Kimberly Unger
CEO/Executive Director
79 Madison Ave., 2nd Fl.
New York, NY 10016
212.344.0410
www.stany.org

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Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Enhance National Securities Clearing Corporation's Haircut-Based Volatility Charge Applicable to Illiquid Securities and UITs and Make Certain Other Changes to Procedure XV (Release No. 34-88474 File No. SR-NSCC-2020-003)

Dear Ms. Countryman:

The Security Traders Association of New York, Inc. ("STANY")[1] appreciates the opportunity to provide comments on the National Securities Clearing Corporation's ("NSCC") proposed rule change to enhance NSCC's Haircut-Based Volatility Charge Applicable to Illiquid Securities and UITs.

STANY understands the important of vigilant monitoring, assessing, and addressing potential credit risks and appreciates NSCC's diligence in carrying out this function. However, we have concerns that the instant proposal, ostensibly intended to increase transparency in the manner in which NCSS manages risk, is opaque, confusing, and advanced without adequate justification and demonstrated need. The NSCC has not demonstrated that current margin requirements are insufficient to cover credit risks to its members, nor has it demonstrated that it carefully considered the potential impact on investors or on the availability of clearing services for small company securities. Moreover, the Proposal unfairly and disproportionately impacts smaller broker-dealers and small companies whose shares trade on the OTC Markets.

The proposed rule change consists of modifications to NSCC's Rules and Procedures in order to enhance the calculation of certain components of the Clearing Fund Formula. The stated purposes of the proposed changes are to:

1. clarify and enhance the methodology for identifying securities as illiquid for purposes of determining the applicable calculation of the volatility component of the Clearing Fund formula,

[1] STANY, a membership association representing professionals engaged in the trading of securities, is committed to be a leading advocate of policies and programs that foster investor trust, professional ethics, and marketplace integrity and that support capital formation, marketplace innovation and education of market participants. As an industry organization comprised of individuals employed in the securities markets, STANY does not represent a single business or business model, but rather provides a forum for trading professionals representing institutions, hedge funds, broker-dealers, ATSs, trading centers and technology companies that support trading to share their unique perspectives on issues facing the securities markets.

and revise the Rule's definition of "Illiquid Security" to reflect these changes;

2. enhance the calculation of the haircut-based volatility component of the Clearing Fund formula that is applied to positions in (1) Illiquid Securities (which include securities that are priced at less than a penny ("sub- penny securities") and initial public offerings ("IPOs")), and (2) unit investment trusts ("UITs");
3. eliminate the existing Illiquid Charge as the risk it was designed to address would be addressed by the other enhancements being proposed;
4. make certain changes to Section I.(A) of Procedure XV (Clearing Fund Formula and Other Matters) of the Rules ("Procedure XV") for greater transparency.

For the reasons stated below, we do not support the Proposal.

The Proposal does not provide enough detail or analysis to meet its statutory requirements for clearing firm/SRO rulemaking.

The Securities Exchange Act of 1934, as amended (the "Exchange Act"), SEC Rule 17Ad-22 promulgated thereunder, and the Clearing Supervision Act require a systemically important clearing agency like NSCC to design its clearing member liquidity requirements to enable members to predict the financial consequences of their activities and the impact of those actives on their liquidity obligations. Despite the NSCC's aim to provide greater transparency and clarity for member firms through an "enhanced" Clearing Fund Formula with respect to illiquid securities, the Proposal relies on undisclosed models and calculations and does not provide (i) an explanation of why these changes are necessary and appropriately tailored to achieve an articulated and legitimate regulatory purpose, (ii) a description of how they would impact members, investors and other market participants or (iii) an analysis of the Proposal's potential burden on competition – all requirements for any SRO rulemaking.

Without additional detail and clarification, members are unable to ascertain the likely financial and operating impacts of the proposed changes or how the changes will affect their liquidity requirements. At a minimum the NSCC should disclose the models and calculations on which it relies so that market participants can assess the Proposal's impact on competition and provide meaningful comment on the proposed changes. While it is difficult to understand the complex and vague calculation of the volatility charge in the Proposal, it does appear that the changes will require significantly more margin than currently required without adequate justification or demonstrated need.

The Proposal would serve to further exacerbate the problems facing smaller firms, thinly-traded securities, and their investors.

While the Proposal only cites undisclosed "impact studies", it does acknowledge that firms with "lower operating margins or higher costs of capital" may be disproportionately impacted. This added competitive burden favors clearing members affiliated with large banks and discriminates against, smaller self-clearing NSCC members. Many brokers and smaller clearing firms already impose significant fees for transactions in thinly-traded securities due to high compliance costs and other regulatory burdens. Others have chosen to leave OTC equities business. We are extremely concerned that the increased margin requirements and the burdens imposed by the Proposal will cause additional firms to exit the already costly business of providing liquidity in thinly-traded stocks, to the ultimate detriment of retail investors and small companies. If the Proposal causes more NSCC members to exit self-clearing, the likely result will be further concentration of risk at the largest NSCC clearing member firms. We are equally concerned that there may be fewer firms willing to accept the deposit of thinly-traded stocks, or impose exorbitantly high fees to do so, thereby discouraging entry to the public market by small and growing companies and impairing capital

formation. Additional requirements that increase the already high costs and difficulty of clearing and settlement of small securities, will negatively impact small company liquidity and shareholder value.

The additional requirements for illiquid securities must be tied to the actual risks posed to NSCC and member firms.

The Proposal classifies "Illiquid Securities" as certain exchange-traded securities and all securities not listed on a "specified securities exchange" (defined as a national securities exchange that has established listing services and is covered by industry pricing and data vendors) without regard to capitalization or trading history. NSCC justifies additional requirement on these securities by blanketly stating that securities defined as illiquid, "tend to exhibit unpredictable illiquid characteristics including limited trading volumes or infrequent trading." This unsubstantiated conclusion is not a legitimate justification for including all 10,000+ securities traded on OTC markets in the definition of "Illiquid Security", especially when some of the largest international companies such as Roche, Adidas, and Heineken trade on these markets. Categorizing all securities traded on one venue, including those with market capitalization in excess of $300M, as "illiquid" without further analysis is arbitrary. Many securities listed on the OTC markets trade with depth and liquidity or otherwise meet the requirements to be listed on a "specified securities exchange." Lumping all these securities into one bucket makes it significantly more difficult and costly to deposit, trade and settle these securities. Any definition of "illiquid security" should be based on the risks inherent in the security itself, rather than where it trades.

Margin requirements for "illiquid" securities are already excessive and unconnected to actual risk. Under the current NSCC Deposit Requirement Formula, NSCC treats long sales of an "illiquid" security, held at DTC, as if it were a short sale. To understand the unreasonableness of current margin requirements, a recent long sale of securities trading at $.0001 per share with a market value of $9,500 required the carrying broker, a member of both DTC and NSCC, to maintain $1,284,500 in collateral ($544,500 Mark to Market, $550,000 in Illiquid Charges and $190,000 Value at Risk or Volatility ("VaR"). The situation is exacerbated because the Mark to Market and VaR contribute to the excess capital premium charge which is applied when a firm's "core components" exceed that of the firm's excess net capital according to the firm's latest FOCUS filing. When a member firm's core components, which are driven primarily by the Mark to Market and VaR, exceed that of the firm's excess net capital, NSCC will impose an additional punitive margin requirement. Therefore, in this example, the broker was required to put up over one and a half million dollars to support the liquidation of securities with a market value of $9,500 for a client that was holding the stock in an account at DTC. Under current NSCC rules, charges have no rational relationship to the transaction value, or any possible risk from the particular transaction. Additional margin requirements contemplated by the Proposal, would only add to the absurdity. Rather than net long and short positions in sub-penny stocks, the Proposal suggests that NSCC will calculate the Clearing Fund requirements separately for each. NSCC has not sufficiently articulated a rationale for considering long and short positions independently, nor have they adequately identified the risk which they seek to mitigate by doing.

NCSS also offers little justification for the proposed $300M market cap requirement for exchange-listed stocks. NSCC states that it "believes that given the lack of public information and limited trading volumes, securities with capitalization below this threshold tend to involve higher risks and exhibit illiquid characteristics." However, NSCC acknowledges that it may adjust this definition from time to time to continue to reflect a threshold that captures securities with capitalization that would indicate that the securities exhibit illiquid characteristics. Again, to justify additional requirements for settlement, the NSCC must tie these requirements to the actual risks facing NSCC and member firms rather than reliance on

unsupported generalizations drawn from unnamed studies.

Summary

Without transparent disclosure concerning the impact of the NSCC's proposed requirements for "Illiquid Securities", we believe that the Proposal exacerbates the existing clearing, deposit, and liquidity issues facing small firms and retail investors. The Commission should require the NSCC to provide an explanation of why these changes are necessary and appropriately tailored to achieve an articulated regulatory purpose, a description of how the proposal would impact members, investors and other market participants and an analysis of the Proposal's potential burden on competition. Additionally, we respectfully request that the Commission compel the NSCC to disclose the models and calculations on which it relies so that market participants can assess the Proposal's impact on competition and provide meaningful and informed comment.

Please do not hesitate to contact the undersigned with any questions or requests for additional information.

Respectfully submitted,

Kimberly Unger
CEO & Executive Director