



Farzad Seyfnia, Esq.
[REDACTED]

Patrick Zakhary, Esq.
[REDACTED]

SEYFNIA & ZAKHARY, P.C.
633 West 5th Street, Suite 2600
Los Angeles, California 90071
Main: 213.770.4529
[REDACTED]
www.sandzlaw.com

February 7, 2022

VIA SEC portal (rule-comments@sec.gov):

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

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

Dear Ms. Countryman:

Seyfnia & Zakhary, P.C. (“S&Z”), counsel for broker-dealer members operating in the small-capitalization market, submits this comment letter in response to the National Securities Clearing Corporation’s (“NSCC”) prejudicial proposed rule change to enhance capital requirements and make other changes, as provided in File No. SR-NSCC-2021-016 (“Proposed Rule”). Specifically, S&Z requests the Office of the Secretary consider this comment letter and reject the NSCC’s Proposed Rule, as it is a patently unfair to small broker-dealers, anti-competitive, discourages economic growth for the small- capitalization market, and invites avoidable litigation.

NSCC’s arbitrary and improper Proposed Rule

NSCC’s Proposed Rule inappropriately seeks to increase capital requirements for broker-dealer members between 200% and 1000%, or from \$500,000 to \$5,000,000 for self-clearing firms and from \$1,000,000 to \$10,000,000 for firms that clear for others. As a central counterparty, NSCC has an interest in ensuring that it has sufficient liquidity and financial resources to withstand a default by one of its members. However, the NSCC claims, without substantive merit or thoughtful consideration, that the Proposed Rule is necessary to mitigate their present risk. The NSCC does not provide any evidence of actual exposure that it currently faces from smaller firms that are not already addressed. Instead, the NSCC highlights its own flaws.

The NSCC admits that the Proposed Rule could “have an impact on competition because some [broker-dealer] members could be required to maintain capital in excess of their current capital levels.” (Proposed Rule, at p. 43.) The NSCC further states that this impact could impose a burden on competition on some of those broker-dealer members “because they may bear higher costs to raise capital in order to comply with the enhanced capital requirements.” (*Ibid.*). In fact, this was the same problem that the NSCC faced in 2013 in its failing bid to substantially increase capital requirements. (Proposed Rule, at p. 6.).

The NSCC is sufficiently protected by the Required Fund Deposit. The Required Fund Deposit applies to a member's trading activity and contemplates NSCC's calculation of market volatility. In February 2021, the NSCC expanded the Required Fund Deposit to cover the same purported risk of member default. The NSCC increased margin charges in transaction for small-cap market stocks, including volatility charges, margin differential charge, coverage component, and back testing charges. (SR-NSCC-2020-003, SEC Release No. 34-88474. 85; SEC Release No. 34-90502.). The NSCC acknowledges as much in that it "does collect margin from its members to help address these types of risk...." (Proposed Rule, at p. 43.). Despite this, the NSCC fails to explain or justify why its existing margin charges are not more than sufficient cover its counterparty risks.

The NSCC ignores less burdensome, clear alternatives

The NSCC fails to consider less burdensome, clear alternatives, including eliminating two-day settlements periods in favor of same-day/one-day settlements, which would eliminate NSCC's risk without prejudicing smaller firms. Indeed, the Commission agrees, and Chairman Gary Gensler has acknowledged that technology currently exists "to shorten the settlement cycles" and that this would be a method to mitigate the systemic risk posed.

The Commission should reject the Proposed Rule

Put simply, the proposed increase is an attack on small-cap firms serving markets that the NSCC disfavors in direct contradiction of Congress. Congress, through the Securities Exchange Act, explicitly "finds that...[i]t is in the public interest to assure...***fair competition*** among brokers and dealers, among markets, and between exchange markets and markets other than exchange markets." (15 U.S.C.A. § 78k-1(a)(1)(C)(ii), emphasis added.). The NSCC, in turn, must *not* advance rules "designed to permit ***unfair competition*** in the admission of participants or among participants in the use of the clearing agency...." (15 U.S.C.A. § 78q-1(b)(2), emphasis added.). Not only must the Commission give "due regard for the public interest," but also for "the maintenance of ***fair*** and orderly markets." (15 U.S.C.A. § 78k-1(a)(2), emphasis added.). It is the Commission's duty to prevent anti-competitive rules and to scrutinize the NSCC's actions at this stage. Therefore, the Commission must determine if the Proposed Rule promotes efficiency, competition, and capital formation. (15 U.S.C.A. § 78c(f).).

Small-capitalization market companies are frequently early-stage development and startup companies with significant growth potential that are often ignored by preeminent financial institutions and investors. There are significantly more companies in the small-cap market space than there are listed on the national exchange, accounting for hundreds of billions of dollars.¹ Small-cap markets represent innovation and opportunity, which is critical for the creation, capitalization, and survival of small businesses and the U.S. economy. The radically increased capital requirements will discourage new broker-dealer entrants into the market and cause others to close. If small firms are unable to meet NSCC's proposed expansion, small-cap investors will be unable to liquidate their shares and small businesses will be unable to raise sufficient funds for the economic growth potential that many possess. This would lead to an enormous amount of litigation, including for the small firms that are forced to appeal and obtain Commission review of the Proposed Rule if passed. Unfortunately, not only will this be a costly expenditure, but it will also be a time-consuming process that will result in irreparable harm, as the shoe would have already dropped.

¹ 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>

Conclusion

In sum, the Commission should reject the Proposed Rule because the NSCC fails to provide factual support and evidence for the change's necessity, it conflicts and is inconsistent with the Exchange Act, fails to protect investors and promote capital formation, and is completely unfair to the small-capitalization market.

Respectfully,
SEYFNIA & ZAKHARY, P.C.


Patrick Zakhary
Attorney at Law