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January 27, 2022

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:

On behalf of the members of The Security Traders Association of New York, Inc. ("STANY")[1] we submit the following comments in response to the National Securities Clearing Corporation's ("NSCC") proposed rule change, captioned above, seeking to impose as much as a ten-fold increase to capital requirements for its broker-dealer members (the "Proposed Changes" or the "Proposal").[2] STANY respectfully urges the U.S. Securities Exchange Commission (the "Commission") to not approve the Proposal for the reasons set forth herein.

Summary of the Proposed Changes as they relate to Broker-Dealers

The Proposal seeks to impose an increase on broker-dealer applicant's or member's capital requirements of between 200 and 1000 percent. The excess net capital requirements (i.e., capital in excess of the minimum net capital required by the Commission or such higher minimum capital required by its designated examining authority) for self-clearing broker-dealers would increase from $500,000 to as much as $5,000,000 and for broker-dealers who clear for others, excess net capital requirements would

[1] STANY, a membership association representing professionals engaged in the trading of securities since 1937, is committed to be a leading advocate of policies and programs that foster investor trust, professional ethics, and marketplace integrity and that support capital formation, marketplace innovation, and education of market participants. As an industry organization comprised of individuals employed in the securities markets, STANY does not represent a single business or business model, but rather provides a forum for trading professionals representing institutions, hedge funds, broker-dealers, ATSs, trading centers and technology companies to share their unique perspectives on issues facing the securities markets.

[2] See Release No. 34-93856 (December 21, 2021)

increase from $1,000,000 to as much as $10,000,000, if their "value-at-risk tier" exceeds $500,000.[3] NSCC also proposes that a member that is a national securities exchange registered under the Exchange Act and/or a non-U.S. securities exchange or multilateral trading facility, must have and maintain at all times at least $100 million in equity capital.[4]

The Proposed Changes are Anti-Competitive and Discriminatory against Small Broker-Dealers

STANY acknowledges the NSCC's important interest, ensuring that, as a central counterparty, it has sufficient liquidity and financial resources to withstand a default by one of its members. However, we believe that its recently increased Require Fund Deposits and the margin charges that the NSCC imposes on trading are more than sufficient to cover the purported central counterparty risk and that the Proposed unnecessary and dramatic increases in net capital will be borne disproportionately by small broker-dealers to the detriment of small cap companies and investors.

We agree with those who submitted comment letters to NSCC concerning this proposal, that the Proposed Changes are anti-competitive and discriminatory against smaller broker-dealers. [5] The dramatically increased capital requirements will discourage new broker-dealer entrants into the market and cause others to close. Moreover, the Proposed Changes will have an outsized effect on small company issuers who are principally serviced by smaller broker-dealers. Significantly, the increased capital requirements will ultimately disadvantage investors who trade in microcap and OTC market securities.

Mergers, acquisitions, and closures of broker-dealers have narrowed the number of firms servicing microcap and OTC securities. But as NSCC notes, in the last 20 years, we have also seen "new market entrants some of whom are focusing on niche parts of the market with innovative business models."[6] Both the contraction and expansion of its membership are mentioned as reasons for the NSCC's proposed increases in excess net capital. We believe that the burden on competition imposed by the Proposed Changes will stifle competition and lead to further concentration of risk at the largest NSCC clearing member firms. NSCC also cites an increase in trading activity and volatility as additional justification for the Proposed increases in excess net capital. However, NSCC also acknowledges that it "does collect margin from its members to help address these types of risk" and that "the above factors do not directly require NSCC to increase capital requirements for its membership."[7] The competition and innovation that the industry has witnessed in the past 20 years, that the Proposed Changes are likely to suppress, has made our markets better and allowed the US to maintain its competitive advantage amongst trading centers worldwide.

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[3] *See* SEC Release No. 34-93856, at 17-18.
[4] *See* id., at 28.
[5] *See* id., at 43-44 and Exhibit 2.
[6] *See* id., at 4.
[7] *See* ibid., Although national securities exchanges are not required to be members of NSCC, the Proposed Charges to their capital requirements will likely discourage any new or existing exchanges from NSCC membership.

While the Proposal notes that "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"[8], this acknowledgement does not fully and carefully consider the potential impact on the availability of clearing services for small company securities and the individuals who invest in them.

We are extremely concerned that the spate of recent and proposed increased margin requirements and the burdens imposed by the Proposal will cause additional firms to exit the already costly business of providing liquidity to microcap and OTC securities, to the ultimate detriment of retail investors and small companies. As the NSCC notes, the past 20 years witnessed numerous mergers and acquisitions within NSCC's membership[9]. Many broker-dealers and smaller clearing firms have chosen to leave the OTC equities business. Others, impose significant fees for transactions in microcap and OTC traded securities due to high compliance costs and other regulatory burdens. As the NSCC adds additional costs and burdens, we expect that there will be fewer firms willing to accept the deposit of microcap and OTC stocks, or impose exorbitantly high fees to do so, thereby discouraging entry to the public market by small and growing companies and impairing capital formation. Additional requirements that increase the already high costs and difficulty of clearing and settlement of small securities, will negatively impact small company liquidity and shareholder value. Harming smaller broker-dealers will cut off avenues for smaller companies to trade their stocks and make it harder for investors to buy and sell microcap securities and securities listed on the OTC Market.

Many of the smaller less capitalized firms that will be most impacted by the Proposed Changes and will have a hard time meeting the onerous new capital requirements are agency-only firms. Agency only firms rely on their customer's accounts, which are subject to strict margin requirements, and haircuts to broker-dealers if the accounts become under-margined. NSCC could raise customer margin requirements if it feels current levels provide insufficient protection however, we suggest that, agency only broker-dealers should be able to use customers' funds to meet customers' margin requirements, similar to the way in which the Options Clearing Corporation approaches customer funds. However, in failing to distinguish between proprietary trading firms that trade for their own accounts and agency only firms, NSCC's Proposed Changes will unnecessarily affect firms that pose little risk to NSCC.

NSCC has not demonstrated a need for the proposed dramatic increase in excess net capital

Our concerns about the proposal are exacerbated by the NSCC's failure to demonstrate that current margin requirements are insufficient to cover credit risks. On the contrary, we question NSCC's rationale that the Proposed Changes are needed to mitigate its "risk" as a central counterparty since the NSCC has claimed within the past year that increases in the Required Fund Deposit gave it a "confidence"

[8] *See* id., at 43.
[9] *See* id., at 4.

level well in excess of 99%.[10] A year ago, NSCC increased elements of its Require Fund Deposit significantly increasing margin charges for microcap and OTC securities, including the volatility charge, the margin differential charge, the coverage component and backtesting charge. [11] NSCC is already protected against credit risk from member trading and market volatility, many times over via transactional margin charges and offers no explanation for why the margin charges, already imposed on trading are not more than sufficient to cover its central counterparty risk. Additionally, the NSCC has failed to explain why it would be appropriate to use the value-at-risk ("VaR") model to determine the minimum excess net capital requirements for membership. The VaR model is already used to calculate and impose margin on trading activity. Using this model would double count this alleged risk: at the transactional level where NSCC already collects margin that commonly exceeds the value of the position to be cleared, and in the proposed increases in broker-dealer excess net capital.

The principal rationale advanced by the NSCC for these drastic Proposed Changes is the fact that that margin requirements have not been increased in 20 years. NSCC's failed attempt to increase capital requirements in 2013 because of the "undue burden" the changes would have on small broker-dealers,[12] appears to be the impetus behind the effort to increase in net capital at this time. However, the proposed increases in capital requirements are just the latest in a string of increased capital demands that effectively are making it impossible for many small broker-dealers to remain in business. For example, within the past year the Commission approved a 2,500% increase- from $10,000 to $250,000 in the Required Fund Deposit, which apply to broker-dealer member's trading activity and heavily weigh NSCC's calculation of market volatility.[13]

Implementing new membership requirements because NSCC feels "the current requirements are outdated" is not a legitimate justification for imposing such burdensome anti-competitive requirements absent proof of real risk. NSCC claims, that the enhanced capital requirements are justified by its credit-risk exposure as a central counterparty from member trading activity and market volatility, fail to acknowledge that many small broker-dealers who will be subject to the proposed drastic increase in capital engage only in liquidating transactions, creating no risk to NSCC. There is simply no data presented by NSCC for, in many cases, a ten-fold increase in net capital.

NSCC's assertions that additional net capital is necessary to allay legal, operational, and cyber risk occasioned by its members are vague at best. Other than naming these risks, there is no analysis of the

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

[11] *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).

[12] *See*, SEC Release No. 34-93856, at 6 (acknowledging that, in 2013, NSCC's attempt to increase its minimum capitalrequirements for broker-dealer members failed because, *inter alia,* it "would present an undue burden on less capitalized firms.").

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

impact of these risks on NSCC's capital exposure, no proof that these risks are material, or that the proposed drastic increases in excess capital are proportionate to these perceived risks.

Further demonstrating the anti-competitive nature of the Proposed Changes, all newly admitted NSCC broker-dealer members would be placed into the applicable middle VaR Tier (unless NSCC determines that they belong in the highest tier)[14]. This places an extremely high bar ($2,5000,000 for self-clearing firms and $5,000,000 for firms that clear for others) for NSCC memberships and will no doubt discourage new broker-dealer entrants. When compared with the current excess net capital requirements of $500,000 for self-clearing firms, these Proposed Changes will be significantly impactful on new and small broker-dealers.

Shortening the settlement cycle would more effectively mitigate any purported risk without discriminatory and anti-competitive impact

Rather than continuing to address the argued risk exposure to NSCC by new and ever increased capital requirements, many of which are designed to, or at best have the unintended consequences, of diminishing the availability of firms willing to service microcap and OTC securities, counterparty risks could be mitigated effectively and directly by shortening the settlement cycle. We understand that doing so may take time but believe that DTCC would be less incentivized to push for shorter settlement cycle if NSCC continues to monetize risk with added capital requirements. The damaging effect of the increased capital requirements on small broker-dealers, new market entrants and the investors and companies they service, is unnecessary given the lack of actual uncovered risk. However, asserted central counter party risks can be mitigated by looking instead to accelerate the settlement cycle. In the interim, the Commission should not allow irreparable harm to be done.

Conclusion

The dramatically increased capital requirements proposed by NSCC are discriminatory and anticompetitive and designed to have a disproportionate impact on small broker-dealers and the markets they serve. Only smaller firms will struggle to meet the new capital requirements, making us question if it is the intention of the NSCC to use these changes to close broker-dealer members with limited resources. The negative anticipated impact on small broker-dealers, and the public companies and investors who rely on them, demand a risk-based justification for such dramatic changes in net capital requirements. NSCC has not demonstrated that the proposed new capital requirements are necessary, appropriate, or tied to a legitimate and demonstrable risk and we urge the Commission to reject the Proposed Changes. We encourage the Commission to direct DTCC to address the asserted central counterparty risk by focusing its attention on shortening the settlement cycle rather than placing an anticompetitive and discriminatory burden on small broker-dealers.

[14] *See* SEC Release No. 34-93856, at 21.

Respectfully submitted,
/s/ Kimberly Unger
Kimberly Unger
CEO

cc:
The Honorable Gary Gensler, Chair
The Honorable Elad L. Roisman, Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Allison Herren Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner