Comments on SR-NSCC-2022-003

The current state of US securities and security derivatives markets is insidiously disingenuous and the culmination of decades of mismanaged monetary policy specifically designed to subvert the fundamental underlying economic principle of supply and demand. What should be a simple, uncomplicated series of transactions whereby buyers are matched with sellers in these markets has been perversely distorted into a system of unnecessarily complex and esoteric bureaucratic mechanisms designed, by their very construction, to suppress comprehension by the layman in favor of financial elites. The latest proposed rule change, SR-NSCC-2022-003, discussed below is simply the latest example of this.

SR-NSCC-2022-003 proposes to "…(iii) establish the securities financing transaction clearing service ("Securities Financing Transaction Clearing Service" or "SFT Clearing Service") to make central clearing available at NSCC for equity securities financing transactions, which are, broadly speaking, transactions where the parties exchange equity securities against cash and simultaneously agree to exchange the same securities and cash, plus or minus a rate payment, on a future date (collectively, "Securities Financing Transactions" or "SFTs"),…" (pg 1). This mechanism appears quite similar initially to existing mechanisms for establishing a security position, whether it be long or short, and immediately begs the question of *why* a new mechanism providing the same functionality is needed. The answer is quickly provided in SR-NSCC-2022-003: "NSCC understands that SFTs provide liquidity to markets and facilitates the ability of market participants to make delivery on short-sales, and thereby avoid failures to deliver, "naked" shorts, and similar situations." (pg 2) Clearly, the goal here is to provide a short-term mechanic expressly constructed to subvert existing market structure because it is inconvenient to various institutions. Namely, there currently exists, at least on paper, a mechanic which requires market participants to reasonably locate shares which they desire to sell short. A full commentary on whether this current mechanic is functioning properly is outside the scope of this document but suffice to say that it represents an inconvenience to certain market participants as seen in the above quote from SR-NSCC-2022-003. If current market mechanics were sufficient to provision desired short-selling activity and sufficient shares to sell short were reasonably locatable, then there would be no reason to establish a new rule with SR-NSCC-2022-003 to allow for greater levels of short-selling. As mentioned above, this is a direct subversion of traditional supply and demand. There is a supply of shares, determined by the company listing their shares in one of various markets, and there may or may not be demand for those shares. The market participants wish to artificially distort apparent market demand by establishing long or short positions without actually locating the necessary shares to do so. *If they were willing to do so according to current market mechanics, then SR-NSCC-2022-003 would be unnecessary.*

Furthermore, the next statement in SR-NSCC-2022-003 directly indicating its true purpose as distortion of market supply and demand follows a few pages later. "In addition to creating capital efficiency opportunities for market participants, NSCC believes that broadening the scope of central clearing at NSCC to SFTs would also reduce the potential for market disruption from fire sales." (pg 6) Whether the market determines to engage in a "fire sale" is irrelevant in principle to market participants who are not over leveraged. It is only relevant to those market participants who have over leveraged themselves and wish to evade their financial obligations through artificial limitation of market supply and demand. This is precisely the purpose of proper risk management at a firm engaging in the use of leverage and not the responsibility of any other institution.

In defense of allowing this artificial market flow, the following rationale is offered: "In the case of securities lending transactions, the primary risk of fire sales relates to the reinvestment of cash collateral by institutional firms that are the lenders in securities lending transactions. Those institutional firms will typically reinvest the cash collateral they receive from the borrower into other securities. If the borrower of the securities thereafter defaults, the institutional firm lenders generally need to quickly liquidate the securities representing the reinvestment in order to raise cash to purchase the originally lent security. A substantial number of disconnected and competing liquidations by multiple lenders can create fire sale conditions for the securities being liquidated, which can harm not only the institutional firm lenders by potentially lowering the amount of cash they can raise in the sale of such securities, but also create market losses for all holders of such securities." (pg 6-7) This is laughable, as once again this *cannot* happen without agreement of all parties involved for the consequences described. By undertaking the practices mentioned, "reinvestment of cash collateral" and serving as "lenders in securities lending transactions", the market participants involved in all sides of this

transaction have expressly agreed to any and all risks involved under current market mechanics. Principally, this includes the risk of one party defaulting and that default requiring sale of securities as described above in SR-NSCC-2022-003. If market participants cannot handle this risk exposure, the solution already exists and is incredibly simple. *The solution is not to engage in practices carrying the risk of forced asset sales, in the event of default or otherwise*. The solution is *not* to propose and institute additional rules allowing market participants to subvert their financial responsibilities, as is done in SR-NSCC-2022-003. Lastly, as all market participants know, being the "smart money" elites they are, losses are only realized once a position is closed. As long as a position remains open, losses are unrealized. Again, unrealized losses only represent problems for those parties which are over leveraged. That a fire sale could intrinsically be responsible for "market losses for all holders of such securities" is incorrect. It is the risk-prone and ill-advised investment practices of any given holder of such securities that can result in the forced sale of such securities. If the investment remains sound and market price undervalues a security, then an investor not utilizing margin would be prudent to hold that position if they think the price will recover or sell if they think it will not. In either case, it is their voluntary decision to dispose of their holdings as they see fit.

Yet another example of how this rule proposes to alleviate poor risk management through additional bureaucratic backstops is on pages 19-20: "It is occasionally the case in the securities lending market that a borrower is solvent and able to satisfy its general obligations as they become due but unable to deliver the lent securities to the lender within the timeline requested by the lender. The contractual remedy that has developed in the bilateral securities lending market for these situations is a "buy-in." Under this remedy, the lender may purchase securities equivalent to the borrowed securities in the market and charge the borrower for the cost of this purchase. This serves to benefit the lender because it allows the lender to recover the securities within its required timeline, and it benefits the borrower by avoiding a situation in which the borrower's failure to perform under a single transaction results in an event of default and close-out of all of its securities lending transactions (and potentially other positions through a cross-default). Similarly, in the bilateral space, securities borrowers may have the need to accelerate settlement of securities lending transactions if they lose a "permitted purpose" for such loans under Regulation T. The proposed SFT Clearing Service would seek to retain the buy-in and acceleration mechanisms, as they ensure the smooth functioning of securities markets without causing unnecessary and disorderly defaults or regulatory violations." Once again, *if market participants locate the securities sold short as the current market mechanics REQUIRE then they will not experience this problem.* If market participants cannot handle their risk exposure appropriately, it is (once again) not the responsibility of other parties to backstop their poor financial decisions. Market participants must be held accountable and satisfy all their agreed-upon financial obligations, not merely those they deem convenient.

Moving beyond the aforementioned grotesque justifications given in SR-NSCC-2022-003 for supporting some market participants' bad bets at the expense of all others (including retail), who may not be privileged enough to benefit from new rules subverting financial accountability, a number of disconcerting loopholes are present in SR-NSCC-2022-003 (again) allowing subversion of new rules at the arbitrary discretion of the NSCC.

- "Under the proposal, if the sum of the Volatility Charges (as defined below and in the proposed rule change) applicable to a Sponsoring Member's Sponsored Member Sub-Accounts (as defined below and in the proposed rule change) and its other accounts at NSCC exceeds its Net Member Capital (as defined below and in the proposed rule change), the Sponsoring Member would not be permitted to submit activity into its Sponsored Member Sub- Accounts, unless otherwise determined by NSCC in order to promote orderly settlement." (pg 34)
- "Specifically, under the proposal, if the sum of the Volatility Charges applicable to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account(s) (as defined below and in the proposed rule change) and its other accounts at NSCC exceeds its Net Member Capital, the Agent Clearing Member would not be permitted to submit activity into its Agent Clearing Member Customer Omnibus Account(s), unless otherwise determined by NSCC in order to promote orderly settlement." (pg 38)
- "With respect to an obligation to make payment due to any loss allocation amounts assessed on a Sponsoring Member pursuant to Section 9(b) of proposed Rule 2C, the Sponsoring Member may instead elect to terminate

its membership in NSCC pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4;" (pg 63)

- "With respect to an obligation to make payment due to any loss allocation amounts assessed on an Agent Clearing Member pursuant to Section 8(a) of proposed Rule 2D, the Agent Clearing Member may instead elect to terminate its membership in NSCC pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4;" (pg 91-92)

These examples represent a distressing pattern whereby the NSCC appears to directly condone market participants' evasion of their financial obligations in the event of unfavorable or inconvenient market conditions and essentially allow the NSCC to operate in an arbitrary fashion to "promote orderly settlement" over market integrity.

In summary, SR-NSCC-2022-003 represents a collection of new market mechanics designed to subvert ordinary supply and demand in the markets in favor of convenience for legacy market participants who fashion themselves above the law. In the name of ever-increasing greed and narcissism, these market participants would provision and expand a new type of security derivative, the SFT, to hide their failures and protect themselves from the consequences of their wanton risk negligence at the expense of greater market integrity. They would do this in the name of capitalism. Capitalism without accountability is exploitation, which they endorse. Capitalism without equitable competition (like special privileges granted to some, but not all, market participants) is predatory financial abuse. The US markets require more, not less, simplicity and transparency in operation in order to fix the deep-rooted corruption that has taken hold. SR-NSCC-2022-003 is not in the best interests of market integrity, though it is in the best interests of a fraudulent market economy. SR-NSCC-2022-003 should be unequivocally rejected.