WILSON-DAVIS & CO., INC.

July 29, 2020

VIA EMAIL
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U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: SR-NSCC-2020-003

SECURITIES AND EXCHANGE COMMISSION (Release No. 34-88474; File No. SR-NSCC-2020-003) March 25, 2020

Self-Regulatory Organizations; 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

Ladies and Gentlemen:

Wilson-Davis & Co., Inc. submits these comments in response to the proposal and request of the U.S. Securities and Exchange Commission (the "Commission") to comment on the rule change proposed by the National Securities Clearing Corporation (the "NSCC") respecting its haircut-based volatility charges applicable to illiquid securities and UITs and related changes (the "Proposed Rule").

We submitted substantive comments and requested an extension of the comment period on May 1, 2020 https://www.sec.gov/comments/sr-nscc-2020-003/srnscc2020003-7144486-216265.pdf. We reiterate and expand our position in this comprehensive response.

Our Firm

We are a 50+-year-old correspondent clearing firm in the Intermountain West with retail customers across the nation. We principally handle securities liquidation resales for our own retail customers and for the customers of introducing brokers for which we clear on a fully disclosed basis. Frequently, the access that we provide to holders of low-priced securities fulfills a limited niche through which private investors in small businesses can obtain liquidity for their securities. Investor liquidity is a fundamental requirement for small companies to attract initial investment equity. Without assured liquidity channels, private investment would dry up for many start-up or otherwise capital deficient small companies. Our role is critical to our customers, small businesses, and in turn, the formation of capital in our economic system. Similarly, the liquidity we help provide fulfills a real need of small investors who have long voted with their dollars to fund small and emerging enterprises.

As we provide liquidity and devote the required capital to those activities, it is critical that we be able to predict the financial consequences of our activities and their impact on our own liquidity needs and our ability to serve our customers. The Proposed Rule does not accomplish that result and does not, consequently, discharge the NSCC's obligations under Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) and (v) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), for the reasons noted below.

Our nationwide retail customers are typically investors in small businesses that invest via private placements under Regulation D, Regulation A+ offerings, or crowd funding. These small businesses have limited access to large money center financial intermediaries to undertake underwritten public offerings on their behalf.

For the following reasons, the Commission should reject the Proposed Rule.

Comments on the Proposed Rule

1. The Proposed Rule is inconsistent with the statutory mandate that the NSCC "remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest . . . ." Exchange Act, Section 17A(b)(3)(F).

The Commission has adopted a number of rules and policy changes, consistent with a Congressional mandate, that recognize the difficulty that small businesses encounter in raising early-stage capital and, based on that concern, has adopted a number of rule policy changes reflected in its rules to facilitate capital formation.

Congress mandated Commission action respecting small business capital formation comprehensively in The Jumpstart Our Business Startups Act (the "JOBS Act"), enacted on April 5, 2012. In the JOBS Act, Congress instructed the Commission to establish a regulatory structure for startups and small businesses to raise capital through offerings exempt from registration under Section 5 of the Securities Act of 1933, as amended (the "Securities Act").

Regulation D

Regulation D provides a popular exemption from registration on which small business issuers rely in seeking capital. The provisions of Regulation D were materially changed under the Jobs Act to facilitate capital formation.

The Commission's Division of Economic and Risk Analysis has issued a series of studies of capital formation from Regulation D offerings, most recently in 2018. *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Offerings, 2009-2017* (August 2018) ("Reg D Study") https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf). This study, based on a survey of Commission Form D filings, provides extensive, detailed data regarding the popularity of Regulation D offerings and the capital raised in reliance on that exemptive safe harbor, indicated by the following main findings:

- In 2017, there were 37,785 Regulation D offerings reported on Form D filings, accounting for more than $1.8 trillion raised in new capital.

- Issuers in non-financial industries reported raising $105 billion during 2017. Among financial issuers, hedge funds reported raising $382 billion and private equity funds $582 billion, while financial issuers that are not pooled investment funds reported $72 billion during 2017 and $570 billion during the 2009-2017 period.

. . .

- During 2009-2017, Rules 506(b) and 506(c) account for 99.9% of the amounts reported sold through Regulation D, including 93% of capital raised in offerings with maximum offer size of $1 million and 98% of capital raised below the amended Rule 504 offering limit threshold ($5 million), suggesting that issuers continue to value the preemption of state securities laws provided for offerings conducted pursuant to Rule 506.

. . .

- Capital raised through Regulation D offerings continues to be positively correlated with public market performance, suggesting that capital formation in the unregistered market is pro-cyclical, i.e., the strength of the unregistered market is closely tied to the health of the public market and the overall economy.

- Consistent with the original intent of Regulation D to target the capital formation needs of small business, the median size of offerings by non-financial issuers is less than $1 million.

- Approximately 398,000 investors participated in Regulation D offerings during 2017. A large majority of these investors participated in offerings by non-financial issuers. Non-accredited investors were present in only 9% of Regulation D offerings.

Footnotes omitted. Reg D Study at p. 2.

During 2009 through 2017, about 100,000 issuers initiated Regulation D offerings of $5.0 million or less. Reg D Study at p. 19. The average offering size for non-financial issuers during the study period was $1.0 million. Reg D Study at p. 27. Many of these issuers were companies that file periodic reports with the Commission under the Exchange Act. Hundreds of thousands of investors participated in these Regulation D offerings. Reg D Study at p. 34. Regulation D offerings are more numerous and raise significantly more capital than either crowdfunding or Regulation A+ offerings. Reg D study at pp. 43-44.

As with other offerings exempt from registration under the Securities Act, investors look to Rule 144 in order to sell their securities purchased in Regulation D offerings in any trading market that may then exist for their securities.

Regulation A+

Regulation A, a long-standing exemption from registration under the Securities Act, was substantially restructured and expanded by the Commission under the authority granted under the JOBS Act, now newly denominated Regulation A+. New Regulation A+ substantially eased restrictions, expanded availability, and improved small business access to capital formation through this vehicle. The impact of the Regulation A+ iteration of Regulation A was also the subject of a study by the staff of the Commission, *Regulation A Lookback Study and Offering Limit Review Analysis* (March 4, 2020) https://www.sec.gov/files/regulationa-2020.pdf. Regulation A+ categories offerings in either Tier 1 for offerings of up to $20.0 million during 12 months or Tier 2 for offerings of up to $50.0 million during 12 months. The Commission staff found:

- $2.446 billion reported raised by 183 issuers in ongoing and closed offerings (average of $13.4 million), including $230 million in Tier 1 and $2.216 billion in Tier 2 offerings;

- $9.095 billion sought across 382 qualified offerings (average of $23.8 million), including $759 million sought across 105 qualified Tier 1 offerings and $8.336 billion sought across 277 qualified Tier 2 offerings (excluding withdrawn offerings); and

- $11.170 billion sought across 487 filed offerings (average of $22.9 million), some of which have not been qualified, including $1.102 billion sought across 145 filed Tier 1 offerings and $10.069 billion sought across 342 filed Tier 2 offerings (excluding withdrawn and abandoned offerings).

Id. at p. 5.

A possible investor advantage to Regulation A+ offerings as compared to Regulation D and crowdfunding offerings is that Regulation A+ offered securities do not constitute "restricted securities" under Rule 144 and can be resold in any trading market that may then exist freely by persons that are not affiliates of the issuer.

Crowdfunding

On October 30, 2015, the Commission adopted the final rules, effective in May 2016, for Regulation Crowdfunding to implement Congress's mandate. Again, this funding vehicle has been studied by the staff of the Commission. Report to the Commission, Regulation of Crowdfunding (June 18, 2019) https://www.sec.gov/files/regulation-crowdfunding-2019_0.pdf ("Crowdfunding Report"). As the Crowdfunding Report notes on page 14: "We estimate that there were 1,351 offerings, excluding withdrawn filings, seeking in the aggregate a target, or minimum, amount of $94.3 million and a maximum amount of $775.9 million (footnote omitted)." Securities sold to nonaffiliates in a crowdfunding offering are generally available for resale immediately, without any required holding period. *See* Regulation A+. Thereafter, sales of such securities into any public market that may then exist can be effected immediately in accordance with Rule 144. In order for this avenue to provide effective liquidity, cost-effective and efficient access to the public markets via a broker-dealer with securities clearing access is essential.

The Critical Role of Securities Clearing to Small Business Capital Formation

The numerous investors that provide a substantial amount of small business capital through the mechanisms outlined above can only achieve liquidity for their investments if they are able to deposit their securities with a broker-dealer that can execute a sales transaction that can be cleared effectively through a clearing facility. The NSCC provides that function for many of the investors in small business financings. The NSCC proposal undermines the Commission's congressionally mandated efforts to facilitate small business capital formation by adding uncertainty, reducing process predictability, and increasing costs, all without a statutorily required explanation or justification by the NSCC, as discussed below.

The above discussion of small businesses using the principal alternatives available to them demonstrates that the Commission's efforts to facilitate small business capital formation are attractive and popular. Small businesses have raised and continue to raise significant amounts of capital. These capital formation tools highlight only a part of the capital formation process. Fundamentally, investors purchase securities in small business financings on the expectation that they will be able to liquidate their investments at a profit. Therefore, a threshold issue that arises before an investor invests is how that investor may realize liquidity. The common avenue is for these securities to be sold into any public trading market that may then exist for their securities, most often by depositing the securities, either in paper or electronic form, with a securities broker-dealer that is engaged to sell the securities into the market.

When the broker sells those securities, it must clear that transaction through a clearing agency, principally the NSCC. Typically, small business investors frequently invest in fledgling companies that trade at lower market prices. To use the NSCC parlance, these securities frequently have a "micro-capitalization" of less than $300 million and may be deemed "illiquid securities" that, under the Proposed Rule, would be subject to a "haircut-based volatility charge." In such circumstances, the NSCC analyzes a transaction submitted for clearing and applying its criteria, determines whether an additional margin deposit by the broker-dealer is required.

The NSCC's rules place an undue burden on broker-dealers as illustrated by these examples of actual trades.

Date	Trading Symbol	Shares	Price	Contract Amount	NSCC Charge Amount	Percent of Contract Amount
07/24/20	ENDV	77,349	$0.097	$ 7,503	$ 298,258	3975%
06/04/20	HWKE	97,700	$0.430	$ 42,011	$ 131,496	313%
05/05/20	AXIM	197,162	$0.130	$ 25,631	$ 37,754	147%
03/13/20	AXIM	136,303	$0.130	$ 17,719	$ 41,400	234%
02/18/20	GRLB	249,023	$0.050	$ 12,451	$ 174,315	1400%
01/24/20	SGMD	350,000	$0.010	$ 3,500	$ 48,800	1394%
01/09/20	SMME	198,661	$0.012	$ 2,384	$ 10,166	426%
01/09/20	VIVK	123,449	$0.176	$ 21,764	$ 51,322	236%
07/27/20	DPW	571,814	$2.790	$1,595,304	$1,135,740	71%

These significant assessments result in a predictable cascade of adverse consequences to small business capital markets that land squarely on small businesses and their investors. First, broker-dealers are required to have operating margin deposits with the NSCC and to maintain substantial reserve liquidity several times larger than the regulatory minimum net capital to respond to these overnight margin calls. Yet even with these deposits, broker-dealers remain vulnerable to, and can be ambushed by, substantial additional overnight margin assessments. Second, because of the potential for these unpredictable margin calls, broker-dealers are forced to limit the number and kinds of securities liquidations and open market trades it handles for investors, thereby severely restricting the liquidity for small business investors and the development of robust trading markets. Finally, investors, fearful of the potential lack of effective liquidity, become reluctant to invest in what to them might otherwise be attractive investment opportunities in small businesses.

Even more damaging is that the NSCC imposes its liquidity charges based on its own internal, essentially secret, statistical analyses so that broker-dealers are unable to predict whether specific transactions may result in additional liquidity margin assessments. Before the NSCC continues or modifies a regime addressing mitigation of risks, Section 17A(b)(3)(F) requires that the NSCC address the impact of those rules on small business capital formation.

A common theme under the JOBS Act and related regulatory changes is that there are trade-offs in relaxing securities laws standards requirements in order to encourage small business capital formation. Each of the staff reports cited above recognizes and discusses the necessary balancing to meet the statutory mandate. Generally, the studies conclude that the balancing to accommodate the capital-raising needs of small businesses has not really created regulatory problems. The NSCC proposal does into address this balancing concept. Exchange Act Section 17A(b)(3)(F), as quoted at the outset of this section, requires the NSCC to present in its rule proposals details that meet those requirements.

2. The NSCC has failed to meet the requirements of Commission Rule 17Ad-22(e)(23).

SEC Rule 17Ad-22(e)(23)(ii) and (iii) requires a clearing agency to provide for the following:

> (ii) Providing sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency;
>
> (iii) Publicly disclosing relevant basic data on transaction volume and values.

In attempting to justify the purpose of the Proposed Rule, the NSCC has provided scant details, none of which approaches the standards required by this rule. Particularly, there are no transaction volumes or values of the transactions that allegedly expose the NSCC to excessive risk or the new paradigm under the Proposed Rule. In fact, there is no data illustrating how the Proposed Rule would operate or how it would quantitatively diminish the NSCC's risk.

The NSCC should disclose the current nature and amount of "illiquid securities" as well as the nature and amount of securities within that definition using the proposed "enhanced methodologies." Similarly, the NSCC has failed to quantify the current inadequate market capitalization and median illiquidity ratios or how those factors would be improved under the Proposed Rule. The NSCC claims that the Proposed Rule provides greater clarity and transparency, but justifies its assertions with only conclusory statements unsupported by data.

The NSCC accumulates massive amounts of data from internal and external sources as part of its day-to-day business. The NSCC's proposal for the revised rule is sprinkled throughout with references to its data-based functionality, calculation of median liquidity ratios, statistical analysis, generally accepted statistical analysis, and similar terms. With access to all of its data and routine use of statistical analysis, Rule 17Ad-22(e)(23)(ii) and (iii) requires the NSCC to provide meaningful data respecting the nature and extent of the problems it currently believes exist and how the Proposed Rule will be an improvement.

Without the requisite fundamental data required by clause (iii) quoted from the rule above, members, such as our company, are unable to "identify and evaluate the risks, fees, and other material costs they incur by participating in" the NSCC, to quote clause (ii) above. In fact, without that fundamental underlying data, the NSCC cannot justify its own conclusions.

3. The Changes Outlined in the Rule Proposal Do Not Satisfy Fundamental Principles of Due Process and Fairness.

Notwithstanding the NSCC's stated desire to achieve transparency, in fact, the NSCC's proposal continues the its practices and policies to rely on undisclosed "models" and calculations that do not provide its members or the industry with sufficiently clear, unambiguous rules to guide compliant conduct. In operation, these secret models and calculations are used by the NSCC to act, frequently in the form of illiquidity charges imposed overnight, without explanation or justification.

The broad regulatory concepts outlined in the proposing release are so general that it is impossible to submit focused, precise, and meaningful comments. We are unable to glean any indication from the proposing release of the likely financial and operating impacts of the proposals. What is the measure of projecting the NSCC risk production? How will the proposals affect our day-to-day liquidity requirements? Without substantial additional clarification and detail, we are unable to appreciate the likely and reasonable impact of the proposed changes.

4. The Changes Outlined in the Rule Proposal Fail to Provide Remedial Guidance.

One of the fundamental burdens of the NSCC is to design rules to "assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible." Proposed Rule at p. 30. A more holistic, thorough, and helpful approach would be to transparently disclose the models and calculations on which the NSCC relies, so that they could be used by individual firms and information/service providers to assist them in avoiding high-risk transactions and positions before they place any firm or the system at risk. That would be true transparency and a real contribution to safeguarding the securities and funds of the NSCC as well as its member firms.

Conclusion

The Proposed Rule does not meet the statutory mandate imposed on the NSCC to facilitate prompt and accurate clearance and settlement of securities transactions and protect investors and the public interest. The NSCC has not detailed the purpose of the Proposed Rule beyond self-serving, conclusory platitudes, and the proposed changes fail to provide remedial guidance. The NSCC has not satisfied fundamental principles of due process and fairness.

For the foregoing reasons, the Proposed Rule should be rejected.

We reserve the right to submit additional substantive comments. We will be happy to respond to your questions respecting the foregoing comments or the Proposed Rule.

Sincerely,

WILSON-DAVIS & CO., INC.

[redacted]

James C. Snow
Chief Compliance Officer