WILSON-DAVIS & CO., INC.

February 3, 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: File No. SR-NSCC-2021-016
Comment Letter to SEC Release No. 34-93856

Dear Ms. Countryman:

Wilson-Davis & Co., Inc. ("WDCO") submits this comment letter in response to the rule change recently proposed by the National Securities Clearing Corporation ("NSCC"), which seeks to impose up to a ten-fold increase to its capital requirements for its broker-dealer members (the "Proposed Rule Change").[1]

The Proposed Rule Change should be rejected because it violates numerous statutory provisions governing NSCC rules. At best, the Proposed Rule Change is a frail attempt at fixing a problem partly created by NSCC itself; a problem for which a superior, more direct, and simpler alternative solution is already available. At worst, the Proposed Rule Change is a targeted attack on smaller firms serving markets that NSCC disfavors in open contradiction of the express mandate of Congress. Further, if approved, the Proposed Rule Change would not only jeopardize the continued existence of smaller member firms, but also significantly injure the small-cap market, which is critical for the creation, capitalization, and survival of small businesses.

In light of the numerous deficiencies of this destructive Proposed Rule Change, WDCO urges the SEC to closely examine the proposal and reject it in its entirety.

Summary of NSCC's Proposed Enhanced Capital Requirements

NSCC's Proposed Rule Change is extreme, proposing a 200%-to-1000% increase in a U.S. broker-dealer applicant's or member's capital requirements.[2] 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.[3] Broker-dealers that clear for others would see their excess net capital requirements increase

[1] *See* Release No. 34-93856; File No. SR-NSCC-2021-016 [hereinafter the "Proposed Rule Change"].
[2] *Id*. at 17–18.
[3] *Id*.

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.[4]

The Proposed Rule Change Violates Numerous Statutory Provisions

In addition to complying with other statutory requirements, NSCC rules may not be designed to impose any unnecessary or inappropriate burden on competition or permit unfair discrimination.[5] Rather, NSCC rules must be designed to remove impediments to and perfect the mechanism of a national clearance and settlement system and protect investors and the public interest.[6] Further, in determining whether NSCC rules are necessary and in the public interest, the SEC is required to consider whether the rule will promote "efficiency, competition, and capital formation."[7]

As described below, the Proposed Rule Change violates all of these statutory requirements, and therefore, WDCO urges the SEC to reject the Proposed Rule Change in its entirety. Otherwise, the only avenue for small firms will be to institute proceedings before the SEC to obtain review of the rule. Not only is this a costly and lengthy process, but any relief awarded will be too late—firms and their clients will already be irreparably harmed.

The Proposed Change is Unnecessary

NSCC has failed entirely to justify the Proposed Rule Change and ignores an alternative risk solution which is more effective, less discriminatory, and already supported by the SEC and DTCC.

NSCC Fails to Identify why the Proposed Change is Necessary

NSCC is prohibited from passing rules that are not necessary,[8] and NSCC fails to provide any valid, risk-based evidence or justification for its continuous efforts to increase the capital requirements to membership or to trade stock. NSCC posits several rationales for the Proposed Rule Change, none of which passes muster.

First, NSCC states that its capital requirements have not been updated in over 20 years.[9] This is essentially an argument for rulemaking for the sake of change, which certainly does not by itself constitute a "necessity" under applicable statutory law. Notably, the age of the capital requirements is also not any barrier to membership.

Second, although NSCC claims theoretical price volatility for two days, transactions frequently settle on the next day, thereby eliminating NSCC's exposure completely. The fact that NSCC holds member capital deposits for three days is as unnecessary as it is abusive.

[4] *Id*.
[5] 15 U.S. Code § 78q–1(b)(3)(I), (F).
[6] 15 U.S. Code § 78q–1(b)(3)(F).
[7] 15 U.S. Code § 78c(f).
[8] 15 U.S. Code § 78q–1(b)(3)(I).
[9] *See* Proposed Rule Change at 46.

Third, NSCC fails to provide any evidence that the Proposed Rule Change is necessary to mitigate against its purported risk or that its existing monitoring, rules, and procedures, including its existing capitalization requirements, are insufficient to guard against such risk. In fact, the Proposed Rule Change fails to cite any instance in which any member, under the current membership capital requirements, lacked the capital to post the margin for a trade. NSCC also fails to cite any instance in which any lack of capital has created actual exposure to NSCC. Indeed, firms like WDCO that engage only in liquidating transactions in which the firm is long in the stock, create no risk at all to NSCC. WDCO is unaware of any time that NSCC has suffered a material settlement loss in recent memory. WDCO is also unaware of any time that NSCC had to use the clearing fund deposits of a non-defaulting participant firm, even as the country recently experienced the steepest and most severe recession since the Great Depression. Further, 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 collapse suddenly and unexpectedly.

Fourth, NSCC is already amply protected from the risk of potential counterparty failure. The value-at-risk ("VaR") tiers that NSCC proposes to use to calculate the enhanced capital requirements stem directly from the volatility component of the Required Fund Deposit.[10] The Required Fund Deposit applies to a member's trading activity and specifically weighs NSCC's calculation of market volatility. Indeed, NSCC admits that the purported risk is already covered by margin charges.[11] Therefore, NSCC would be double counting its asserted risk: first, at the transactional level where NSCC already collects margin that commonly exceeds the value of the position to be cleared, and second in the proposed enhancements to broker-dealer excess net capital requirements. Yet, NSCC fails to explain why its existing onerous margin charges on trading are not more than sufficient to cover its asserted central-counterparty risk.

Fifth, NSCC fails to provide any evidence—because there is none—that it is any less able to meet its obligations as a central counterparty or under the Exchange Act than it was the last time it sought to increase the minimum Required Fund Deposit. Just eight months ago, on May 10, 2021, NSCC sought approval to increase the minimum Required Fund Deposit from $10,000 to $250,000, an increase of 2,500%.[12] NSCC represented that a minimum deposit of $250,000 "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."[13] However, in the Proposed Rule Change 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 undermine

[10] The VaR model is barely described 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." *Id.* at 19 (footnotes omitted). NSCC also 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.
[11] *See* Proposed Rule Change at 46 (noting that ". . . NSCC does collect margin from its members to help address [trading activity and market volatility risk]").
[12] *See* SEC Release No. 34-91809, SR-NSCC-2021-005 (May 10, 2021).
[13] *Id.* at at 12-13.

its confidence of 99% that its ability to meet its obligations as a central counterparty to its members or under the Exchange Act.[14] To the contrary, NSCC claims that the enhanced capital requirements in the new Proposed Rule Change have been in development since 2013.[15] 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," without the enhanced capital requirements under the new proposed rule.[16]

Finally, NSCC's other stated risks do not make the Proposed Rule Change any more necessary. NSCC argues that the enhanced capital requirements will help mitigate against legal, operational, and cyber risks posed by members.[17] However, NSCC's descriptions of these risks are worryingly vague to justify increasing minimum capital requirements by up to 1000%. Every business in the world faces legal, operational, and cyber risks, 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 risks.[18] 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, meet their margin or other obligations to NSCC or creating any actual exposure to NSCC.

NSCC's ramping up of capital requirements over the last decade already provides security against credit risk from member trading and market volatility many times over, and the SEC should not approve such a rule change without evidence that there is actual uncovered risk exposure to NSCC that makes the change a "necessity."

A More Direct and Efficient Solution is Available: T+1 and T+0

The Proposed Rule Change should be rejected because an alternative solution is available that has already been recommended by SEC's leadership and would be more effective (and less prejudicial to smaller firms) than NSCC's proposed increase in capital requirements. WDCO recommends that NSCC devote its significant data processing resources to facilitating transaction settlement and shortening the settlement period to T+1 or T+0, which would dramatically reduce, if not completely remove, NSCC's theoretical exposure to volatility during the clearing process.

Currently, NSCC supposedly assesses margin deposits to cover the risk of loss resulting from market fluctuations between the trade date and the settlement date two days later (T+2). In fact, NSCC often assesses margin deposits against transaction risk that actually ended the preceding day. This completely belies NSCC's rationale for the Proposed Rule Change because NSCC is already insulated not only from future risk but also risk that has already passed.

[14] A "high degree of confidence" is a confidence level of at least 99%. *See* 17 C.F.R. § 240.17Ad-22(a)(13).
[15] *See* Proposed Rule Change at 5-6.
[16] *Id*., at 12, 16.
[17] *See* Proposed Rule Change at 5, 47.
[18] *Id*.

In addition to continuing its unjustified taking of property, NSCC is seeking to further increase capital requirements to cover risk that it could more directly address by modifying the securities settlement timeline. NSCC fails to mention same-day or one-day settlement in its 55-page Proposed Rule Change, despite the fact that eliminating the two-day settlement cycle in favor of one- or same-day electronic settlement would eliminate NSCC's risk without injuring smaller firms and other parties.

Furthermore, this is a solution that has been recommended by SEC's leadership. On May 6, 2021, following the volatile trading of "reddit" or "meme" stocks, particularly GameStop, in December 2020 to January 2021, SEC Chairman Gensler stated that "shortening the standard settlement cycle could reduce costs and risks in our markets."[19] He also noted that "we now have the technology to further shorten the settlement cycles" not only to T-1 but to same-day (T+0) settlement.[20] Further, pursuant to Chairman Gensler's request, the SEC Staff published a report on the GameStop events, concluding that "[o]ne method to mitigate the systemic risk posed…to the clearinghouse and other participants is to shorten the settlement cycle."[21]

Moreover, in the same month that NSCC published its proposal for rule change in December 2021, DTCC published a white paper recommending a move to T+1.[22] DTCC and its leadership have stated that a one-day settlement cycle would lead to "[r]eduction of risk, particularly during periods of high volume and volatility" and "[r]eduction in liquidity requirements" and margin requirements.[23] Such reductions will "allow broker-dealers to better manage their capital and liquidity risks and better utilize their available capital."[24] Therefore, the Proposed Rule Change is unnecessary because, as the SEC and DTCC have noted, the industry and key actors (including firms, DTCC, and regulators) have both the capability and will for a T+1 system.

NSCC is yet again proposing complicated and burdensome rules to increase capital requirements rather than decreasing or eliminating the underlying risk altogether through a change to settlement timing, which is already supported by the SEC Chairman, SEC Staff, and DTCC itself. A settlement cycle of T+1

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[19] Chair Gary Gensler, Testimony Before the House Committee on Financial Services (May 6, 2021), available at https://www.sec.gov/news/testimony/gensler-testimony-20210505.

[20] *Id*.

[21] STAFF OF THE U.S. SECURITIES & EXCHANGE COMMISSION, Staff Report on Equity and Options Market Structure Conditions in Early 2021 (Oct. 14, 2021), at 44 [hereinafter "SEC Staff Report"].

[22] SIFMA, ICI, DTCC & DELOITTE & TOUCHE LLP, Accelerating the U.S. Securities Settlement Cycle to T+1, version 1.0 (Dec. 1, 2021), at 37, available at https://www.dtcc.com/-/media/Files/PDFs/T2/Accelerating-the-US-Securities-Settlement-Cycle-to-T1-December-1-2021.pdf.

[23] *Id*. at 8–9; *see also* DTCC CONNECTION STAFF, Evolution to an Accelerated Settlement Cycle (June 21, 2020), available at https://www.dtcc.com/dtcc-connection/articles/2021/june/21/evolution-to-an-accelerated-settlement-cycle (noting the impact of the T+0 on reduced settlement and margin requirements); MICHAEL C. BODSON (President & CEO of DTCC), Accelerating Settlement: Why T+1 is the Right Approach at this Time (Aug. 20, 2021), available at https://www.dtcc.com/dtcc-connection/articles/2021/august/20/accelerating-settlement-why-t1-settlement-is-right-approach-at-this-time.

[24] *Id*. Although DTCC suggests that a move to T+0 would impose a disproportionate burden on small to medium-sized firms because of their lower "financial and technical resources," it is not unclear that DTCC consulted smaller firms on this alleged impact, and notably it is NSCC's unnecessary rule change that could jeopardize small firms by reducing the capital available to them.

would impact all firms equally and eliminate risks to NSCC and member firms. The SEC should reject the Proposed Rule Change and encourage NSCC to address instead the issue of risk directly.

The Proposed Rule Change does not Remove Impediments to or Perfect the Mechanism of a National Clearance and Settlement System

The Proposed Rule Change does not remove impediments to and does not perfect the U.S. clearance and settlement system, as required under applicable law.[25] Conversely, the Proposed Rule Change creates impediments to that system by imposing capital requirements that could jeopardize the continued access of small firms and, therefore, their customers, to an efficient transaction settlement mechanism.

NSCC asserts that its enhanced capital requirements will ensure that members have "sufficient capital to sustain unexpected and/or sustained increases" in margin requirements.[26] These margin requirements are set by NSCC in reliance on proprietary algorithms and without transparency. Further, the requirements should be tailored to enable firms to manage their transaction flow and, therefore, their settlement risk. Instead, NSCC minimum capital requirements are disconnected from a particular broker's transaction flow and far higher than the risk to which NSCC is actually exposed. Moreover, NSCC has often imposed astronomical margin calls that clearing firms must meet within hours of demand, thereby applying even greater financial pressure to smaller firms. Despite firms maintaining additional discretionary deposits in anticipation of NSCC's unpredictable margin calls, these margin calls inject unnecessary risk into the U.S. clearing and settlement system rather than mitigating against it. Thus, the Proposed Rule Change will multiply the number of required deposits that are disconnected from a broker's transaction flow to protect against risk that is largely created and maintained by NSCC.

A poignant example of the systemic risks created by NSCC capital requirements arose during the volatile trading of meme stocks at the end of December 2020. NSCC was at the center of that short-squeeze saga despite receiving remarkably little attention in the national debate or Congressional hearings that followed. As noted in the SEC Staff Report commissioned by Chairman Gensler:

> A number of clearing brokers experienced intraday margin calls from [NSCC]. In reaction, some broker-dealers decided to restrict trading in a limited number of individual stocks in a way that some investors may not have anticipated. This episode highlights the integral role clearing plays in risk management for equity trading, but raises questions about the possible effects of acute margin calls on more thinly-capitalized broker-dealers and other means of reducing their risks.[27]

Thus, at the heart of the issue was NSCC's margin calls on member firms. In short, NSCC contributed to and exacerbated the problem rather than mitigating it. NSCC's margin calls were calculated without transparency and were higher than the actual risk to which NSCC was ever exposed. Key firms were able to cover the risk of the transactions entered by their customers but were unable to cover NSCC's margin calls that supposedly covered that same risk. Despite this, NSCC is now proposing up to a ten-fold

[25] *See* 15 U.S. Code § 78q–1(b)(3)(F).
[26] *See* Proposed Rule Change at 46.
[27] SEC Staff Report at 43–44.

increase in capital requirements that are far above any underlying transactional risk and will yet again inject even further risk into the U.S. clearing and settlement system.

The Proposed Rule Change Does Not Protect Investors or the Public Interest

Rather than protecting investors and the public interest, as required under applicable law and which the SEC is required to ensure,[28] the Proposed Rule Change will deeply injure the very large number of issuers and individuals that rely upon small firms like WDCO that actively support the capital formation system that is served by the microcap and OTC markets.

Microcap and OTC markets represent the core of the U.S. economy and jobs, allowing for the sale and purchase of twice the number of companies as those listed on national exchanges.[29] The aggregate value of OTCQX, OTCQB, and Pink securities was approximately $375.2 billion in 2018, and WDCO alone facilitates tens of millions of dollars of capital liquidity for small business each month through its deposit, clearance, and liquidation services.[30] Congress has explicitly noted that "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."[31] The Proposed Rule Change is yet another indication of NSCC's patent disapproval of the OTC markets. This disapproval is diametrically opposed to the will of Congress and the American people.

Firms like WDCO provide their services on behalf of customers that provide direct financing to numerous innovative, startup, and early-stage development businesses that operate in the United States. Major national stock exchange member firms, online discount firms, and clearing firms for exchange-traded securities do not serve the OTC markets. Instead, small firms like WDCO are the only broker-dealers left that fully service the critical microcap and OTC markets. If the only firms that service retail investors and main street businesses are unable to meet NSCC's ever escalating capital requirements, investors holding microcap stock will be unable to liquidate their investments, and small businesses will be unable to raise money, contribute to the U.S. economy, and provide jobs to fellow Americans.

The U.S. federal government designed U.S. securities laws to encourage widespread participation in the nation's capital markets, including the microcap and OTC markets. Congressional committees and the SEC leadership have reiterated this principle in the wake of the GameStop saga, condemning the inability of customers to realize potential gains—an inability directly resulting from NSCC rulemaking.[32]

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[28] 15 U.S. Code § 78q–1(b)(3)(F); 15 U.S. Code § 78c(f).
[29] OTC MARKETS GROUP INC., OTC Markets Group Reports 2018 Trading Statistics and Highlights (Jan. 17, 2019), available at https://www.prnewswire.com/news-releases/otc-markets-group-reports-2018-trading-statistics-and-highlights-300779908 html.
[30] *Id*.
[31] S. Rep. 94-75 (1975).
[32] *See* HOUSE OF REP. COMMITTEE ON FINANCIAL SERVICES, Virtual Hearing - Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide (Feb. 18, 2021), available at https://financialservices house.gov/events/eventsingle.aspx?EventID=407107; HOUSE OF REP. COMMITTEE ON FINANCIAL SERVICES, Virtual Hearing - Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part II (Mar. 17, 2021), available at

The Proposed Rule Change directly opposes the central principle of open participation by crushing smaller firms with unnecessary capital requirements, as well as the investors and issuers these firms serve.

The Proposed Rule Change does not Promote Efficiency, Competition, or Capital Formation

The SEC is required to determine whether NSCC rules promote efficiency, competition, and capital formation.[33] As noted throughout this letter, the Proposed Rule Change will reduce the capital that firms could otherwise use to promote growth in U.S. capital markets, instead forcing firms to dedicate capital to cover risk that is nonexistent and adequately covered. This is an embarrassing example of the economic inefficiency of regulatory institutions, which are already immersed in a mounting wave of public distrust.

The Proposed Rule is also anticompetitive. NSCC concedes that the Proposed Rule Change "could have an impact on competition because some BD members could be required to maintain capital in excess of their current capital levels."[34] This concession alone is sufficient to require the SEC to disapprove the Proposed Rule Change because the SEC is statutorily required to consider the anticompetitive impact of the rule.

Finally, firms like WDCO help raise capital for small companies that are under the radar of more prominent financial institutions and investors. The Proposed Rule Change effectively precludes smaller firms from assisting these companies to raise capital. Further, even if WDCO could continue providing these services, investors will be dissuaded from investing in smaller businesses due to uncertainty of stock liquidation. The Proposed Rule Change would therefore shut down opportunities for small businesses to raise funds from investors, and for investors that are looking for opportunities to invest in them.

The Proposed Rule Change is Unfairly Discriminatory

The Proposed Rule Change violates the Exchange Act's prohibition of unfair discrimination among clearing firms[35] and directly contradicts Congressional support for "fair competition among brokers and dealers."[36] Unfortunately, the Proposed Rule Change is merely the latest in a long series of rules that

https://financialservices house.gov/events/eventsingle.aspx?EventID=406268; HOUSE OF REP. COMMITTEE ON FINANCIAL SERVICES, Virtual Hearing - Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III (May 6, 2021), available at https://financialservices house.gov/events/eventsingle.aspx?EventID=407748; SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, Who Wins on Wall Street? GameStop, Robinhood, and the State of Retail Investing (Mar. 9, 2021), available at https://www.banking.senate.gov/hearings/who-wins-on-wall-street-gamestop-robinhood-and-the-state-of-retail-investing; *see also* Chair Gary Gensler, Testimony Before the House Committee on Financial Services (May 6., 2021), available at https://www.sec.gov/news/testimony/gensler-testimony-20210505.

[33] 15 U.S. Code § 78c(f).

[34] *See* Proposed Rule Change at p. 43.

[35] 15 U.S. Code § 78q–1(b)(3)(F).

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

disproportionately impact smaller members or, less generously, that weed out smaller members through increased capital demands.[37]

Conclusion

The Proposed Rule Change should be rejected because NSCC fails to provide factual support for the change's necessity and shortening the settlement period would be an easier and simpler solution to mitigating transaction risk. In addition, the Proposed Rule Change is inconsistent with Congress's statutory mandates to remove impediments to an efficient national clearing mechanism, to protect investors, and to promote capital formation.

Respectfully submitted,

WILSON-DAVIS & CO., INC.

Robert McBey
Chief Executive Officer

[37] *See, e.g.*, SEC Release No. 34-92640 (Aug. 11, 2015) (approving SR-NSCC-2021-005, as amended); SR-NSCC-2020-003, SEC Release No. 34-88474, 85 F.R. 17910 (Mar. 31, 2020); Order Approving Rule Change, SEC Release No. 34-90502 (Nov. 24, 2020).