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Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

Re: Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Establish the Securities Financing Transaction Clearing Service and Make Other Changes

File No. SR-NSCC-2021-010

Dear SEC:

In summary:

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[1] All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else. I am very grateful to Georgetown University for financial support. Over the years I have served as a Visiting Academic Fellow at the NASD (predecessor to FINRA), served on the boards of the EDGX and EDGA stock exchanges, served as Chair of the Nasdaq Economic Advisory Board, and performed consulting work for brokerage firms, stock exchanges, other self-regulatory organizations, market makers, industry associations, and law firms. I am the academic director for the FINRA Certified Regulatory and Compliance Professional (CRCP®) program at Georgetown University. I've also visited over 75 stock and derivative exchanges around the world. As a finance professor, I practice what I preach in terms of diversification and own modest and well-diversified holdings in most public companies, including brokers, asset managers, market makers, and exchanges.

- The SEC should approve NSCC's proposed Securities Financing Clearing Service ("SFT") without further delay.
- The SFT will help to modernize the securities lending market by providing a cost-effective credit solution to the market.
- Beneficial owners such as "Mr. and Mrs. 401-k" will benefit.
- The $5 minimum price is capricious and arbitrary and should be scrapped.

Introduction

The National Securities Clearing Corporation (NSCC) is proposing to establish a new Securities Financing Clearing Service ("SFT"). The SFT provides a credit solution to the securities lending market. In securities lending, a borrower puts up collateral, typically cash, in exchange for a security.

The borrower is typically a short seller. Contrary to the populist myth motivating many commenters, most short-selling activity actually benefits the rest of the market: Arbitrageurs often sell short when they buy low and short high to keep ETF prices in line with their underlying baskets. Shorting allows market makers to provide liquidity to a buyer even when the market maker has no shares in inventory. If the market maker could not short, the buyer would have to pay more. Thus, the ability to short helps to reduce the transactions costs faced by investors. This is why numerous studies of the ill-conceived short selling bans during financial crises inevitably find that such bans hurt market quality.[2]

Securities lending involves bilateral credit risk on both sides of the transaction: the borrower of the security may fail to return the security under the terms of the loan, and the lender may fail to return the collateral. Therefore, market participants must be very choosy about their counterparties and will only deal with counterparties whom they trust and with whom they have negotiated and signed stock lending agreements. This limits the number of counterparties available to any particular market participant.

This credit limitation results in the fragmentation of the market. As the beneficial owner wishing to lend may not have a credit agreement in place with the borrower, transactions may have to go through several intermediaries, adding cost, expense, and risk along the way.

SFT provides a much needed credit solution.

DTCC, through its NSCC subsidiary, will apply its long experience as a clearing agency to act as a central counterparty to securities lending transactions. In short, they will guarantee both sides of the transaction by stepping into the middle ("novating") and becoming the borrower to the lender and the lender to the

[2] For but one example, see Beber, Alessandro, and Marco Pagano. "Short-selling bans around the world: Evidence from the 2007–09 crisis." *The Journal of Finance* 68, no. 1 (2013): 343-381.

borrower. They will guard our financial system from the risk involved by having both sides put up collateral, which we colloquially call margin.

Beneficial owners including Mr. and Mrs. 401-k will benefit.

By reducing the inefficient fragmentation of the securities lending market, the SFT will make it possible for beneficial owners to reap more of the rewards of securities lending. This will help retail investors including those who invest through funds, as their funds will be able to lend to a wider variety of counterparties and thus have both a higher utilization of their shares.

The $5 limit makes no economic sense.

There is one glaring problem with the proposal: The proposed $5 limit on stocks in the system.

In the words of the proposing release, "NSCC selected $5 as the per share price minimum for underlying equity securities that could be the subject of a novated SFT because $5 is a common share price minimum adopted in brokerage margin eligibility schedules."

While it is true that some brokerage firms do not offer margin for stocks under $5, this is an arbitrary and obsolete practice going back to the days of paper stock certificates. In the days before computers, it was a quick and dirty crude way to identify more volatile and less liquid securities. It no longer makes economic sense. It should not be further enshrined in the rules of our market infrastructure. In the modern world, we have computerized risk models that do a much better job of predicting risk.

The proposed limit keeps many good stocks out of the SFT system. The screener on finviz.com finds 1,124 NYSE- and Nasdaq-listed stocks under $5. Many stocks under $5 are highly liquid billion-dollar market cap entities that trade millions of shares per day. Examples include Santander (SAN) and Clear Channel (CCO). There is no reason such securities should not be eligible for the service.

Restricting stocks under $5 with obsolete rules further hurts their liquidity and thus harms their share price even more. As many of these stocks have suffered declines in value, it is a clear case of "kick them when they are down."

Even worse, the proposal calls for 100% margin when a stock already loaned out dips under $5. Again, this is arbitrary, makes no economic sense, and exacerbates the "kick them when they are down" problem.

While there is certainly some tail risk in novating an illiquid sub-penny stock that might be manipulated to the moon, NSCC can and should be trusted to come up with the right margins based on the liquidity and volatility of the underlying shares. NSCC has a long and successful history of managing risk as a central counterparty and they can be trusted to set appropriately conservative parameters to protect our

financial system from systemic risk. If anything, the GameStop episode shows that they may have been too conservative by requiring excessive margin at times.

Fortunately, the proposal gives NSCC the ability to change this totally arbitrary limit without a rule filing. I don't think the SEC should delay this much needed system any further over this, but instead urge NSCC to scrap this unnecessary restriction as soon as possible.

The SEC should approve this proposal without further delay.

The whole reason for the SRO model is to let the SROs work out the details, while the SEC makes sure that the process is fair and transparent. This proposal has been well publicized within the industry and put out for public comment for many, many months. If there were serious flaws with the proposal, somebody would have mentioned them by now. Other than a generally misinformed dislike of short selling, none of the comment letters have raised any substantial objections. We can trust NSCC to work out the details, so there is no reason for further delay. It just makes the SEC look bad to drag its feet on something as useful as this.

Respectfully submitted,

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