



Information Memo

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Regulatory Bulletin

**NYSE American RB-19-024  
NYSE Arca RB-19-029  
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**March 11, 2019**

**To:** NEW YORK STOCK EXCHANGE LLC (“NYSE”) MEMBERS and MEMBER ORGANIZATIONS  
NYSE AMERICAN LLC (“NYSE AMERICAN”) MEMBERS, MEMBER ORGANIZATIONS and ATP HOLDERS  
NYSE ARCA, INC. (“NYSE ARCA”) ETP HOLDERS, OTP HOLDERS and OTP FIRMS  
NYSE NATIONAL, INC. (“NYSE NATIONAL”) ETP HOLDERS  
NYSE CHICAGO STOCK EXCHANGE, INC. (“CHX”) PARTICIPANT FIRMS and PARTICIPANTS  
(collectively, “Members”)

**From:** NYSE REGULATION

**Subject:** **MEMBER POST-TRADE REVIEW OBLIGATIONS UNDER THE MARKET ACCESS RULE & EXCHANGE SUPERVISORY RULES**

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The purpose of this Information Memorandum is to further remind all Members of their obligations with regard to conducting post-trade reviews for potentially manipulative, disruptive, and/or other improper trading. Specifically, this Information Memorandum provides guidance on both Securities Exchange Act of 1934 Rule 15c3-5 (the “Market Access Rule” or “Rule 15c3-5”)<sup>1</sup> and applicable Exchange supervisory rules (“Exchange Supervisory Rules”),<sup>2</sup> which are applicable to both floor brokers and other Members.

NYSE Regulation has previously issued information memoranda addressing both the Market Access Rule generally,<sup>3</sup> as well as credit limit requirements more specifically.<sup>4</sup> This Information Memorandum should be read in connection with that guidance.

## Introduction

Pursuant to the Market Access Rule and Exchange Supervisory Rules, broker-dealers with access to trading on an exchange are required to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage financial, regulatory, and other risks of this business activity. This includes, among other things, controls and procedures reasonably designed to “ensure compliance with all regulatory requirements” that are applicable in connection with market access.<sup>5</sup>

In connection with this requirement, this Information Memorandum reminds Members that provide access to any of the NYSE Exchanges of their post-trade obligations to monitor for “manipulation, fraud and other illegal activity.”<sup>6</sup> This Memorandum addresses the following topics:

- Post-Trade Reviews;
- Use of Third-Party Risk Management Technology and Software;
- Investigation and Follow-Up; and
- Allocating Post-Trade Reviews to Broker-Dealer Customers.

## Post-Trade Reviews

Under both the Market Access Rule and Exchange Supervisory Rules, Members providing market access “have post-trade obligations to monitor for manipulation, fraud, and other illegal activity.”<sup>7</sup> Unless a Member formally allocates its reviews to its broker-dealer customers (as discussed below), it is important that the Member maintains supervisory systems and internal control procedures that are specifically tailored to its business model and the types of clients or counterparties with whom it does business. This includes maintaining risk management controls and supervisory procedures that are “reasonably designed to . . . [a]ssure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access.”<sup>8</sup>

Thus, based on the facts and circumstances relevant to that Member, for example:

- Surveillance procedures that might be sufficient for a small number of manual orders may not be sufficient for a larger number of electronic orders.
- Surveillance procedures that could be reasonable for electronic orders may not be sufficient for algorithmic or high-frequency trading strategies.

- Surveillance procedures that may be reasonable for customers that the Member deems to be “low-risk” may not be reasonable for other customers that the Member deems as having “higher-risk” (for example, those end customers that use a master-sub account structure to sponsor trading activity of individuals).<sup>9</sup>

NYSE Regulation has brought actions against Members under the Market Access Rule and/or Exchange Supervisory Rules for failing to implement reasonable post-trade controls to review for improper trading activity.<sup>10</sup> For example, given the facts and circumstances, NYSE Regulation has sanctioned firms for not having any risk management controls in place to identify wash sales, layering, spoofing, quote stuffing, marking, odd lot manipulation, or unusual price and/or volume movement in thinly traded securities that could be indicative of manipulative trading. NYSE Regulation sanctioned other Members that had in place certain controls because those controls were not reasonable in light of the Member’s business – for example, because a Member set surveillance parameters at levels that were unreasonable to detect manipulative activity, or utilized surveillances that were defective due to coding errors. Still other Members have been sanctioned for failing to dedicate sufficient resources to reasonably monitor the significant order flow by its Market Access Customers to ensure compliance with federal securities laws and exchange rules. Such matters demonstrate the importance not only of establishing post-trade controls, but also of making sure that such controls are reasonably designed to identify and prevent manipulative and other improper trading.

#### Use of Third-Party Risk Management Technology and Software

Although the Market Access Rule requires that regulatory and risk management controls “be under the direct control of the broker-dealer providing market access,” Members “have the flexibility to seek out risk management technology and software that is developed by third-parties, so long as it is ‘independent’ of the market access customer or any of its affiliates.”<sup>11</sup>

Still, Members “relying on third-party technology or software should perform appropriate due diligence to assure that its controls and procedures are consistent with Rule 15c3-5, including with respect to the independence of the developer from the market access customer or its affiliates.”<sup>12</sup> Thus, in addition to making sure that the technology is sufficient for a Member’s needs, Members should also assess the developer’s independence. In assessing the independence of the third-party, Members should do more than merely rely on the third-party’s representation. While the details of what additional due diligence efforts are reasonable will differ depending on facts and circumstances, the SEC has stated that there may be several appropriate approaches to achieve this goal – including “the review of publicly available information about the ownership and material business relationships of the third-party technology provider and the customer, following up on any information that may indicate a lack of independence, and requesting the technology provider and customer to certify their independence from each other.”<sup>13</sup>

## Investigation and Follow-Up

While surveilling for potentially improper trading is important, surveillance by itself is not sufficient for Members to discharge their duties under the Market Access Rule and Exchange Supervisory Rules. As the SEC has stated, the purpose of post-trade reports is to “provide surveillance personnel with important information about potential regulatory violations, and better enable them to investigate, report, or halt suspicious or manipulative trading activity.”<sup>14</sup> Accordingly, Members should conduct their own investigations and follow-up into why exceptions are taking place. This may include reaching out to customers for an explanation of the trading. Even then, Members may not be able to reasonably take such explanations at face value. Rather, they may have to follow-up depending on the facts and circumstances, which may include seeking documentation or other evidence to support or refute the customer’s explanation. Indeed, in the past, Members’ controls have been found to be unreasonable (and disciplinary action taken) in situations where they have failed to reasonably follow-up on exceptions identified by post-trade reviews.

Members should also document the reviews of trading activity that they conduct. Doing so can provide the Member with, among other things, contemporaneous records that may be referenced to identify a pattern or practice of potentially improper activity. It also may be helpful in providing evidence of the reasonableness of its supervisory system.

## Allocating Post-Trade Reviews to Broker-Dealer Customers

Rule 15c3-5(d)(1) provides that a firm “may reasonably allocate, by written contract, after a thorough due diligence review, control over specific regulatory risk management controls and supervisory procedures described in paragraph (c)(2) of this section to a customer that is a registered broker or dealer, provided that such broker or dealer . . . has a reasonable basis for determining that such customer, based on its position in the transaction and relationship with an ultimate customer, has better access than the broker or dealer to that ultimate customer and its trading information such that it can more effectively implement the specified controls or procedures.”<sup>15</sup> These regulatory risk management controls can include post-trade reviews.<sup>16</sup> Members who wish to allocate such regulatory risk management controls should keep the following points in mind:

- First, such regulatory reviews may only be allocated to a customer if that customer itself is also a registered broker-dealer (“BD Customer”).
- Second, the Member must conduct thorough due diligence into its BD Customer’s regulatory risk management controls and supervisory procedures.
- Third, the Member must have reasonably determined that its BD Customer has better access to the ultimate customer and the ultimate customer’s trading

information so that it (the BD Customer) is better able to implement the required risk management reviews.

- Fourth, the allocation of the specific risk management controls and supervisory procedures to the BD Customer must be pursuant to a written contract. According to the SEC, such a contract would likely need to be in addition to a typical clearing agreement as “existing clearing agreements likely do not address with sufficient specificity the details of the allocation arrangement permitted by Rule 15c3-5 . . . .”<sup>17</sup>
- Fifth, pursuant to Rule 15c-5(e), the Member that allocated the controls to a BD Customer still must itself “establish, document, and maintain a system to regularly review the performance of the broker-dealer customer to which control has been allocated under contract, and promptly address any performance weaknesses, including termination of the allocation agreement if warranted.”<sup>18</sup>
- Finally, notwithstanding any allocation contract, the Member providing market access is still “ultimately responsible for the efficacy of the regulatory risk management controls.”<sup>19</sup>

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It is important that all Members understand and address the requirements set forth by the SEC’s Market Access Rule and applicable Exchange Supervisory Rules. Members are urged to carefully review this and prior NYSE Regulation Information Memoranda as part of their efforts to review, further develop, and update their Market Access Rule policies, practices, and procedures.

If you have questions regarding this memo, please contact [NYSE-Regulation@theice.com](mailto:NYSE-Regulation@theice.com).

## Endnotes

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- <sup>1</sup> See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69791 (November 15, 2010) (“Market Access Rule Adopting Release”).
- <sup>2</sup> See, e.g., NYSE Rule 3110; NYSE American Rule 3110-Equities; NYSE American Rule 320; NYSE Arca Rule 11.18; NYSE National Rule 11, Section 3; CHX Article 6, Rule 5 (requiring Members, *inter alia*, to have supervisory systems in place that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Exchange rules).
- <sup>3</sup> See NYSE Information Memo 17-08; NYSE American Information Memo 17-05; NYSE American Regulatory Bulletin RB-17-036; NYSE Arca Regulatory Bulletin 17-137, all of which were published on October 5, 2017.
- <sup>4</sup> See NYSE Information Memo 18-04, NYSE American Information Memo 18-02, NYSE American Regulatory Bulletin RB-18-113, NYSE Arca Regulatory Bulletin RB18-134, and NYSE National Regulatory Bulletin RB-18-62, all of which were published on August 13, 2018.
- <sup>5</sup> Rule 15c3-5(c)(1). Other required controls include preventing the entry of erroneous orders, as well as orders that exceed appropriate pre-set credit or capital controls. With limited exceptions, some of which are discussed herein, the risk management controls mandated by the Market Access Rule must be under the direct and exclusive control of the broker-dealer providing market access. See, e.g., Rule 15c3-5(d); 15c3-5 FAQ #10.
- <sup>6</sup> Market Access Rule Adopting Release at 69797-98; 15c3-5 FAQs n.15. For a discussion of Member responsibilities not to engage in or effect manipulative, fraudulent, or disruptive trading, see, NYSE Information Memo 16-06, NYSE MKT Information Memo 16-06, NYSE Amex Regulatory Bulletin RB-16-07, NYSE Arca Equities Regulatory Bulletin RB-16-69, and NYSE Arca Options Regulatory Bulletin RB-16-09, all of which were published on May 19, 2016.
- <sup>7</sup> 15c3-5 FAQs n.15; see also Market Access Rule Adopting Release at 69797-98; Exchange Supervisory Rules, *supra* n.2.
- <sup>8</sup> Rule 15c3-5(c)(2)(iv).
- <sup>9</sup> For example, Members that have customers that engage in algorithmic trading should develop and have compliance monitoring tools that are broad enough in scope to include activity that may result from the interaction of multiple algorithms, e.g., wash sales, self-trades, various forms of manipulation.
- <sup>10</sup> For actions brought by or on behalf of a NYSE Exchange, see <https://www.nyse.com/regulation/disciplinary-actions>.
- <sup>11</sup> 15c3-5 FAQs, FAQ #14.
- <sup>12</sup> *Id.*
- <sup>13</sup> *Id.*
- <sup>14</sup> Market Access Rule Adopting Release at 48.
- <sup>15</sup> Rule 15c3-5(c)(2) concerns regulatory risk management controls and supervisory procedures. Financial risk management controls and supervisory procedures (*i.e.*, credit limits and erroneous order controls) may not be delegated pursuant to Rule 15c3-5(d).
- <sup>16</sup> Credit limits and pre-trade erroneous order controls, however, are not covered by this provision, and therefore may not be allocated to a broker-dealer customer.
- <sup>17</sup> 15c3-5 FAQs, FAQ #12.
- <sup>18</sup> *Id.*
- <sup>19</sup> 15c3-5 FAQs, FAQ #3; Market Access Rule Adopting Release at 69808.