Stock Market, LLC, Nasdaq BX, Inc. Nasdaq GEMX, LLC, Nasdaq ISE, LLC, Nasdaq MRX, LLC, et. al, No. 23-13396 (11th Cir. Oct. 17, 2023) ("Brief"). The other industry participants that signed on to the SIFMA-led brief include the Alternative Investment Management Association, Committee on Capital Markets Regulation, Managed Funds Association, and Virtu Financial, Inc.

[2] Under the Administrative Procedure Act, which governs federal agency regulatory action, an agency action should be set aside if it is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." 5 U.S.C. § 706(2)(a).

[3] Brief at 4. The brief further argues that the transparency of the budgeting process, including the requirement that fee filings be approved by the SEC under SEC Rule 19b-4, are not sufficient measures for controlling the CAT's costs. Id. at 12.

[4] Id. at 22.

[5] Id. at 9. The brief also highlights the problem that the SROs themselves may be able to pass through their own share of CAT costs to the broker-dealers. Id. at 23-26.