

AMERICAN CUSTOMER INFORMATION PROTECTION ACT

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MAY 7, 2018.—Committed to the Committee of the Whole House on the State of the  
Union and ordered to be printed

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Mr. HENSARLING, from the Committee on Financial Services,  
submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 4785]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 4785) to prohibit the consolidated audit trail from accepting personally identifying information, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

On January 12, 2018, Representative Bill Huizenga introduced H.R. 4785, the “American Customer Information Protection Act” to help protect highly sensitive personal information of Americans. H.R. 4785 prohibits the Consolidated Audit Trail (CAT) authorized in 2012 by the Securities and Exchange Commission (SEC) from accepting Personally Identifiable Information (PII), except where such information would apply to large traders under the SEC’s large trader reporting rule. Under the legislation, social security numbers, individual taxpayer identification numbers, other customer identifying information sufficient to identify an individual, such as names, addresses, dates of birth, account numbers, and any other information the Commission determines could be defined as PII will not be reported to the CAT.

## BACKGROUND AND NEED FOR LEGISLATION

The goal of H.R. 4785 is to protect customer's personal information by preventing the CAT from storing PII where it might be susceptible to a cyber breach.

Largely in response to the 2010 Flash Crash, on July 11, 2012, the SEC voted to adopt Rule 613 under Regulation National Market System to require the national securities exchanges and national securities associations listed below to submit a National Market System plan to the SEC to create, implement, and maintain a consolidated audit trail. At the time the SEC adopted the Rule, former SEC Chairman Mary Shapiro stated, "A consolidated audit trail that accurately tracks orders throughout their lifecycle and identifies the broker-dealers handling them will provide us with an unprecedented ability to effectively oversee the markets we regulate."

The SEC's press release noted, "A consolidated audit trail will increase the data available to regulators investigating illegal activities such as insider trading and market manipulation, and it will significantly improve the ability to reconstruct broad-based market events in an accurate and timely manner. A consolidated audit trail also will significantly increase the ability of regulators to monitor overall market structure and assess how SEC rules are affecting the markets, and will reduce the regulatory data production burdens on SROs and broker-dealers by reducing the number of ad hoc requests from regulators presently."

On November 15, 2016, the SEC approved a plan for the CAT system. The CAT will collect and identify every order, cancellation, and trade execution for all exchange-listed equities and options across all U.S. markets. National Market System Plan participants selected Thesys Technologies in January 2017 to be the plan processor for the CAT. On November 15, 2017, SROs were required to start reporting data to the CAT, with broker-dealers reporting information beginning in November 2018. As part of broker-dealer reporting, information collected by the CAT will include American customer PII. To be clear, broker-dealers will not be required to submit PII of any foreign traders—only the PII of Americans would be reported to the CAT and potentially compromised. According to testimony from Thesys Technologies CEO Mike Beller, any PII stored in the CAT must be stored separately from other data and access to such PII must be limited to a "need-to-know" basis—underscoring the sensitivity of the data.

Hackers have demonstrated a significant interest in obtaining PII and information related to financial transactions. In April 2016, the GAO identified weaknesses in the SEC's information security protocols and noted the SEC's failure to implement an agency-wide data security program. In May 2017, Chairman Clayton then initiated an assessment of the SEC's internal cybersecurity risk profile and their approach to cybersecurity from a regulatory and oversight perspective. Based on the GAO's April 2016 report and a subsequent July 27, 2017 report, the SEC's internal assessment was long overdue—both reports identified inadequate controls and serious cyber and data risks. While it is promising to see the SEC, under the leadership of Chairman Clayton, finally endeavor to reform and update their cyber and data security, the reliability of

data and cyber security at the SEC remains in question, particularly with other major data initiatives such as the CAT coming on line.

On September 20, 2017, Chairman Clayton issued a statement on cybersecurity in which he revealed that a cyber breach “previously detected in 2016 may have provided illicit gain through trading.” Specifically, a software vulnerability existed in the test filing component of the SEC’s Electronic Data Gathering Analysis and Retrieval (“EDGAR”) system which resulted in access to non-public information. In addition to providing the hackers access to highly sensitive material nonpublic information, it later was determined that the PII of at least two individuals was compromised, including names, dates of birth, and social security numbers. This revelation came on the heels of the massive Equifax data breach in which sensitive information of 145.5 million Americans is believed to have been compromised. Together, they underscore the importance of proactively ensuring that any highly sensitive data being collected by the SEC or at the SEC’s direction (and subject to the SEC’s oversight) is protected with appropriate safeguards.

The CAT can serve an important regulatory function to help prevent disruptions and keep our capital markets operating efficiently, but it is important this system is implemented effectively. Given the recent data breach at the SEC and the amount of PII and market moving data that the CAT will provide, the Commission needs to ensure that they have adequate data security controls before implementation. Commissioner Michael Piwowar recently commented regarding CAT that “Deadlines are important, but [the SEC has] one chance to get this right. We have to make sure we have everything locked down. We can get it done, or we can get it done right. We need to get it done right.”

On September 28, 2017, Chairman Hensarling, Chairman Huizenga, and Vice-Chairman Hultgren wrote a letter to SEC Chairman Jay Clayton to “encourage the SEC to delay implementation of the CAT system until the SEC can implement information security safeguards and internal controls to ensure the security of confidential and sensitive data.” In response to a similar request for a delay from the SROs tasked with implementing the CAT, Chairman Clayton on November 14, 2017 issued a statement on the status of the CAT, noting that “I am not in a position to support the issuance of the requested relief on the terms currently proposed . . . I urge the SROs to continue their efforts to work cooperatively with each other and to meet their responsibilities as promptly as practicable.”

Many are concerned with the amount of PII that will be required to be collected by the CAT and the data security of such information, as well as who will have access to such information. Last Congress, Members of this Committee wrote former SEC Chair White expressing serious concerns about the security of PII held within the CAT, especially given that some 3,000 individuals, including SEC staff members, will have access to the CAT data, and the SEC does not have to follow the same security protocols as the CAT plan participants. In his September 7, 2017 testimony before the Capital Markets Subcommittee, FINRA’s President and CEO, Robert Cook, questioned whether PII even was necessary to be collected for the

CAT to perform its function. As part of a statement on the status of the CAT, Chairman Clayton on November 14, 2017 stated:

Commission staff is currently conducting an evaluation of our needs for personally identifiable information (“PII”) in the CAT. It is important that the Commission, the SROs, and the plan processor continuously evaluate the approach to the collection, retention and protection of PII and other sensitive data, as we continue to progress in the development and operation of the CAT.

Ultimately, this bill will help ensure the CAT can be completed more efficiently, as it will reduce some complications associated with constructing the CAT; and it will help it operate more efficiently once established, as it will reduce the likelihood of it being targeted by hackers in an effort to steal PII.

Additionally, nothing in this bill will hinder the SEC’s ability to monitor trading activity that actually might be market-moving. Under the SEC large trader rule, both foreign and domestic persons and entities employing such persons, including investment advisers, must register with the SEC and obtain a Large Trader Identification Number (LTID). Under the SEC’s rules, a “large trader” is defined as a person or entity who effects transactions in exchange-listed equities and options that equal or exceed 2 million shares or \$20 million during any calendar day, or 20 million shares or \$200 million over the course of any calendar month. By having the CAT still collect large trader information, individuals that are trading at a volume that could distort the market would still have their information collected, while retail investor PII would not be required to be collected by the CAT. However, if suspicious trading activity is detected by a retail investor, the SEC could still obtain that individual’s information through the blue-sheet process. During a November 2017 Capital Markets Subcommittee hearing on the CAT, CBOE President and Chief Operating Officer Chris Concannon, prompted by questions from Chairman Huizenga, stated:

Among the industry and some regulators, we have talked about a large-trader solution. This is a method that’s used in the futures market. There’s a concept of a large-trader ID. It follows every order into the surveillance system so you can track the large trader based on their activity. So yes, there are solutions that are being kicked around to avoid having that PII information in the database. We will always get access. Regulators have ample access to PII information under the blue-sheet technology that we have.

#### HEARINGS

The subcommittee on Capital Markets, Securities, and Investment held a hearing examining matters relating to H.R. 4785 on November 30, 2017.

#### COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on January 17, 2018, and January 18, 2018, and ordered H.R. 4785

to be reported favorably to the House without amendment by a recorded vote of 31 yeas to 25 nays (recorded vote no. FC-149), a quorum being present.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole recorded vote was on a motion by Chairman Hensarling to report the bill favorably to the House without amendment. The motion was agreed to by a recorded vote of 31 yeas to 25 nays (Record vote no. FC-149), a quorum being present.

## Record vote no. FC-149

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling .....	X			Ms. Maxine Waters (CA) .....	X		
Mr. McHenry .....				Mrs. Carolyn B. Maloney (NY) .....	X		
Mr. King .....				Ms. Velázquez .....	X		
Mr. Royce (CA) .....	X			Mr. Sherman .....	X		
Mr. Lucas .....	X			Mr. Meeks .....	X		
Mr. Pearce .....	X			Mr. Capuano .....	X		
Mr. Posey .....	X			Mr. Clay .....			
Mr. Luetkemeyer .....	X			Mr. Lynch .....	X		
Mr. Huizenga .....	X			Mr. David Scott (GA) .....	X		
Mr. Duffy .....	X			Mr. Al Green (TX) .....	X		
Mr. Stivers .....				Mr. Cleaver .....	X		
Mr. Huitgren .....	X			Ms. Moore .....	X		
Mr. Ross .....	X			Mr. Ellison .....	X		
Mr. Pittenger .....	X			Mr. Perlmutter .....	X		
Mrs. Wagner .....	X			Mr. Himes .....	X		
Mr. Barr .....	X			Mr. Foster .....	X		
Mr. Rothfus .....	X			Mr. Kildee .....	X		
Mr. Messer .....	X			Mr. Delaney .....	X		
Mr. Tipton .....	X			Ms. Sinema .....	X		
Mr. Williams .....	X			Mrs. Beatty .....	X		
Mr. Poliquin .....	X			Mr. Heck .....	X		
Mrs. Love .....	X			Mr. Vargas .....	X		
Mr. Hill .....	X			Mr. Gottheimer .....	X		
Mr. Emmer .....	X			Mr. Gonzalez (TX) .....	X		
Mr. Zeldin .....	X			Mr. Crist .....	X		
Mr. Trott .....	X			Mr. Kihuen .....	X		
Mr. Loudermilk .....	X						
Mr. Mooney (WV) .....	X						
Mr. MacArthur .....	X						
Mr. Davidson .....	X						
Mr. Budd .....	X						
Mr. Kustoff (TN) .....	X						
Ms. Tenney .....	X						
Mr. Hollingsworth .....	X						

## COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 4785 will protect sensitive customer information by prohibiting the CAT from collecting personal identifiable information from individuals not classified as “large traders.”

## NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, April 10, 2018.*

Hon. JEB HENSARLING,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4785, the American Customer Information Protection Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

KEITH HALL,  
*Director.*

Enclosure.

*H.R. 4785—American Customer Information Protection Act*

In 2017 the Securities and Exchange Commission (SEC) directed the national securities exchanges and the Financial Industry Regulator Authority to develop, implement, and maintain a consolidated audit trail (CAT). The CAT is intended to enable regulators to better oversee securities markets. H.R. 4785 would prohibit the CAT

from accepting personally identifying information except in connection with large traders.<sup>1</sup>

Using information from the SEC, CBO estimates that implementing H.R. 4785 would cost less than \$500,000 over the 2019–2023 period for the SEC to amend the CAT plan to implement the bill’s requirements. However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending would be negligible, assuming appropriation actions consistent with that authority.

Enacting H.R. 4785 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

CBO estimates that enacting H.R. 4785 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2029.

H.R. 4785 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

If the SEC increases fees to offset the associated costs, H.R. 4785 would increase the cost of an existing mandate on private entities required to pay those fees. Using information from the SEC, CBO estimates that the incremental cost of the mandate would fall well below the annual threshold for private-sector mandates established in UMRA (\$160 million in 2018, adjusted annually for inflation).

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Jon Sperl (for mandates). The estimate was approved by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

#### FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

#### ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

#### EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not

<sup>1</sup>The SEC defines a large trader as a person whose transactions in national securities markets equal or exceed 2 million shares or \$20 million during any calendar day, or 20 million shares or \$200 million during any calendar month.



contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

#### DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111-139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95-220, as amended by Pub. L. No. 98-169).

#### DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rule makings within the meaning of such section.

#### SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

##### *Section 1. Short title*

This section cites H.R. 4785 as the “American Customer Information Protection Act”.

##### *Section 2. No Acceptance of personally identifying information*

This section states that the consolidated audit trail may not accept personally identifying information from individuals that do not meet the definition of a large trader.

#### CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

H.R. 4785 does not repeal or amend any section of the statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by clause 3(e)(1)(B) of rule XIII of the House of Representatives.

## MINORITY VIEWS

H.R. 4785 is a reckless bill that would weaken an important and long overdue regulatory tool required by the Securities and Exchange Commission (“SEC”). Specifically, the bill would prohibit the consolidated audit trail (“CAT”)—a comprehensive trade reporting system that will allow regulators to monitor all equity and options trading in the U.S. securities markets and quickly identify manipulative and disruptive conduct—from accepting personally identifying information (“PII”), except with respect to companies classified as “large traders” under existing law. Accordingly, the bill would reduce regulators’ ability to immediately identify bad actors to only a miniscule fraction of the millions of traders whose conduct the CAT is intended to monitor.

The CAT was part of the response to the May 2010 “Flash Crash,” during which the Dow Jones Industrial Average rapidly plunged 1,000 points, losing \$1 trillion in value, before mostly rebounding minutes later. Because there was no uniform system for tracking activity in the markets, regulators took nearly five months to determine that the Flash Crash was caused by a flawed trading algorithm of a large institutional investor. This determination proved inaccurate when, five years later, the true culprit was revealed to be a single individual sending out manipulative futures orders from his parents’ basement.

In 2012, the SEC ordered the creation of the CAT to address the oversight challenges arising from the use of disparate audit trail systems. In doing so, the SEC determined that “the identification of each customer responsible for every order is critical to the effectiveness of a consolidated audit trail.” After years of delay, the national securities exchanges were required to begin reporting data on the entire lifecycle of each order to the CAT on November 15, 2017. However, they failed to meet this deadline due to concerns about security of reportable customer information, including PII.

SEC Chairman Jay Clayton rejected the exchanges’ request to further delay the CAT, but committed to evaluating the SEC’s needs for PII while simultaneously working to make the system operational. H.R. 4785 ignores the SEC’s efforts and takes the counterproductive and unjustified step of prohibiting the CAT from collecting information used to identify bad actors. Although the bill includes an exception for PII related to “large traders,” the classification would only apply to the 6,000 or so traders who conduct an exceptionally high number of securities transactions (at least 2 million shares or \$20 million a day, or 20 million shares or \$200 million a month). H.R. 4785 would thus prohibit the CAT from identifying millions of traders, including bad actors known as “spoofers,” who, like the individual responsible for the Flash Crash, attempt to manipulate securities prices by illegally posting orders that they never intend to execute.

Investor advocacy groups like Consumer Federation of America (“CFA”) and Americans for Financial Reform (“AFR”) oppose H.R. 4785 because it would undermine effective policing of U.S. securities markets. In a letter to the Committee, CFA wrote, “[s]ummarily prohibiting the retrieval of [PIT] without any thoughtful analysis or evidence-based justification flies in the face of smart and effective governance and would hamstring the SEC from effectively carrying out its mission.” Similarly, AFR opposed the bill because it “would prevent the CAT from identifying customers and brokers who were potentially involved in fraud, or in manipulative or destabilizing trading.”

Even the bill’s sponsor, Rep. Huizenga, acknowledged that the purpose of the CAT is to “collect and accurately identify *every* order from origination through its entire lifecycle, including any cancellation, modification, and trade execution for all exchange-listed equities and options across the U.S. markets,” (emphasis added). H.R. 4785 would undermine that purpose by eliminating identifying information for the vast majority of securities traders.

For these reasons, we oppose H.R. 4785.

MAXINE WATERS.  
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