



August 9, 2010

Via Electronic Mail: rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Consolidated Audit Trail; File No. S7-11-10

Dear Ms. Murphy:

Managed Funds Association (“MFA”)¹ appreciates the opportunity to provide comments on the Securities and Exchange Commission’s (“Commission” or the “SEC”) proposed rule on a Consolidated Audit Trail (the “Proposed Rule”).² MFA fully supports regulators having efficient access to appropriate granular information. As investors, we rely on markets that operate with integrity and efficiency, and the ability of regulators to detect, deter and act upon fraudulent and manipulative practices in the marketplace. MFA members make significant investments in market research, proprietary investment technology and intellectual property, and the confidentiality of such information is critical to the success of their businesses. As such, we have a strong interest in ensuring that the Proposed Rule adequately protects intellectual property of market participants. Given the immense scope, complexity and estimated costs of the project,³ we believe the Commission should also consider and weigh the cost-effectiveness of undertaking an initiative smaller in scope that wouldn’t risk broadening spreads and raising transaction costs for investors, such as modifying the existing regulatory infrastructure and tools.⁴ We note the Commission is considering adopting a Large Trader Report and believe that it should be considered in conjunction with the Proposed Rule.⁵ We submit comments on the Proposed Rule with respect to customer information and confidentiality for the Commission’s consideration.

¹ MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

² Securities Exchange Act Release No. 62174; 75 FR 32556 (June 8, 2010).

³ The Commission estimates that the one-time aggregate cost to implement the Proposed Rule would be approximately \$4 billion and the total ongoing aggregate annual costs would be approximately \$2.1 billion. 75 FR 32602.

⁴ For example, the Commission might explore the possibility of expanding the Financial Industry Regulatory Authority’s Order Audit Trail System reporting to capture additional fields of information.

⁵ Securities Exchange Act Release No. 61908, 75 FR 21456 (April 23, 2010) (“Large Trader Report Proposal”). See also letter to Elizabeth M. Murphy, Secretary, SEC, from Stuart J. Kaswell, Executive Vice President & Managing Director, Managed Funds Association on June 16, 2010 *available at*:

Confidentiality of Customer Information

a. Customer Information

The Proposed Rule would require national securities exchanges and national securities associations to create and implement: (a) a consolidated audit trail that captures customer and order event information, in real time, for all orders in National Market System (“NMS”) securities, across all markets, from the time of order inception through routing, cancellation, modification, or execution; and (b) a central repository.⁶ The Proposed Rule would require any member of an exchange or association to submit each order or reportable event to a central repository with customer information, including information to identify the customer, a unique customer identifier for each customer and customer account information.⁷

We agree with the Commission that audit trail information that provides the identity of the customer that generates the order would be useful to regulators for purposes of market surveillance and enforcement.⁸ In response to the Commission’s questions regarding customer information, we believe the customer information linked to individual trades should remain at the customer level, as proposed, rather than be coded at the individual strategy, trading desk, or particular computer algorithm level. Regulators have a valid interest in requesting customer order information. However, this interest should be balanced with the need for a simple, manageable and cost-effective audit trail system. By requiring the collection of less critical categories or fields of information, the Commission is likely to result in a cost-prohibitive, overly-complicated and ultimately an unmanageable data population. We believe regulators would be better served receiving information on the customer level and requesting further information from customers to the extent it is needed.

b. Confidentiality of Consolidated Data

The Proposed Rule proposes to consolidate order and customer information in a central repository and would limit the use of consolidated data by national securities exchanges, national securities associations and the Commission to performing their respective regulatory and oversight responsibilities pursuant to the federal securities laws, rules, and regulations.⁹ We believe access to consolidated audit trail data should be restricted to employees of regulators whose job function is to monitor and surveil markets. MFA members and other market participants make significant investments in proprietary investment technology and intellectual property. We believe it is critical that audit trail information be safeguarded and used only for regulatory purposes. As the Commission recognizes, security breaches could potentially have a

<http://www.managedfunds.org/downloads/MFA%20Comments%20to%20Large%20Trader%20Reporting%20Proposal.pdf>. MFA submitted comments to the Commission on its Large Trader Report Proposal, expressing support for establishing a consolidated audit trail before implementation of the Large Trader Report Proposal. We believe the Commission should consider the Proposed Rule and the Large Trader Report Proposal together to ensure that it receives the appropriate market data in the most efficient and cost-effective means possible.

⁶ 75 FR 32568.

⁷ See Proposed Rule 613(c)(7)(i).

⁸ 75 FR 32573.

⁹ 75 FR 32581.

detrimental impact on the financial condition of a firm, the firm's trading activity and the markets.¹⁰ In a related context, Congress has recently mandated the protection of proprietary trading information of investment advisers from public disclosure.¹¹ To the extent that individuals steal or misappropriate audit data, and proprietary trading strategies are reverse-engineered, the replication of such strategies by multiple market participants could significantly erode global confidence as well as exacerbate market volatility and stock movements, apart from the financial harm our members would experience.

Due to the sensitivity and confidentiality of their business information, MFA members expend significant time and resources to employ safeguards to preserve the confidentiality of their trading strategies and protect their proprietary information and work product. Protections that MFA members have implemented include, without limitation: (i) entering into comprehensive non-disclosure agreements with employees, service providers, contractors and anyone else who may have access to such data; (ii) investing in technology-related security and consulting services, such as firewalls and other anti-hacking devices and techniques; (iii) adopting restrictions on transportability of data (*e.g.*, disabling USB ports and restricting any uploads to the Internet); (iv) limiting and controlling internal employee access to certain highly proprietary data; and (v) prohibiting the copying of information onto removable media (*e.g.*, disks and tapes). In addition to "hard" investments in technology, MFA members may also take more process-driven steps to limit the number and type of personnel who have access to, or possession of, their full trading records. We urge regulators to consider adopting similar proven safeguards, among others, with respect to the handling of customer information and audit trail data.

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We would be pleased to meet with the Commission or its staff to further discuss our comments. If the staff has questions or comments, please do not hesitate to call Jennifer Han or the undersigned at (202) 367-1140.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director &
General Counsel

CC: The Hon. Mary Schapiro, Chairman
The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
Robert Cook, Director
Division of Trading and Markets
James Brigagliano, Deputy Director
Division of Trading and Markets

¹⁰ 75 FR 32581.

¹¹ Dodd-Frank Wall Street Reform and Consumer Protection Act § 404, 15 U.S.C. 80b-4 (2010).