Brent R. Baker
Aaron D. Lebenta
**CLYDE SNOW & SESSIONS**
201 South Main Street, Suite 1300
Salt Lake City, Utah 84111
Phone: (801) 322-2516
Fax: (801) 521-6280
brb@clydesnow.com
adl@clydesnow.com
*Attorneys for Petitioner*

Maranda E. Fritz
**THOMPSON HINE**
335 Madison Avenue, 12th Floor
New York, New York 10017-4611
Phone: (212) 344-5680
Fax: (212) 344-6101
Maranda.Fritz@thompsonhine.com



**UNITED STATES OF AMERICA**

**SECURITIES AND EXCHANGE COMMISSION**

| | |
|---|---|
| In the Matter of the Application of<br><br>ALPINE SECURITIES CORPORATION, a Utah limited liability company<br><br>For Review of Adverse Action Taken By<br><br>NATIONAL SECURITIES CLEARING CORPORATION | **APPLICATION FOR REVIEW**<br><br>3-18979<br><br>**Oral Argument Requested** |

To: The Office of the Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

**PLEASE TAKE NOTICE** that Alpine Securities Corporation ("**Alpine**") hereby applies for review, pursuant to Section 19(d) and (f) of Securities Exchange Act of 1934 (the "Exchange Act"), of certain "Required Deposit" charges imposed by the National Securities Clearing Corporation ("NSCC"), a registered clearing agency, which are onerous, discriminatory and otherwise inconsistent with the requirements of the Exchange Act, and which result in a denial or limitation of Alpine's access to services at NSCC, as set forth below.[1]

[1] These components include: (1) NSCC's imposition of "Illiquid Charges," including its decision to eliminate the Depository Trust Company ("DTC") inventory offset for members that NSCC claims have weak credit ratings; (2) NSCC's implementation of a secret "Credit Risk Matrix" or "CRRM Rating," which NSCC uses to determine whether to impose an Illiquid Charge, including whether the member qualifies for a DTC inventory offset; (3) NSCC's imposition of "Excess Net Capital Premium" ("ENCP"); (4) NSCC's calculation of the volatility charge for OTC and microcap stocks ("OTC Volatility Charge"), particularly as applied to sub-penny stocks; (5) OTC's calculation of mark-to-market charge for sub-penny microcap and OTC stocks ("OTC Mark-to-Market Charge"). These components are set forth in NSCC's Rules and Procedures, at Rules 1 (defining Illiquid Charge and CRRM).

## APPLICATION FOR REVIEW

Alpine is a small, registered self-clearing broker-dealer, engaged primarily in clearing microcap and over the counter ("OTC") stock transactions for other firms. Alpine is a member in good standing of NSCC. As a member, Alpine is entitled to access NSCC's central-counterparty clearing and settlement services, for which the NSCC requires Alpine to contribute to a Clearing Fund on an ongoing basis in the form of a "Required Deposit."[2]

The challenged components of the Required Deposit, particularly as applied in the aggregate, result in arbitrary, onerous and unreasonable charges that impermissibly limit Alpine's access to NSCC's services, unnecessarily stifle competition, and unfairly discriminate against small broker-dealers in the OTC or microcap market in violation of the Exchange Act. [3]

First, there is an "actual limitation of access" to "fundamentally important services offered by the SRO." [4] As detailed in the Declaration of David Brant, and Alpine's concurrently filed Petition for Rulemaking, Exs. A and B hereto, NSCC's calculation and application of the specified Required Deposit components to Alpine substantially limits Alpine's access to NSCC's essential clearing and settlement services. Alpine primarily clears liquidation (or sale-side) microcap or OTC stock transactions, including, frequently, stocks with a price less than $.01/share. To clear such trades, NSCC imposes the Required Deposit, including the challenged components, as "margin."[5] These "margin" charges, taken individually or collectively, are astronomical, exceeding the market value of the underlying transaction by many times, and are particularly egregious when a sub-penny stock is involved.[6] The challenged components of the Required Deposit are so onerous they often required Alpine to turn down transactions due to

---

*and* 4 (discussing Required Deposit), and Procedure XV, at §§ 1(A)(1)(a)(ii) (volatility/haircut), (b) *and* (c) (mark-to-market), (h) (Illiquid Charge), and 1(B)(2) (ENCP).

[2] NSCC Rules and Procedures, at Rule 2, §§ 1 and 2(i), Rule 4 and Procedure XV.

[3] In light of the two-page limitation on this Petition for Review in Rule of Practice 420(c), Alpine incorporates its Petition for Rulemaking herein by reference and attaches it as Ex. B, and requests an opportunity to provide further briefing and evidence, as well as oral argument, to aid the Commission in its consideration of these issues.

[4] *See In re Application of Securities Industry and Financial Markets Association for Review of Action by Self Regulatory Organizations ("In re SIFMA"),* SEC Release No. 72182, 2014 WL 1998525, at *8-9 (May 16, 2014).

[5] NSCC Rules & Procedures at Rule 2A, § 1(F), Rule 4, §§ 1, 8.

[6] *See* Brant Decl., ¶¶ 19, 22, and 38 for examples of charges and Rulemaking Petition, at pp. 8-25, for full discussion of the challenged components and their impacts on Alpine.

regulatory capital constraints,[7] even though Alpine's runs its operations in a manner that should allow it to avoid at least the Illiquid Charge.[8] As a direct result of these charges, Alpine's liquidation business is down approximately 75%. *See* Brant Decl., at ¶¶ 33, 40.

Second, NSCC's calculation and imposition of the Required Deposit violates the Exchange Act in a number of ways, discussed at length at pages 19-28 of Alpine's attached Rulemaking Petition.[9] In summary, the CRRM and the charges at issue, and the rules on which they are based: (a) are arbitrary and unsupported by any adequate rationale; (b) result in charges that are onerous and facially unreasonable in relation to the value of the underlying transaction; and (c) impose an unnecessary discriminatory and anticompetitive burden by targeting smaller NSCC members in the OTC and microcap markets.[10]

Alpine is adversely impacted by the rules, and the charges imposed by application of the rules, on a continuous and ongoing basis, and is seeking review and prospective relief within 30 days of receiving the NSCC's Notices of Daily Margin Statement for transactions at issue.[11]

---

[7] Brant Dec., at ¶¶ 31-37 and Alpine's Rulemaking Petition for detailed discussion of the damage from the charges.

[8] As discussed in Alpine's Rulemaking Petition, at pp. 11-12, NSCC imposes the Illiquid Charge on transactions involving OTC or microcap stocks that exceed volume thresholds based on a firm's CRRM rating, which NSCC sets from an undisclosed formula. In determining whether the volume threshold is met, NSCC generally offsets the quantity of shares in the member's sell position against the number of those shares held by the member at DTC (the DTC offset); if the DTC offset places the member below the applicable volume threshold, no Illiquid Charge will be assessed. Alpine almost always has sufficient shares at DTC to avoid the Illiquid Charge completely. Brant Decl., at ¶ 13. However, without providing any rationale, NSCC has determined to make the DTC offset unavailable to members with the weakest CRRM rating, such as Alpine.

[9] Specifically, as detailed in Alpine's Rulemaking Petition, at 19-28, the challenged components violate Section 17A, 15 U.S.C. § 78q-1(b)(3)(D), (F) and (I), *and* (b)(6); Section 19(f), 15 U.S.C. § 78s(f); 17 C.F.R. § 17Ad-22(e)(1), (23) (requiring transparency); *id.* at (e)(4), (6) and (7) (requiring NSCC's margin systems and procedures be "reasonably designed," and produce margin levels "commensurate with" the risk), and the APA, 5 U.S.C. 552.

[10] *In re SIFMA,* at *9 (stating, "the applicant must assert a basis that, if established, would lead the Commission to conclude that the fees violate Exchange Act Section 19(f)," and holding that allegations that SRO fees were "onerous" and "supracompetitive" and violated the Exchange Act sufficient for Commission review).

[11] Brant Decl., at ¶¶ 19, 22, 38 (describing recent charges). *See* 15 U.S.C. § 78s(d)(2) (requiring a petition for review to be filed "within thirty days *after the date such notice was filed* [by the NSCC] with such appropriate regulatory agency and received by such aggrieved person . . . ." (emphasis added)); 17 C.F.R. § 201.420(b) (same). Additionally, it is well-established that statutory timelines "do not foreclose subsequent examination of a rule" brought for review of "further . . . action applying it," because rules "are capable of continuing application." *N.L.R.B. Union v. F.L.R.A.,,* 834 F.3d 191, 196 (D.C. Cir. 1987) (citation omitted); *see also Weaver v. Fed. Motor Carrier Safety Admin.*, 744 F.3d 142, 145–46 (D.C. Cir. 2014) (same). Further, even assuming *arguendo* that the original 30-day period to seek review ran from the date of entry of the Orders approving the NSCC rules at issue, extraordinary circumstances exist under Rule 420 of the Commission's rules of practice to extent this period because this Petition involves novel legal factual and legal issues, and because Alpine could not discern the impact of the rules, and whether they would result in a denial or limitation of Alpine's access to NSCC's services, until after NSCC's imposition of the components at issue caused the actual limitation of access that spurred this Petition.

DATED this 19th day of December, 2018.

**CLYDE SNOW & SESSIONS**

Brent R. Baker
Aaron D. Lebenta

**THOMPSON HINE**

Maranda E. Fritz

*Counsel for Petitioner*

## CERTIFICATE OF SERVICE

I hereby certify that on the 19th day of December, 2018, I caused the foregoing to be served by U.S. Mail Certified, Return Receipt Requested, on the following:

The Office of the Secretary
Attn: Brent J. Fields, Director
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Office of Deputy General Counsel
Attn: Nikki Poulos
National Securities Clearing Corporation
55 Water Street
New York, NY 10041

Brent R. Baker
*Counsel for Alpine Securities Corporation*

# EXHIBIT A

## DECLARATION OF DAVID BRANT

I, David Brant, pursuant to 28 U.S.C. § 1746, declare under penalty of perjury under the laws of the United States of America that the following statements are true and correct:

1. My name is David Brant and I am a resident of Salt Lake County, Utah, am over 18 years of age, and make the statements herein based on my personal knowledge.

2. I am the Chief Financial Officer at Alpine Securities Corporation ("Alpine") in Salt Lake City, Utah.

3. Alpine is a small, self-clearing broker-dealer, registered with the Securities and Exchange Commission ("SEC"). Alpine's business primarily involves clearing and settlement services for microcap and over-the-counter ("OTC") stock transactions for itself and for other brokerage firms.

4. I am familiar with Alpine's Application for Review and Rulemaking Petition with respect to certain actions, practices and rules of the National Securities Clearing Corporation ("NSCC") and submit this Declaration in support of that Petition.

5. A clearing broker, such as Alpine, provides clearing and settlement services for itself and for its correspondent clients ("correspondents" or "clients"), who are generally broker-dealers, and its clients' non-broker-dealer customers ("customers"), who are the beneficial buyers and sellers of a security.

6. In order for Alpine to provide clearing and settlement services and function as a clearing firm for its correspondent firms, Alpine must be a member of NSCC. Alpine is a clearing broker member in good standing of the NSCC and a Depository Trust Company ("DTC") participant.

7. As an ongoing condition to membership, and thus use of NSCC's clearance,

settlement and other essential services for Alpine and its customers, NSCC requires members, including Alpine, to contribute to a "Clearing Fund," by making "Required Deposits."

8. The formula used to calculate the Required Deposit charges is very complex and includes many discretionary and fact-specific variables set forth in Procedure XV of the NSCC's Rules and Procedures.

9. As detailed below, certain components of NSCC's Required Deposit charges have resulted in extremely high and onerous charges that so far exceed the amount of the underlying transactions to be cleared and settled that they cannot be credibly justified, which has limited and denied Alpine's access to NSCC's essential clearance and settlement services and caused Alpine to lose a significant amount of its liquidation business.

10. While the Required Deposit has many separate components, the ones that are the most onerous, and impose the greatest hardship on Alpine and limitation of Alpine's access to NSCC's clearance and settlement services in connection with its liquidation or sale-side clearance and settlement of OTC and microcap market transaction for its correspondent brokers and other clients, are: (a) the "Illiquid Charge"; (b) the Excess Net Capital Premium ("ENCP"); (c) the Volatility Charge for microcap and OTC stock transactions (the "OTC Volatility Charge"), particularly as applied to sub-penny stock transactions; (d) the Mark-to-Market Charge as applied to sub-penny stock OTC or microcap stock transactions ("OTC Mark-to-Market Charge"); and (c) NSCC's Credit Risk Rating Matrix ("CRRM"), pursuant to which NSCC assigns to members ratings between 1 and 7, with a rating of "7" being the weakest. I have reviewed the description and discussion of these Required Deposit components in the Rulemaking Petition, and agree with and adopt them herein.

11. I note that the CRRM is not itself a charge imposed on members by the NSCC.

However, it is my understanding that it directly factors into the NSCC's calculation of the Illiquid Charge, and is thus a component of the Required Deposit. In particular, in calculating and determining the applicability of the Illiquid Charge to a particular transaction, it is my understanding that NSCC imposes different volume thresholds based upon a member's CRRM rating, with members with better CRRM ratings being able to larger net sell positions in the so-called "Illiquid Securities" than members with weaker CRRM ratings. Importantly for Alpine, in determining these volume thresholds, NSCC will first generally "offset" the quantity of shares in a member's sell position against the number of shares in the same security held by the member at DTC. NSCC calls this the "DTC Offset." Thus, if certain members have offsetting shares at DTC, they could fall below the applicable volume threshold after the offset and would not be subject to the Illiquid Charge. However, NSCC has taken the position that the DTC Offset is not available to members with the weakest CRRM Rating.

12. NSCC has assigned Alpine the weakest CRRM Rating – a "7," and thus does not allow Alpine to utilize the DTC Offset.

13. This is critically important, because Alpine, as a matter of policy and operations, requires that securities positions on a liquidation transaction be cleared and settled at DTC before entering liquidating trades on a regular way basis. As a result, Alpine almost always would be able to avoid the Illiquid Charge, if it were able to utilize the DTC Offset. I have not heard or located any explanation from NSCC or its representatives as to why NSCC determined to make the DTC Offset unavailable to certain members but not others.

14. Because Alpine's CRRM Rating is critical to the Required Deposit amounts it will have to post, particularly the Illiquid Charge, Alpine has attempted to understand how its CRRM rating is calculated. However, NSCC has not disclosed to the industry the basis for its

calculation of the CRRM rating.

15. According to the information available, the formula includes consideration of quantitative factors (size, i.e., total excess net capital; capital, leverage, liquidity and profitability) and qualitative factors (market position and sustainability, management quality, capital and liquidity management, geographic and business/product diversity, and access to funding). It is unclear what weight NSCC ascribes to each individual factor within the larger quantitative and qualitative categories to arrive at a CRRM rating for a member. The CRRM rating bears no relationship to a firm's actual credit rating or, apparently, whether the firm has ever defaulted on any obligation to NSCC.

16. Under current ownership that has been in place since 2011, for example, Alpine has not defaulted on its obligations to NSCC to my knowledge.

17. I have personally participated in several telephonic conferences with representatives of NSCC to discuss Alpine's CRRM rating, including how it is calculated and how it could be improved, and to request relief from the Required Deposit charges at issue from NSCC. In one such conversation occurring on or around September 6, 2018, a representative of NSCC told me that the CRRM rating is based on a mix of objective and subjective factors that NSCC assesses, but that NSCC will not disclose how each individual factor is weighed or assessed on the basis that such information is "proprietary." During this conversation, NSCC was also not receptive to Alpine's requests for waiver or other relief from the deleterious impacts of the Required Deposit charges at issue in the Rulemaking Petition and Petition for Review.

18. As a result of NSCC's implementation of the Required Deposit charges and components at issue, I believe that Alpine's and its correspondent customers' businesses have been unfairly targeted with excessive and arbitrary charges which are non-conducive to entering

into a trade and thus inhibit and discourage market access and participation.

19. By way of example, consider the following trades processed by Alpine for clearing through NSCC's CNS system.

a. The first trade involved a contract to sell 99,000 shares of PMCB on November 23, 2018, valued at $0.020, for a total proceeds amount of $2,008.32. To process this $2,008.32 trade for clearing through NSCC, however, ***Alpine was required to deposit $40,803.00,*** including:

i. Illiquid Charge: $34,956.60.

ii. OTC Volatility Charge: $5,846.40 (NSCC's rules indicate that the OTC Volatility Charge shall be, at NSCC's discretion, a haircut of not less than 10% of the position. Here, however, the Volatility Charge was 100% of the transaction amount. Although I am not certain of NSCC's precise method of calculation, because a sub-penny stock was involved, I believe that NSCC imposed a fictional $.01/share price to calculate the Volatility Charge.

iii. OTC Mark-to-Market Charge: $116,179.78 (although this charge can either be a debit or credit based on the closing price of the security pending settlement, in this case NSCC appears to have used the fictional $.01/share price so it created a mark-to-market-loss charge).

b. The second trade involved a contract to sell another 99,000 shares of PMCB on November 26, 2018, valued at $0.020, for the same total proceeds amount of $2,008.32. To process this $2,008.32 trade for clearing through NSCC, however, ***Alpine was required to deposit $887,372.84,*** including:

i. Illiquid Charge: $868,800.00.

ii. OTC Volatility Charge: $17,376.00.

iii. OTC Mark-to-Market Charge: $1,196.84.

20. Although the entire exposure associated with the above trades totaled $4,016.64, NSCC's methodology resulted in Alpine being required to deposit a total of $928,175.84 to access NSCC's (CNS) clearance and settlement services. These two trades resulted in an NSCC deposit trade proceeds multiple of 231.08 (that is, 231 times the value of the underlying trade). The OTC Volatility Chare and Illiquid Charge exceeded the value of the transaction by several multiples.

21. Even under NSCC's methodology, the Illiquid Charge would have been minimal or non-existent on this sample transaction except, as indicated above, NSCC does not permit Alpine to avail itself of the DTC Offset based on Alpine's CRRM rating.

22. Below are additional recent trades from Alpine's customers wherein the Required Deposit charges are similarly arbitrary and grossly and unfairly disproportionate to the value of the transaction:

a. Client: Power Up; trade date: 11/29/2018 and 11/30/2018; Symbol: TSOI; Description: Therap Sol

i. 4,347,826 total shares traded over the two days (3,085,100 on 11/29/2018 and 1,262,726 on 11/30/2018), valued at $0.003, resulting in a total trade value of $12,710.64 with a total illiquid charge of $262,118.21, total volatility charge of $14,865.85, total Mark-to-Market charge of $51,192.51, and an NSCC deposit trade proceeds multiple of 25.82.

b. Client: La Jolla; trade date: 11/29/2018; Symbol: VGID; Description: V Group Inc.

i. 1,800,000 shares valued at $0.00033, resulting in a trade value of $587.20, with an illiquid charge of $18,000.00, volatility charge of $3,600.00, Mark-to-Market charge of $17,280.00, and an NSCC deposit trade proceeds multiple of 66.21.

c. Client: Silver Rock; trade date: 11/19/2018 and 11/20/2018; Symbol: PMCB; Description: Pharmacyte .

i. 942,319 total shares traded over the two days (400,000 on 11/19/2018 and 542,319 on 11/20/2018), valued at $0.045, resulting in a total trade value of $42,138.09 with a total illiquid charge of $68,439.11, total volatility charge of $11,604.73, total Mark-to-Market charge of $317.68, and an NSCC deposit trade proceeds multiple of 1.91.

23. If Alpine were able to utilize the DTC Offset, it would have avoided the large applicable Illiquid Charges, on these transactions as well.

24. Alpine receives Notices of Daily Margin Statements from NSCC imposing similar charges each business day. The daily cumulative Illiquid Charges alone generally range from $500,000 to $1.5 million on transactions that are a fraction of that amount. Upon request, I can provide many more examples of similarly onerous and disproportionate Require Deposit charges.

25. When a transaction involves stocks that are below $.01/share, it is my understanding that NSCC generally does not use the actual stock price in calculating the Illiquid Charge, Volatility Charge and Mark-to-Market. Instead, it is my understanding that NSCC

commonly uses a fictional "minimum" price per share of $.01 in its calculations of these components. It is my belief that use of a "rounded up" share value instead of the actual share value results in Required Deposit charges that are grossly disproportionate to the transaction value. By simple illustration, changing a share value from $.001 to $.01 in a formula results in a tenfold increase in the resultant product. Similarly, it almost invariably ensures that there will be a Mark-to-Market charge, instead of a credit, because the current market price will be artificially increased in comparison to the transaction amount. Although it is not completely clear for all the occasions that NSCC's uses a fictional share price in the calculating the Illiquid Charge, OTC Volatility or Mark-to-Market to Alpine, and appears to be inconsistent, I believe that this practice explains some of the more disproportionate charges. Based on my review of NSCC's rules and Procedure XV, I do not see any authorization for NSCC to use a fictional price per share in calculating the OTC Volatility Charges or Mark-to-Market.

26. I also note that NSCC indicates that it has discretion to impose a different formula for calculating Volatility for OTC and microcap stocks (sub-penny stocks are not mentioned) than for shares traded on registered exchanges or which exceed $5/share. NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(a)(ii). NSCC indicates that to calculate the OTC Volatility Charge it will impose a "haircut" based on the multiple of the absolute value of such positions and a percentage that NSCC designates that shall not be less than 10%. From these descriptions, I would expect the OTC Volatility Charge to be a fraction of the underlying transaction – i.e., a "haircut." However, as indicated above, in actual practice NSCC's OTC Volatility Charge to Alpine, particularly when sub-penny stocks are involved, is frequently equal to or in excess of the actual value of the transaction, sometimes by many orders of magnitude. This, particularly when combined with the Illiquid Charge and OTC Mark-to-Market Charge, has a devastating

impact on Alpine's available regulatory capital and access to NSCC's CNS system for customer transactions, and thus, Alpine's business, as explained further below.

27. Alpine did not incur an "Excess Net Capital Premium" or "ENCP" charge with respect to the sample transactions above. In fact, Alpine rarely incurs that charge. However, this is for a very specific reason: Alpine has been forced to limit its business – to turn down customer transactions – in order to avoid paying this onerous charge.

28. Given that the trades Alpine processes have a relatively low dollar-value, Alpine should have sufficient net capital for Alpine to provide clearing services for all of its correspondents' potential liquidation transactions. Alpine currently has excess net capital of approximately $2.8 million. Prior to November of 2018, its excess net capital was $1.1 million.

29. However, because the Required Deposit charges are added to the absolute value of the transaction, and require a deposit of funds significantly higher than the underlying transaction amount (particularly when a sub-penny stock is involved), Alpine is forced to artificially limit the number of transactions it can clear for its customers per day, including to avoid the ENCP charge.

30. Alpine also believes, based on discussions with NSCC in which I have participated, that NSCC would take a negative view of a member that was continuously required to post ENCP charges, and that doing so may result in adverse action against Alpine such as a downgrade in CRRM rating, or other more adverse actions.

31. Alpine makes a relatively small amount of money per transaction it processes, particularly in comparison to the Required Deposit amounts. Given this, Alpine neither has the ability nor the motive to post the potentially astronomical ENCP charges and potentially incur further adverse consequences from NSCC. To operate its business, of course, Alpine has no

choice but to post the Illiquid Charge, OTC Volatility Charge and OTC Mark-to-Market Charges, where applicable. But, as indicated and discussed further below, Alpine is forced to limit its business as a result because it simply does not have all of the available regulatory capital necessary to fund the Required Deposit for all of its transactions brought to it by its customers.

32. Alpine has attempted to employ creative solutions to avoid the deleterious impact of these Required Deposit charges. For example, for a time, Alpine was able to use ex-clearing contra-party clearing partnerships to perform clearance and settlement service manually and thereby avoid clearing trades through NSCC's CNS system altogether. However, once the last of those ex-clearing partnerships expired at the end of April 2018, Alpine was forced to again utilize NSCC's CNS system to clear transactions, and to post the Illiquid Charge and the other onerous components at issue of the Required Deposit.

33. The cumulative impact of these margin requirements creates a self-propelling downward cycle. Alpine must devote additional capital to post the Required Deposit each day in order to process trades through NSCC's CNS system when sub-penny stocks are involved. Because of this, Alpine must limit the volume of trades it can process per day, both due to capital constraints necessary to post the Required Deposit and to avoid ENCP charges. This, in turn, limits Alpine's ability to raise additional capital through its clearing business, and effectively pull out of the cycle. As a direct result, as would be expected, Alpine's liquidation business is down almost 75% s due to the artificial restraints on the number of liquidation transactions it can clear through NSCC per day (due to the Required Deposit) and attrition of customers who leave or go out of business because they cannot clear their transactions through Alpine.

34. Further, it is my understanding that the number of NSCC members who are independent or small clearing brokers providing clearing services for firms and investors holding

microcap or OTC stocks is down significantly, as a result of the Required Deposit charges targeted at the microcap and OTC markets. I am aware of only a few firms that currently provide clearing services for OTC microcap stocks.

35. The impact is not felt by Alpine alone; I believe it affects all participants in the OTC and microcap market – from brokers to issuers to investors. To my knowledge, very few small clearing firms exist today that serve the OTC and microcap securities market, which are most adversely affected by the Required Deposit charges at issue. Indeed, the Illiquid Charges, and the use of the fictional $.01 price-per-share to exponentially increase the Illiquid Charge and OTC Volatility and OTC Mark-to-Market Charges, appear to be intentionally targeted at the OTC and microcap securities markets. Although larger NSCC members – banks, Wall Street firms and online discount firms – likely have sufficient net capital to avoid the ENCP charges or illiquid charges (including through use of the DTC Offset), to my knowledge, very few of these firms are willing to work with OTC stocks and microcap stock, let alone accept certificates or newly issued securities for microcap issuers, leaving but a handful of firms that operate in this space. To my knowledge, in addition to Alpine, the list of firms that operate in this space includes Wilson Davis Securities, Lek Securities, and Wedbush Securities. I am not aware of any other firms providing clearing services for OTC microcap stocks.

36. As a direct result of the Required Deposit charges, it is my understanding that the small firms that do serve this segment of the market, such as Alpine, must also charge additional fees to try to offset the immense burden of devoting capital to post the challenged components of the Required Deposit, which cumulatively reduces the value of the trade for all involved.

37. Given the disproportionately high amount of the Required Deposit in comparison to the underlying value of the trade, many of Alpine's correspondent broker clients (or their

customers – the underlying buyers or sellers – to whom the correspondent brokers pass the fees) are often unwilling or unable to pay the additional amounts to sell the shares, leaving the shares effectively untradeable, and worthless.

38. Below are recent proposed trade transactions that Alpine could not complete, either due to capital constraints associated with the Required Deposit or because the customers decided to not trade due to the Required Deposit, and the resultant processing fees (below are the estimates of Alpine's calculation of the Required Deposit fees):

a. Client: Betty Cam; trade date: 11/20/2018; Symbol: COBI

   i. 1,000,000 shares valued at $0.0005 would result in a trade value of $500.00 with an illiquid charge of $2,000.00, volatility charge of $9,500.00, Mark-to-Market charge of $95,000.00, and an NSCC deposit trade proceeds multiple of 213.

b. Client: Black Ridge; trade date: 11/23/2018; Symbol: TGRO

   i. 100,000 shares valued at $0.0052 would result in a trade value of $520.00 with an illiquid charge of $34,100.00, volatility charge of $2,200.00, Mark-to-Market charge of $7,590.00, and an NSCC deposit trade proceeds multiple of 84.

c. Client: EMA; trade date: 11/21/2018; Symbol: ZNGY

   i. 4,900,000 shares valued at $0.0003 would result in a trade value of $1,470.00 with a volatility charge of $8,000.00, Mark-to-Market charge of $38,800.00, and an NSCC deposit trade proceeds multiple of 32.

d. Client: EMA; trade date: 11/21/2018; Symbol: BGFT

i. 3,000,000 shares valued at $0.0004 would result in a trade value of $1,200.00 with a volatility charge of $4,000.00, Mark-to-Market charge of $19,200.00, and an NSCC deposit trade proceeds multiple of 19.

e. Client: EMA; trade date: 11/23/2018; Symbol: VYST

i. 1,000,000 shares valued at $0.0030 would result in a trade value of $3,000.00 with an illiquid charge of $8,000.00, volatility charge of $1,600.00, Mark-to-Market charge of $5,600.00, and an NSCC deposit trade proceeds multiple of 5.

39. Upon request, I can provide additional examples of similar transactions Alpinc was unable to process due to the Required Deposit.

40. As indicated, Alpine's liquidation business is down approximately 75% as a result as a direct result of the Required Deposit charges targeted at the microcap and OTC market segment. Almost every one of Alpine's large customers is now bringing in significantly less business as a result of fall out due to the Required Deposit charges at issue. To illustrate this, Alpine's revenue from commissions in November 2017 was $555,647. By comparison, Alpine's revenue from commissions in November 2018 was $122,901. As discussed above, Alpine was able to use its use ex-clearing contra-party clearing partnerships to avoid clearing through NSCC, and thus avoid the Required Deposit, prior to April of 2018.

41. Alpine's business is thus being irreparably harmed due to the financial stress from the required deposit. If Alpine were even given relief from the Illiquid Charge or if Alpine were permitted to utilize the DTC Offset, including interim relief while its Petition for Rulemaking or Petition for Review were decided, it would allow Alpine to continue to operate.

42. It is also my belief, that the Required Deposit charges at issue also have a profound adverse effect on small companies whose stock trades in the OTC and microcap markets. Microcap companies depend on issuance of shares to obtain services and finance their growth. Alpine, and other small broker-dealers in this segment of the market, play a critical role in providing liquidity for securities of small companies. A substantial part of Alpine's customer base consists of institutional lenders to small companies and the key service providers/ professionals to small companies – i.e., lawyers, accountants, transfer agents, advisors, etc. Without firms willing and able to process these transactions, like Alpine, and without correspondent brokers or investors willing or able to pay increased transaction fees, professionals and investors will be unwilling to accept stock and these small companies will be cut-off from the capital markets to raise money to grow their businesses.

WHEREFORE, I declare under penalty of perjury that the foregoing is true and correct.

DATED this 19th day of December, 2018.

David Brant

# EXHIBIT B

ClydeSnow
ATTORNEYS AT LAW
CLYDE SNOW & SESSIONS
A PROFESSIONAL CORPORATION
ONE UTAH CENTER • THIRTEENTH FLOOR
201 SOUTH MAIN STREET, SUITE 1300
SALT LAKE CITY, UTAH 84111-2216
TEL 801.322.2516 • FAX 801.521.6280
www.clydesnow.com



***Via U.S. Mail Certified – Return Receipt Requested***

December 19, 2018

The Office of the Secretary
Attn: Brent J. Fields, Director
U.S. Securities and Exchange Commission
100 F. Street NE
Washington, D.C. 20549

**Re: Rulemaking Petition Regarding N.S.C.C.**

Dear Mr. Fields:

Pursuant to 5 U.S.C. § 553(e), Rule 192(a) of the SEC's Rules of Practice and Sections 17A(d) and 23(a) of the Securities Exchange Act ("Exchange Act"), 15 U.S.C. §§ 78q-1(d) and 78w(a), respectively, Petitioner Alpine Securities Corporation ("Alpine"), through undersigned counsel, submits the following Rulemaking Petition with respect to certain actions, practices and rules of the National Securities Clearing Corporation ("NSCC"). Those NSCC actions result in the imposition of excessive, onerous and discriminatory fees and charges in the use of NSCC's clearing services, effectively deny and limit access to Alpine and others, and contravene the requirements of the Exchange Act and the rules and regulations thereunder.

The specific NSCC actions, practices and rules at issue in this Petition include: (1) NSCC's imposition and calculation of "Illiquid Charges," including the decision to eliminate the Depository Trust Company ("DTC") inventory offset for members that NSCC determines have weak credit ratings; (2) NSCC's development and implementation of secret "Credit Risk Matrix" formula or "CRRM Rating," which NSCC uses to determine, *inter alia,* whether to impose an Illiquid Charge on a member for a particular transaction, including whether the member qualifies for a DTC inventory offset; (3) NSCC's imposition of "Excess Net Capital Premium" or "ENCP" Charges; (4) NSCC's calculation and imposition of the discretionary volatility charge for over the counter ("OTC") and microcap stocks (the "OTC Volatility Charge"), particularly as applied to sub-penny stock transactions; (5) OTC's implementation and calculation of the mark-to-market charge, (the "OTC Mark-to-Market Charge"), with respect to sub-penny stock transactions.

As described below, these rules, practices and actions, particularly when considered in combination, have a discriminatory, inequitable and anticompetitive impact on a specific segment of the market – the OTC and microcap markets – and on a specific type of NSCC participant – small broker-dealers, such as Alpine. Those discriminatory fees and charges have been imposed without any factual or analytical support for the view that they are reasonable, rational and appropriate. In this Rulemaking Petition, Alpine respectfully requests the SEC exercise its essential oversight function with respect to NSCC and consider rulemaking designed to ameliorate or eliminate the deleterious and unlawful effects of these NSCC's rules and practices, including by enacting rules that repeal the NSCC rules at issue and/or prevent NSCC from imposing these charges or utilizing the CRRM rating, as presently constituted.

## I. Background

### *NSCC*

Congress directed the SEC to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions when it added Section 17A to the Exchange Act as part of the Securities Act Amendments of 1975.[1] "The Commission's ability to achieve this goal and its supervision of securities clearance and settlement systems is based upon the regulation of registered clearing agencies."[2]

NSCC is a securities clearing agency registered with the Securities Exchange Commission under Section 17A(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q-(b). NSCC is a wholly owned subsidiary of the Depository Trust Clearing Corporation ("DTCC"), which also owns, *inter alia,* the Depository Trust Company ("DTC").[3]

NSCC provides centralized clearance and settlement services for its members,[4] and clears and settles nearly all broker-to-broker trades of equity securities in the United States.[5] The

---

[1] *See* 15 U.S.C. § 78q-1 and S. Rep. 94-75, 1975 U.S.C.C.A.N 179, at p. 4.

[2] *See* Clearing Agency Standards, SEC Release No. 34-68080, at 4 (October 22, 2012).

[3] The DTC is the central securities depository in the United States for equity securities. *See* Virginia B. Morris and Stuart Z. Goldstein, Guide to Clearance & Settlement: An Introduction to DTCC, p. 23 ("DTC, as a central securities depository, holds custody of 85% to 90% of all securities in the United States and services those assets for financial firms on behalf of investors.").

[4] Clearing and settlement is "a process, which, at the end of the day, ensures that sellers are paid for the securities they sold, and buyers receive the securities they bought." The Depository Trust & Clearing Corporation, Following a Trade: A Guide to DTCC's Pivotal Roles in How Securities Change Hands, p. 1. "In the clearance process, the clearing agency compares trades submitted by its broker-dealer 'members' or 'participants.' The clearing agency matches the submitted trades, and verifies that they will 'clear,' that is, the trades submitted by each side are consistent." "101 Key Terms You Need to Know About DTCC and Financial Market Infrastructures," The Depository Trust & Clearing Corporation, p. 3. In the process of "settlement," the seller delivers shares and receives payment, while the buyer sends payment and receives shares. *Id.* at p. 11.

[5] *See Pet Quarters, Inc. v. Depository Trust and Clearing Corp.,* 559 F.3d 772, 776-77 (8th Cir. 2009) (stating that "NSCC provides centralized clearance, settlement and information services for virtually all securities transactions in the United States.").

NSCC interposes itself as central counterparty to each trade and guarantees both ends of the settlement of a trade – *i.e.*, the delivery obligations of every seller, and the payment obligations of every buyer – in the event of a default of one of the original buyers or sellers.[6] The clearing systems requires integration between NSCC and DTC, such that NSCC's clearing firm members are DTC participants that hold securities in depository accounts at the DTC.[7] The actual settlement of trades takes place in the NSCC's Continuous Net Settlement ("CNS") System – an accounting and settling system for broker-dealer who are members of NSCC ("Clearing Members").[8]

DTCC's board is comprised of representatives affiliated with large banking and brokerage firms. For example, the Non-Executive Chairman and Chairman of the Board Executive Committee of DTCC spent nearly 16 years at Citi.[9] Other board members include representatives from UBS, Morgan Stanley, Bank of America, JPMorgan Chase Bank, and TD Ameritrade.[10] There is not a single representative from a small brokerage firm. Without question, such representative interests factor into the types of policy choices and rules passed by the NSCC.

***Alpine***

Alpine is a small, self-clearing broker-dealer, registered with the SEC. Alpine's business primarily involves clearing and settlement services for microcap and over-the-counter ("OTC")

---

[6] CNS Settlement as Delivery Versus Payment in DTC (CNS for Value), NSCC and DTC White Paper, September 2011.

[7] Because securities are held in street name and ownership records are held in electronic form, delivery in the settlement of a trade takes the form of a book entry movement of securities entitlements from one DTC participant's account to another. Delivery is precipitated when the DTC receives delivery instructions from NSCC, which is authorized to give such instructions for the delivering account. As NSCC is the central counterparty, shares are delivered from a DTC participant's account to NSCC's account or from NSCC's account to a DTC participant's account. The Depository Trust & Clearing Corporation, *Following a Trade: A Guide to DTCC's Pivotal Roles in How Securities Change Hands*, p. 4.

[8] When trades are processed through CNS, all the trades on a given security that are cleared through a particular Clearing Member and are due to settle on a given trade are batched together. That is, all buys and sells for the day are netted out against each other, resulting in a single settlement obligation per security for each Clearing Member. On any one day, the Clearing Member will either have a single obligation to deliver shares to, or a right to receive shares from, the NSCC. NSCC, Rules and Procedures, Rule 11. Because the delivery and receipt of shares is done on a net basis, no Clearing Member directly owes shares to any other Clearing Member. Rather the Clearing Members have a net delivery obligation to, or net receipt from, the NSCC as the central counterparty. If members do not deliver securities to NSCC on a trade's settlement date, unsettled, or "open," positions result: the buyer has an unsettled long ("fail to receive") position, and the seller has an unsettled short ("fail to deliver") position. Such open positions are "marked-to-market" daily, *i.e.*, NSCC credits or debits the money activity accounts it maintains for each participating member to reflect changes in the market price of the particular security until a trade is settled.

[9] *See* http://www.dtcc.com/about/leadership/board (listing biographies of board members).

[10] *Id.*

stock transactions for other brokerage firms.[11] Brokers who are not members of the registered clearing agency need the services of a clearing broker in order to clear and settle their own trades or the trades of their customers.[12] A clearing broker provides clearing and settlement services for its correspondent clients ("correspondents" or "clients"), who are generally broker-dealers, and its clients' non-broker-dealer customers ("customers"), who are the beneficial buyers and sellers of a security.

To provide clearing and settlement services and function as a clearing firm for its correspondent firms, Alpine must be a member of NSCC and have access its services.[13] Alpine is a clearing broker member in good standing of the NSCC and a DTC participant.[14]

***Overview of SEC Oversight Authority and Responsibility Over NSCC***

"The SEC is charged with supervising the exercise of th[e] self-regulatory power [by NSCC and other SROs] in order to assure that it is used effectively to fulfill the responsibilities assigned to the self-regulatory agencies, and that it is not used in a manner inimical to the public interest or unfair to private interests," and to "assur[e] that the self-regulatory organizations follow effective and fair procedures, that their activities are not anticompetitive and that the Commission's oversight powers are ample and its responsibility to correct self-regulatory lapses is unmistakable."[15]

The regulation of clearing agencies begins with Section 17A(b) of the Exchange Act and Exchange Act Rule 17Ab2-1, which require entities to register with the SEC prior to performing the functions of a clearing agency.[16] The SEC is not permitted to grant registration unless it

---

[11] *See* Declaration of David Brant, at ¶ 3 ("Brant Decl."), attached hereto as Ex. A. The designation "OTC stocks" generally refers to securities that do not meet the requirements for trading on a registered national exchange, such as the NASDAQ, or are OTC Bulletin Board or OTC link issues.

[12] "Most broker-dealers are not members of a clearing corporation or a depository. Only clearing firms, who can meet the membership requirements of substantial assets, liquidity, and capital, are permitted to be clearing agency participants. These clearing firms also must maintain a large back office of expert employees and state of the art information facilities, since most communications between a participant and a clearing agency are by electronic communication. In addition, substantial banking relationships are required for regular movement of money. Because of these infrastructure and capital requirements, the number of clearing agency participants is limited. Broker-dealers who are not clearing agency participants require access through a clearing firm." Paul B. Uhlenhop and Michael Wise (2014), Clearing Arrangements for Introducing Broker-Dealers, Practising Law Institute, Second edition, p. 25-7.

[13] Brant Decl., at ¶ 6.

[14] *Id.*

[15] S. Rep. No. 94-75, at p. 23.

[16] *See* 15 U.S.C. § 78q-1(b) and 17 C.F.R. § 240.17Ab2-1.

determines that the rules and operations of the clearing agency meet the standards set forth in Section 17A.[17]

Following registration, the SEC has continued responsibility to oversee the clearing agency to ensure and facilitate compliance with the Exchange Act.[18] For example, Section 17A(d) gives the SEC authority to adopt rules for clearing agencies as necessary and appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act, and prohibits a registered clearing agency from engaging in in any activity in contravention of these rules and regulations.[19] Registered clearing agencies, as self-regulatory agencies, are also subject to the provisions of Section 19 of the Exchange Act.[20] Pursuant to Section 19(g), registered clearing agencies must comply with the Exchange Act, the rules and regulations thereunder and the clearing agency's own rules.[21] Additionally, SRO rule changes, including those implemented by the NSCC, require SEC approval, contingent on its finding that any proposed rule change is consistent with the requirements of the Exchange Act before approving any such rule changes.[22] As part of its supervisory authority, the SEC also has the authority to abrogate, amend or delete an existing rule of an SRO, including the rules of the NSCC, as a registered clearing agency.[23]

---

[17] *See* Section 17A(b)(3), 15 U.S.C. § 78q-1(b)(3). These standards are discussed in detail, below.

[18] *See* SEC Release No. 34-68080 (Clearing Agency Standards) (October 22, 2012), at 4; *see also* S. Rep. No. 94-75, at p. 23.

[19] *See* 15 U.S.C. § 78q-1(d); *see also* S. Rep. 94-75 (indicating Section 17A(d) "would empower the Commission to review the rules of such clearing agencies . . . and to adopt all necessary or appropriate rules for their regulation."); *see also* SEC Release No. 34-68080, at 4-5 (describing SEC's authority).

[20] 15 U.S.C. §78s. A registered clearing agency, such as NSCC, is defined as a self-regulatory organization under the Exchange Act and is thus subject to Section 19. 15 U.S.C. § 78c(a)(26) ("The term 'self-regulatory organization' means any national securities exchange, registered securities association, or registered clearing agency...").

[21] 15 U.S.C. § 78s(g)(1).

[22] 15 U.S.C. § 78s(b).

[23] *See* 15 U.S.C. § 78q-1(d) (*supra*); *see also* 15 U.S.C. § 78w(a)(empowering Commission to "make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which [it] is responsible or for the execution of the functions vested in [it] by this chapter . . . ."); 15 U.S.C. § 78s(c)(4) ("Nothing in this subsection shall be construed to impair or limit the Commission's power to make, or to modify or alter the procedures the Commission may follow in making, rules and regulations pursuant to any other authority under this chapter."); *see also* S. Rep. No. 94-75, at 127 (stating, "nothing in the bill would interfere with the use of any authority the Commission may have under the Exchange Act or any other law to make rules concerning clearing agencies and transfer agents and to enforce compliance with such rules and the provisions of the Exchange Act by such clearing agencies and transfer agents."); *see also id.* at 31-32 ("In order to avoid any doubt as to the SEC's authority in areas where its direct authority overlaps its indirect authority, Section 19(c)(4) would make clear that where the Commission has direct authority, it would not be required to proceed under Section 19(c) or to follow procedures specified in that section. In such cases, the SEC could rely on its direct authority and follow the usual Administrative Procedure Act requirements for notice and comment rule-making."). Congress continued:

> Where the SEC has direct authority with respect to a specific subject matter and a self-regulatory organization also exercises authority in the area, the SEC may change regulatory policy in any one of three ways: (1) by promulgating its own substantive rule preempting self-regulatory rules on the subject . . . ; (2) by promulgating a rule under its grant of substantive authority which imposes conditions on the exercise of

Finally, the SEC has the authority to review any action by a registered clearing agency that, *inter alia,* denies membership or participation to any applicant, or prohibits or limits any person's access to services offered by the registered clearing agency, and must set aside any such action unless it finds that the action and any SRO rule was, *inter alia,* consistent with the purposes of the Exchange Act and that it does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[24] The SEC is also empowered to suspend or revoke registration, impose limitations upon a clearing agencies activities, functions or operations, or impose other sanctions, if the SEC finds that the registered clearing agency has violated or is unable to comply with any provision of the Exchange Act.[25]

## II. NSCC's Rules and Determinations Regarding Certain Required Deposit Contributions to NSCC's Clearing Fund Are Unreasonable, Not Supported by Substantial Evidence, and Inconsistent with the Exchange Act and Rules Thereunder

### A. Discussion of the Required Deposit Contribution to the Clearing Fund

#### 1. *Overview of the Required Deposit and its Effects*

As an ongoing condition to membership, and thus access to NSCC's clearance, settlement and other essential services, NSCC requires members to contribute to a "Clearing Fund," by making "Required Deposits."[26] In discussing the Required Deposit in a recent publication, NSCC claims it "determin[es] the appropriate Required Deposits to the Clearing Fund and monitor[s] its sufficiency" in order to "manage[] its credit exposure to Members.[27] NSCC continued:

> The Required Deposit serves as each Member's margin. The objective of a Member's Required Deposit is to mitigate potential losses to NSCC associated with liquidation of such Member's portfolio in the event that NSCC ceases to act for such Member (hereinafter referred to as a "default"). The aggregate of all Members' Required Deposits constitutes the Clearing Fund of NSCC, which it would access should a defaulting

---

self-regulatory jurisdiction in the area or the utilization of self-regulatory facilities . . . ; or (3) by utilizing section 19(c) to force the self-regulatory organization to change its rules. The bill would not alter the SEC's ability to proceed in these ways.

S. Rep. 94-75, at 131.

[24] 15 U.S.C. § 78s(d), (f).

[25] *See* 15 U.S.C § 78s(h); 15 U.S.C. § 78u; S. Rep. 94-75 at 34-35 (generally discussing such authority); SEC Release No. 34-68080, at 5 (describing such authority).

[26] NSCC Rules and Procedures, Rule 2, § 1, Rule 2A, § 1(F), Rule 2B, § 1, Rule 4, § 1.

[27] *See* SEC Release No. 34-82631, File No. SR-NSCC-2017-808, at 5 (February 5, 2018).

> Member's own Required Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that Member's portfolio.[28]

NSCC admits in its Rules, however, that it also uses the deposits to the Clearing Fund as one of its "two principal sources of liquidity" to "enable it to effect the settlement of its payment obligations as a central counterparty," as well as for "investment purposes."[29]

According to NSCC's Rules and Procedures, the minimum Required Deposit to the Clearing Fund is $10,000. In practice, however, members are required to deposit far more than the minimum amount. The actual amount of each member's Required Deposit is calculated by NSCC according to a complex and inscrutable formula, consisting of multiple discretionary and subjective components – which seemingly increase in number on a yearly basis – set forth in Procedure XV of NSCC's Rules.[30]

As set forth herein, an examination of certain components of the Required Deposit, and the manner in which they are actually calculated and applied by NSCC, demonstrates that they result in onerous, inequitable and arbitrary charges that *so far exceed the amount of the underlying transactions* to be cleared and settled that they cannot be credibly justified as necessary to protect NSCC from credit risk. Indeed, as demonstrated below, the amount of each one of the Illiquid Charge, OTC Volatility Charge or OTC Mark-to-Market Charge individually is frequently in excess of the amount of the underlying transaction by several factors; when assessed together, as they almost always are, Alpine is often required post margin amounts that substantially exceed the underlying transaction value, sometimes by hundreds of times.

These charges, as both designed and applied to microcap or OTC Stocks, impermissibly limit Alpine's access to NSCC's essential clearing and settlement services, and contravene the purposes and requirements of the Exchange Act. They impose an unreasonable and disproportionate burden on small clearing-broker members, such as Alpine, and reflect a discriminatory and anticompetitive policy towards a specific segment of the market – the microcap or OTC market – for which Alpine provides clearing services.

As a direct result of NSCC's Required Deposit charges, Alpine is suffering ongoing harm to its business; Alpine's liquidation business alone is down approximately 75% due to the capital constraints necessary to fund the Required Deposit.[31] Further, the number of independent or small clearing broker members of NSCC providing clearing services for firms and investors holding microcap or OTC stocks overall is also down significantly. Alpine is aware of only a

---

[28] *Id.* (footnotes omitted).

[29] *See* NSCC Rules and Procedures, at Rule 4, § 2, and Rule 4A, § 1. NSCC's other primary source of liquidity is a "committed line of credit." *Id.* at Rule 4A, § 1.

[30] *See* NSCC Rules and Procedures, at Rule 4 and Procedure XV.

[31] Brant Decl., at ¶¶ 33, 40.

handful of firms that currently provide clearing services for these types of stocks.[32] Commission intervention is necessary to prevent NSCC – which is helmed by a "Who's Who" in major financial institutions – from destroying its small broker-dealer constituents and choking off a significant, lawful segment of the market through the imposition of onerous and unjust factors to calculate and impose the Required Deposit charges.

### 2. *Discussion of Specific Components of the Required Deposit*

The formula used to calculate the Required Deposit, set forth in Procedure XV, is itself long (spanning 16 pages), complex and confusing, incorporating numerous discretionary and interwoven components and fact-specific variables. For example, for CNS Transactions alone, NSCC calculates and cumulatively imposes (or has discretion to impose) many separate charges based on a variety of components:

> 1. Volatility Component: NSCC calculates and imposes a "volatility" charge purportedly "designed to measure market price volatility" and to "capture market price risk associated with each Member's portfolio at a 99th percentile level of confidence."[33] The standard volatility formula is complex, to say the least, but essentially imposes a "Value at Risk" charge that is based on the highest of a "core parametric estimation," a "gap risk measure," and "the portfolio margin floor." [34] NSCC has discretion to impose a different volatility charge for microcap stocks (below $5/share) or OTC or pink sheet issues ("OTC Volatility Charge") consisting of a multiple of "the absolute value of such positions [and] a percentage designated by [NSCC], which percentage shall not be less than 10% . . . ."[35]
>
> -plus-
>
> 2. Mark-To-Market Component: NSCC calculates and imposes a mark-to-market charge generally based on the net of each day's difference between the contract price of the net positions and the current market price for such positions.[36] Thus, this component could result in either a debit or a credit, if applied as written, based upon the direction in which the current market price fluctuates.
>
> -plus-

---

[32] *Id.*, at ¶¶ 34-35.

[33] *See* SEC Release No. 34-82631, File No. SR-NSCC-2017-808, at 6. The volatility charge formula is set forth at Procedure XV, § 1(A)(1)(a)(i), page 287-290 of the NSCC Rules and Procedures.

[34] *See* SEC Release No. 34-82631, File No. SR-NSCC-2017-808, at 2 (summarizing charges and components).

[35] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(a)(ii), at p. 288. NSCC purports to justify the different discretionary charge based on positions in these stocks on the basis that they are "less amenable to statistical analysis." *Id.* NSCC also sometimes refers to this OTC Volatility Charge as a "haircut margin charge." *See* NSCC's Form 19b-4, SR-NSCC-2017-001 (March 22, 2017) (Illiquid Charge), at 4, n. 3, and 5.

[36] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(b) and (c), at p. 290.

3. Discretionary Volatility Component: NSCC may also impose a "special charge" upon "Members in view of price fluctuations in or volatility or lack of liquidity of any security." No formula is identified for calculating this charge. Rather, NSCC states that it "shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time."[37]

-plus-

4. CNS Fail Position Component: NSCC calculates and imposes a charge for a Member's "aggregate CNS Fails Positions" by multiplying the current market value for such positions by (i) 5% for Members rated 1 through 4 on NSCC's Credit Risk Rating Matrix ("CRRM"); (ii) 10% for Members rated 5 or 6 on the CRRM; or (iii) 20% for Members rated 7 on the CRRM. NSCC has assigned Alpine a CRRM Rating of 7.[38]

-plus-

5. Margin Requirement Differential Component: NSCC calculates and imposes a "margin requirement differential component charge" by taking the "sum of the exponentially weighted moving average ('EWMA') of the daily positive changes over a 100-day lookback period in the Member's (i) Regular Mark-to-Market component, (ii) ID Net Mark-to-Market component and (iii) volatility components, times a multiplier calibrated based on backtesting results."[39]

-plus-

6. Coverage Component: NSCC calculates and imposes a "coverage component charge" calculated as "the EWMA of the Member's daily backtesting coverage deficiency amount over a 100 day lookback period." The Member's "backtesting deficiency amount" for each day is the "difference between the simulated profit and loss on the Member's portfolio and the sum of the Member's (i) volatility component, (ii) margin requirement differential component and (iii) Illiquid Charge."[40]

-plus-

7. Illiquid Charge Component: NSCC calculates and imposes a charge on "Illiquid Positions." An "Illiquid Position" means "a Net Unsettled Position in an Illiquid Security that exceeds applicable volume thresholds. For net buy positions in an Illiquid Security, the volume thresholds shall be no greater than 100 million shares based on the Member's

---

[37] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(d), at p. 290.

[38] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(e), at p. 290. The CRRM component is discussed below.

[39] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(f), at p. 290-91.

[40] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(g), at p. 291.

rating on the Credit Risk Rating Matrix. For net sell positions in an Illiquid Security, the volume threshold shall be no greater than 1 million shares on an absolute value basis, and based on both the Member's excess net capital and the Member's rating on the Credit Risk Rating Matrix." Additionally, "[i]n determining if the volume threshold is met with respect to a net sell position in Illiquid Securities, [NSCC] shall apply an offset against shares of Illiquid Securities in the Member's inventory at DTC to the quantity of shares in a Member's Illiquid Position. Such offset shall not be applied to (1) net buy positions in Illiquid Securities, or (2) Members that have the weakest rating on the Credit Risk Rating Matrix."[41] The conditional offset is known as the "DTC Offset."

An "Illiquid Security" is defined as "a security . . . that either (i) is not traded on or subject to the rules of a national securities exchange registered under the Securities Exchange Act of 1934, as amended; or (ii) is an OTC Bulletin Board or OTC Link issue."[42]

Different calculations apply depending on whether the "Illiquid Position" is net "buy" or "sell" position. For "buy positions in sub-penny Illiquid Securities," the Illiquid Charge is "the aggregate shares in such positions multiplied by $.01." For "sell positions," if the current market price is "equal to or below $1.00," the Illiquid Charge is "the product of the aggregate quantity of Illiquid Securities in the position and either (i) the One Month High Price, or (ii) the Current Market Price of the Illiquid Securities in the position multiplied by a factor of between 2 and 10,[43] based on the minimum share price, which shall not be less than $0.01."[44] Thus, for net-sell positions in sub-penny securities, NSCC imposes a price of $.01 to calculate the Illiquid Charge, regardless of the actual price of the stock. NSCC will use the *lesser* of the "One Month High Price" and "Current Market Price" if the share quantity in the position is less than 100% and greater than or equal to 25% of the average daily trading volume ("ADV"), and the *greater* of One Month High Price and Current Market Price if the share quantity in the position is greater than or equal to 100% of the ADV.[45]

-plus-

---

[41] *See* NSCC Rules and Procedures, Rule 1, at p. 10 (emphasis added).

[42] *Id.*

[43] NSCC appears to have discretion in determining which number to use between 2 and 10 as a multiplier. However, in its Form 19b-4 for the Illiquid Charge, NSCC indicated that "[g]enerally, the factor would be 10 where the market price is less than $0.10"; 5 where the market price is between $0.10 and $0.20; and 2 where the market price is between $0.20 and $1.00. *See* NSCC Form 19b-4 (Illiquid Charge), SR-NSCC-2017-001, at 8 n. 14.

[44] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(h), at p. 291. Although not applied as frequently to Alpine because Alpine generally focuses on clearing liquidation transactions with share prices below $1.00, for Illiquid sell positions with a current market price above $1.00, NSCC calculates the "Illiquid Charge as the "product of the aggregate quantity of Illiquid Securities in the position and either (i) the One Month High Price, or (ii) the Current Market Price of the Illiquid Securities in the position rounded up to the next $0.50." *Id.*

[45] *See id.*

8. Excess Net Capital Premium Component: NSCC calculates and imposes an excess net capital premium ("ENCP") charge where "a Member's contribution to the Clearing Fund," including Illiquid Charges, Volatility Charges, Mark-to-Market Charges, and CNS Fail Charges, "when divided by its excess net capital or capital . . . is greater than 1.0 (the 'Excess Net Capital Ratio'). In such circumstances, NSCC "may require" the member to deposit an ENCP as part of the Required Deposit that is "equal to the product of (a) the amount by which the Calculated Amount exceeds its excess net capital or capital . . . multiplied by (b) its Excess Capital Ratio."[46] In practice, this means that if the member has a clearing fund requirement of $11.4 million and excess net capital of $10 million, its clearing fund requirement would exceed its excess net capital by $1.4 million, its Excess Net Capital Ratio would be 1.14 (or 114%), and thus the applicable ENCP would be 114% of $1.4 million or $1,596,000. If the same member had a clearing fund requirement of $20 million, its Excess Net Capital Ratio would be 2.0 (or 200%) and the applicable ENCP would be 200% of $10 million, or $20 million.[47] NSCC has discretion whether to collect the ENCP.[48]

9. Credit Risk Rating Matrix Component: NSCC's CRRM rating is not an express component of the Required Deposit formula. However, it directly impacts several of the components, including whether the member will face an Illiquid Charge. For example, as indicated, the Illiquid Charge only applies on net sell positions when a member exceeds certain volume thresholds in Illiquid Securities. For a member with a CRRM rating between 1-4, the volume threshold is 1 million shares when the net sell position is equal to or greater than 25% of the ADV in those shares. For members with a CRRM rating between 5-7, who have the same net sell position in the same securities, the applicable volume threshold is 500,000 shares if that member's excess net capital exceeds $10 million. For members with a CRRM rating between 5-7 whose excess net capital is equal to or less than $10 million, the applicable volume threshold is 100,000 shares.[49] Additionally, members with the weakest CRRM rating cannot utilize the DTC Offset to get below the applicable volume threshold.[50]

NSCC's CRRM rating is based on a mix of objective and subjective factors that NSCC assesses in a manner that it has been withheld from the industry on the basis that it is "proprietary."[51] According to the information available, the formula includes consideration of quantitative factors (size, i.e., total excess net capital; capital, leverage,

---

[46] *See* NSCC Rules and Procedures, Procedure XV, § 1(B)(2), at p. 297.

[47] *See* SEC Release No. 34-54457, File Nos. SR-FICC-2006-03 and SR-NSCC-2006-03, at 3-5 (September 15, 2006) (using these sample calculations).

[48] *See* NSCC Rules and Procedures, Procedure XV, § 1(B)(2), at p. 297

[49] *See* NSCC's Form Rule 19(b)(4) (Illiquid Charge), SR-NSCC-2017-001, at 7.

[50] *See* NSCC Rules and Procedures, Rule 1, at p. 10.

[51] Brant Decl., at ¶ 17.

liquidity and profitability) and qualitative factors (market position and sustainability, management quality, capital and liquidity management, geographic and business/product diversity, and access to funding).[52] It is unclear what weight NSCC ascribes to each individual factor within the larger quantitative and qualitative categories to arrive at a CRRM rating for a member. It bears no relationship to a firm's actual credit rating or, apparently, whether the firm has ever defaulted on any obligation to NSCC.

### B. Damage to Alpine and Other Small Broker-Dealers

As indicated, NSCC purports to justify each of these various and accumulating charges contained in the Required Deposit on the same basis: that they are necessary to mitigate potential losses to NSCC associated with member default.[53] Alpine agrees that some degree of credit risk protection, including a reasonable margin charge, is both laudable and necessary.[54] However, certain of these components, particularly when applied in the aggregate by NSCC to Alpine and other similarly situated clearing-broker members, result in charges that are so unreasonably high, and have such a plainly anticompetitive and discriminatory impact, that they cannot possibly be justified as necessary or appropriate to alleviate credit exposure from a potential member default.

Specifically, Alpine challenges, and asks the Commission to engage in rule-making to set aside, the following components of the NSCC's Required Deposit as contrary to the Exchange Act and the rules and regulations thereunder: (a) the Illiquid Charge, including the decision to make the DTC Offset unavailable to certain members, such as Alpine, who have received a derogatory credit rating from the NSCC; (b) the ENCP charge; (c) the CRRM; (d) the OTC Volatility Charge, as applied to microcap and OTC stocks; and (e) the OTC Mark-to-Market Charge, as applied to sub-penny microcap and OTC stocks. As noted above, the Illiquid Charge *alone,* the OTC Volatility Charge *alone,* and the OTC Mark-to-Market *alone* generally equal or exceed the underlying transaction value by several multiples and cannot be justified as necessary or consistent with the Exchange Act even in their individual capacities, let alone as they are applied together.

The impact on Alpine's and its correspondent customers' businesses from these targeted components is devastating, particularly since they are calculated and applied cumulatively by NSCC. By way of example, consider the following trades processed by Alpine for clearing through NSCC's CNS system for its client, Bezalel, on November 23, 2018 and November 26, 2018.[55] The trades involved a contract to sell 198,000 total shares (99,000 on 11/23/2018 and 99,000 on 11/26/2018) of PMCB at a price of $0.020 for total proceeds of $4,016.64. To process

---

[52] *See* NSCC Rules and Procedures, Rule 1, at p. 5.

[53] *See* SEC Release No. 34-82631, File No. SR-NSCC-2017-808, at 5.

[54] The SEC requires NSCC to take steps to effectively identify, measure, monitor and manage its credit exposure to its participants. *See* 17 C.F.R. § 240.17Ad-22(e)(4), (6).

[55] This trade is detailed in the Brant Decl., at ¶ 19.

this $4,016.64 trade for clearing through NSCC, however, ***Alpine was required to deposit $928,175.84,*** including the following total charges for the two trades:

1. Illiquid Charge: $903,756.60.

2. OTC Volatility Charge: $23,222.40 (NSCC's rules indicate that the OTC Volatility Charge shall be, at NSCC's discretion, a haircut of not less than 10% of the position. Here, however, the Volatility Charge was 100% of the transaction. Although NSCC's precise method of calculation remains unclear, because a sub-penny stock was involved, Alpine believes that NSCC imposed the fictional $.01/share price).

3. OTC Mark-to-Market Charge: $1,196.84 (although this charge can either be a debit or credit based on the closing price of the security pending settlement, in this case NSCC appears to have used the fictional $.01/share price so it created a mark-to-market-loss charge).

Although the entire exposure associated with the above trades totaled $4,016.64, NSCC's methodology resulted in Alpine being required to deposit a total of $928,175.84 to access NSCC's (CNS) clearance and settlement services. These two trades resulted in an NSCC deposit trade proceeds multiple of 231.08 (that is, 231 times the value of the underlying trade). The OTC Volatility Chare and Illiquid Charge exceeded the value of the transaction by several multiples.

These charges are patently unreasonable and frankly absurd. Yet, Alpine faces similarly egregious and disproportionate Required Deposit charges involving these component charges every single day, particularly when processing a sub-penny stock trade for clearance and settlement through NSCC's CNS system.[56] Several additional examples of similar charges, as applied to recent trades, are set forth in the attached Declaration, including charges that exceeded the underlying transaction value by over 200 times or 20,000 %.[57]

Even under NSCC's methodology, Alpine could have reduced the impact by avoiding the Illiquid Charge on the PMCB trade and almost every other transaction, except that NSCC does not permit Alpine to avail itself of the DTC Offset. With respect to OTC securities that Alpine processes, Alpine requires that the security position be deposited, cleared and settled at DTC before entering liquidating trades on a regular way basis.[58] As a result, if the DTC Offset were

[56] Alpine has attempted to employ creative solutions to avoid the deleterious impact of these Required Deposit charges. For example, for a time, Alpine was able to use ex-clearing contra-party clearing partnerships to perform clearance and settlement service manually and thereby avoid clearing trades through NSCC's CNS system altogether. However, once the last of those ex-clearing partnerships expired at the end of April 2018, Alpine was forced to again utilize NSCC's CNS system to clear transactions, and to post the Illiquid Charge and the other onerous components at issue of the Required Deposit. *See* Brant Decl., at ¶ 32.

[57] *See* Brant Decl., at ¶ 22.

[58] *Id.*, at ¶ 13.

available to Alpine, it would have eliminated the Illiquid Charge completely on the sample transactions, and many, if not all, other transactions, because it would take Alpine below the minimum volume threshold.[59] However, because NSCC has arbitrarily assigned Alpine the weakest CRRM Rating of a "7" – even though Alpine has not defaulted on any of its obligations to NSCC under current ownership and has no understanding of the basis for its rating, as discussed *infra* – Alpine is not able to utilize the DTC Offset.[60]

The irrationality of the Required Deposit is also exasperated where NSCC imposes a fictional price per share of $.01 to calculate its charges on sub-penny stock transactions because it exponentially and artificially increases the costs to clear and settle microcap and OTC stock transactions through NSCC. NSCC provided no justification for its decision to set the minimum price per share for transactions at $.01 when it added the Illiquid Charge to its rules.[61]

To the extent NSCC is also rounding-up the value sub-penny stocks to $.01 in calculating the OTC Volatility and OTC Mark-to-Market Charges, Alpine is aware of no authorization for such a practice in NSCC's Rules and Procedures.[62] Indeed, the Volatility component, as indicated, is described by NSCC as a "haircut" on the absolute value of the microcap or OTC stock positions – i.e., something *less than* the absolute value. Although NSCC has discretion to set this "haircut" at not less than 10% of the absolute value of the position, in application the reality is that the OTC Volatility Charge frequently exceeds 100% of the absolute value of the position.[63] Whether this is due to the arbitrary use of a fictional price per share to artificially increase the share price or some other equally arbitrary measure or exercise of discretion – i.e., NSCC simply electing to impose charges in excess of 100% of the transaction – is immaterial: the charges to, and impact on, Alpine are the same.

Similar arbitrariness exists with respect to NSCC's calculation and imposition of the OTC Mark-to-Market Charges. Simply stated, substituting a rounded-up fictional price-per-share for the actual current market value of the stock in order to compare it to the contract price and calculate the Mark-to-Market will almost invariably ensure there will be a Mark-to-Market Charge imposed (instead of a credit), and one that exceeds the value of the transaction by many orders of magnitude.[64]

---

[59] *See id.*, at ¶¶ 13, 23. *See also* Discussion of the Illiquid Charge and CRRM rating, *supra.*

[60] *See id.* at ¶¶ 11-13 (identifying Alpine's CRRM Rating from NSCC of a "7", and confirming that Alpine has not defaulted on its obligations to NSCC under current ownership – in place since at least 2011 when Alpine was purchased by current ownership); *see also* NSCC Rules and Procedures, Rule 1, at p. 10.

[61] Although NSCC's Form 19b-4 for the Illiquid Charge rule indicated that it would round up sub-penny securities to $.01 in calculating the Illiquid Charge, it did not provide any rationale for why it could not or would not use the actual value of the securities to calculate the charge. *See* NSCC's Form 19b-4, SR-NSCC-2017-001 (Illiquid Charge), at 6-8.

[62] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(a)(ii), (b) and (c).

[63] *See* Brant Decl., at ¶ 22 (providing examples).

[64] *See* discussion above regarding calculation of the Mark-to-Market under NSCC rules.

The use of artificial components to exponentially increase these charges beyond the transaction value is not rationally related to any purported credit risk justification, is not consistent with either the Exchange Act or even NSCC's rules and, as detailed below, is causing significant damage to Alpine and the broader OTC and microcap markets.

Alpine did not incur an ENCP charge with respect to the sample transactions. In fact, Alpine rarely incurs that charge. However, this is for a very specific reason: Alpine has been forced to further limit its business – to turn down customer transactions – in order to avoid paying this onerous charge.[65] Given that the trades Alpine processes have a relatively low dollar-value, Alpine should have sufficient net capital to provide clearing services for all of its correspondents' potential liquidation transactions.[66] However, because the Required Deposit charges are added to the absolute value of the transaction, and require a deposit of funds significantly higher than the underlying transaction amount (particularly when a sub-penny stock is involved), Alpine is forced to artificially limit the number of transactions it can clear for its customers per day, including to avoid the ENCP charge.[67] Alpine also believes, based on discussions with NSCC, that NSCC would take a negative view of a member that was continuously required to post ENCP charges,[68] and that doing so may result in adverse action, such as a downgrade in CRRM rating, placement on the "watch list," or more aggressive adverse consequences, such as a suspension or other additional limitation on services. Given that Alpine makes a relatively small amount of money per transaction it processes, it has neither the ability nor the motive to post the potentially astronomical ENCP charges and potentially incur further adverse consequences from NSCC. To operate its business, of course, Alpine has no choice but to post the Illiquid Charge, OTC Volatility Charge and OTC Mark-to-Market Charges.

The cumulative impact of these margin requirements creates a self-propelling downward cycle. Alpine must devote additional capital to post the Required Deposit each day in order to process OTC and microcap trades through NSCC's CNS system, including the onerous and disproportionate Illiquid Charges, and the similarly exorbitant OTC Volatility and OTC Mark-to-Market charges. Because of this, Alpine must limit the volume of trades it can process per day, both due to capital constraints and to avoid ENCP charges. This, in turn, limits Alpine's ability to raise additional capital through its clearing business, and effectively pull out of the cycle. As a direct result, as would be expected, Alpine's liquidation business is down almost 75% due to the artificial restraints on the number of liquidation transactions it can clear through NSCC per day and attrition of customers who leave or go out of business because they cannot clear their transactions through Alpine.[69]

---

[65] *See* Brant Decl. at ¶ 27.

[66] *Id.* at ¶ 28. Alpine currently has excess net capital of approximately $2.8 million. Prior to November of 2018, its excess net capital was $1.1 million. *Id.*

[67] *Id.* at ¶ 29.

[68] *Id.* at ¶ 30.

[69] *Id.* at ¶¶ 33, 40-42.

The impact is not felt by Alpine alone; because NSCC operates a virtual monopoly, all players in the OTC and microcap market – from brokers to issuers to investors – are affected. As indicated, very few small clearing firms exist today that serve the OTC and microcap securities market, which are most adversely affected by the Illiquid Charges.[70] Indeed, the Illiquid Charges, and any use of a rounded-up, fictional share price for sub-penny stocks or other mechanism to arbitrarily and disproportionately increase the Required Deposit charges well beyond the transaction value, are intentionally targeted at the OTC and microcap securities markets. Although larger NSCC members – banks, Wall Street firms and online discount firms – likely have sufficient net capital to avoid the ENCP charges or Illiquid Charges (including through use of the DTC Offset), to Alpine's knowledge, very few of these firms are willing to work with OTC stocks and microcap stocks.[71] Many of these firms do not accept certificates or newly issued securities for microcap issuers, leaving but a handful of firms that operate in this space.[72]

There is yet another aspect to the vicious cycle created by NSCC's discriminatory Required Deposit charges. Those small firms that do serve this segment of the market, such as Alpine, must also charge additional fees to try to offset the immense burden of devoting capital to post the challenged components of the Required Deposit, which cumulatively reduces the value of the trade for all involved.[73] Given the high amount of the Required Deposit in comparison to the underlying value of the trade, many of Alpine's correspondent broker clients (or their customers – the underlying buyers or sellers – to whom the correspondent brokers pass the fees) are unwilling or unable to pay the additional amounts to sell the shares, leaving the shares effectively untradeable, and worthless.

The ripple effect from these charges also has a profound adverse effect on small companies whose stock trades in the OTC and microcap markets. Microcap companies depend on issuance of shares to obtain services and finance their growth. Alpine, and other small broker-dealers in this segment of the market, play a critical role in providing liquidity for securities of small companies. A substantial part of Alpine's customer base consists of institutional lenders to small companies and the key service providers/professionals to small companies – i.e., lawyers, accountants, transfer agents, advisors, etc.[74] Due to the financial crisis of 2008 and other regulatory concerns, traditional banks do not provide loans to these companies, and, as indicated, the large investment banks, which comprise a majority of the membership of DTC/NSCC, do not serve this segment of market. Without firms willing and able to process these transactions, like Alpine, and without correspondent brokers or investors willing or able to pay the transaction

---

[70] Brant Decl., at ¶ 34-35.

[71] *See id.*

[72] *Id.* In addition to Alpine, this list includes Wilson Davis Securities, Lek Securties, and Wedbush Securities. Alpine is aware of no others. *Id.* at ¶ 35.

[73] *Id.* at ¶ 36. To be clear, no fee begins to ameliorate the damage to Alpine from the loss of business volume caused by the Required Deposit. *See id.* at ¶¶ 33, 40-42.

[74] *See id.*, at ¶ 42.

fees, professionals and investors will be unwilling to accept stock and these small companies will be cut-off from the capital markets to raise money to grow their businesses. It is simply no longer viable or profitable to be in this segment of the market as an NSCC member, broker, investor or issuer.

These charges not only violate the Exchange Act and result in an unjustified denial or limitation on access to services (as discussed below), they also lack any adequate rationale. There is no support for NSCC's contention that the Required Deposit components at issue, and NSCC's calculation thereof, are necessary to manage its credit exposure to its members. NSCC has presented no evidence, either at the time it added these components or since, that the many other existing margin requirements were insufficient to protect against the credit risk from a member default. For instance, as indicated, each of the Required Deposit components at issue targets trading in the OTC or microcap markets and/or smaller clearing members who tend to have less excess net capital and weaker CRRM ratings. NSCC presented no evidence that smaller members, or those who deal in the OTC or microcap stock markets, tend to default at a greater rate to justify its decision to impose greater margin requirements on these members. Nor did NSCC present evidence demonstrating that it is either necessary or appropriate for NSCC to require a deposit amount many times the value of the transaction to protect a firm the size of NSCC from risk of member default.

Moreover, NSCC's actions appear redundant and even more arbitrary when one considers that two components of the Required Deposit that result in some of the highest charges to Alpine on a per transaction basis – the OTC Volatility Charge and Illiquid Charge – purport to guard against the same risk: volatility in the OTC and microcap markets. The Mark to Market component is also designed to account for price fluctuations. The NSCC has not, nor could it, justify duplicative margin charges that far exceed the underlying transaction value (which have in fact resulted in charges over 200 times the value of the transaction) and effectively prevent the clearing of countless trades. These charges, and any framework or model that leads to such charges, are neither a necessary, reasonable, nor commensurate means to identify, measure, and manage NSCC's credit risk.[75] Further, if there were a specific security or position of concern, NSCC already had (and has) discretion to impose a special volatility charge,[76] in addition to the other margin components detailed above.

Nor can NSCC offer any basis to justify the sheer size of the charges imposed on OTC and microcap stock transactions in relation to the value of the underlying transaction.[77] Rather

---

[75] *See, e.g.,* 17 C.F.R. § 240.17Ad-22(d)(6) (requiring registered clearing agencies to be "cost-effective" in offering services); *id.* at § 240.17Ad-22(e)(4) (requiring covered clearing agencies to "[e]ffectively identify, measure, monitor and measure its credit exposure to participants"); *id.* at § 240.17Ad-22(e)(6)(i) (requiring clearing agencies to establish a "risk-based margin system" that, *inter alia,* "[c]onsiders, and produces margin levels *commensurate with,* the risks and particular attributes of each relevant product, portfolio and market," and uses "an appropriate method for measuring credit exposure . . . ." (emphasis added)).

[76] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(d), at p. 290

[77] Brant Decl., at ¶¶ 19, 22 (discussing the Required Deposit amounts in relation to the underlying transaction amounts).

than design a formula that corresponds to the actual value of the transaction and the associated default risk, NSCC has designed and applied a formula that allows it to extract far more margin that it reasonably needs from just a few members. NSCC's arbitrary use of a fictional price of $.01 for sub-penny stock transactions is illustrative of these excesses,[78] as is its arbitrary imposition of "haircut" OTC Volatility Charges that exceed the value of the transaction, often by several factors.[79]

The Required Deposit components at issue also have an improper disproportionate impact upon small broker dealers – those with small excess net capital, and thus weaker CRRM ratings. For example, NSCC purports to justify the Illiquid Charge on the basis that Illiquid Securities "lack marketability, based on insufficient access to a trading venue, and may have low and volatile share prices."[80] Based on this construct, NSCC claims the Illiquid Charge is "designed to mitigate the risk that NSCC may face when liquidating Illiquid Securities following a Member default and such liquidation is difficult or delayed due to a lack of interest in a particular Illiquid Security or limitations on the share price of the Illiquid Security."[81] However, where the stated risk purports to be inherent in the Illiquid Security itself, it makes no sense for NSCC to allow members with higher CRRM ratings to incur larger positions in these securities before incurring the Illiquid Charge, or to disallow the DTC Offset only for those with the weakest CRRM rating. It is actually counterintuitive and nonsensical because the failure of a large member – those who NSCC tends to assign higher CRRM ratings – would have a much more dramatic impact on NSCC solvency.

The decision to make the DTC Offset available to some members, but not others, is itself discriminatory and baseless. Presumably, NSCC uses the DTC Offset in determining whether an Illiquid Charge will apply because it recognizes that there is less risk in clearing and settling a transaction if the member is long the shares at DTC – as Alpine is with respect to nearly every liquidation transaction it processes.[82] The reduction in risk to NSCC from a member having the offsetting shares at DTC would, of course, be the same regardless of a member's CRRM rating; the two are independent. If anything, allowing members with weaker credit ratings to utilize the DTC Offset would further reduce any purported credit risk to NSCC from positions in the so-called Illiquid Securities because such a member could use the DTC Offset to avoid the Illiquid Charge, and therefore improve its ratio of clearing fund requirement to excess net capital and its overall financial condition by processing more transactions. Such a member would then be *less*

---

[78] That a rational, need-based justification for these decisions could be offered is dubious at best. Certainly, it must be technologically and administratively feasible for NSCC to utilize the actual share value, even though it may be below a penny, in calculating margin, and NSCC has not sought to justify it as unfeasible. From a purported credit risk perspective, it makes no more sense to impose a fictional share price for a sub-penny stock than it does for any other stock. In either circumstance, use of a fictional share price does not accurately measure or ameliorate the risks from the actual position.

[79] *See* Brant Decl., at ¶¶ 19, 22.

[80] *See* NSCC Form 19b-4 (Illiquid Charge), SR-NSCC-2017-001, at 3.

[81] *Id.*

[82] *See* Brant Decl., at ¶ 13, 23.

likely to default. Where NSCC has provided no explanation for its disparate application of the DTC Offset,[83] the only rational conclusions are that it has no justification or, worse yet, that it is simply discriminatory.

Finally, the CRRM that NSCC uses to determine the applicability of the Illiquid Charge is itself vague and arbitrary. As indicated, the CRRM involves a mix of quantitative and qualitative factors.[84] Not only is a qualitative factor inherently subjective and arbitrary, but the manner in which NSCC actually evaluates and weighs the factors within the overall quantitative and qualitative categories to assign a member a CRRM rating is undisclosed.[85] About the only thing that is apparent is that NSCC does not, unlike most credit rating systems, take into account recent history of performance of obligations, including an absence of prior defaults to NSCC. Thus, a member has no actual way of determining how its CRRM rating is determined or, more importantly, how to improve it. This permits arbitrary determinations by the NSCC. Although Alpine has no quarrel with the use of a credit rating system to evaluate credit risk, NSCC's secret CRRM formula is simply too vague a basis to serve as an adequate justification for actions that have the effect, if not the purpose, of threatening a critical segment of the market.

### C. NSCC's Rules and Procedures with Respect to the Required Deposit Fail to Comply with the Exchange Act and SEC's Rules

Sections 3, 17A and 19 of the Exchange Act impose mandatory requirements with which NSCC, as a registered clearing agency and SRO, must comply in designing, implementing and applying its rules and procedures, and in calculating and imposing charges.[86] In addition, NSCC is required to comply with any rules and regulations promulgated by the SEC under the Exchange Act, as well as NSCC's own rules.[87]

Section 19(f) requires the Commission to set aside an SRO action denying or limiting access to services if it does not find, *inter alia,* that the SRO's "rules are, and were applied in a manner, consistent with the purposes" of the Exchange Act, or if it finds the prohibition or

---

[83] *See* NSCC's Form 19b-4 (Illiquid Charge), SR-NSCC-2017-001, at 7-8.

[84] In its Form 19b-4 filing wherein NSCC proposed adding qualitative factors to the CRRM, NSCC indicated that the weight split between quantitative and qualitative factors would be 60/40, respectively. *See* NSCC Form 19b-4, SR-NSCC-2017-002, at 7.

[85] When Alpine asked NSCC for details about how NSCC actually determined a CRRM rating, NSCC refused to answer the question on the basis that its CRRM formula was "proprietary." Brant Decl., at ¶ 17.

[86] For example, Section 17A(b) requires, as a condition to registration, that a clearing agency's rules meet certain standards, such as fair and reasonable allocation of fees and nondiscriminatory purpose and effect. Section 19(g) similarly requires all SROs to comply with the Exchange Act, and Section 19(f) requires, *inter alia,* that any fee constituting a limitation on access be consistent with the Exchange Act. Sections 17A, 19 and 3(f) all proscribe clearing agency rules with an unnecessary anticompetitive burden and effect. Section 3(f) also requires the SEC, in reviewing an SRO rule, to determine whether the action promotes "efficiency" and "capital formation."

[87] Both Section 17A(d) and Rule 19(g) require SROs to comply with SEC rules and regulations, and Section 19(g) requires SROs to comply with their own rules.

limitation on access "imposes any burden on competition not necessary or appropriate."[88] Excessive fees and charges can constitute a denial of access to services.[89] ***The burden is on NSCC to demonstrate that its rules and actions are consistent with the Exchange Act and the SEC's rules.***[90]

Here, for the reasons stated herein, and in Alpine's concurrently filed Petition for Review pursuant to Section 19(d),[91] the challenged components, particularly when applied in the aggregate, result in disproportionate and onerous charges that create an actual limitation on access to NSCC's essential CNS clearing and settlement services by Alpine and other similarly situated members. Additionally, as demonstrated below, the challenged components violate the Exchange Act, the SEC's rules, and even NSCC's own rules because, *inter alia,* they are unreasonable, discriminatory, and impose an unnecessary and inappropriate burden on competition.[92]

### 1. *Unreasonable and Inequitable Allocation of Fees*

Section 17A(b)(3)(D) requires that the "rules of the clearing agency provide for the equitable allocation of reasonable dues, fees and other charges among its participants."[93] This statute thus imposes two requirements: (1) fees, dues and charges must be "reasonable," and (2) they must be "equitabl[y] allocate[d]." NSCC's rules with respect to the Required Deposit, and the resultant charges that NSCC imposes on Alpine under these rules, meets neither requirement.

As demonstrated above, the challenged components of the Required Deposit combine to impose margin charges on Alpine that are exponentially greater than the underlying transaction amount. This is facially unreasonable for a number of reasons, including: (a) the sheer amount of the charges, (b) the lack of adequate justification to require margin that is so disproportionately high compared to the transaction, and (c) the chilling effect this has upon Alpine's ability to provide clearing services to its customers, including the number of transactions it can clear per day, and upon the OTC and microcap markets in general. The Illiquid Charge alone is unreasonable also because the NSCC employs its secret CRRM rating to eliminate the DTC Offset which Alpine could have used, in almost every circumstance, to avoid the charge altogether. The unreasonableness of Illiquid Charge, OTC Volatility Charge and OTC Mark-to-Market Charge is further heightened when a sub-penny stock is involved, which result in margin

---

[88] 15 U.S.C. § 78s(f).

[89] *See Sec. Indus. Fin. Mkts. Ass'n,* SEC Release No. 72182, 2014 WL 1998525, at *8 (May 16, 2014).

[90] *See* Section 19(f), 15 U.S.C. § 78s(f) and Rule of Practice 700, 17 C.F.R. § 201.700. *See also Sec. Indus. Fin. Mkts. Ass'n,* 2014 WL 1998525, at *9 n. 88.

[91] Alpine's Petition for Review is attached hereto as Ex. B, and incorporated herein by reference.

[92] Because Alpine has discussed the challenged components, their impact on Alpine and the flaws in NSCC's purported justifications for these components in detail above, Alpine will address the violations here by reference to the earlier sections of the brief, in a more summary fashion.

[93] 15 U.S.C. § 78q-1(b)(3)(D).

charges that are grossly disproportionate to the transaction value, including where the share value is arbitrarily rounded up to $.01/share, for which, as indicated, NSCC provided no justification.[94]

The ENCP charge is also unreasonable, based on: (a) the punitive amount of the charge (at least 100% of the amount by which the Required Deposit exceeds excess net capital); (b) the fact that the ENCP charge is based on the Required Deposit amount, which in turn already factors in the Illiquid Charge, OTC Volatility Charge and OTC Mark-to-Market Charge; (c) NSCC's failure to establish that the other components of the Required Deposit are insufficient to protect against the purported credit exposure; and (d) the chilling effect the ENCP charge has upon Alpine's ability to provide clearing services to its customers and upon the OTC and microcap markets in general.

The challenged components are also not "equitably allocated." Each of the challenged components is directed at and applied exclusively to members providing services to microcap or OTC markets, and imposes a disproportionate burden on smaller members. Because the purported "risk" to NSCC associated with clearing OTC and microcap stocks has not been justificd by citation to actual evidence, and could be adequately addressed through other more appropriate and objective means, including by designing reasonable margin requirements that are commensurate with actual identified risks that are equally applied to all members, this piling-on of discriminatory charges is not equitable.

### 2. *The Challenged Components Are Anticompetitive and Restrain Capital Formation*

Promoting competition and capital formation are each central to the purpose of the Exchange Act. As Congress noted in amending the Exchange Act in 1975, which added Sections 17A and 19 to the Exchange Act, "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."[95] The goal is not to hinder, but to "enhance competition" and to "allow economic forces, **interacting in a fair regulatory field**, to arrive at appropriate variations in practices and services."[96] Congress continued:

> [T]he ability of individual firms as well as the various exchange and over-the-counter markets to compete with one another will be a critical element in the successful functioning of the national market system. Unfortunately, because of excessive and unnecessary regulatory restraints, competition in the securities industry has not been as vigorous and as effective in advancing the public interest as it could be. . . . [T]he most effective way to foster competition would be to

[94] *See Sec. Indus. Fin. Mkts. Ass'n,* SEC Release No. 84432, at p. 28 (October 16, 2018) (holding that the SRO failed to establish its fees were fair and reasonable where SRO failed to present adequate evidence to justify the fees).

[95] S. Rep. 94-75, at 8.

[96] *Id.* (emphasis added).

> charge the Commission with an explicit obligation to eliminate all present and future competitive restraints that cannot be justified by the purposes of the Exchange Act. Following this pattern, various sections of S. 249 would direct the Commission to remove existing burdens on competition and to refrain from imposing, or permitting to be imposed, any new regulatory burden on competition 'not necessary or appropriate in furtherance of the purposes' of the Exchange Act.[97]

Given this critical element, it is unsurprising that Congress' "charge" to the Commission found its way into several provisions of the Exchange Act. Relevant here, Section 17A(b)(3)(I) requires that the "rules of the clearing agency do not impose any burden on competition not necessary and appropriate in the furtherance of the purposes of this chapter."[98] Section 19(f) requires the SEC, in reviewing fees or other SRO action for a denial or limitation on access of the SRO's essential services, to set aside any such fees or action that "imposes any burden on competition not necessary or appropriate in the furtherance of the purposes of this chapter."[99] Section 3 requires the SEC, "in the review of a rule of a self-regulatory organization," to "consider or determine . . . whether the action will promote efficiency, competition and capital formation."[100] Despite being repeatedly emphasized in the Exchange Act itself, in a recent speech, Commissioner Robert J. Jackson lamented the SEC's duty to "ensure[] robust competition" as the "forgotten fourth pillar of the SEC's mission."[101]

Following these directives, the Commission should set aside the challenged components of the Required Deposit as they have a blatantly anticompetitive effect as applied, and serve to limit, rather than promote capital formation.

As indicated, each component is designed to impose, and results in, additional charges and restrictions being applied to smaller, less capitalized members who provide clearing services in the OTC and microcap markets. This directly affects competition and capital formation of those member firms subject to the restrictions because they must use NSCC to provide clearing services, which gives those member firms who do not face these restrictions an unfair

---

[97] *Id.* at 13.

[98] 15 U.S.C. § 78q-1(b)(3)(I).

[99] 15 U.S.C. § 78s(f).

[100] *See* 15 U.S.C. § 78c(f).

[101] *See* Jackson, Robert J., *Competition: The Forgotten Fourth Pillar of the SEC's Mission* (October 11, 2018), available at https://www.sec.gov/news/speech/speech-jackson-101118#_ftn9. Commissioner Jackson observed that the current "unprecedented concentration of power in the American economy" in "just a few players of enormous size and scope" raises "real questions" about whether America's stock markets "reflect the competitive marketplaces investors deserve." *Id.* Commissioner Jackson remarked that the SEC shares the blame for this due to its complacency in fulfilling its mission of promoting competition over the past several decades in reviewing proposed rules. *Id.*

competitive advantage. As a direct result of these charges, as indicated, Alpine is able to process only a handful of trades at a time and its liquidation business is down 75%.[102]

Moreover, corporate entities who issue shares to facilitate their business development, or firms or entities who receive those shares, cannot sell that stock at Alpine once it has reached its artificially imposed daily limit, and more and more there is no other firm *willing to clear OTC stocks.*[103] Even when they find a participant who is willing or able to process the trade, issuers and investors in the OTC and microcap markets often face delays or fees necessary for the clearing broker to clear enough capital to pay the exorbitant Illiquid Charge and other Required Deposit charges applicable solely to OTC and microcap stocks.[104] These are barriers to access simply not faced by securities traded on registered exchanges, further working to concentrate wealth in the few.

Alpine, and other small broker-dealers play a critical role in providing liquidity for securities of small companies that have no other access to capital, such as through loans. Large investment bank members do not typically serve this market segment. Without firms willing and able to process these transactions, like Alpine, these small companies will be cut-off from the capital markets to raise money to grow their businesses. In this regard, the challenged components do not just have an anti-competitive and discriminatory effect, they also impermissibly limit access to services by Alpine's actual and potential customers, in violation of yet another provision of the Exchange Act – Section 17A(b)(6).[105]

These impacts to the market are neither "necessary" nor "appropriate." For the reasons detailed above, NSCC does not need to choke the microcap and OTC markets, or its small clearing members, by imposing excessive charges and restrictions in order to limit its credit exposure. There is no evidence that the risks NSCC claims to justify these discriminatory components exist in fact, or are likely to ever materialize, particularly given the number of additional margin charges and options that exist to guard against the perceived concerns. Certainly, an illusory risk does not warrant the significant, and real, anticompetitive effects.[106]

---

[102] *See* Brant Decl., at ¶¶ 33, 40.

[103] *See id., at* ¶¶ 34-35.

[104] *See id.* Given the high amount of the Required Deposit in comparison to the underlying trade, many customers are simply unwilling or unable to pay processing fees to sell the shares, leaving the shares effectively untradeable, and worthless. *See id.*

[105] *See* 15 U.S.C. § 78q-1(b)(6) ("No registered clearing agency shall prohibit or limit access by any person to services offered by any participant therein.").

[106] It is expected that NSCC would contend, as it did in responding to criticism that the proposal to impose the ENCP was anticompetitive, that there is no right to be a direct member of NSCC. *See* SEC Release No. 34-54457, at 14. However, NSCC misses the point. Alpine *is a member* of NSCC. As a registered clearing agency and SRO, NSCC enjoys a virtual monopoly – nearly all U.S. equities security transactions are, and must be, cleared through NSCC. The cost of this virtual monopoly is that NSCC cannot deny or limit access to its essential services, including through imposition of rules, unreasonable charges and other restrictions that impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act. 15 U.S.C. § 78s(f). Moreover, NSCC's argument also ignores the general lack of members willing to clear OTC and microcap stocks at all.

### 3. *The Challenged Components are Unfairly Discriminatory*

Section 17A(b)(3)(F) requires, *inter alia,* that the "rules of the clearing agencies are designed" to "protect investors and the public interest," and "are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency . . . ."[107] The challenged components disproportionately impact those small members who focus on the OTC and microcap markets and those issuers and investors in that market segment. Indeed, they were designed with this very purpose. There is no justifiable reason – and as demonstrated above, NSCC's "credit exposure" rationale is specious, at best – to single out certain members or market segments for additional margin charges, at devastating impact to their business, just because they provide services to, or within, the OTC and microcap markets and have less capital.

NSCC's development and use of the CRRM is also unfairly discriminatory, separate and apart from the other challenged components of the Required Deposit. As discussed, because the various quantitative and qualitative factors that make up the CRRM are themselves vague, and the manner in which NSCC weighs these factors to assign a CRRM rating is withheld by NSCC, it allows for arbitrary treatment. NSCC can use the CRRM to unilaterally classify a member, such as Alpine, as a credit risk, and thereby exponentially increase its Required Deposit, without reference to Alpine's spotless credit history, its record of compliance with NSCC's requirements, or Alpine's profitability, operational and financial capabilities.

### 4. *The Challenged Components Violate the SEC's Regulations*

Section 17A(d) and Section 19(g) require NSCC to comply with the rules and regulations promulgated by the SEC.[108] Pursuant to this authority, the SEC has promulgated a rule imposing "Standards for Clearing Agencies."[109] The challenged components violate several provisions of these standards.

First, the Subsection (e)(1) of the standards imposes transparency requirements mandating NSCC to "establish, implement, maintain and enforce written policies and procedures reasonable designed to . . . [p]rovide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions."[110] Similarly, Section (e)(23)(ii) requires NSCC to provide "sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agencies."[111] NSCC's CRRM rating system, which as indicated employs a secret formula to

---

[107] 15 U.S.C. § 78q-1(b)(3)(F).

[108] *See* 15 U.S.C. § 78q-1(d) *and* 15 U.S.C. § 78s(g).

[109] *See* 17 C.F.R. 240.17Ad-22.

[110] *Id.* at § 240.17Ad-22(e)(1).

[111] *Id.*at § 240.17Ad-22(e)(23)(ii).

weigh a variety of undefined factors, clearly fails to comply with these transparency requirements.

Second, Alpine acknowledges that the SEC requires NSCC to establish and implement, *inter alia,* a "risk-based margin system" and to identify, measure and manage its credit exposure and liquidity risks.[112] However, there is language within these provisions that constrains the types of margin requirements that NSCC can impose, in addition to the limits imposed by the Exchange Act itself (discussed above). Specifically, Subsection (e) of the standards requires that NSCC's written policies and procedures must be "*reasonably designed*" to "*effectively* identify, measure, monitor and manage its credit exposure" and "liquidity risk."[113] Additionally, while NSCC, as a central counterparty, must establish a "risk based margin system," that system must "consider[], and produce[] margin levels *commensurate with,* the risk and particular attributes of each relevant product, portfolio and market," and "use[] an *appropriate method for measuring* credit exposure that accounts for relevant product risk factors and portfolio effects across product."[114]

In each of these respects, NSCC's design and application of the challenged components falls short. The margin requirements that NSCC has imposed through the Illiquid Charge and ENCP, or the OTC Volatility Charge and OTC Mark to Market Charge when sub-penny stocks are involved, are not "commensurate" with the credit exposure from these positions. To the contrary, as demonstrated above, they are unreasonably far in excess of any possible credit exposure from these positions, particularly when Alpine has the shares on deposit at DTC. Certainly, NSCC has not attempted to justify a need to be so grossly over-secured on these positions.[115] As a result, they are also not "reasonably designed" and "appropriate" to "effectively" measure and manage credit exposure.

### 5. *The OTC Volatility Charge and OTC Mark to Market Charge, as Calculated and Applied to Microcap and OTC Stock Transactions, Are Not Authorized by NSCC's Rules.*

Section 19(g) requires every SRO to "comply with . . . its own rules . . . ."[116] As indicated, Alpine can find no support in NSCC's Rules or Procedure XV for its practice of imposing OTC Volatility Charges or OTC Mark to Market charges that equal or exceed the

---

[112] *Id.* at § 240.17Ad-22(e)(4), (6) and (7).

[113] *See id.* at § 240.17Ad-22(e)(4), (7) (emphasis added).

[114] *Id.* at § 240.17Ad-22(e)(6)(i), (v) (emphasis added).

[115] By way of example, NSCC could also attempt to manage its credit exposure by trying to impose minimum clearing fund contribution of $5 million per member. However, this would likely face stiff opposition, and would almost certainly not be approved, because it is patently unreasonable and arbitrary in that it is not tied to any actual evidence that such an amount is appropriate, or an effective and commensurate way to manage the purported risk (although it would be, at least, equitably applied). Yet, NSCC has acted no less unreasonably and arbitrarily by imposing discriminatory margin charges that are many times the amount of the underlying transaction.

[116] 15 U.S.C. § 78s(g).

underlying transaction amount just because a microcap or OTC stock is involved. [117] Nor can Alpine locate any authorization in NSCC's Rules or Procedure XV to round-up the price of the stock/positions to the fictional price of $.01/share on sub-penny stock transactions to calculate Volatility Charges or Mark-to-Market.

## III. THE DIVISION OF TRADING AND MARKETS FAILED TO ENGAGE IN THE REQUISITE INDEPENDENT ANALYSIS PRIOR TO APPROVING NSCC'S ILLIQUID CHARGE, CRRM AND ENCP RULES.

The Commission delegated its authority to approve SRO rules and rule changes, including by the NSCC, to the Director of the Division of Trading and Markets ("Director of Market Regulation").[118] In reviewing and permitting these rule changes, the Director of Market Regulation failed to comply with its obligation to engage in the requisite independent analysis necessary to satisfy the SEC's obligations under the Administrative Procedure Act, 5 U.S.C. § 551, *et seq.*[119]

The D.C. Circuit's recent decision in *Susquehanna International Group, LLP v. SEC,* 866 F.3d 442 (2017), specifically addressed the SEC's abdication of that responsibility under similar circumstances. That case involved a challenge to a rule change by a registered clearing agency, Options Clearing Corporation ("OCC"), which was approved by the SEC, to boost its capital reserves and to alter how fees and refunds were calculated.[120] On a petition for judicial review, the D.C. Circuit analyzed the Order approving the rule change under the "arbitrary and capricious" standard of the APA, which requires the SEC to have substantial evidence for a decision and "to examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and choices made.'"[121]

The *Susquehanna* petitioners argued that that the SEC erred in approving OCC's rule because it violated several provisions of the Exchange Act.[122] The D.C. Circuit did not reach these arguments, however, but instead held the SEC's Order approving the rule failed in a "more

---

[117] *See* NSCC Rules and Procedures, Procedure XV, § 1(A)(1)(a)(ii), (b) and (c).

[118] *See* 17 CFR 200.30-3(a)(12); *Sacks v. SEC*, 648 F.3d 945, 948 (9th Cir. 2011) (recognizing the delegation).

[119] The pertinent approval orders include: SEC Release No. 34-54457, SR-NSCC-2006-03 (September 15, 2006) (ENCP Charge); SEC Release No. 34-80597, SR-NSCC-2017-001 (May 4, 2017) (Illiquid Charge); *and* SEC Release No. 34-80734, SR-NSCC-2017-002 (May 19, 2017) (CRRM). Because NSCC did not follow the required process to alter its formula to impose OTC Volatility or Mark-to-Market charges that equal or greatly exceed the underlying transaction value, or to justify its use of a fictional $.01/share price to calculate those charges for sub-penny stocks, the Division of Trading and Markets had no opportunity to approve such a practice. NSCC has simply acted without any authority in respect to its calculation of these charges.

[120] *Susquehanna,* 866 F.3d at 443-44 (discussing OCC's rule changes).

[121] *Id.* at 445 (citation omitted).

[122] *Id.* at 445-446 (petitioners argued, *inter alia,* that OCC's rule violated the exchange act because it was designed to permit unfair discrimination among participants in use of the clearing agency and imposed an unnecessary burden on competition).

basic respect: the Commission did not itself 'find[]' or 'determin[e]' that the [OCC rule] met any of those requirements."[123]

> Instead, the SEC effectively abdicated that responsibility to OCC—the proponent of the Plan and the entity whose rule changes the SEC is statutorily obligated to approve or disapprove. Moreover, the SEC's Order reflects little or no evidence of the basis for the OCC's own determinations—and few indications that the SEC even knew what that evidence was.[124]

The Court continued, "the SEC cannot simply accept what a [self-regulatory agency] has done, but rather is obligated to make an independent review"; "stating that a factor is considered – or found – is not a substitute for considering or finding it."[125] "[T]he SEC's unquestioning reliance on OCC's defense of its own actions is not enough to justify approving the Plan. Instead, the SEC should have critically reviewed OCC's analysis or performed its own," not simply relied on the "self-serving views of the regulated entity." [126] The D.C. Circuit has further observed that, in reviewing a proposed rule, the Commission "has a statutory obligation to determine as best it can the economic implications of the rule."[127]

Here, even a cursory review of the Orders approving the Illiquid Charge, CRRM and ENCP demonstrates that the Director of Market Regulation did not engage in the necessary independent analysis to determine that proposed rule changes complied with the Exchange Act and the SEC's rules, but instead merely took NSCC's word for it. The Orders approving the Illiquid Charge, ENCP and CRRM changes does little more than track the language that NSCC used to try to justify the rule changes. There appears to be no independent analysis.

For example, the Order approving the Illiquid Charge provides no discussion or evaluation of NSCC's unexplained decisions to impose a fictional minimum price of $.01/share or to allow different volume limitations or the DTC Offset for some members but not others, beyond merely repeating NSCC's description of how it would calculate the Illiquid Charge.[128] There was no analysis done on the economic, competitive or discriminatory impacts of those decisions.[129] In fact, the Illiquid Charge Order does not discuss the burdens on competition, the impacts on capital formation, or whether it would permit unfair discrimination at all. The Order instead merely references *some* of these requirements in a cursory footnote that states: "In approving the proposed rule change, the Commission considered the proposals' impact on

---

[123] *Id.* at 446 (internal citations omitted).

[124] *Id.* (internal citations omitted).

[125] *Id.* (internal quotations and citations omitted)

[126] *Id.* at 447 (quotations and citations omitted).

[127] *Business Roundtable v. SEC,* 647 F.3d 1144, 1148 (D.C. Cir. 2011).

[128] *See* SEC Release No. 34-80597, SR-NSCC-2017-001 (Illiquid Charge), at 5-7, and 9-12

[129] *Id.*

efficiency, competition, and capital formation."[130] This is precisely the type of "referencing a requirement," rather than "complying with the requirement," mode of decision-making that was held to be unacceptable in *Susquehanna.*[131] Moreover, because NSCC did not provide any evidence or actual risk to justify the Illiquid Charge or any estimation of the amount of the Illiquid Charges that would be imposed, the Director of Market Regulation did not, and could not, find that the charges were "reasonable" and "equitabl[y] allocate[ed],"[132] or otherwise analyze the "economic implications" of the rule.[133]

Similar flaws exist in the Orders approving the changes to the CRRM and ENCP. For instance, with respect to the CRRM, there was no discussion of whether NSCC complied with the transparency requirements by not disclosing the manner in which it weighed the quantitative and qualitative factors to determine a CRRM rating.[134] The Order approving the CRRM also contains the same insufficient, cursory footnote recital that the SEC considered the impact on efficiency, competition and capital formation as the Order approving the Illiquid Charge, and no discussion or mention of discriminatory impacts.[135]

While the Order approving the ENCP Charge does discuss the burden on competition, it merely repeats the statements made by NSCC in responding to comment letters, without any independent analysis.[136] Once again, no discussion of economic impact or the reasonableness of the ENCP charges exists in the Order.[137]

Therefore, the Orders themselves lack the necessary findings, resulting in arbitrary and capricious decision-making. As a result of this, and the evidence Alpine has provided demonstrating the unwarranted and impermissible limitations on access, devastating impacts, and violations of the Exchange Act resulting from the application of these rules and charges, the Commission should undertake a comprehensive review and consider the rulemaking proposals below.

## IV. Proposals

The undersigned, through counsel, petitions the Commission to use its supervisory authority to adopt the following rules with respect to NSCC's Clearing Fund Formula:

---

[130] *Id.* at 13, n. 39.

[131] 866 F.3d at 446.

[132] 15 U.S.C. § 78q-1(b)(3)(D).

[133] *Business Roundtable v. SEC,* 647 F.3d at 1148.

[134] *See* SEC Release No. 34-80734, SR-NSCC-2017-002 (CRRM), at 11.

[135] *Id.* at 14, n. 24.

[136] *See* SEC Release No. 34-54457, SR-NSCC-2006-03 (ENCP), at 13-15.

[137] *Id.*

1. THE COMMISSION SHOULD AMEND OR REQUIRE NSCC TO AMEND RULE 1 AND PROCEDURE XV OF THE NSCC RULES AND PROCEDURES TO ELIMINATE THE ONE OR MORE OF THE FOLLOWING COMPONENTS OF THE CLEARING FUND FORMULA: (1) THE ILLIQUID CHARGE AND (2) THE EXCESS NET CAPITAL PREMIUM.

   The undersigned petition asks the Commission to use its supervisory authority to adopt a rule amending, or requiring NSCC to amend Rule 1 and Procedure XV of the NSCC Rules and Procedures to eliminate both or either of the Illiquid Charge and the Excess Net Capital Premium on the basis that NSCC's justification for these charges lacks evidentiary support, and the actual calculation and application of the charges leads to unreasonable, inequitable, discriminatory and anticompetitive charges, and an impermissible denial or limitation of access, in violation of the Exchange Act and the rules promulgated thereunder.

2. THE COMMISSION SHOULD AMEND OR REQUIRE NSCC TO AMEND RULE 1 AND PROCEDURE XV OF THE NSCC RULES AND PROCEDURES TO ELIMINATE THE CREDIT RISK RATING MATRIX, AS CURRENTLY FORMULATED AND APPLIED AS A COMPONENT OF THE CLEARING FUND FORMULA AND/OR REQUIRE NSCC TO DISCLOSE THE SPECIFIC CRITERIA AND MANNER BY WHICH NSCC DETERMINES AND ASSIGNS CREDIT RATINGS BASED ON THE CREDIT RISK RATING MATRIX

   The undersigned petition asks the Commission to use its supervisory authority to adopt a rule amending, or requiring NSCC to amend, Rule 1 and Procedure XV of the NSCC Rules and Procedures to Eliminate the Credit Risk Rating Matrix, used to determine the applicability of Illiquid Charge and other components of the Required Deposit, on the basis that it provides for arbitrary, unfair and discriminatory application in violation of the Exchange Act, and fails to comply with the transparency requirements of the SEC Rule 240.17Ad-22(e)(1) and (23)(ii). Alternatively, the undersigned petition the adopt a rule requiring NSCC to disclose the specific criteria and manner, including the weight given to each component, by which NSCC determines and assigns credit ratings based on the Credit Risk Rating Matrix.

3. THE COMMISSION SHOULD PROMULGATE A RULE PROHIBITING NSCC FROM CALCULATING ANY REQUIRED DEPOSIT CHARGES FOR SUB-PENNY MICROCAP AND OTC STOCKS EXCEPT THROUGH USE OF THE ACTUAL VALUE OF THE SHARES.

   The undersigned petition asks the Commission to use its supervisory authority to adopt a rule requiring NSCC to use the absolute or actual value of the share price in calculating the Required Deposit in OTC and microcap stocks, and to disallow

any practice by NSCC to use artificial share prices or any exercise of discretion to impose Volatility Charges or Mark-to-Market Charges in amounts that would not be imposed based on the actual share value or which impermissibly exceed the value of the transaction. The basis is that NSCC's practices result in unreasonable, inequitable, discriminatory and anticompetitive charges, and an impermissible denial or limitation on access, in violation of the Exchange Act and the rules promulgated thereunder, and NSCC's Rules and Procedures do not authorize the use of a fictional share price to calculate Mark-to-Market or Volatility Charges, or the imposition of Volatility Charges for OTC and microcap stocks that equal or exceed the transaction value.

4. ALTERNATIVE TO PROPOSAL 1: THE COMMISSION SHOULD AMEND OR REQUIRE NSCC TO AMEND RULE 1 AND PROCEDURE XV OF THE NSCC RULES AND PROCEDURES TO REQUIRE NSCC, IN CALCULATING THE ILLIQUID CHARGE, TO OFFSET THE QUANTITY OF SHARES IN A EVERY MEMBER'S SELL POSITION AGAINST THE NUMBER OF SHARES IN THE SAME SECURITY HELD BY THE MEMBER AT DTC, REGARDLESS OF THE MEMBER'S CREDIT RATING

In the event the Commission does not adopt Proposal 1, the undersigned petition the Commission, in the alternative, to use its supervisory authority to adopt a rule, or requiring NSCC to amend Rule 1 and Procedure XV of the NSCC Rules and Procedures to require NSCC, in calculating the Illiquid Charge, to offset the quantity of shares in every member's sell position against the number of shares in the same security held by the member at DTC (the DTC Offset), regardless of the member's credit rating, on the basis that NSCC's justification for disallowing the DTC Offset for such members lacks evidentiary support, and leads to unreasonable, inequitable, discriminatory and anticompetitive results and charges, and an impermissible denial or limitation of access, in violation of the Exchange Act and the rules promulgated thereunder.

Sincerely,

**CLYDE SNOW & SESSIONS**

Brent R. Baker
Aaron D. Lebenta

**THOMPSON HINE**

Maranda Fritz