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January 19, 2022

Via the SEC Portal

Ms. Vanessa Countryman
Office of the Secretary
U.S. Securities and Exchange Commission
100 F. Street NE
Washington, D.C. 20549

Re: Comment Letter to SEC Release No. 34-93856; File No. SR-NSCC-2021-016

Dear Ms. Countryman:

This firm represents Alpine Securities Corporation ("Alpine"). We submit this comment letter, on behalf of Alpine, in response the National Securities Clearing Corporation's ("NSCC") proposed rule change, referenced above, seeking to impose up to a ten-fold increase to its capital requirements for its broker-dealer members (the "Proposed Rule Change"). Alpine thanks the Commission for taking the time to consider this comment letter.

Through this comment letter, Alpine respectfully requests that the Commission disapprove the Proposed Rule Change for the reasons detailed herein. In summary, the dramatic increase in minimum capital requirements is patently discriminatory and anti-competitive as against smaller, independent broker-dealer members, such as Alpine, which would see those base requirements jump from $1,000,000 to $10,000,000. The resulting closure of small broker-dealers will, in turn, harm those small company issuers and their investors which trade in the microcap and over-the-counter ("OTC") markets serviced by those firms. And that constraint on the access of smaller issuers to the markets will impair economic growth and development in the critical microcap sector. Furthermore, NSCC's rationale that the Proposed Rule Change will mitigate its "risk" as a central counterparty is vague, arbitrary and specious, particularly because NSCC has claimed within the past year that increases in the Required Fund Deposit gave it a "confidence" level well over 99%.[1] Nor has NSCC properly considered and implemented the far more efficient and rational solution to its supposed "risk" of counterparty failure, i.e., same day settlement.

The Commission should strictly scrutinize the NSCC's ongoing practice of mitigating its purported risk by monetizing it through ever escalating capital requirements on its members – a

[1] *See* SEC Release No. 34-91809 , SR-NSCC-2021-005 (May 10, 2021), at 12-13 (emphasis added).

process that is inherently discriminatory. One of the Commission's fundamental tenets is to promote competition and capital formation, including among broker-dealers and markets, as opposed to deliberately forcing smaller firms to close. Imposing significant new pay-to-play capital increases that only the largest and richest broker-dealers can afford is inimical to those goals. NSCC tried to impose a similarly dramatic increase to its capital requirements in 2013, which failed because of its impact on the small broker-dealer members. Those same concerns not only continue to exist today, they are heightened while the world remains embroiled in a global pandemic. Rejecting the Proposed Rule Change and other efforts by NSCC to monetize its central-counterparty risks would also incentivize NSCC finally to focus on actually addressing the root cause of those asserted risks: shortening the settlement cycle.

Summary of Proposed Enhanced Capital Requirements

On its face, the new capital requirements under the Proposed Rule Change are extreme: it proposes a between a 200% and 1000% increase in a U.S. broker-dealer applicant or member's capital requirements. Under the Proposed Rule Change, purely self-clearing broker-dealers would see their excess net capital requirements increase from $500,000 to as much as $5,000,000, and broker-dealers who clear for others would see their excess net capital requirements increase from $1,000,000 to as much as $10,000,000, if their so called "value-at-risk tier" exceeds the very low sum of $500,000.[2]

The value-at-risk ("VaR") model receives a vague and perfunctory single-sentence description in the Proposed Rule Change: "The VaR Tier in the table … is based on the daily volatility component of a Member's Net Unsettled Positions calculated as of the start of each Business Day pursuant to Procedure XV of the Rules as part of the Member's daily Required Fund Deposit."[3] NSCC makes no effort to establish why it would be appropriate to use the VaR model, which NSCC uses to calculate and impose margin on trading activity, to determine the minimum excess net capital requirements for membership, or how it determined the tier amounts.[4] Nor does NSCC offer any reasoned explanation for why the onerous margin charges NSCC *already* imposes on trading, of which volatility is the single greatest component, are not more than sufficient to cover NSCC's asserted central-counterparty risk.

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[2] *See* Proposed Rule Change, SEC Release No. 34-93856, at 17-18.

[3] *See id.*at 19.

[4] *See id., passim.* By contrast, the Proposed Rule Release contains an extended discussion of how a broker-dealer member may move between VaR tiers. *See id.* at 19-21, 49.

The Proposed Rule Change Impermissibly Targets and Disproportionately Impacts Smaller NSCC Members

As a small, independent clearing-broker member of NSCC, Alpine is within the target zone of the Proposed Rule Change, and believes it would face an increase of its excess net capital requirements from $1 million to $10 million if the change is approved. Although NSCC withheld the information from its public filing regarding the number of firms within each tier of the new capital requirements, Alpine assumes that most broker-dealers members would be subject to a ten-fold increase under the Proposed Rule Change based on their business/trading activity and the low dollar threshold ($500,000) of the highest VaR tier.[5]

There can be little debate that a ten-fold increase in capital requirements will have the effect, if not the purpose of closing down broker-dealer members that have limited capital resources. Only small firms will struggle to meet the new capital requirements, which NSCC admits: "NSCC believes that the proposed rule change to enhance its capital requirements for BD Members could have an impact on competition because some BD members could be required to maintain capital in excess of their current capital levels."[6] While NSCC provides lip service to these impacts, Alpine believes that NSCC's proposal could be fatal to Alpine, to other similarly situated smaller members, and to the issuers and customers who rely on Alpine and other small NSCC members for access to the markets.

Nor can NSCC's latest Proposed Rule Change be viewed in a vacuum. Rather, these proposed changes come on the heels of other recent significant increases in the Required Fund Deposit that also target smaller broker-dealer members. For example, just this past year, the Commission approved a 2,500% increase (from $10,000 to $250,000) in the minimum Required Fund Deposit for broker-dealer members.[7]

Compounding the issue further, NSCC has continuously expanded the Required Fund Deposit margin charges to double, and triple cover the same purported risk of member default. On February 1, 2021, for instance, NSCC began implementing a rule change which altered several components of the Required Fund Deposit to substantially increase the margin charges for transactions in microcap/OTC stocks, including the volatility charge, the margin differential

[5] NSCC essentially admits this through its statement that, if the proposed VaR Tiers had been in effect for the last two years, only one U.S. broker-dealer applicant would have belonged in the lowest VaR Tier at admittance, and that applicant's trading activity would have placed it within the highest VaR tier within the second month of its membership. *See* Proposed Rule Change, at p. 21, *fn. 21.* Even if a broker-dealer member is purely self-clearing, and would see an increase of excess net capital requirements from $500,000 of up to $5 million, that is still a significant increase and would be similarly impactful.

[6] *See id.,* at 43.

[7] *See* SEC Release No. 34-92640 (August 11, 2015) (approving SR-NSCC-2021-005, as amended).

charge, the coverage component, and the backtesting charge.[8] Once NSCC began implementing that rule change, Alpine's Required Fund Deposit skyrocketed overnight, increasing from an average minimum of $2.5 million – an already enormous sum relative to the value of the positions to be cleared – to over $3.2 million, and has included several large unexpected margin call spikes that left Alpine rushing to locate capital to cover the calls.[9] Although ostensibly directed at the type of stock, this margin increase effectively targeted small firms which are the only broker-dealers left who fully service the critical microcap and OTC markets that represent the core of the U.S. economy and jobs.[10] Major clearing firms, such as Merrill Lynch, Fidelity, Morgan Stanley and UBS have chosen, at the urging of regulators, to no longer service the OTC market. Online discount firms (e.g., E-Trade, Charles Schwab, etc.) do not process this business either.

The enhanced capital requirements in the Proposed Rule Change at issue thus represent only the latest effort by NSCC to weed out its smaller members through increased capital demands. As indicated above, a similar attempt by NSCC to substantially increase its member capital requirements in 2013 failed because of the "undue burden" the changes would have on small broker dealers, which NSCC admits.[11] NSCC claims that its current proposal seeks to impose a lower amount than in 2013 which is difficult to envision given the stunning extent of the increase currently sought. NSCC is not, after all, putting forth evidence of actual exposure that it faced, and seeking a calibrated increase to address that factual problem. Rather, and in the absence of presentation of any evidence, it is seeking not a 50% or 100% increase in the current capital requirements, but instead up to a ten-fold increase. Such an increase would still impose an undue and onerous burden on smaller members and the markets they service, particularly in light of the significant increases to margin requirements NSCC has imposed in the interim and, of course, the current economic conditions brought upon by the global pandemic, which has already led to significant inflation and supply chain concerns, among other issues that signal an impending economic downturn.

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[8] *See* SR-NSCC-2020-003, SEC Release No. 34-88474, 85 F.R. 17910 (March 31, 2020); Order Approving Rule Change, SEC Release No. 34-90502 (November 24, 2020).

[9] Alpine filed an application for review with the Commission with respect to this rule change in March of 2021. *See* Admin. Proc. File No. 3-20238. It remains pending with no substantive Commission action.

[10] This is undeniably a critically important market segment. There are more than 10,000 issued stocks trading in the OTC markets, over twice the number of exchange-listed companies. The aggregate value of OTCQX, OTCQB and Pink Securities was approximately $ 375.2 billion in 2018. https://www.prnewswire.com/news-releases/otc-markets-group-reports-2018-trading-statistics-and-highlights-300779908 html. Alpine alone facilitates tens of millions of dollars of capital financing for small business each month through the deposit, clearance and liquidation of microcap securities on behalf of its customers who provide direct financing to thousands of innovative, startup and early-stage development business that operate in the United States.

[11] *See* Proposed Rule Change, at 6 (acknowledging that, in 2013, NSCC's attempt to increase its minimum capital requirements for broker-dealer members failed because, *inter alia,* it "would present an undue burden on less capitalized firms.").

The disproportionate impacts from NSCC's increasing demand for capital, of which its current proposal is just the latest example, are not felt by Alpine or other small independent broker-members alone. They inevitably have destructive impacts on the small firm customers/investors, and the small businesses who rely on investors to raise funds. If the only firms who service the mom-and-pop investors and main street businesses are unable to meet NSCC's ever escalating capital requirements, investors holding microcap stock will be unable to sell their shares and the small businesses will be unable to raise money. Inevitably, the microcap and OTC markets will become extinct , due in no small part to the enormous regulatory costs and burdens of compliance imposed by NSCC and other SROs.

It is the Commission's duty to prevent discriminatory and anti-competitive rules and practices by NSCC, of which the Proposed Rule Change is but the latest example. Section 17A(b)(3)(F) of the Exchange Act requires that clearing agency rules "are not designed to permit unfair discrimination … among participants in the use of the clearing agency . . . ."[12] Similarly, "promot[ing] efficiency, competition and capital formation" are each central to the purpose of the Exchange Act, and the Commission is required to ensure these critical factors are protected in evaluating SRO rules. *See* 15 U.S.C. §§ 78c(f), 78s(f). As Congress noted in amending the Exchange Act in 1975, which added Sections 17A and 19 to the Exchange Act, "it is in the public interest to assure . . . fair competition among brokers and dealers, among markets and between exchange markets and over-the-counter markets."[13] NSCC's actions need to be closely scrutinized by the Commission *at the rulemaking stage*.[14]

There can be little question that the Proposed Rule Change, and the recent increases in Required Fund Deposit requirements, represent an effort by NSCC to try to eliminate small clearing firms, especially those that service disfavored markets, from NSCC's membership rolls. The drastically increased capital requirements are facially discriminatory and anticompetitive because, as designed, they have a disproportionate impact on small broker-dealers and the markets they serve. And it must be recognized that DTCC's board is comprised of representatives affiliated with large banking and brokerage firms, which clearly factors into the types of policy choices and rules passed by NSCC.

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[12] 15 U.S.C. § 78q-1(A)(b)(3)

[13] S. Rep. 94-75 (1975).

[14] Instituting proceedings before the Commission to obtain review or rulemaking, after an SRO rule has already been approved, is not only a costly and lengthy process, as Alpine's own experience can attest (*see supra*), any relief comes too late. The damage to the firm and its customers has already been done.

NSCC's Justifications for the Enhanced Capital Requirements are Arbitrary and Specious and in fact Alpine's Transactions Pose No Risk to NSCC

The detrimental impacts to small firms from a ten-fold increase in capital requirements must also be judged against NSCC's vague, arbitrary and capricious rationale for the change. First, NSCC claims that its capital requirements for its members have not been updated in over 20 years, as if that is a reason to erect such a new barrier to membership. Plainly, it is not. The Commission must evaluate NSCC's Proposed Rule Change in accordance with the Exchange Act and its rules, including Section 3(f), Section 17A(b)(3) and Section 19 of the Exchange Act, and Exchange Act Rule 17Ad-22. Nowhere in these statutes or this rule does it allow an SRO to impose new membership requirements, particularly where the changes are so significant, because the SRO feels "the current requirements are outdated."[15]

NSCC's risk-mitigation rationale, while ostensibly more colorable, also fails under scrutiny. NSCC claims, for example, that the enhanced capital requirements are justified by its credit-risk exposure as a central counterparty from member trading activity and market volatility.[16] First, in relation to a firm like Alpine that engages only in liquidating transactions in which the firm is long the stock, there is ***no*** risk to NSCC, nor is there any other aspect of Alpine's operations that could expose NSCC to risk.

Second, the specter of potential counterparty failure, relied upon by NSCC, has already been repeatedly address in the increases to the margin requirements of the Required Fund Deposit, which apply to a member's trading activity and specifically weigh, and weigh heavily, NSCC's calculation of market volatility. While NSCC admits the purported risk is already covered by margin charges,[17] it fails to account for this fact in its attempts to justify the proposed exponential increase to member capital requirements. Indeed, the VaR tiers that NSCC proposes to use to calculate the enhanced capital requirements stem directly from the volatility component of the Required Deposit, and NSCC would therefore be double counting this asserted risk: first, at the transactional level where NSCC already collects margin that commonly exceeds the value of the position to be cleared, and again in the proposed enhancements to broker-dealer excess net capital requirements. NSCC has ramped up its transactional requirements to the point where it is already secured against credit risk from member trading and market volatility, many times over, and the proposed new capital requirements are neither necessary nor appropriate, particularly in light of their admitted anticompetitive and discriminatory impact and effect on small broker-dealer

[15] *See* Proposed Rule Change at 46.

[16] *See id.*, at 4, 46

[17] *See id.* ("While NSCC does collect margin from its members to help address these types of risk ….").

members.[18] Approving such a rule change without evidence that there is actual uncovered risk exposure to NSCC would be arbitrary and capricious.

Moreover, just eight months ago, on May 10, 2021, in seeking approval to increase the minimum Required Fund Deposit from $10,000 to $250,000, NSCC represented that the "proposed changes" in *that* proposed rule were consistent with Rule 17A-d-22(e)(4)(i) because they "would enhance NSCC's ability to effectively identify, measure, monitor and manage its credit exposures and would enhance its ability to maintain sufficient financial resources ***to cover its credit exposure to each Member fully with a high degree of confidence***."[19] In the Proposed Rule at issue, NSCC does not claim that its analysis in the May 10, 2021 issuance was incorrect or that any intervening circumstances have arisen that undermines its confidence level in its ability to meet its obligations as a central counterparty to its members or under the Exchange Act. To the contrary, NSCC claims that the enhanced capital requirements in the new Proposed Rule Change have been in development since 2013.[20] By its own analysis and admission in May of 2021, NSCC already has "sufficient financial resources to cover its credit exposure to participant fully with a high degree of confidence," Rule 17Ad-22(e)(4)(i), without the enhanced capital requirements under the new proposed rule.

The Commission should also reject NSCC's assertions that the enhanced capital requirements will help mitigate against legal risk, operational risk and cyber risk posed by members. NSCC's descriptions of these risks are so vague that they cannot possibly serve as a basis to reasonably and rationally evaluate NSCC's request to increase minimum capital requirements by up to 1000%. Every business in the world faces legal, operational and cyber risk, and NSCC makes no effort to describe or quantify these risks beyond referring to generalized categories. NSCC fails also to analyze and articulate the impact of these possible risks upon ***NSCC's*** credit exposure to its members or to identify how increasing the capital requirements for members would mitigate this risk, beyond its conclusory statement that better capitalized firms have more financial resources to weather these risks.[21] Most troubling, NSCC identifies no evidence in its Proposed Rule Change that the generalized legal, operational or cyber risks have ever materialized into broker-dealer members being unable to, or in danger of being unable to,

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[18] *See* 15 U.S.C. § 78q-1(b)(3)(I) (stating that the rules of the clearing agency may not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter."; *cf. also* 15 U.S.C. §78s(f) (requiring the Commission to set aside SRO action that denies or limits membership or access to SRO services where it, *inter alia,* "imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter."

[19] *See* SEC Release No. 34-91809 , SR-NSCC-2021-005 (May 10, 2021), at 12-13 (emphasis added). A "high degree of confidence" is a confidence level of at least 99%. *See* 17 C.F.R. § 240.17Ad-22(a)(13).

[20] *See* Proposed Rule Change, at 5-6.

[21] *See* Proposed Rule Change at 5, 47.

meet their margin or other obligations to NSCC or creating any actual exposure to NSCC. These vague justifications should be disregarded as inadequate to support such a substantial change.

Finally, the Commission should also reject NSCC's assertion that the enhanced capital requirements will better ensure that members have "sufficient capital to sustain unexpected and/or sustained increases in the margin requirements."[22] This confounding statement is a prime example of circular reasoning: NSCC claims that it needs to impose onerous increases to minimum capital requirements to guard against a risk NSCC itself has created through onerous charges NSCC imposes on trading. NSCC's rationale is also unsupported by citation to any evidence that any member, under the current membership capital requirements, lacked the capital to post the margin for a trade, that any lack of capital created actual exposure to NSCC, or that NSCC's existing monitoring, rules and procedures for ensuring that members meet the margin requirements for trading are insufficient to guard against the purported risk. Furthermore, proposing up to a 10x increase in capital requirements in anticipation of potential future increases in margin requirements – a concerning proposition in and of itself given that NSCC already collects margin far in excess of the transaction amount – does not establish it is either necessary, appropriate, or in the public interest to impose burdensome, anticompetitive and potentially destructive new membership requirements now.

In the end, while NSCC may believe that larger firms, with greater resources, are more desirable, it has presented no facts, data or basis to establish that there is a current problem with existing capitalization requirements, that there is any risk that reduces its confidence level below 99% that needs to be fixed, or that raising the current capital requirements is necessary or appropriate in light of its admitted burden on competition. Given NSCC's size and capitalization, there is no possibility, and certainly no evidence, that NSCC would face any actual risk even in the exceptionally unlikely event that one or more of the small firms targeted by this rule were to suddenly and unexpectedly collapse. There is simply no valid risk-based justification for NSCC's continuous effort to increase the capital requirements to for membership or to trade stock

NSCC Should Focus on Efforts to Eliminate the Asserted Risk,
Instead of Continuing to Monetize It.

There is a more efficient and specific approach to mitigate the asserted central counterparty risk exposure to NSCC than this cycle of new and increased capital requirements: shortening the settlement cycle. Monetizing risk is an inefficient mitigation strategy; it does not address the root cause of the risk and has negative collateral consequences on the industry, as described above.

In a series of white papers, DTCC has recognized the significant and detrimental impact of margin calls on firms, which can "strain[]" their "liquidity," "as members draw down credit lines

[22] *Id.* at p. 46.

and increase liquidity buffers."[23] In its February 2021 white paper, DTCC acknowledged that "the most logical way to reduce the risks that drive margin requirements is to shorten the settlement cycle," and indicated that its goal to move the United States to at least a T+1 settlement by 2023, and even shorter thereafter.[24] It is notable that NSCC is trying to get approval of these new capital requirements *before it* takes the more appropriate step of shortening the settlement period; undoubtedly it will not, after it accomplishes that change, then acknowledge a reduced risk and lower these spiraling charges.

Alpine appreciates and wholly supports DTCC's efforts to accelerate the settlement cycle if it reduces the costs to trade. However, DTCC's observations regarding the impact of margin charges, as well as its laudable goal to accelerate settlement, appear to be in conflict with NSCC's recent efforts to unnecessarily increase capital requirements for members or increase margin requirements further.

Alpine appreciates that DTCC may need to wade through some industry intransigence to accomplish the change, but Alpine respectfully submits that such issues could be more expeditiously and efficiently overcome if DTCC and its subsidiaries focused on those efforts rather than spending resources on purported risk management charges that appear designed to force closure of smaller firms. In light of the detrimental impacts on the industry of the increased capital requirements continually pushed by NSCC, and the lack of any actual remaining uncovered risk, the Commission should disapprove any further effort by NSCC to monetize the asserted risks, including the Proposed Rule Change, until (at the very least), accelerated settlement has been proposed. That issue is far more impactful and beneficial to the industry than more unnecessary capital and margin demands.

Conclusion

Alpine appreciates the Commission's consideration of this comment letter and its careful review of NSCC's Proposed Rule Change. For the foregoing reasons, Alpine respectfully requests that the Commission disapprove the enhanced capital requirements in the Proposed Rule Change and instead direct DTCC to move forward expeditiously with its plans to propose an accelerated settlement cycle as a better approach to guard against NSCC's asserted central counterparty credit risks.

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[23] *See* DTCC, *Advancing Together: Leading the Industry to Accelerated Settlement* (February 2021), available at: DTCC-Accelerated-Settle-WP-2021.pdf; *see also, e.g.,* DTCC, *Modernizing the U.S. Equity Markets Post-Trade Infrastructure* (January 2018), available at modernizing-the-u-s-equity-markets-post-trade-infrastructure.pdf (dtcc.com); *see also* DTCC, *Project Ion Case Study* (May 2020), available at Project-ION-Paper-2020.pdf (dtcc.com)

[24] *See* DTCC-Accelerated-Settle-WP-2021.pdf

Respectfully Submitted

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