LEKSECURITIES

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In the fall of 2013, NSCC proposed to increase the minimum capital requirements for broker dealers from $500,000 to $7.5 million for self-clearing firms and from $1 million to $15 million for firms that clear for other broker dealers. At the time, this would have had the effect of putting approximately 20% of DTCC's participants out of business or some 40 small broker dealers. NSCC's participants and other stakeholders were almost unanimous in their response to the proposal, which was considered discriminatory and anti-competitive. As a result, the proposal was shelved.

In the fall of 2019, NSCC circulated a whitepaper again proposing to increase capital requirements. This time the proposal sought to raise the capital requirement for self-clearing firms from $500,000 to $5 million and for firms that clear for other from $1 million to $10 million. Once again, the reaction to the proposal was almost unanimously negative. It was widely argued that small firms that traditionally do not trade for their own accounts pose little risk for NSCC, and that NSCC, which is a systemically important financial market utility ("SIFMU") would be better served to concentrate on systemic risks posed by its large members. Once again, given the negative reaction, it appeared that the proposal was off the table.

The 2019 proposal has now been filed with the Commission as a rule change.

Small firms do not pose significant risk to NSCC. If a small firm were to fail, NSCC's losses (if any) would be small. Take a firm with capital of $5 million. Assume the firm fails and NSCC loses money. Now assume a firm that is one hundred times larger, but in all other respects identical to the first firm. If the larger firm were to fail, NSCC's losses would be 100 times larger. So why keep the larger firm and expel the small one? There is no logical reason.

NSCC also fails to distinguish between firms that trade for their own account, which can be risky, and pure agency firms. Almost all of the affected firms are agency-only firms. Agency firms pose little risk to NSCC. They rely on their customers' capital to make good on their trades. Customer accounts are subject to strict margin requirements and if an account is under-margined, the broker must take a haircut. Therefore, when looking at capital to make good on trades, NSCC should look at the net capital of the participant combined with the aggregate buying power of all of its customers. If NSCC were to do this, it would discover that agency firms are much stronger than many large firms that speculate for their own account.

Practice has shown what the above logic dictates: During the financial crisis large firms either failed or had to take TARP money from the government. All of the problems were caused by proprietary positions. In contrast not a single small firm or agency broker experienced problems. So why target small, low risk agency firms? There is not a shred of evidence to suggest that this makes any sense.

In fact, one can easily image that requiring agency firms to attract more capital will create more risk. Capital, if even available, comes at a cost. Agency brokers assume little risk, and as a result they generally do not make the same return on equity as proprietary trading firms. Consequently, agency brokers do not have, and they cannot be expected to be able to raise, the same amount of capital that proprietary trading firms have. If NSCC were nevertheless to require agency brokers to raise capital that their existing business does not warrant, the firm will be under pressure to change its business model by going into more profitable, but also more risky businesses such as proprietary and high frequency trading. Clearly this would be counterproductive.

NSCC mentions that the Financial Stability Oversight Council (FSOC) has designated NSCC as a SIFMU. NSCC should take this designation seriously and concentrate on firms that create systemic risk, while leaving safe small agency-only firms alone.

NSCC's proposals are anti-competitive and anti-small business. Small businesses are the backbone of the American economy. If allowed to pass, the elimination of small firms will destroy jobs and hurt the economy, while doing nothing to make our financial system safer.

If NSCC feels that its existing margin requirements do not sufficiently protect its risk, it should raise the margin requirements. NSCC claims that its models protect NSCC at a "confidence level" over 99%. While this sounds impressive, if this means that in 1% of the cases NSCC has not collected enough margin, and with approximately 252 trading days in the year, this would mean that on average on 2.52 days each year, each of NSCC's participants could expose the clearinghouse to losses. An agency firm would not be permitted to be that aggressive when margining its customers. If NSCC does not feel sufficiently protected by its margin alone, it should raise the margin requirement. At the same time however, it should use the margin in a way that would allow agency brokerage firms to be able to use the customers' money to meet the customers' margin requirements, in the same manner that this is done by the Options Clearing Corporation and the commodities exchanges. This would better protect NSCC and the financial system as a whole, without placing an undue burden on small low-risk agency firms.

Another element of NSCC's proposal is to require national securities exchanges to have $100 million in capital. Like the broker dealer proposal this is an anti-competitive barrier to entry, and it will make it harder for new exchanges with new trade matching algorithms to be created.

If NSCC feels that it is insufficiently protected, it can raise the margin requirement, change its rules so that the customers' money can be used to meet the customers' margin requirement and shorted the settlement cycle. However, the current proposal is ineffective, anti-competitive and unfairly discriminates against small agency firms that pose little or no risk for NSCC.

Accordingly, the proposed rule is in conflict with the Exchange Act and should be rejected by the Commission.

Respectfully submitted,

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