

March 10, 2022

**VIA ELECTRONIC MAIL** ([rule-comments@sec.gov](mailto:rule-comments@sec.gov))

Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-0609

**Re: Response Comment Letter to Proposed Rule Change SR-NSCC-2021-016**

Dear Ms. Countryman:

National Securities Clearing Corporation ("NSCC") appreciates the opportunity to respond to the eight comment letters submitted by seven commenters<sup>1</sup> to the U.S. Securities and Exchange Commission ("Commission") regarding NSCC's proposed rule change SR-NSCC-2021-016 ("Filing").<sup>2</sup> The Filing proposes to amend the NSCC Rules & Procedures ("Rules") to (i) enhance NSCC's capital requirements for Members and Limited Members (collectively, "members"), (ii) redefine NSCC's Watch List and eliminate NSCC's enhanced surveillance list, and (iii) make certain other clarifying, technical and supplementary changes in the Rules, including definitional updates, to accomplish items (i) and (ii), as described in detail in the Filing.<sup>3</sup>

Having reviewed each of the comment letters in detail, it is NSCC's understanding that the substantive claims raised in the letters are directed at (i) the Filing's proposed minimum capital requirements for U.S. broker-dealer Members ("Proposed U.S. BD Capital Requirements") and (ii) whether the Proposed U.S. BD Capital Requirements are necessary and appropriate, given that the requirements could impose a burden on competition for some U.S. broker-dealer ("BD") Members.

As described in the Filing, NSCC fully appreciates that the Proposed U.S. BD Capital Requirements may impose a burden on competition for some U.S. BD Members that would need to raise or keep more capital

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<sup>1</sup> Letter from Charles F. Lek, Chief Executive Officer, Lek Securities Corporation, dated January 13, 2022 ("Lek Letter I"); Letter from Charles F. Lek, Chief Executive Officer, Lek Securities Corporation, dated January 19, 2022 ("Lek Letter II"); Letter from Aaron D. Lebenta, Attorney, Parson Behle & Latimer, P.C., Counsel for Alpine Securities Corporation, dated January 19, 2022 ("Alpine Letter"); Letter from Kimberly Unger, CEO/Executive Director, The Securities Traders Association of New York, Inc., dated January 27, 2022 ("STANY Letter"); Comment from Kevin, dated January 30, 2022 ("Kevin Comment"); Letter from Robert McBey, Chief Executive Officer, Wilson-Davis & Co., Inc., dated February 3, 2022 ("WD Letter"); Letter from Patrick Zakhary, Attorney, Seyfnia & Zakhary, P.C., dated February 7, 2022 ("Zakhary Letter"); Letter from Scott G. Monson, Attorney, dated February 10, 2022 ("Monson Letter"), available at <https://www.sec.gov/comments/sr-nscc-2021-016/srnscc2021016.htm>.

<sup>2</sup> Securities Exchange Act Release No. 93856 (December 22, 2021), 86 FR 74185 (December 29, 2021) (SR-NSCC-2021-016) ("Notice").

<sup>3</sup> Capitalized terms not defined herein are defined in the Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

on hand in order to comply with the new requirements.<sup>4</sup> As explained in the Filing,<sup>5</sup> however, NSCC believes that such a burden would be necessary and appropriate in furtherance of the purposes of the Securities Exchange Act of 1934, as amended (“Exchange Act”), as permitted by Section 17A(b)(3)(I) thereunder,<sup>6</sup> notwithstanding the claims raised by commenters, which NSCC addresses below.

## **I. The Proposed U.S. BD Capital Requirements are Necessary**

### **A. Evidence Supporting the Proposed U.S. BD Capital Requirements**

Five commenters claim in varying but similar ways that the Filing does not present sufficient evidence to support the need for the Proposed U.S. BD Capital Requirements.<sup>7</sup> For example, four of those commenters claim that the references to legal, operational, and cyber risks in the Filing, which NSCC raised and explained in support of the proposed capital requirement changes more broadly, are too vague.<sup>8</sup> Moreover, three of those commenters claim that there is no evidence of a BD Member “being unable to, or in danger of being unable to,” satisfy its obligations to NSCC on account of those risks (i.e., the risks have not materialized).<sup>9</sup> Similarly, two of those commenters simply claim that the “small firms” subject to the Proposed U.S. BD Capital Requirements do not pose substantive risk to NSCC.<sup>10</sup>

First, as a matter of law and regulation, NSCC is required to manage many different risks, including legal, credit, liquidity, operational, general business, investment, custody, etc., as required by Rule 17Ad-22(e) under the Exchange Act,<sup>11</sup> regardless of whether any of the risks materialize into an actual issue. In this case, the Proposed U.S. BD Capital Requirements would help manage the credit risk presented to NSCC by U.S. BD Members. While members may not routinely experience issues related to legal, operational, or cyber risks, these issues can arise,<sup>12</sup> possibly without advance warning, and, as such, they are considered a critical part of the ongoing credit risks that members present to NSCC and that NSCC must manage. NSCC’s approach to addressing these types of credit risk is multifaceted. For example, pursuant to NSCC’s Rules, NSCC requires members to meet certain standards of operational capability, experience, and competence, as well as financial responsibility.<sup>13</sup> Moreover, reviewing and updating NSCC’s minimum capital requirements is prudent risk governance, particularly given the extensive changes in the regulatory environment, membership, trading activity, and market volatility, as discussed in the Filing,<sup>14</sup> all of which influence the credit risk that NSCC must manage.

Second, “smaller” BD Members with lower excess net capital (“ENC”) tend to present greater relative risk to NSCC. As described in the Filing and submitted to the Commission as a confidential Exhibit 3 to the

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<sup>4</sup> See Notice, supra note 2, at 43, 45.

<sup>5</sup> See id. at 39-40, 46-51.

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>7</sup> Alpine Letter, supra note 1, at 7-8; STANY Letter, supra note 1, at 4-5; WD Letter, supra note 1, at 4; Zakhary Letter, supra note 1, at 1, 3; Monson Letter, supra note 1, at 2-3.

<sup>8</sup> Alpine Letter, supra note 1, at 7; STANY Letter, supra note 1, at 4; WD Letter, supra note 1, at 4; Monson Letter, supra note 1, at 3.

<sup>9</sup> Alpine Letter, supra note 1, at 7; WD Letter, supra note 1, at 4; Monson Letter, supra note 1, at 2-3.

<sup>10</sup> Lek Letter II, supra note 1, at 1; WD Letter, supra note 1, at 3.

<sup>11</sup> 17 CFR 240.17Ad-22(e).

<sup>12</sup> See Commission v. Alpine Sec. Corp., 982 F.3d 68 (2d Cir. 2020) (upholding \$12 million civil penalty against a BD member).

<sup>13</sup> NSCC Rule 2A – Initial Membership Requirements, supra note 3.

<sup>14</sup> See Notice, supra note 2, at 3-5.

Filing, NSCC's analysis of the average value-at-risk ("VaR") margin requirement of each member divided by the current ENC of each member ("VaR/ENC") shows that members with ENC less than \$5 million have an average VaR/ENC of 15 percent. That ratio declines to 13 percent for members with ENC of \$5-10 million, to 10 percent for members with ENC of \$10-50 million, to 3 percent for members with ENC of \$50-100 million, to 7 percent for members with ENC of \$100-500 million, and, finally, to 2 percent for members with ENC greater than \$500 million. In other words, the data demonstrates that members with lower ENC tend to present higher risk exposure to NSCC relative to their capital level, as compared to NSCC members with higher ENC. If the Proposed U.S. BD Capital Requirements are applied to that analysis, then the average VaR/ENC ratio declines to 7 percent for members with ENC less than \$5 million, and 9 percent for members with ENC of \$5-10 million, which aligns more closely to members with greater ENC. This same information was shared in October 2019 with members of the Regional Firm Council,<sup>15</sup> which includes three of the commenters.<sup>16</sup>

#### B. Market Risk v. Credit Risk

Six commenters claim in varying but similar ways that the risk that the Proposed U.S. BD Capital Requirements are intended to address is already addressed by the margin that NSCC collects from members.<sup>17</sup> In support of this claim, five of those commenters cite to recently filed and approved NSCC proposals to enhance the calculation of certain components of its Clearing Fund formula<sup>18</sup> and increase its minimum Required Fund Deposit.<sup>19</sup> Those proposals, however, are designed to address market risk presented by members' clearing activity, whereas the Proposed U.S. BD Capital Requirements, and the proposed capital requirements more generally, are designed to address the credit risks that members present to NSCC.

For NSCC, market risk arises from price fluctuations in members' open securities positions at NSCC between trade date and settlement date, which NSCC must manage against as the central counterparty to those positions. A key component in managing that risk is the margin requirement that NSCC calculates on those positions, via its Clearing Fund formula, and collects in the form of a Required Fund Deposit. In contrast, credit risk for NSCC is generally the risk that a member will be unable to meet its obligations to NSCC as an ongoing concern. For example, credit risk can manifest in a member's inability to meet either a margin requirement or its settlement obligations for any number of reasons, including if a member has insufficient capital or liquidity (as suggested by a VaR/ENC analysis, as described above), suffered a cyber-attack, or is experiencing an operational issue.

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<sup>15</sup> The Regional Firm Council was created by The Depository Trust and Clearing Corporation ("DTCC") – DTCC is the parent company to NSCC and NSCC's affiliate clearing agencies, The Depository Trust Company and Fixed Income Clearing Corporation (altogether, "Clearing Agencies") – to provide a forum for regional or "smaller" members to openly and candidly discuss Clearing Agency initiatives relevant to them and provide greater transparency into the Clearing Agencies' decision making. Any Clearing Agency member is welcome to join, although the Council is tailored to regional member interests. The Council meets no less than three times a year, but over the past two years it has met four times a year, during which the changes proposed in the Filing were a standing agenda topic.

<sup>16</sup> Letter from Daniel McElligott, Executive Director, DTCC, to Regional Firms Council (October 24, 2019), included as a confidential Exhibit 3 to the Filing.

<sup>17</sup> See Lek Letter II, supra note 1, at 2; Alpine Letter, supra note 1, at 1-3, 6-7; STANY Letter, supra note 1, at 2-4; WD Letter, supra note 1, at 3-4; Zakhary Letter, supra note 1, at 2; and Monson Letter, supra note 1, at 3.

<sup>18</sup> Alpine Letter, supra note 1, at 4; STANY Letter, supra note 1, at 4; WD Letter, supra note 1, at 9; Zakhary Letter, supra note 1, at 2; and Monson Letter, supra note 1, at 3.

<sup>19</sup> Alpine Letter, supra note 1, at 1, 3, 7; STANY Letter, supra note 1, at 2-4; WD Letter, supra note 1, at 3-4, 9; Zakhary Letter, supra note 1, at 2; and Monson Letter, supra note 1, at 3.

Ultimately, as required by Rule 17Ad-22(e) under the Exchange Act<sup>20</sup> and as a matter of prudent risk management, NSCC assesses, monitors, and manages market risk and credit differently, with the Proposed U.S. BD Capital Requirements helping to manage the credit risk presented by U.S. BD Members.

### C. Shortened Settlement Cycle

In varying but similar ways, five commenters urge NSCC to shorten the standard settlement cycle for most broker-dealer transactions in securities from two business days post-trade date (“T+2”) to one business day post-trade date (“T+1”) or even shorter.<sup>21</sup> Those commenters claim that a shortened settlement cycle would alleviate the need for the Proposed U.S. BD Capital Requirements.<sup>22</sup> Although NSCC appreciates those commenters’ interest in and support of a shortened settlement cycle, which NSCC also supports,<sup>23</sup> NSCC cannot unilaterally shorten the settlement cycle. Such a change takes extensive coordination among many stakeholders, including the Commission, which recently issued a proposal on this topic.<sup>24</sup> Moreover, moving from a T+2 to a T+1 settlement cycle, as the Commission proposes, does not negate the credit exposure that U.S. BD Members present to NSCC, as described above. As such, the Proposed U.S. BD Capital Requirements are still needed. A shortened settlement cycle, however, would decrease the market risk presented by portfolios of U.S. BD Members, and other members more broadly. Thus, NSCC expects that members may see a reduction in the amount of margin that NSCC will need to collect in a shortened settlement cycle.<sup>25</sup>

## II. **The Proposed U.S. BD Capital Requirements are Appropriate**

### A. Effect of the Proposed U.S. BD Capital Requirements

In varying but similar ways, each of the commenters claim that the Proposed U.S. BD Capital Requirements are discriminatory, anticompetitive, disproportionate, and/or burdensome against “smaller” BD Members.<sup>26</sup> NSCC believes that those categorizations are inaccurate or overstated.

First, the Proposed U.S. BD Capital Requirements are not the only minimum capital requirements proposed. In developing this proposal, NSCC undertook a comprehensive review of its membership standards as they apply to all membership types. As described in detail in the Filing, NSCC proposes extensive changes to the minimum capital requirements for almost all members, including U.S. banks and trust companies, non-U.S. BDs and banks, U.S. and non-U.S. exchanges, Index Receipt Agents, Mutual Fund/Insurance Services Members, and Fund Members or Settling Bank Only Members that are a U.S. bank or trust company.<sup>27</sup>

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<sup>20</sup> 17 CFR 240.17Ad-22(e).

<sup>21</sup> See Alpine Letter, supra note 1, at 1-2, 8-9; STANY Letter, supra note 1, at 5; WD Letter, supra note 1, at 4-5, 9; Zakhary Letter, supra note 1, at 2; and Monson Letter, supra note 1, at 2.

<sup>22</sup> See Alpine Letter, supra note 1, at 1-2, 8-9; STANY Letter, supra note 1, at 5; WD Letter, supra note 1, at 4-5, 9; Zakhary Letter, supra note 1, at 2; and Monson Letter, supra note 1, at 2.

<sup>23</sup> See, e.g., Industry Roadmap to Achieving T1 in 2024, <https://www.dtcc.com/dtcc-connection/articles/2021/december/01/industry-roadmap-to-achieving-t1-in-2024> (last visited March 9, 2022).

<sup>24</sup> SEC Issues Proposal to Reduce Risks in Clearance and Settlement, <https://www.sec.gov/news/press-release/2022-21> (last visited March 9, 2022).

<sup>25</sup> See, e.g., Advancing Together: Leading the Industry to Accelerated Settlement, <https://www.dtcc.com/-/media/Files/PDFs/White%20Paper/DTCC-Accelerated-Settle-WP-2021.pdf> (last visited March 9, 2022).

<sup>26</sup> See, e.g., Lek Letter I, supra note 1, at 1; Lek Letter II, supra note 1, at 2; Alpine Letter, supra note 1, at 1, 3-5, 8, 9; STANY Letter, supra note 1, at 2-5; Kevin Comment, supra note 1; WD Letter, supra note 1, at 1, 2, 5, 8, 9; Zakhary Letter, supra note 1, at 1-3; and Monson Letter, supra note 1, at 1-2.

<sup>27</sup> See Notice, supra note 2, at 16-30.

Therefore, a claim that the Filing is discriminatory toward U.S. BD Members is inaccurate, as the proposed minimum capital requirements are quite broad and in no way focus solely on U.S. BD Members.

Second, the Proposed U.S. BD Capital Requirements were born from multiple iterations, including Member feedback, over many years. For example, and as explained in the Filing, a 2013 iteration, which was never filed with the Commission, contemplated much higher, fixed minimum requirements, which some Members at the time claimed were too high, rigid, and burdensome.<sup>28</sup> In contrast, the Proposed U.S. BD Capital Requirements are lower and more dynamic due to a tiering system that considers the risk presented by the Member's activity, as determined by NSCC's VaR model and associated charges.<sup>29</sup> As a result, NSCC's analysis, which was filed with the Commission as a confidential Exhibit 3 to the Filing, shows that only a few U.S. BD Members currently fall short of the proposed requirement that would be applicable to them and, therefore, the proposal would not prove to be overly burdensome for such Members. To provide time for those few Members to come into compliance, the Proposed U.S. BD Capital Requirements, along with the other proposed capital requirements, would not become effective until one year after the Commission's approval of the Filing.<sup>30</sup> Therefore, a claim that the Proposed U.S. BD Capital Requirements are disproportionate or unduly burdensome for "smaller" BDs, such that the requirements would jeopardize an entire segment of the BD industry, is overstated.

Third, the Proposed U.S. BD Capital Requirements are agnostic as to the size of the applicable Member. The requirements would apply equally to all U.S. BD Members, regardless of size. As described above and in the Filing, the Proposed U.S. BD Capital Requirements would consider the risk exposure that the U.S. BD Member's activity presents to NSCC as part of the proposed tiering structure.<sup>31</sup> As such, U.S. BD Members that present similar activity to NSCC would have the same minimum capital requirements. Therefore, a claim that the Proposed U.S. BD Capital Requirements are discriminatory, anticompetitive, or disproportionate for "smaller" BDs is inaccurate.

#### B. Agency Trading v. Proprietary Trading

Two commenters claim that the Proposed U.S. BD Capital Requirements fail to distinguish between "agency firms," which trade on behalf of customers, and proprietary trading firms ("prop firms"), which trade for their own account, in that agency firms present less risk to NSCC than prop firms.<sup>32</sup> Although NSCC understands the general claim raised, there are many more factors to consider (e.g., types of trades being made, types of customers, available capital of the customer or firm, etc.) when identifying, determining and managing the risks presented to NSCC by its members. Credit risks are not driven simply by whether a firm is or is not an agency or prop firm. Matter of fact, members could be engaged in both prop trading and customer trading, and there is not an efficient way for NSCC to determine which trades are which. Moreover, NSCC cannot assume that customers of an agency firm, which are likely not members of NSCC, do not present their

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<sup>28</sup> See id. at 6.

<sup>29</sup> See id. at 17-22.

<sup>30</sup> See Notice, supra note 2, at 36. NSCC also notes that, while not at all the desired outcome or intent of this proposal and one that NSCC has worked to avoid by incorporating the tiered structure, in the unfortunate situation that an existing BD Member was unable to meet the new capital requirements and had to retire its membership, its activity still could be submitted to NSCC if it is able to establish a clearing relationship with a remaining member. That is, a BD need not be a Member in order to submit its transactions to NSCC for clearance and settlement. Alternatively, clients of the retired BD could choose to establish a relationship at another BD that does have an NSCC membership in order to have its activity submitted to NSCC for clearance and settlement. Ultimately, those would be business decisions of the retired BD and the client.

<sup>31</sup> See Notice, supra note 2, at 17-22.

<sup>32</sup> See Lek Letter II, supra note 1, at 1; and STANY Letter, supra note 1, at 3.

own risks to the agency firm. Therefore, such a factor cannot be a viable input in setting capital requirements for U.S. BD Members.

### C. Exchange Membership

Two commenters claim that the proposed minimum capital requirements for exchanges that are Members will discourage other exchanges from joining NSCC as Members.<sup>33</sup> First, NSCC membership is not required for an exchange to submit trades of other NSCC members to NSCC. Second, only a few exchanges are actual Members of NSCC. Those exchanges joined as Members many years ago to address a legacy NSCC processing structure that is no longer applicable. As such, NSCC does not expect any other exchanges to seek membership. However, to address the credit risks, as described above, presented by those few exchanges that are Members, NSCC is proposing a minimum capital requirement.

### D. Standard of Review

Three commenters claim in varying but similar ways that the Proposed U.S. BD Capital Requirements do not meet the applicable statutory provisions necessary for the Commission to approve the Filing.<sup>34</sup> Those commenters highlight in whole or in part<sup>35</sup> that NSCC's rules must be designed to (i) remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions,<sup>36</sup> (ii) protect investors and the public interest,<sup>37</sup> (iii) not permit unfair discrimination in the admission or participants or among participants in the use of the clearing agency,<sup>38</sup> and (iv) not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>39</sup>

NSCC believes that the Proposed U.S. BD Capital Requirements meet each of the requirements stated above. A U.S. BD Member that is unable to meet certain minimum capital requirements increases the risk the Member will be unable to meet its margin or end of day settlement obligations, which could impede the prompt and accurate clearance and settlement of securities. Requiring U.S. BD Members to maintain a certain minimum amount of capital does protect investors and is in the public interest because it helps ensure that those Members are able to meet their obligations to NSCC, a systemically important financial market utility,<sup>40</sup> notwithstanding the Member encountering an external issue, such as a legal, operational, or cyber event. As described above, the Proposed U.S. BD Capital Requirements are not discriminatory or anticompetitive, as they would be applied equally to all U.S. BD Members, irrespective of the Members size but in consideration of the activity and potential risk that the Member submits to NSCC.

The commenters also claim that the Commission must “determine” whether the Filing will promote efficiency, competition, and capital formation.<sup>41</sup> That is not the correct standard. Pursuant to Section 3(f) of the

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<sup>33</sup> Lek Letter I, supra note 1, at 1; and STANY Letter, supra note 1, at 2.

<sup>34</sup> Alpine Letter, supra note 1, at 5; WD Letter, supra note 1, at 1-2, 6-9; and Zakhary Letter, supra note 1, at 2.

<sup>35</sup> Alpine Letter, supra note 1, at 5; WD Letter, supra note 1, at 2, 6-8; and Zakhary Letter, supra note 1, at 2.

<sup>36</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>37</sup> Id.

<sup>38</sup> Id.

<sup>39</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>40</sup> U.S. Department of the Treasury, Designations, Financial Market Utility Designations, available at <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations>.

<sup>41</sup> Alpine Letter, supra note 1, at 5; WD Letter, supra note 1, at 2, 8; and Zakhary Letter, supra note 1, at 2.

Exchange Act,<sup>42</sup> when the Commission is reviewing a rule of a self-regulatory organization, such as NSCC, and in doing so is required to consider or determine whether an action is necessary or appropriate in the public interest, which is arguably the case here, then the Commission also must “consider” (not “determine”) whether the action will promote efficiency, competition, and capital formation. In any event, NSCC believes the Filing meets the standard because systemically important financial market utilities, such as NSCC,<sup>43</sup> need sound risk management standards and practices to help ensure their continued function during market disruptions, thereby promoting efficiency, competition, and capital formation within the financial markets.

### **III. Conclusion**

Again, NSCC appreciates the opportunity to respond to the comment letters received on the Filing. NSCC does not take the comments lightly. At no time does NSCC wish for any existing member to end its membership or for any potential applicant not to apply for membership because of an NSCC requirement. NSCC works to operate reasonably and fairly for all members and the industry more broadly. NSCC believes it has done so with each of the proposed changes detailed in the Filing, including the Proposed U.S. BD Capital Requirements. Notwithstanding the claims raised by the commenters, NSCC believes that the Proposed U.S. BD Capital Requirements are necessary and appropriate in furtherance of the Exchange Act, as permitted by Section 17A(b)(3)(I) thereunder,<sup>44</sup> and that the statutory obligations applicable to the Filing have been met, as described above and in the Filing itself.

Respectfully submitted,

/s/ Michael Leibrock  
Managing Director

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<sup>42</sup> 15 U.S.C. 78c(f).

<sup>43</sup> U.S. Department of the Treasury, Designations, supra note 40.

<sup>44</sup> 15 U.S.C. 78q-1(b)(3)(I).