

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88776; File No. SR-NYSE-2020-17)

April 29, 2020

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving a Proposed Rule Change to Amend its Rules to Add New Rule 7.19

I. Introduction

On March 10, 2020, New York Stock Exchange LLC (the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to provide members certain optional risk settings under proposed Rule 7.19. The proposed rule change was published for comment in the Federal Register on March 18, 2020.³ The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

In order to assist member organizations’ efforts to manage their risk, the Exchange proposes to amend its rules to add new Rule 7.19 (Pre-Trade Risk Controls) to establish a set of pre-trade risk controls by which Entering Firms⁴ and their designated Clearing Firms⁵ may set

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 88376 (March 12, 2020), 85 FR 15526 (“Notice”).

⁴ The Exchange proposes to define the term “Entering Firm” to mean a member organization that either has a correspondent relationship with a Clearing Firm whereby it executes trades and the clearing function is the responsibility of the Clearing Firm or clears for its own account. See proposed Rule 7.19(a)(1).

⁵ The Exchange proposes to define the term “Clearing Firm” to mean a member organization that acts as principal for clearing and settling a trade, whether for its own account or for an Entering Firm. See proposed Rule 7.19(a)(2).

credit limits and other pre-trade risk controls for an Entering Firm’s trading on the Exchange and authorize the Exchange to take action if those credit limits or other pre-trade risk controls are exceeded.⁶

Proposed Rule 7.19(a) would set forth the definitions that would be used for purposes of the Rule. In addition to the defined terms of “Entering Firm” and “Clearing Firm,” as described above, the Exchange proposes the following definitions:

- The term “Single Order Maximum Notional Value Risk Limit” would mean a pre-established maximum dollar amount for a single order before it can be traded.
- The term “Single Order Maximum Quantity Risk Limit” would mean a pre-established maximum number of shares that may be included in a single order before it can be traded.
- The term “Gross Credit Risk Limit” would mean a pre-established maximum daily dollar amount for purchases and sales across all symbols, where both buy and sell orders are counted as positive values. For purposes of calculating the Gross Credit

⁶ See Notice, supra note 3, at 15526. The Exchange initially filed a proposed rule change to add new Rule 7.19 relating to pre-trade risk controls on November 27, 2019. See Securities Exchange Act Release No. 87715 (December 11, 2019), 84 FR 68995 (December 17, 2020 (Notice of Filing) (SR-NYSE-2019-68) (“Original Filing”). The Exchange withdrew the Original Filing and filed this proposed rule change as its replacement. Comments received on the Original Filing are available on the Commission’s website at <https://www.sec.gov/comments/sr-nyse-2019-68/srnyse201968.htm>. This filing is substantially the same as the Original Filing and proposes the same functionality. It differs because it includes proposed Commentary .02 through .04, which provides additional detail specific to Floor Brokers and Designated Market Makers, and makes minor, clarifying changes to the proposed rule text as compared to the Original Filing.

Risk Limit, unexecuted orders in the Exchange Book,⁷ orders routed on arrival pursuant to Rule 7.37(a)(1), and executed orders are included.

Proposed Rule 7.19(b) would set forth the Pre-Trade Risk Controls that would be available to Entering Firms and Clearing Firms. Under proposed Rule 7.19(b)(1), an Entering Firm may select one or more of the following optional pre-trade risk controls with respect to its trading activity on the Exchange: (i) Gross Credit Risk Limits; (ii) Single Order Maximum Notional Value Risk Limits; and (iii) Single Order Maximum Quantity Risk Limits, which would collectively be referred to as the “Pre-Trade Risk Controls.”

In addition, under proposed Rule 7.19(b)(2)(A), an Entering Firm that does not self-clear may designate its Clearing Firm to (i) view any Pre-Trade Risk Controls set by the Entering Firm, or (ii) set one or more Pre-Trade Risk Controls on the Entering Firm’s behalf, or both. Proposed Rule 7.19(b)(2)(B) provides that an Entering Firm would be able to view any Pre-Trade Risk Controls that its Clearing Firm sets with respect to the Entering Firm’s trading activity on the Exchange. According to the Exchange, because both an Entering Firm and Clearing Firm (if so designated by the Entering Firm) would be able to access information about Pre-Trade Risk Controls, this mechanism would foster transparency between an Entering Firm and its Clearing Firm regarding which Pre-Trade Risk Control limits may have been set.⁸ For example, if an Entering Firm designates its Clearing Firm to view the Pre-Trade Risk Controls set by that Entering Firm, its Clearing Firm may determine that it does not need to separately set Pre-Trade Risk Controls on behalf of such Entering Firm.

⁷ The term “Exchange Book” is defined in Rule 1.1(k) to refer to the Exchange’s electronic file of orders, which contains all orders entered on the Exchange.

⁸ See Notice, supra note 3, at 15527.

Because the Entering Firm is the member organization that is entering orders on the Exchange, the Exchange will not take action based on a Clearing Firm's instructions about the Entering Firm's trading activities on the Exchange without first receiving consent from the Entering Firm. Accordingly, proposed Rule 7.19(b)(2)(C) would provide that if an Entering Firm designates a Clearing Firm to set Pre-Trade Risk Controls for the Entering Firm, the Entering Firm would be consenting to the Exchange taking certain prescribed actions (discussed further below) with respect to the Entering Firm's trading activity as provided for in proposed Rules 7.19(c) and (d), described below. The Exchange would consider an Entering Firm to provide such consent by authorizing a Clearing Firm to enter Pre-Trade Risk Controls via the risk management tool that will be provided to Entering Firms in connection with this proposed rule change. Once such authorization is provided by the Entering Firm, the Clearing Firm would have access to the Pre-Trade Risk Controls that the Entering Firm designates. The proposed Rule makes clear that by designating a Clearing Firm to set limits on its trading activities, the Entering Firm will have authorized the Exchange to act pursuant to the Clearing Firm's instructions if the limits set by the Clearing Firm are breached.

Proposed Rule 7.19(b)(3) would set forth how the Pre-Trade Risk Controls could be set or adjusted. Proposed Rule 7.19(b)(3)(A) would provide that Pre-Trade Risk Controls may be set before the beginning of a trading day and may be adjusted during the trading day. Proposed Rule 7.19(b)(3)(B) would provide that Entering Firms or Clearing Firms may set Pre-Trade Risk Controls at the MPID level or at one or more sub-IDs associated with that MPID.⁹

⁹ Entering Firms may request that the Exchange create sub-IDs associated with their MPIDs. If an Entering Firm uses a Floor broker to enter orders on the Exchange, it can assign a sub-ID that would be used for the entry of orders by that Floor broker on the Entering Firm's behalf.

Proposed Rule 7.19(b)(4) would provide that with respect to Gross Credit Risk Limits, an Entering Firm and, if so designated, its Clearing Firm, will receive notifications when the Entering Firm is approaching or has breached a limit set by itself or by the Clearing Firm. The Exchange believes that by providing such notifications, the Entering Firm, and if designated, its Clearing Firm, would have advance notice that the Entering Firm is approaching a designated limit and could take steps to mitigate the potential that an automated breach action would be triggered.

Proposed Rule 7.19(c) would set forth the actions the Exchange would be authorized to take when a Pre-Trade Risk Control set by an Entering Firm or a Clearing Firm is breached, which would be referred to as “Automated Breach Actions.” These proposed actions would be automated; if a Pre-Trade Risk Control is breached, the Exchange would automatically take the designated action and would not need further direction from either the Entering Firm or Clearing Firm to take such action.

Proposed Rule 7.19(c)(1) would provide that if both an Entering Firm and its Clearing Firm set the same type of Pre-Trade Risk Control for the Entering Firm but have set different limits, the Exchange would enforce the more restrictive limit. For example, if an Entering Firm sets a Single Order Maximum Notional Value Risk Limit of \$20 million and its Clearing Firm sets the same risk limit at \$15 million, the Exchange will take action when the more restrictive limit is breached—i.e., \$15 million.

Proposed Rule 7.19(c)(2) would set forth the Automated Breach Action the Exchange would take if an order would breach the designated limit of either a Single Order Maximum Notional Value Risk Limit or Single Order Maximum Quantity Risk Limit. As proposed, the Exchange would reject the incoming order that would have breached the applicable limit.

Proposed Rule 7.19(c)(3)(A) would set forth the Automated Breach Actions the Exchange would take if a designated Gross Credit Risk Limit is breached. The Exchange proposes to provide options of which Automated Breach Action the Exchange would be authorized to take if a Gross Credit Risk Limit is breached. Such Automated Breach Actions would be taken at the MPID or sub-ID level that is associated with the designated Gross Credit Risk Limit. As proposed, when setting Gross Credit Risk Limits, the Entering Firm or Clearing Firm setting the limit would be required to indicate one of the following actions that the Exchange would take if such limit is breached:

- “Notification Only.” As set forth in proposed Rule 7.19(c)(3)(A)(i), if this option is selected, the Exchange would continue to accept new orders and order instructions and would not cancel any unexecuted orders in the Exchange Book. Proposed Rule 7.19(b)(4), described above, sets forth the notifications that would be provided to an Entering Firm, and if designated, a Clearing Firm regarding the Pre-Trade Risk Controls that have been set. With the “Notification Only” action, the Exchange would provide such notifications, but would not take any other automated actions with respect to new or unexecuted orders.
- “Block Only.” As set forth in proposed Rule 7.19(c)(3)(A)(ii), if this option is selected, the Exchange would reject new orders and order instructions but would not cancel any unexecuted orders in the Exchange Book. The Exchange would continue to accept instructions from the Entering Firm to cancel one or more orders in full (including Auction-Only Orders) or any instructions specified in proposed Rule 7.19(e) (described below), but would not take any automated action to cancel orders.

- “Cancel and Block.” As set forth in proposed Rule 7.19(c)(3)(A)(iii), if this option is selected, in addition to the Block actions described above, the Exchange would also cancel all unexecuted orders in the Exchange Book other than Auction-Only Orders.

If an Entering Firm and its Clearing Firm each set different limits for a Gross Credit Risk Limit for the Entering Firm’s activities on the Exchange, proposed Rule 7.19(c)(3)(B) would provide that the Exchange would enforce the action that was chosen by the party that set the limit that was breached. For example, if a Clearing Firm sets a lower limit and designates the “Cancel and Block” Automated Breach Action, if that limit is breached, the Exchange will implement that “Cancel and Block” action even if the Entering Firm designated a different Automated Breach Action.

Proposed Rule 7.19(c)(3)(C) would provide that if both the Entering Firm and Clearing Firm set the same Gross Credit Risk Limit and that limit is breached, the Exchange would enforce the most restrictive Automated Breach Action. As further proposed, for purposes of this Rule, the “Cancel and Block” action would be more restrictive than “Block Only,” which would be more restrictive than “Notification Only.” For example, if the Entering Firm selects the “Block Only” action for a Gross Credit Risk Limit and its Clearing Firm selects the “Cancel and Block” action for the same Gross Credit Risk Limit, if the limit is breached, the Exchange would take the “Cancel and Block” action for the Entering Firm’s orders.

Proposed Rule 7.19(c)(4) would provide that if a Pre-Trade Risk Control set at the MPID level is breached, the Automated Breach Action specified at the MPID level would be applied to all sub-IDs associated with that MPID. For instance, if a Clearing Firm sets a Gross Credit Risk Limit for an MPID at \$500 million and the Entering Firm sets Gross Credit Risk Limits for each

of three sub-IDs associated with that MPID at \$500 million each, if two of the sub-IDs reach a \$250 million limit, which combined is the Gross Credit Risk Limit at the MPID level, the Automated Breach Action associated with the limit at the MPID level would be triggered and would apply also to the associated sub-IDs, even though none of the sub-IDs have breached their separate \$500 million limits. This functionality ensures that an Entering Firm cannot effectively override a Pre-Trade Risk Control set at the MPID level by setting risk limits for each of the MPID's associated sub-IDs that cumulatively equal more than the MPID's total Gross Credit Risk Limit.

Proposed Rule 7.19(d) concerns how an Entering Firm's ability to enter orders and order instructions would be reinstated after a "Block Only" or "Cancel and Block" Automated Breach Action has been triggered. In such case, proposed Rule 7.19(d) provides that the Exchange would not reinstate the Entering Firm's ability to enter orders and order instructions on the Exchange (other than instructions to cancel one or more orders (including Auction-Only Orders) in full) without the consent of (1) the Entering Firm, and (2) the Clearing Firm, if the Entering Firm has designated that the Clearing Firm's consent is required. The Exchange proposes to include this functionality because the Clearing Firm bears the risk of any exposure of its correspondent Entering Firms.¹⁰

Finally, proposed Rule 7.19(e) would set forth "kill switch" functionality, which would allow an Entering Firm or its designated Clearing Firm to direct the Exchange to take certain bulk Kill Switch Actions with respect to orders. In contrast to the Automated Breach Actions described above, which the Exchange would take automatically after the breach of a credit limit,

¹⁰ See Notice, supra note 3, at 15528.

the Exchange would not take any of the Kill Switch Actions without express direction from the Entering Firm or its designated Clearing Firm.

Specifically, Proposed Rule 7.19(e) would specify that an Entering Firm, or if authorized pursuant to proposed Rule 7.19(b)(2)(A), its Clearing Firm, could direct the Exchange to take one or more of the following actions with respect to orders at either an MPID, or if designated, sub-ID Level: (1) Cancel all Auction-Only Orders; (2) Cancel all unexecuted orders in the Exchange Book other than Auction-Only Orders; or (3) Block the entry of any new orders and order instructions, provided that the Exchange would continue to accept instructions from Entering Firms to cancel one or more orders (including Auction-Only Orders) in full, and later, reverse that block.

The Exchange proposes that the Kill Switch functionality proposed in Rule 7.19(e) would supersede and replace the Exchange's previously filed proposed rule change,¹¹ which provided certain post-trade risk management tools to member organizations, but not to their Clearing Firms.

The Exchange proposes to provide these post-trade Kill Switch Actions in addition to the pre-trade Automated Breach Actions described above in order to give Entering Firms and their Clearing Firms more flexibility in setting risk controls.¹² An Entering Firm that wants more control over when and which actions are taken with respect to its orders may choose to use these Kill Switch Actions instead of the "Block" or "Cancel and Block" Automated Breach Actions described above. For example, for an Entering Firm that selects the "Notification Only"

¹¹ See Securities Exchange Act Release No. 71164 (December 20, 2013), 78 FR 79044 (December 27, 2013) (SR-NYSE-2013-80).

¹² See Notice, supra note 3, at 15528.

Automated Breach Action, if it receives notification of a credit breach, it could choose to direct the Exchange to take a Kill Switch Action described in proposed Rule 7.19(e).

The Exchange proposes Commentary .01 to Rule 7.19 to specify that the Pre-Trade Risk Controls described in this Rule are meant to supplement, and not replace, the member organization's own internal systems, monitoring and procedures related to risk management and are not designed for compliance with Rule 15c3-5 under the Act ("Rule 15c3-5").¹³ This proposed Commentary specifies that use of the Exchange's pre-trade risk controls would not automatically constitute compliance with Exchange or federal rules and responsibility for compliance with all Exchange and SEC rules remains with the member organization. The Exchange does not guarantee that these controls will be sufficiently comprehensive to meet all of a member organization's needs, the controls are not designed to be the sole means of risk management, and using these controls will not necessarily meet a member organization's obligations required by Exchange or federal rules (including, without limitation, the Rule 15c3-5).

Proposed Commentary .02 would provide that when a customer of a Floor broker firm is a member organization ("Customer"), both the Customer and the Floor broker firm would be considered an "Entering Firm" for purposes of setting Pre-Trade Risk Controls or Kill Switch Actions for that Floor broker's trading activity on the Exchange on behalf of that Customer. There would be no differences in the Pre-Trade Risk Controls available to the Customer and Floor broker.

Proposed Commentary .03 would provide that manual transactions by a Floor broker and crossing transactions pursuant to Rule 76 will be excluded from Pre-Trade Risk Controls. The

¹³ See 17 CFR 240.15c3-5.

Exchange proposes this exception because the proposed Pre-Trade Risk Controls would be incorporated into the Exchange's matching engine systems, and neither manual transactions nor crossing transactions pursuant to Rule 76 are processed in such systems.¹⁴ Floor brokers representing such orders would continue to have their independent obligation to comply with Rule 15c3-5 with respect to these orders.

Proposed Commentary .04 would specify how the proposed Pre-Trade Risk Controls would apply to Designated Market Makers ("DMMs") on the Exchange. The proposed commentary would provide that if either a "Block Only" or a "Cancel and Block" Automated Breach Action has been triggered by an Entering Firm acting as a DMM in an assigned security, such DMM would be prevented from facilitating an auction that would include any DMM Interest, as defined in Rule 7.35(a)(8).¹⁵ If the DMM has not yet been reinstated, the DMM can facilitate an auction if it does not include DMM Interest. This restriction would apply whether the DMM attempted to facilitate the auction electronically or manually; if the DMM attempted to electronically facilitate the auction and include DMM Interest, the Exchange would reject the attempt. However, the DMM would still have an opportunity to facilitate such auction manually without DMM Interest. The Exchange anticipates that a DMM will set Gross Credit Risk Limits at levels that would not result in Automated Breach Actions, and if they do trigger a "Block Only" or a "Cancel and Block" Automated Breach Action, they would promptly reinstate themselves to avoid such a situation.

¹⁴ See Notice, supra note 3, at 15529.

¹⁵ DMMs have an affirmative obligation to facilitate openings, reopenings, and the close of trading for each of the securities in which the DMM is registered as required by Exchange rules. See Rule 104(a)(2) and (3).

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹⁷ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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.

The Commission believes that the proposed rule change is reasonably designed to provide members with optional tools to manage their credit risk. The Commission notes that other exchanges have established risk protection controls that are similar in many respects to the Exchange's proposal.¹⁸ The Commission believes that the proposed rule change would provide additional options for members to manage their risk while transacting on the Exchange. The Commission also believes that the proposed rule change is reasonably designed to assist clearing members in monitoring and managing the potential risks that they assume when clearing for members of the Exchange, as well as to provide clearing members with greater control over their

¹⁶ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b)(5).

¹⁸ See, e.g., Cboe BZX Exchange, Inc. Rule 11.13, Commentary .03 and Investors Exchange LLC Rule 11.380.

risk tolerance and exposure on behalf of their correspondent members, while also providing notification options designed to help ensure that both members and clearing members are made aware of developing issues.

The Commission notes that the proposed Pre-Trade Risk Controls and kill switch functionality are optional functionalities. The Commission reminds members electing to use these proposed functionalities to be mindful of their obligations to, among other things, seek best execution of orders they handle on an agency basis. A broker-dealer has a legal duty to seek to obtain best execution of customer orders, and the decision to utilize the proposed functionalities, including the parameters set forth by the member for the risk setting, must be consistent with this duty.¹⁹ For instance, under the proposal, members, and their respective clearing members on their behalf, have discretion to set the Single Order Maximum Notional Value Risk Limit, Single Order Maximum Quantity Risk Limit, or Gross Credit Risk Limit. While the Exchange did not affirmatively establish minimum and maximum permissible settings for these limits in its proposed rule change, the Commission expects the Exchange to periodically assess whether the risk limits are operating in a manner that is consistent with the promotion of fair and orderly markets. In addition, the Commission expects that members will consider their best execution obligations when establishing the parameters for the risk limits.²⁰ For example, to the extent that a member's risk settings are set to overly-sensitive parameters, particularly if a member's order

¹⁹ See Securities Exchange Act Release Nos. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) (“Order Handling Rules Release”); 51808 (June 9, 2005), 70 FR 37496, 37537-38 (June 29, 2005).

²⁰ The Commission reminds broker-dealers that they must examine their procedures for seeking to obtain best execution in light of market and technology changes and modify those practices if necessary to enable their customers to obtain the best reasonably available prices. See Order Handling Rules Release, *supra* note 19, at 48323.

flow to the Exchange contains agency orders, a member should consider the effect of its chosen settings on its ability to receive a timely execution on marketable agency orders that it sends to the Exchange in various market conditions.²¹ The Commission cautions that brokers considering their best execution obligations should be aware that agency orders they represent may be blocked or canceled on account of the Single Order Maximum Notional Value Risk Limit, Single Order Maximum Quantity Risk Limit, or Gross Credit Risk Limit.

Based on the foregoing, the Commission finds that the proposed rule change is consistent with the Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²² that the proposed rule change (SR-NYSE-2020-17) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²³

J. Matthew DeLesDernier
Assistant Secretary

²¹ For example, a marketable agency order that would have otherwise executed on the Exchange might be prevented from reaching the Exchange on account of other interest from the member that causes it to exceed the pre-established risk limit and thereby results in the Exchange blocking new orders from the member.

²² 15 U.S.C. 78s(b)(2).

²³ 17 CFR 200.30-3(a)(12).