

September 3, 2020

By Electronic Mail (rule-comments@sec.gov)

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Response to Comment Letters Filed with the Commission Regarding File No. SR-NSCC-2020-003 – Exchange Act Release No. 88474 (the “Rule Filing”) and SR-NSCC-2020-802 – Exchange Act Release No. 88615 (“Advance Notice” and collectively with the Rule Filing, the “Filings”) by National Securities Clearing Corporation

Dear Ms. Countryman:

National Securities Clearing Corporation (“NSCC” or the “Corporation”)¹ appreciates the opportunity to respond to the comment letters submitted by The Securities Industry Professional Association,² Alpine Securities Corporation (“Alpine”),³ Lek Securities Corporation,⁴ Wilson-

¹ NSCC is a clearing agency registered with, and under the supervision of, the U.S. Securities and Exchange Commission pursuant to Section 17A of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). NSCC has been designated as a systemically important financial market utility (“SIFMU”) by the Financial Stability Oversight Counsel pursuant to Section 805 of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 in recognition of NSCC’s critical role in the national financial infrastructure. NSCC is a subsidiary of The Depository Trust & Clearing Corporation (“DTCC”), which is a user-owned, user-governed holding company for NSCC, two other registered clearing agencies and SIFMUs regulated by the Commission, and several other companies that provide a variety of post-trade processing and information services.

² Letter from John Busacca, Founder, The Securities Industry Professional Association, dated April 23, 2020 (“SIPA Letter”).

³ Letter from Cristopher R. Doubek, CEO, Alpine, dated April 21, 2020 (“Alpine Letter”).

⁴ Letter from Charles F. Lek, Lek Securities Corporation, dated April 30, 2020 (“LSC Letter”).

Davis & Co., Inc.,⁵ OTC Markets Group Inc.⁶ and The Security Traders Association of New York, Inc.⁷ (each, a “Commenter;” collectively, the “Commenters”) to the Securities and Exchange Commission (“Commission”)⁸ relating to a proposal by NSCC to amend the NSCC Rules & Procedures (“Rules”)⁹ set forth in the Filings to enhance NSCC’s haircut based volatility charge applicable to illiquid securities and unit investment trusts (“UITs”) and make certain other changes to Procedure XV of the Rules (“Proposal”).¹⁰ NSCC’s comments to issues raised by the Commenters with respect to the Proposal are set forth below. Where Commenters raised similar issues, they are addressed collectively. This response does not address comments that are outside of the scope of the Proposal.

I. Background

NSCC, acting as a central counterparty (“CCP”), provides centralized clearance, settlement and information services for virtually all broker-to-broker equity, corporate bond and municipal bond and other securities transactions in the U.S. NSCC is required by statute to have written policies and procedures, including the Rules, which, among other things, (i) identify, measure and manage credit exposure to each NSCC member (each, a “Member”), fully, with a high level of confidence, including a risk-based margin particular to each product, portfolio, and market and (ii) cover its credit exposures to each Member by establishing a risk-based margin system that produces margin levels commensurate with the risk and particular attributes of each relevant product, portfolio, and market.¹¹ NSCC’s Commission-approved Clearing Fund rules include

⁵ Letters from James C. Snow, President/Chief Compliance Officer, Wilson-Davis & Co., Inc., dated May 1, 2020 (“WDCO Letter”) and dated July 29, 2020 (“WDCO Letter II”).

⁶ Letters from Daniel Zinn, General Counsel, OTC Markets Group Inc. and Cass Sanford, Associate General Counsel, OTC Markets Group Inc., dated June 26, 2020 (“OTC Markets Letter”) and dated July 21, 2020 (“OTC Markets Letter II”).

⁷ Letter from Kimberly Unger, CEO & Executive Director, The Security Traders Association of New York, Inc. dated June 30, 2020 (“STANY Letter”).

⁸ Comment letters are available at <https://www.sec.gov/comments/sr-nbcc-2020-003/srnsc2020003.htm>.

⁹ Capitalized terms not defined herein are defined in the Rules, available at https://dtcc.com/~media/Files/Downloads/legal/rules/nbcc_rules.pdf.

¹⁰ See File No. SR-Nbcc-2020-003 and File No. SR-Nbcc-2020-802.

¹¹ See Section 17A(d)(1) of the Exchange Act, 15 U.S.C. § 78q-1, and Rule 17Ad-22, 17 C.F.R. § 240.17Ad-22, thereunder. Rule 17Ad-22 provides in pertinent part:

(e) Each covered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable:

(4) Effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by:

(i) Maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence;

* * *

procedures pursuant to which NSCC quantifies daily the risks associated with each Member's trading activities, and assesses each Members' Required Fund Deposit.¹²

In the Proposal, NSCC is proposing to (1) clarify and enhance the methodology for identifying securities as illiquid for purposes of determining the applicable calculation of the volatility component of the Clearing Fund formula, and revise the definition of "Illiquid Security" in the Rules to reflect these changes; (2) enhance the calculation of the haircut-based volatility component of the Clearing Fund formula that is applied to positions in (a) Illiquid Securities (which include securities that are priced at less than a penny ("sub-penny securities") and initial public offerings, and (b) UITs; (3) eliminate the existing Illiquid Charge (as defined in the Rules), as the risk it was designed to address would be addressed by the other enhancements being proposed and (4) make certain changes to Section I.(A) of Procedure XV (Clearing Fund Formula and Other Matters) of the Rules ("Procedure XV") for greater transparency.

As described in the Proposal, pursuant to the Rules, each Member's Required Fund Deposit amount consists of a number of applicable components, each of which is calculated to address specific clearance and settlement risks faced by NSCC, as identified within Procedure XV. Generally, the largest component of Members' Required Fund Deposits is the volatility component. The volatility component is designed to calculate the amount of money that could be lost on a portfolio over a given period of time assumed necessary to liquidate the portfolio, within a 99 percent confidence level.¹³ NSCC has two methodologies for calculating the volatility component. For the majority of securities, NSCC applies a charge ("VaR Charge") based on a parametric Value at Risk model. Certain securities are excluded from the VaR Charge and instead charged a haircut-based volatility component ("Haircut").

Under the Proposal, a security that is an Illiquid Security, as newly defined, would be excluded from the VaR Charge and instead charged a Haircut based on the securities' price level,

(6) Cover, if the covered clearing agency provides central counterparty services, its credit exposures to its participants by establishing a risk-based margin system that, at a minimum:

(i) Considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market;

* * *

(iii) Calculates margin sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default;

(iv) Uses reliable sources of timely price data and uses procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable;

(v) Uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products[.]

17 C.F.R. § 240.17Ad-22(e)(4) and (6).

¹² See NSCC Rule 4 and Procedure XV.

¹³ See, e.g., Rule Filing at Section II(A)(1) and Advance Notice at II(B)(I). The 99% confidence target is consistent with Rule 17Ad-22(e)(6)(iii) which requires NSCC to calculate margin to cover its "potential future exposure" which is defined in Rule 17Ad-22(a)(13) to mean the "maximum exposure estimated to occur at a future point in time with an established single-tailed confidence level of at least 99 percent with respect to the estimated distribution of future exposure." 17 CFR 240.17Ad-22(a)(13), (e)(6)(iii).

and for sub-penny securities, based on whether the position is long or short. The Proposal re-defines Illiquid Securities for this purpose to include (i) securities that are not listed on a “specified securities exchange,”¹⁴ (ii) micro-cap securities¹⁵ and American depository receipts (“ADRs”), that are listed on a specified securities exchange, if the “illiquidity ratio” of such securities exceeds the median of a calculated illiquidity ratio threshold based on non-micro-cap common stocks¹⁶ and (iii) securities listed on a specified securities exchange that have limited trading history.¹⁷

II. Concerns Stated by Commenters and NSCC Response

Impact on Small Members and Members Concentrating their Business in Illiquid Securities

Some Commenters expressed concerns that the Proposal has a disproportionate effect on smaller NSCC Members¹⁸ and Members that deal predominantly in microcap securities or other Illiquid Securities.¹⁹

The methodology for computing the margin requirement for a Member’s Required Fund Deposit under the Proposal does not take into consideration the Member’s size or overall mix of business in liquid or illiquid securities, including micro-cap securities, relative to other Members, and, therefore, does not discriminate against Members or affect them differently on either of those bases. Any effect the Proposal would have on a particular Member’s margin requirement is solely a function of the default risk posed to NSCC by the Member’s activity at NSCC – firm size or business model is not pertinent to the assessment of that risk.

NSCC is required to manage clearance and settlement risk presented by *each* Member with respect to the *particular* securities products it transacts through the system by, among other things, collecting margin sufficient to cover the risk of default with respect to those trades with a high degree of confidence. Accordingly, each Member is primarily responsible for mitigating the risk associated with its own business.

The amendments are intended to provide more robust assessment and coverage of the risk associated with volatility exhibited by Illiquid Securities that NSCC has identified in backtesting

¹⁴ Specified securities exchange is defined as a national securities exchange that has established listing services and is covered by industry pricing and data vendors.

¹⁵ Micro-cap securities are securities whose market capitalization is below a threshold determined by NSCC from time to time. NSCC will set the micro-capitalization threshold at a level that the NSCC determines indicates that securities with such capitalization exhibit illiquid characteristics based on its regular review of margining methodologies. The initial threshold will be \$300 million.

¹⁶ As discussed in the Proposal and below, ADRs and exchange traded products (“ETPs”) are excluded from the calculation of the illiquidity ratio threshold.

¹⁷ Trading history of each security would be determined on a monthly basis and a security would be an Illiquid Security if it has fewer than 31 business days of trading history over the past 153 business days on an exchange.

¹⁸ See SIPA Letter; LSC Letter; Alpine Letter; OTC Markets Letter; OTC Markets Letter II; STANY Letter.

¹⁹ See Alpine Letter; SIPA Letter; OTC Markets Letter; STANY Letter; WDCO Letter II.

to the statutorily prescribed level. As contemplated by the Exchange Act and Rule 17Ad-22, each Member will be responsible to provide margin commensurate with the default risk posed by its business to NSCC under the Proposal.²⁰

Under the Proposal, each Member's volatility charge/component would continue to be calculated using the same universal standards for each Member. The Proposal nevertheless closes a gap in risk coverage reflected in backtesting and impact studies conducted by NSCC with respect to Illiquid Securities, including securities with micro-capitalization and penny or sub-penny stocks, as a result of the price volatility associated with the securities.²¹ Accordingly, the Proposal may result in an increase in the Required Fund Deposit for a Member effecting transactions in Illiquid Securities. It may also result in higher margin costs overall for Members whose business is concentrated in Illiquid Securities, relative to other Members with more diversified transaction portfolios, commensurate with the proportionate risk posed to NSCC as a result of their business relative to other Members. Members with portfolios that present similar risks would be similarly impacted, regardless of other characteristics of the Member.

Need for Increased Margin

Some Commenters questioned whether any increase in margin as a result of the Proposal is necessary.²² In NSCC's determination, the revised methodology for assessing margin on Net Unsettled Positions in Illiquid Securities is necessary to address the risk presented by the securities in that product category identified in backtest coverage from 96.2 percent to 99.5 percent, the *high degree of confidence* required by statute.²³ Backtesting results and Member impact studies²⁴ indicate that Illiquid Securities, particularly low-priced Illiquid Securities, are more likely to have reduced backtest coverage, which is an indication of additional risk. The proposed change in methodology produces a more accurate Haircut calculation by factoring in price level, resulting in

²⁰ See Rule 17Ad-22(e)(4)(i).

²¹ The Proposal improves the measure of risk associated with Illiquid Securities by better identifying the category of securities with illiquid characteristics and more accurately measuring their volatility. In addition, the changes enable NSCC to collect margin at levels that better reflect the risk presented by Net Unsettled Positions in Illiquid Securities by incorporating a haircut-based volatility component based on the level and risk profile of the security rather than a static percent, which helps to limit exposure.

²² See Alpine Letter; LSC Letter; SIPA Letter; OTC Markets Letter and STANY Letter. In the Alpine Letter, Alpine stated that it received from NSCC an estimated impact of the Proposal identifying an increase in its daily clearing fund requirement of approximately 198 percent, which was based on activity from 2017-2018. NSCC subsequently did a second round of impact studies based on more recent clearing data from the third quarter of 2019. NSCC has since provided Alpine with the result of the second impact study based on Alpine's more recent activity, which reflects an estimated impact that is a significantly lower increase than 198 percent cited by Alpine in the Alpine Letter.

²³ See *Order Approving Proposed Rule Change to Describe the Illiquid Charge that May Be Imposed on Members*, Release No. 34-80597, 82 Fed. Reg. 21, 863 (May 4, 2017); 17 CFR 240.17Ad-22(e)(4)(i).

²⁴ Under Rule 17Ad-22(e)(6)(vi), NSCC is required to perform backtesting and other functions to review, test and verify that the risk-based margin system is appropriate to cover its credit risk to participants. NSCC employs daily backtesting to determine the adequacy of each Member's Required Fund Deposit. NSCC compares the Required Fund Deposit for each Member with the simulated liquidation gains/losses using the actual positions in the Member's portfolio, and the actual historical security returns.

margin levels that better reflect the risks and particular attributes of the Member's portfolio. Together, the enhanced methodology for identifying Illiquid Securities and the calculation of the Haircut-based volatility component applicable to these securities and UITs improves the risk-based methodology that NSCC employs to set margin requirements and better manages its credit exposures to Members.²⁵ The Proposal is designed to provide a more accurate measure of the risks associated with Illiquid Securities and to cover fully that risk presented by them to NSCC. Accordingly, NSCC believes the increase, if any, in a Member's Required Fund Deposit as a result of the Proposal is necessary and appropriate in order for NSCC to meet its risk management obligations under the Exchange Act.

Methodology and Impact Clarity

Some Commenters suggested the description of the methodology in the Proposal is overly complex and the formula for computing the margin requirement is unclear.²⁶ It is not always possible to employ a simple formula that sufficiently measures the element of market risk in a Member's portfolio to determine the appropriate margin necessary to mitigate that risk. NSCC uses models and calculations in its risk management processes that contain the degree of complexity necessary to achieve the intended goal.

NSCC believes the language of the proposed rule change is reasonably transparent and clear enough to enable Members to determine the Member's Required Fund Deposit in accordance with Rule 17Ad-22(e)(23)(ii). The parameters themselves are definitive and non-discretionary to enable application on an algorithmic basis. For example, by specifying that a security with market capitalization of less than \$300 million, or if the security is an ADR, a Member would know that the illiquidity ratio test will be applied in order to determine if the security will be deemed an Illiquid Security. In addition, given that Haircuts are applied according to the price level of the Illiquid Securities, Member's should be able to more easily determine the applied margin impact per the current market price of the security.

In addition, NSCC maintains the Participant Browser Service ("PBS") and NSCC Risk Client Portal ("NSCC Risk Client Portal") to improve transparency of Members' Clearing Fund requirements. PBS is a member accessible website portal for accessing reports and other disclosures. NSCC maintains the NSCC Risk Management Reporting application on the PBS to improve transparency of members' Clearing Fund requirements. The application enables a Member to view and download Clearing Fund requirement information and component details, including issue-level Clearing Fund information related to start of day volatility charge and mark-to-market, intraday exposure, and other components. The reporting enables a Member to view, for example, a portfolio breakdown by asset type, including the amounts attributable to the parametric Value at Risk model, and the amount associated with Illiquid Securities. In addition, Members are able to view and download spreadsheets that contain market amounts for current clearing positions, and the associated volatility charges.

²⁵ Impact studies indicate that the proposed methodology, by calculating a haircut-based volatility charge that addresses the risks presented by a security's price level or risk profile, would result in backtesting coverage that more appropriately addresses the risk of these securities.

²⁶ See Alpine Letter; WDCO Letter; WDCO Letter II; SIPA Letter; OTC Markets Letter; STANY Letter.

The NSCC Risk Client Portal provides members the ability, for information purposes, to view and analyze certain risks relating to their portfolio, including calculators to assess the risk and clearing fund impact of certain activities and to compare their portfolio to historical and average values. On June 22, 2020, new features were added to the NSCC Risk Client Portal. In addition to the existing functionality, the enhancements allow member firms to review 15-minute intra-day slices instead of hourly slices to monitor fluctuations in the volatility and exposure, with more frequent exposure slices helping Members to anticipate potential intra-day margin calls. NSCC also extended evening slices beyond 4:30 pm through 7:00 pm, to provide additional reports that may be used to forecast next-day requirements.

NSCC also maintains the NSCC Client Calculator (“NSCC Client Calculator”) on the NSCC Risk Client Portal that provides functionality to Members to enter ‘what-if’ position data and recalculate their volatility charge to determine margin impact pre-trade execution. The NSCC Client Calculator allows Members to see the impact to the volatility charge if specific transactions are executed, or to anticipate the impact of an increase or decrease to a current clearing position. The NSCC Client Calculator portfolio detail can be downloaded, as many Members have done, to modify a current margin portfolio and then upload the portfolio to run a margin calculation using the approved methodology, and view position level output in order to make informed risk management and execution decisions.

Furthermore, in connection with the proposed amendment, NSCC communicated with its Members and provides resources to enable them to understand the impacts of proposed changes. In 2019 and 2020, NSCC distributed three rounds of impact studies to Members impacted by the change to communicate revisions to the methodology and discuss specific portfolio impacts by reviewing charts and quantitative results.²⁷ Finally, NSCC has performed outreach to Members with details for this Proposal, and other proposals planned by NSCC for the past two years. This process allowed Members to understand and ask questions for all proposals, even if more than one proposal is currently in a stage of development or implementation.

NSCC has also posted an NSCC Risk Margin Component Guide on the NSCC Risk Client Portal which provides descriptions of some of the components used in NSCC’s current risk-based methodology, including the volatility charges, mark-to-market charges, fail charges (for CNS transactions), a charge for Family-Issued Securities to mitigate wrong way risk, a charge for Illiquid Positions, a charge to mitigate day over day margin differentials, a coverage component and a Backtesting Charge. The guide is available for Members to review on the NSCC Risk Client Portal and will be updated to reflect the changes in methodology set forth in the Proposal.

Credit Risk Rating Matrix

One Commenter was uncertain about whether the Credit Risk Rating Matrix (“CRRM”) will continue to be used in the margin calculation for Illiquid Securities.²⁸ For the avoidance of doubt, calculation of the appropriate Haircuts for Illiquid Securities, including calculation of the

²⁷ See *supra*, n. 22.

²⁸ See Alpine Letter.

appropriate volume thresholds, does not consider the Member's CRRM rating. Accordingly, NSCC's volatility component applies to all Members' Net Unsettled Positions and is agnostic to any individual Member's credit rating. The CRRM rating currently is used in determining the Illiquid Position subject to NSCC's Illiquid Charge.²⁹ However, upon implementation of the Proposal, the Illiquid Charge will be eliminated.

ETPs and ADRs

One Commenter appears to be under the mistaken impression that exchange traded funds and other exchange traded products ("ETPs") and ADRs would be exempted from "illiquidity" measure under the Proposal.³⁰ ETPs and ADRs are not excluded by category from the definition of "Illiquid Securities." Under the Proposal, however, one test for determining whether the security is an Illiquid Security is: (i) if it is a micro-cap security or an ADR *and* (ii) its "illiquidity ratio" exceeds the "median of the illiquidity ratio threshold based on non-micro-cap common stocks." The Proposal only excludes ETPs and ADRs from being included when calculating the median of the illiquidity ratio threshold based on non-micro-cap common stocks.³¹ ETPs and ADRs are not excluded from the application of the parameters that might cause them to be considered Illiquid Securities. NSCC would apply a Haircut to such ETPs and ADRs in the same manner as other Illiquid Securities.

Use of Specified Securities Exchanges

Some Commenters objected to the use of specified securities exchanges, claiming that it would disproportionately impact smaller firms whose shares do not trade on those exchanges.³² Other Commenters objected to treating all securities not listed on a specified securities exchange as Illiquid Securities, including those issued by some well-capitalized issuers.³³

The term "specified securities exchange" is defined in the Proposal as a national securities exchange that has established listing services and is covered by industry pricing and data vendors. Securities that trade on a national securities exchange tend to trade with greater frequency in higher volumes than other venues, and Commission registered self-regulatory organizations are subject to price and volume reporting regimes that assure greater accuracy of price and volume information, which NSCC accesses through third party vendors for its model. Securities that are

²⁹ Among other things, the CRRM has been used to determine whether securities available in the Member's account at DTC could be used to offset the Member's Net Unsettled Short Position. The offset is unavailable to Members with the lowest CRRM. The methodology in the Proposal eliminates the Illiquid Charge for *all* Members, and thus discontinues the use of the CRRM for this purpose.

³⁰ See SIPA Letter.

³¹ The Proposal excludes ETPs from the threshold calculation because the underlying common stocks that comprise the indexes of ETPs are included in the calculation. It excludes ADRs from the threshold calculation because the market capitalization of ADRs may be difficult to calculate since each ADR often converts to a different number of shares of a local security.

³² See Alpine Letter; SIPA Letter.

³³ See OTC Markets Letter ; OTC Markets Letter II; STANY Letter.

not listed on a national securities exchange and are traded in certain over-the-counter marketplaces, may trade without being registered with the Commission and have less reliable price and volume information. These issuers may choose to follow alternative financial reporting standards and disclosure guidelines and, in some cases, these disclosures may be elective or discretionary to the issuer. Companies listed on a national securities exchange are subject to heightened public reporting and listing requirements that tend to attract market participants and ultimately enhance liquidity.

The second element of the criteria “covered by industry pricing and data vendors” is included to ensure that NSCC is able to access and utilize quality third party pricing data to derive returns in order to calculate the appropriate margin. The commercial availability of reliable information from independent, third party sources, is critical to ensuring that NSCC can rely on end of day and intraday pricing in order to accurately risk manage positions consistent with its Rules. Accordingly, NSCC believes that the use of “specified securities exchange” as defined in the Proposal is an appropriate basis for determining whether a security is an Illiquid Security.

While securities of some large, well-capitalized issuers not listed on a specified securities exchange would be treated as Illiquid Securities, the Proposal is designed to appropriately address risk that the securities present to NSCC in part by grouping Illiquid Securities by price level, and sub-penny securities by long or short position. Accordingly, not all Illiquid Securities would be given the same Haircut or have the same margin requirements or result in a higher deposit than would be required under the current Rules. For instance, under the proposed price level groupings, Illiquid Securities with a market price greater than \$5 per share should see a reduced margin requirement under the Proposal, which would apply to many of the securities issued by the large companies referred to in some Commenters’ letters that are not on a specified securities exchange. Securities with a smaller price per share, such as sub-penny securities, can be subject to higher price volatility and, as a result, present a greater risk to NSCC. In particular, short positions in sub-penny securities can experience price movements well in excess of 100%.

Microcap Security Threshold

One Commenter suggested that the proposed \$300 market capitalization threshold for micro-cap securities lacks sufficient justification and support.³⁴ Under the Proposal, the initial threshold for determining whether a security is a micro-cap security is a market capitalization level of \$300 million, which was established based on prevailing thresholds for market capitalization categories in the industry. However, the determination whether a micro-cap security is an Illiquid Security is not based on capitalization alone. It is further subject to an illiquidity ratio test. A security with market capitalization less than \$300 million would not be considered an Illiquid Security unless the illiquidity ratio test indicated that its illiquidity ratio exceeds a threshold based on the 99th percentile of the illiquidity ratio of non-micro-capitalization common stocks over the prior six months determined on a monthly basis. Accordingly, a micro-cap security with an illiquidity ratio below the 99th percentile would not be considered an Illiquid Security. So, while the \$300 million threshold is used to initially determine which securities are to be subject to the illiquidity ratio test, it does not mean that all securities

³⁴ See STANY Letter.

that fall within this threshold will be deemed Illiquid Securities or require a higher margin compared to the current Rules.

Specific Margin Examples

Three Commenters' letters provided examples of Required Fund Deposit calculations that purported to illustrate the margin required for sell (short) transactions under the current Rules, which significantly exceeded the principal amount of the sales.³⁵ NSCC is unable to provide meaningful comment without additional information, however, we note that the computations, in all but one example, do not appear to be based on the current Proposal and may be misleading with respect to the current Rules.³⁶ Among other things, one Commenter apparently failed to consider that all buy and sell transactions in a security are netted to one obligation—a net buy or a net sell position—when calculating the Required Fund Deposit under the current Rules, so that the margin purportedly required for one trade for 198,000 shares that appears to have been submitted over the course of two business days in 2018 actually pertained to net short positions of 609,000 shares and 1,810,000 shares on each day, respectively.³⁷

The margin required for particular securities is calculated to address the risk presented by such securities to NSCC and its Members. Short positions cleared by NSCC have unlimited upside market price risk, as the price of a security may increase and could potentially subject NSCC to losses under its trade guaranty. The potential loss may be substantially greater with respect to unsettled positions in Illiquid Securities.

The JOBS Act and Other Legislative Initiatives

One Commenter suggested any increase in Required Fund Deposits that might result from the proposal is inconsistent with The JOBS Act and other legislative initiatives designed to promote small business capital formation.³⁸ NSCC's proposal is not intended to advantage or disadvantage capital formation in any particular market segment. The Proposal focuses entirely on managing the clearance and settlement risk associated with secondary transactions in securities with illiquid characteristics as required by Section 17A of the Exchange Act, which is unaffected by those initiatives.

³⁵ See Alpine Letter; STANY Letter; WDCO Letter II.

³⁶ One Commenter cited a recent sale transaction by an anonymous Member but did not specify the transaction details or whether it was the only transaction in the position. See STANY Letter. Another Commenter provided transactions and all of which, except for one, appear to be examples for which an Illiquid Charge was applied and displayed as the "NSCC Charge Amount", which would not apply under the Proposal. See WDCO Letter II. With respect to the one transaction for which an Illiquid Charge was not applied, the volatility component contribution of that trading symbol is displayed as the NSCC Charge Amount but there is not enough information to provide comment since the transaction amount does not reconcile with the net clearing position. See WDCO Letter II.

³⁷ See Alpine Letter.

³⁸ See WDCO Letter II.

* * * * *

NSCC appreciates the opportunity to respond to the comment letters.

Sincerely,

A handwritten signature in blue ink, appearing to read "Timothy J. Cuddihy".

Timothy J. Cuddihy

Managing Director
DTCC Financial Risk Management