

As has been noted in several other comments (Kevin, Scott Monson, LEK, Alpine, STANY, and Wilson Davis & Company), this proposed rule by the NSCC is discriminatory against its smaller broker dealers, especially those in microcap stock and small businesses by seeking extraordinarily increased capital requirements. It also appears that the NSCC is creating the capital requirements in the rule proposal so that they can cover the potential default of its largest member who is placing extremely lofty bets.

At its surface, it would appear as if the NSCC is increasing capital requirements for all members because the NSCC has repeatedly fallen short of its "Cover 1" obligation as a central counterparty which is "designed to enable it to cover potential losses resulting from the failure of the Member or Member family to which it has to largest credit exposure". The NSCC is allowing its largest member to make such lofty bets that they have failed to have the required liquid capital to cover the potential default of those bets 5 times from January 2021 to September 2021.<sup>1</sup>

In Q1 2021, the NSCC faced a worst-case hypothetical loss of roughly \$40.7 billion which was \$591 million more than the NSCC has set aside to cover these worst-case hypothetical losses.<sup>2</sup> Meaning, NSCC members would be responsible for covering the additional losses had the member defaulted on its credit exposure. In June 2021, the NSCC was caught short of its Cover 1 obligation again, twice. On one of the occasions the NSCC found themselves to be short by roughly \$1.02 billion. The other date was short \$5.1 billion.<sup>3</sup> It should not be the requirement of smaller members to foot the bill for these wagers should these exposures turn sour. It should also not be the requirement of smaller broker dealers to put in such an extreme amount of additional capital so that the largest NSCC members can continue making even loftier bets.

NSCC-2021-005 helped the NSCC's liquidity issues in June of 2021 by requiring that all members have their minimum Required Fund Deposit raised from \$10k to \$250k.<sup>4</sup> One would think this would give the NSCC enough liquid capital to cover their largest member's exposures, but they would be wrong. In July and September of 2021, the NSCC found themselves short of the Cover 1 obligation again. This time by \$594 million and \$32.7 million respectively.<sup>5</sup>

The proposed rule may make it easier for the largest members to place even loftier bets as they absorb the clients/assets from any smaller broker dealers who are unable to meet the extraordinary capital requirements within the proposal, and the NSCC would have additional capital on-hand to clear this large exposure from the increased capital requirements of members who are fortunate enough to afford the increase. Having smaller broker dealers put up additional capital won't stop the largest NSCC member from continuing to place lofty bets. If anything, it will give them the ability to make even larger bets moving forward, which puts all members at risk of that member should the member default and the NSCC fall short of its Cover 1 obligation again.

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<sup>1</sup> See 2021 NSCC Quantitative Disclosures for Cover 1 obligation shortfalls, and December 2021 NSCC Disclosure Framework and 17 CFR § 240.17Ad-22(e)(4)(iii) for additional information on NSCC's Cover 1 obligation.

<sup>2</sup> NSCC 2021 Q1 Quantitative Disclosure

<sup>3</sup> NSCC 2021 Q2 Quantitative Disclosure

<sup>4</sup> <https://www.sec.gov/rules/sro/nscc/2021/34-92640.pdf>

<sup>5</sup> NSCC 2021 Q3 Quantitative Disclosure

This rule proposal should be disapproved so that the NSCC can look at ways to increase the margin and capital requirements of its largest members as this appears to be the NSCC's current issue. Increased Required Fund Deposits, and margin/capital requirements for its largest members would benefit the entire market by ensuring large market participants don't overstep their means. Those who invest with and leverage credit, should be required to follow margin and capital requirements proportional to the risk of their credit exposures. The failure of the largest members' credit exposures can reverberate throughout the entire market if the worst-case were to come to fruition. Had the largest member been required to have additional funds in its accounts while placing these large bets, the NSCC would not have run into a liquidity issue throughout the year.

I'm going to finish the rest of my comment by reiterating comments from STANY on the proposed rule.

*"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." 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." 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."*

*"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" level well in excess of 99%. A year ago, NSCC increased elements of its Required 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. 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, 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.”*

Note: footnotes used within STANY’s comment have been removed from the quoted text. Please see STANY’s comment on proposed rule NSCC-2021-016.