Admin. Proc. File No. 3-20543

UNITED STATES OF AMERICA
Before The
SECURITIES AND EXCHANGE COMMISSION

	:
In the Matter of	
	:
LEK SECURITIES CORPORATION	
	:
For Review of Adverse Action Taken By THE NATIONAL SECURITIES CLEARING CORPORATION and THE DEPOSITORY TRUST COMPANY	:
	:
	:

NATIONAL SECURITIES CLEARING CORPORATION AND THE DEPOSITORY TRUST COMPANY'S RESPONSE SEEKING DISMISSAL OF LEK SECURITIES CORPORATION'S APPLICATION FOR REVIEW UNDER EXCHANGE ACT SECTION 19(d)

OS Received 12/01/2021

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

BACKGROUND 1

A. NSCC's and DTC's Risk Management Obligations under the Exchange Act.. 1

B. The Authority to Establish Members' Required Fund Deposits and Net Debit Caps under the Clearing Agencies' Rules. 3

C. Assurances Required of Lek under NSCC and DTC Rules. 4

ARGUMENT 5

I. Lek's Application Effectively Challenges NSCC Rule 15 and DTC Rule 9(A), which Is Impermissible under Section 19(d) of the Exchange Act 5

II. The Lek Assurances Are Not Disciplinary Sanctions or Limitations on Access to Services Offered by the Clearing Agencies Reviewable under Section 19(d) of the Exchange Act 8

A. The Lek Assurances Are Not Disciplinary Sanctions. 9

B. The Lek Assurances Are Not Limitations on Access to Services Offered by the Clearing Agencies. 12

CONCLUSION 18

OS Received 12/01/2021

TABLE OF AUTHORITIES

Page(s)

CASES AND ADMINISTRATIVE PROCEEDINGS

Brown v. Gilligan, Will & Co.,
287 F. Supp. 766 (S.D.N.Y. 1968) 8

Heath v. S.E.C.,
586 F.3d 122 (2d Cir. 2009)..8

NASDAQ Stock Mkt., LLC v. S.E.C.,
961 F.3d 421 (D.C. Cir. 2020)..5, 14

William Higgins,
Exchange Act Release No. 24429, 1987 WL 757509 (May 6, 1987) 14

STATUTES AND REGULATIONS

17 C.F.R. § 240.17Ad-22.. *passim*

17 C.F.R. § 240.19(b) .... *passim*

17 C.F.R. § 240.19(d)-1 .... *passim*

15 U.S.C. § 78q-1(b)(2) 2

15 U.S.C. § 78q-1(b)(3) 2

15 U.S.C. § 78q-1(b)(3)(H)..11

15 U.S.C. § 78q-l(b)(3)(B) and (F) 13

15 U.S.C. § 78q-l(b)(4)(B)..13

15 U.S.C. § 78q-l(d)..6

15 U.S.C. § 78w(a) 6

15 U.S.C. § 78s(b)..1

15 U.S.C. § 78s(b)(2) 5

15 U.S.C. § 78s(d)..1

15 U.S.C. § 78s(d)(1) 9

15 U.S.C. § 78s(d)(2) 8

OS Received 12/01/2021

OTHER AUTHORITIES

The Depository Trust Company*, Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures* (Dec. 31, 2020*).* 17

The Depository Trust Company, Settlement Service Guide (Feb. 27, 2018)....................4, 7, 16

National Securities Clearing Corporation*, Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures* (Dec. 31, 2020*).* 3

Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Changes to Institute a Clearing Fund Premium Based Upon a Member's Clearing Fund Requirement to Excess Capital Ratio, Release No. 34-54457 (Sept. 15, 2006), 71 Fed. Reg. 55239, 55239-40 (Sept. 21, 2006) 2

Provision for Notices by Self-Regulatory Organizations of Disciplinary Sanctions; Stays of Such Actions; Appeals; and Admissions to Membership or Association of Disqualified Persons, Exchange Act Release No. 13726 (July 8, 1977), 42 Fed. Reg. 36411 (July 14, 1977) 13

Self-Regulatory Organizations; Proposed Rule Change, Release No. 34-15551 (Feb. 6, 1979), 44 Fed. Reg. 9820 (Feb. 15, 1979)....................16

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Modify the DTC Settlement Service Guide to Make Technical Revisions to Clarify and Provide Enhanced Transparency with Respect to the Calculation and Adjustment of Required Participants Fund Deposits, Release No. 34-80762 (May 24, 2017), 82 Fed. Reg. 25038 (May 31, 2017) 16

Restatement (Third) of Agency (Am. L. Inst. 2006) 8

Restatement (Second) of Contracts (Am. L. Inst. 1981)....................8

DTC Rule 1 ....4, 16

DTC Rule 2 2

DTC Rule 9(A) .... passim

DTC Rule 21 ....10, 11

DTC Rule 22 ....11, 16

FINRA Rule 4210 17

NSCC Rule 2A....................2

NSCC Rule 4....................3, 16

OS Received 12/01/2021

NSCC Rule 15 .... passim

NSCC Rule 37 11

NSCC Rule 46 .... 11, 16

NSCC Rule 48 .... 10, 11

NSCC Rule 17 10

NYSE Rule 7.1 17

SEC Rule of Practice 192 6

OS Received 12/01/2021

INTRODUCTION

The application of Lek Securities Corporation ("Lek" or the "Company") for Securities and Exchange Commission ("SEC" or the "Commission") review of certain risk management actions by the National Securities Clearing Corporation ("NSCC") and The Depository Trust Company ("DTC") (each a "Clearing Agency;" together, the "Clearing Agencies"), filed on August 27, 2021 (the "Application") is improper. The Commission does not have jurisdiction to review the measures applied as risk controls to address the concerns about Lek's financial responsibility and ability to meet its obligations to the Clearing Agencies. As explained below, the actions were taken pursuant to the adequate assurance provisions of the Clearing Agencies' rules, and do not constitute disciplinary sanctions or limitations on access to services by NSCC or DTC reviewable under Section 19(d) of the Securities Exchange Act of 1934 (the "Exchange Act" or "Act").[1] Adequate assurances, which go to the core of NSCC's and DTC's responsibilities under Section 17A of the Exchange Act, are risk-management standards authorized by the Clearing Agencies' rules approved by the SEC pursuant to Section 19(b) of the Exchange Act.[2] The Application misrepresents the actions taken by the Clearing Agencies under the assurance provisions, specifically NSCC Rule 15 and DTC Rule 9(A), and essentially challenges the authority of those rules, which is impermissible under Section 19(d).

BACKGROUND

A. NSCC's and DTC's Risk Management Obligations under the Exchange Act.

NSCC and DTC, wholly-owned subsidiaries of The Depository Trust & Clearing Corporation ("DTCC"), are clearing agencies registered with the SEC pursuant to Section

[1] *See* 15 U.S.C. § 78s(d).

[2] *See id.* § 78s(b).

OS Received 12/01/2021

17A(b)(2) of the Exchange Act,[3] and self-regulatory organizations ("SROs") subject to Section 19 of the Act. NSCC provides central counterparty clearance and settlement services, guaranteeing payment and delivery of securities for counterparties for virtually all transactions in equities and other types of securities in the United States. DTC is a central securities depository and settles virtually all U.S. transactions in equity and other securities. Risk-management is central to NSCC's and DTC's obligations as registered clearing agencies. The Clearing Agencies maintain strict membership and participation standards, including stringent financial requirements and ongoing monitoring and review of all members and participants (both referred to as "members") under their rules. Under Section 17A(b)(3) and Rule 17Ad-22,[4] NSCC and DTC must have rules and procedures designed to manage the legal, credit, liquidity, operational, business, custody and other risks borne by the Clearing Agencies, and their credit exposures to each member "fully with a high degree of confidence."[5] NSCC, in particular, must have a "risk-based margin system" designed "to cover its potential future exposure to members in the interval between the last margin collection and the close out of positions following a member default" to a level of assurance exceeding 99 percent.[6] A broker-dealer is not entitled to membership in NSCC or DTC if it cannot meet those standards.[7]

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[3] *See id.* § 78q-l(b)(2).

[4] *See* § 78q-l(b)(3); 17 C.F.R. § 240.17Ad-22.

[5] *See* § 240.17Ad-22(e)(3)(i) and (e)(4)(i).

[6] *See* §§ 240.17Ad-22(e)(6)(iii); 240.17Ad-22(a)(13) (defining "potential future exposure" to mean "maximum exposure estimated to occur at a future point in time with an established single-tailed confidence level of at least 99 percent with respect to the estimated distribution of future exposure").

[7] *See* NSCC Rule 2A, Sec. 1. B.; DTC Rule 2, Section 1; *see also Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Changes to Institute a Clearing Fund Premium Based Upon a Member's Clearing Fund Requirement to Excess Capital Ratio*, Release No. 34-54457 (Sept. 15, 2006), 71 Fed. Reg. 55239, 55239-40 (Sept. 21, 2006) ("While it is possible that the proposed rule changes [increasing excess net capital requirements] will force some members of . . . NSCC to discontinue their direct membership . . . , the [Exchange Act] does not provide broker-dealers with the right to be direct members in a clearing agency. Affected firms have a choice to raise excess

OS Received 12/01/2021

B. The Authority to Establish Members' Required Fund Deposits and Net Debit Caps under the Clearing Agencies' Rules.

A key tool that NSCC uses to manage its credit exposure to members is collecting an appropriate Required Fund Deposit (*i.e.*, margin in the form of cash or eligible securities) from each member. The Required Fund Deposit is designed to mitigate potential losses to NSCC by providing the necessary liquidity and collateral to complete settlements and to cover fully NSCC's exposure from default.[8] NSCC is required to collect enough margin from each member to cover the specific risk of default posed by the member.[9] NSCC's rules establish the minimum Required Fund Deposit for members and contain a standard formula for determining each member's Required Fund Deposit above the minimum requirement.[10] NSCC also has discretion under the rules to require increased Clearing Fund deposits from a member as NSCC deems "necessary or advisable" in order to fulfill its responsibilities.[11] Accordingly, NSCC has the ability to adjust its risk-management controls to address the risks associated with a particular member's

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regulatory capital or to limit their trading activities so that the risk to which the clearing agency and its other members is exposed is proportionate to the firm's excess regulatory capital.").

[8] *See* National Securities Clearing Corporation, *Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures*, at 12, 18 (Dec. 31, 2020).

[9] *See id.*

[10] *See* NSCC Rule 4; Procedure XV.

[11] NSCC Rule 15, Section 2(a) provides, in pertinent part:

> Each Member . . . shall furnish to [NSCC] such adequate assurances of its financial responsibility and operational capability as [NSCC] may at any time or from time to time deem necessary or advisable in order to protect [NSCC], its participants, creditors or investors, to safeguard securities and funds in the custody or control of [NSCC] and for which [NSCC] is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions.

NSCC Rule 15, Section 2(b) provides, in pertinent part:

> Adequate assurances . . . may include . . . (iv) increased Clearing Fund deposits (including additional amounts required in respect of trade activity received by [NSCC] after calculation of the applicable Required Fund Deposit)[.]

OS Received 12/01/2021

financial situation not covered by standard risk calculations. By more specifically addressing the credit risk posed by a particular member, NSCC is better able to meet its obligations as a central counterparty while reducing the possibility that NSCC would need to mutualize among non-defaulting members any losses arising out of the default of the member.

DTC rules also contain a number of risk-management controls, including a Net Debit Cap under DTC rules and related procedures.[12] The Net Debit Cap limits the size of a member's intraday net debit balance to help ensure that DTC can complete settlement even if a member fails to settle. The DTC rules also provide DTC with the discretion to impose on a member any condition that DTC deems necessary for the protection of itself or other members.[13]

C. Assurances Required of Lek under NSCC and DTC Rules.

For reasons set forth in correspondence by DTCC to Lek dated July 21, 2021, and July 28, 2021, included in the Application (the "DTCC Correspondence"), NSCC and DTC took action to increase Lek's minimum Required Fund Deposit to $20 million pursuant to NSCC Rule 15, and to lower Lek's Net Debit Cap from $75 million to $50 million pursuant to DTC Rule 9(A), as assurances under the rules, effective August 2, 2021 (the "Lek Assurances"). As described in the DTCC Correspondence, the principal reasons for the Lek Assurances were the apparent deterioration of, and uncertainty around, Lek's liquidity resources, in particular: (1) the

[12] *See* DTC Rule 1 (defining the term "Net Debit Cap" to mean "an amount determined by [DTC] in the manner specified in the Procedures; provided, however, that the maximum Net Debit Cap of the Participant shall be the least of (i) a maximum amount applicable to all Participants based on the liquidity resources of [DTC], (ii) the Settling Bank Net Debit Cap applicable to such Participant or (iii) any other amount determined by [DTC], in its sole discretion."); The Depository Trust Company, Settlement Service Guide at 67–68 (Feb. 27, 2018) (setting out the methodology for setting the Net Debit Cap generally), available at https://www.dtcc.com/globals/pdfs/2018/february/27/service-guide-settlement (last accessed Dec. 1, 2021) ("DTC Settlement Service Guide").

[13] DTC Rule 9(A), Section 2 ("At the request of [DTC], a Participant or Pledgee shall immediately furnish [DTC] with such assurances as [DTC] shall require of the financial ability of the Participant or Pledgee to fulfill its commitments and shall conform to any conditions which [DTC] deems necessary for the protection of [DTC], other Participants or Pledgees. . . .").

OS Received 12/01/2021

reduction and impending elimination of $75 million in credit provided to Lek by BMO Harris Bank N.A. ("BMOH") and planned termination of BMOH's settlement bank relationship with Lek, and (2) the Clearing Agencies' concerns about the sufficiency of financial liquidity to replace the BMOH credit facility, including questions surrounding financing provided by Lek's parent company.

As required by Section 17A and Rule 17Ad-22, NSCC and DTC applied the Lek Assurances to manage the risk posed by Lek's weakened financial condition. The Lek Assurances are permitted under the Clearing Agencies' rules, and are not reviewable under Section 19(d) of the Exchange Act.

ARGUMENT

I. Lek's Application Effectively Challenges NSCC Rule 15 and DTC Rule 9(A), which Is Impermissible under Section 19(d) of the Exchange Act.

Lek's Application, which takes issue with the Lek Assurances authorized by NSCC Rule 15 and DTC Rule 9(A), essentially challenges the validity of the rules themselves. However, Section 19(d) cannot be used to challenge the authority of those rules made in accordance with Section 19(b) of the Exchange Act. NSCC Rule 15 and DTC Rule 9(A) were promulgated in accordance with Section 19(b)(2), which requires notice and opportunity for public comment, and approval by the SEC only after the Commission has determined that they are consistent with Section 17A(b)(3), Rule 17Ad-22 and the purposes of the Exchange Act.[14]

SRO rules of general application made under Section 19(b) are not subject to review under Section 19(d) of the Exchange Act.[15] It is manifestly improper under the statutory scheme

[14] *See generally* 15 U.S.C. § 78s(b)(2).

[15] *See, e.g.*, *NASDAQ Stock Mkt., LLC v. SEC*, 961 F.3d 421, 424 (D.C. Cir. 2020).

OS Received 12/01/2021

to subject the authorized effects of rules made by the legislative process for the benefit of numerous members and other constituents to alteration by adjudication where the interests of all those other parties are not represented. The only way Lek or anyone else can challenge an SRO rule is to petition for amendment under Rule 192 of the SEC's Rules of Practice, and for the Commission to amend it by rulemaking pursuant to Section 17A(d) and Section 23(a) of the Exchange Act,[16] which also provide for public comment to elicit the views of other parties that would be impacted by the change.

Lek's Application does not refute NSCC's authority to increase its Required Fund Deposit under NSCC Rule 15. Instead, it says "while NSCC may have the authority to set minimum Required Fund Deposits generally, when it does so without a basis in fact, as here, such action constitutes a 'limitation of or restriction on activities' of [Lek] and is therefore a 'disciplinary proceeding' with respect to [Lek]. . . ."[17] Nor does Lek challenge DTC's authority to lower its Net Debit Cap under DTC Rule 9(A). Rather, it says "while DTC may have the authority to reduce (or increase) Net Debit Caps generally, when it does so without a basis in fact, as here, such action constitutes a 'limitation of activities, functions and operations' of [Lek] and is therefore a 'disciplinary sanction. . . .'"[18] Staking its claims on the absence of any *basis in fact* for the Lek Assurances, Lek suggests the actions equate to the "imposition of [] Sanctions" reviewable under Section 19(d) and Rule 19d-3.[19]

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[16] *See* 15 U.S.C. §§ 78q-l(d) and 78w(a).

[17] Lek Application at 1.

[18] *Id*.

[19] *Id.*

OS Received 12/01/2021

However, the Application itself acknowledges the *factual bases* on which the actions were taken:

> The *stated bases* for the imposition of the Sanctions were "several material developments in regards to the liquidity profile of [Lek], which raises concerns about the firm's financial responsibility, operational capability and its continued ability to meet its obligations to NSCC and DTC. Specifically, DTCC stated that it had become aware that (i) BMO Harris Bank, N.A. ("BMOH") reportedly had reduced [Lek's] line of credit from $75 million to $50 million, and that it would further reduce the line to $4 million as of August 4, 2021 and terminate the line as of September 6, 2021, and thus [Lek] would only have $7.5 million of external bank credit borrowing availability after September 6, and (ii) BMOH anticipated terminating its relationship as [Lek's] OCC-approved Clearing Bank on October 6, 2021.[20]

Accordingly, the Application doesn't allege anything more than that Clearing Agencies exercised discretion authorized under NSCC Rule 15 and DTC Rule 9(A), to take actions expressly provided for in the rules, for explicit reasons contemplated by the rules.[21]

SRO rules made under Section 19(b)(2) that require the exercise of discretion, like Rule 15 and Rule 9(A), are no less protected from modification by judicial review than those requiring no discretion, like the Required Fund Deposit and Net Debit Cap computations in Procedure XV and the Settlement Service Guide. Discretion alone does not give rise to jurisdiction under Section 19(d). There must be a discrepancy between the action taken and the authority behind it.

[20] *Id*. (citing DTCC's letter to Lek dated July 21, 2021, included in the Application) (emphasis added). In a footnote, the Application acknowledged an additional basis—*i.e.* "that FINRA was 'reportedly assessing the circumstances surrounding' a promissory note from [Lek's] parent entity," a source of funding referred to in the same letter. *Id.* n.2.

[21] The Application further suggests the Clearing Agencies actions are based on a "misreading of a July 8, 2021 letter from counsel for BMOH concerning the orderly wind down of BMOH's relationship with [Lek]" and "incorrect assumptions concerning the impact of that wind down on [Lek's] liquidity and capital." Lek Application at 3. However, Lek does not offer any more support for mistakes in "reading" and "assumptions" than the explanations offered by the Company in a letter to DTCC on July, 26, 2021, *see id.*, which it acknowledges were taken into consideration in assessing the Lek Assurances (including a *reduction* in the minimum Required Fund Deposit) effective on August 4, 2021.

OS Received 12/01/2021

An SRO normally is entitled to wide berth in exercising discretion authorized by its rules.[22] Generally, the action taken should be deferred to so long as there is a rational basis for it within the context of the rule and it is made in good faith.[23] Any other result would undercut the system of self-regulation included in the Exchange Act. Every discretionary act by an SRO affecting someone's use of its services—essentially all of them—would require notice and be subject to a lengthy review process by the Commission. Instead, Section 19(d) is limited to adjudicating SRO actions outside the parameters of rules duly promulgated under the Exchange Act.

II. The Lek Assurances Are Not Disciplinary Sanctions or Limitations on Access to Services Offered by the Clearing Agencies Reviewable under Section 19(d).

SEC review of SRO actions is limited under Section 19(d) of the Exchange Act. Under Section 19(d)(2) the Commission has jurisdiction to review only SRO actions requiring notice under Section 19(d)(1) of the Act.[24] Section 19(d)(1) requires notice of any action by an SRO (1) to impose a final disciplinary sanction on a member, or (2) to limit a person's access to

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[22] *See, e.g.*, *Heath v. SEC*, 586 F.3d 122, 138–39 (2d Cir. 2009) (collecting various cases in support of proposition that SROs are entitled to deference in administering their own rules).

[23] SRO rules are essentially contractual. *See Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766, 769-70 (S.D.N.Y. 1968). Accordingly, the standard of performance in administering them is essentially strict enforcement of specific provisions, *see* RESTATEMENT (THIRD) OF AGENCY §§ 8.07 (AM. L. INST. 2006), and the exercise of rational decision-making in good faith where the rule provides for discretion, *see* RESTATEMENT (THIRD) OF AGENCY § 8.01, cmt. b; RESTATEMENT (SECOND) OF CONTRACTS § 205, cmt. d (AM. L. INST. 1981). In terms of the Clearing Agencies' exercise of discretion under NSCC Rule 15 and DTC Rule 9(A), Lek has not alleged a deficiency in either respect: The Application acknowledges the bases for the Lek Assurances, which are rational in relation to the purposes of the rules; and Lek has not alleged bad faith by anyone at NSCC or DTC responsible for the decision. The latter does not exist. And the Company is barred from making any claim to that effect now, more than four months after the Lek Assurances were assessed.

[24] Section 19(d)(2) provides, in pertinent part:

> Any action with respect to which a self-regulatory organization is required by paragraph (1) of this subsection to file notice shall be subject to review by the [SEC], on its own motion, or upon application by any person aggrieved thereby filed within thirty days after the date such notice was filed with [the Commission] and received by such aggrieved person, or within such longer period as [the Commission] may determine.

15 U.S.C. § 78s(d)(2).

OS Received 12/01/2021

services offered by the SRO.[25] The Lek Assurances are not disciplinary sanctions or limitations on access to services offered by NSCC or DTC because they are not actions to redress a violation of the Exchange Act or the Clearing Agency's rules, or to curtail access to services offered by the Clearing Agencies under their rules. Therefore, no notice is required for them under Section 19(d)(1), and no review is available with respect to them under Section 19(d)(2).

A. The Lek Assurances Are Not Disciplinary Sanctions.

Rule 19d-1 under the Exchange Act sets forth the notice requirements for SRO actions subject to SEC review under Section 19(d)(2). Rule 19d-1(c) specifically provides for notice of "final disciplinary actions." It provides, in pertinent part:

> Any [SRO] for which the Commission is the appropriate regulatory agency that takes any final disciplinary action with respect to any person shall promptly file a notice thereof with the Commission in accordance with paragraph (d) of this section. For the purposes of this rule, *a "final disciplinary action" shall mean the imposition of any final disciplinary sanction pursuant to section . . . 17A(b)(3)(G) of the Act or other action of a [SRO] which, after notice and opportunity for hearing, results in any final disposition of charges of: (i) One or more* ***violations*** *of (A) The rules of such organization; [or] (B) The provisions of the Act or rules thereunder[.]*[26]

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[25] Section 19(d)(1) provides, in pertinent part:

> If any [SRO] imposes any final disciplinary sanction on any [participant], denies membership or participation to any applicant, or prohibits or limits any person in respect to access to services offered by such organization or member thereof . . . the [SRO] shall promptly file notice thereof with [the Commission]. . . .

§ 78s(d)(1).

[26] 17 C.F.R. § 240.19d-1(c)(1) (emphases added). A violation also is a prerequisite to discipline for a personal decorum or minor rules infraction under sub-paragraphs (c)(1) and (2). Accordingly, paragraph (d), which contains the content requirements for a notice of discipline, requests information pertaining to the alleged violation. It provides, in pertinent part:

> Any notice filed pursuant to paragraph (c)(1) of this section, shall consist of the following, as appropriate:
>
> (1) The name of the respondent . . .;
>
> (2) A statement describing the *investigative* or other origin of the action;
>
> (3) As charged in the proceeding, the specific provisions of the Act, the rules or regulations thereunder, the rules of the organization . . . and, in the event a *violation* of other statutes or rules

OS Received 12/01/2021

(emphases added). The provision clearly contemplates action against a member for "violation" of the Exchange Act or SRO rules.

The Lek Assurances authorized by NSCC Rule 15 and DTC Rule 9(A) are not sanctions for a violation of the Exchange Act or the Clearing Agencies' rules. Instead, they are additional measures required for Lek to fulfill its financial responsibilities under the Clearing Agencies' rules.[27] Neither NSCC Rule 15 nor DTC Rule 9(A) provides for assurances as discipline for violations,[28] which are provided for separately under other Clearing Agency rules.[29] While a failure to comply with assurances required under the rules can give rise to a violation resulting in

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> constitutes a *violation* of any rule of the organization, such other statutes or rules; and a statement describing the answer of the respondent to the charges;
>
> (4) A statement setting forth findings of fact with respect to any act or practice which such respondent was charged with having engaged in or omitted; the conclusion of the organization as to whether such respondent *is deemed to have violated* any provision covered by the charges; and a statement of the organization in support of the resolution of the principal issues raised in the proceedings;
>
> (5) A statement describing *any sanction imposed,* the reasons therefor, and the date upon which such *sanction* has or will become effective, together with a finding if appropriate, as to whether such respondent was a cause of any *sanction* imposed upon any other person; and
>
> (6) Such other matters as the organization may deem relevant.

§ 240.19d-1(d) (emphases added).

[27] The express purpose of assurances under NSCC Rule 15 is "to *demonstrate* the financial responsibility and operational capability of the [member]." Likewise, the purpose of assurances under Rule 9(A) is to demonstrate "the financial ability of the Participant to *fulfill* [a member's] commitments . . . for the protection of [DTC], other Participants or Pledgees. . . ." (emphases added).

[28] Indeed, NSCC Rule 15 explicitly distinguishes between assurances under the rule and discipline under different provisions. Rule 15, Section 4, provides, in pertinent part:

> A participant's *failure to furnish information or otherwise comply with the requirements of this Rule* may subject the participant to the imposition of *a fine pursuant to Rule 17* . . . . or *disciplinary proceedings pursuant to Rule 48*, amongst other rights of the Corporation as provided under these Rules.

(emphases added).

[29] *See* NSCC Rules 17 and 48; DTC Rule 21.

OS Received 12/01/2021

discipline, Lek has complied with the Lek Assurances. Accordingly, neither NSCC nor DTC has taken any disciplinary action against Lek for violating NSCC Rule 15 or DTC Rule 9(A) or any other rule with respect to the Lek Assurances.[30]

Lek's Application does not claim that the Clearing Agencies imposed the Lek Assurances for violations of NSCC's or DTC's rules. In fact, Lek's Application recognizes that the Required Fund Deposit and Net Debt Cap are authorized risk-management controls.[31] Nevertheless, Lek suggests the Lek Assurances are discipline because they purportedly limit the amount of business Lek can conduct through the Clearing Agencies.[32] However, as discussed more fully below, any alleged limitation on business Lek may do through the Clearing Agencies because it must comply with member requirements under the rules is not something that can be addressed by appeal to the Commission under Section 19(d). If compliance with member

[30] Although the DTCC Correspondence advising Lek of the Lek Assurances referred to Lek's failure to respond fully to requests for information, the Lek Assurances were assessed to address the risk Lek's financial situation posed to the clearance and settlement system based on information available to the Clearing Agencies.

[31] *See* Lek Application at 1.

[32] Presumably, Lek asserts the Lek Assurances are *final* disciplinary sanctions because the Clearing Agencies denied it a hearing with respect to them. *See* Letter from Lek to DTCC, dated August 19, 2021, included with the Application. However, Lek is not entitled to a hearing on the Lek Assurances because they are not discipline or limitations on access to services under NSCC and DTC rules. *See* 15 U.S.C. § 78q–1(b)(3)(H). NSCC Rule 48 pertaining to discipline provides for a hearing in accordance with NSCC Rule 37. NSCC Rule 46 relating to the prohibition or limitation on access to services also provides for a hearing under NSCC Rule 37. For its part, Rule 37 provides for hearing procedures for both disciplinary actions and limitations on access to services. Otherwise, NSCC Rule 37, Section 8, provides that NSCC "*may* at any time establish procedures for a hearing not otherwise provided for by these Rules with respect to any action or proposed action of the Corporation," but it is not required. NSCC Rule 15 does not provide for a hearing on adequate assurances because they are not disciplinary. The same is true of the Net Debit Cap under DTC Rule 9(A). *Compare* DTC Rule 9(A) (providing for assurances) *with* DTC Rule 21 (discussing disciplinary sanctions) and DTC Rule 22 (describing right to hearing and hearing procedures).

In its brief, Lek also refers to the Clearing Agencies' powers to impose "limitation[s] of or restriction[s] on activities, functions and operations" under their disciplinary rules, and suggests the Lek Assurances are discipline because they purportedly fit this description. Lek Br. at 10–12 (citing NSCC Rule 48; DTC Rule 21). The terminology normally refers to constraints placed on the *internal* administration of a participant to remedy past violations or to avoid future violations of applicable rules. That is not the purpose of the Lek Assurances. Assuming, *arguendo*, the Lek Assurances fit the description, just because the actions underlying them can *sometimes* be assessed as discipline doesn't mean they are *always* assessed as discipline. For instance, here, where Lek's minimum Required Fund Deposit was increased and its Net Debit Cap was decreased for risk-management purposes, rather than to address a rule violation, the requirements are qualification standards, not disciplinary sanctions. Indeed, margin requirements and debit restrictions would be unusual sanctions for discipline.

OS Received 12/01/2021

requirements was the measure of discipline, all of NSCC's and DTC's actions in administering their rules would equate to daily sanctions against every member of the Clearing Agencies. It is absurd to view the effects of *complying* with SRO rules as tantamount to sanctions for *violating* SRO rules. And neither the language nor the objectives of Section 19(d) and Rule 19d-1 countenance such an irrational interpretation.

B. The Lek Assurances Are Not Limitations on Access to Services Offered by the Clearing Agencies.

Similarly, SEC review of SRO actions limiting access to services offered by the SRO is restricted to matters of non-compliance with the SRO's rules. The Lek Assurances are risk-management requirements under NSCC's and DTC's rules. Lek has complied with the Lek Assurances, and neither NSCC nor DTC has taken any action against Lek for not complying with them. Instead, Lek's Application complains of "limitations" stemming from *compliance* with those requirements. The complaint, therefore, does not pertain to a "limitation on access to services offered by" NSCC or DTC since neither Clearing Agency *offers* services free of compliance with required risk-management controls.

1. Only a Limitation for Non-Compliance with NSCC's or DTC's Rules Is Reviewable under Section 19(d).

Section 19(d)(1) requires notice by an SRO if it "prohibits or limits any person in respect to access to services offered by such organization." Like discipline, a limitation on access to services noticeable for review under Section 19(d)(2) involves action by an SRO for non-compliance with its rules—*albeit* eligibility, qualification or administrative standards, deviation from which typically does not give rise to discipline, but instead results in the denial of service.[33]

[33] *See Provision for Notices by Self-Regulatory Organizations of Disciplinary Sanctions; Stays of Such Actions; Appeals; and Admissions to Membership or Association of Disqualified Persons*, Exchange Act Release No. 13726 (July 8, 1977), 42 Fed. Reg. 36411 (July 14, 1977) [hereinafter, "Rule 19d-1 Adopting Release"].

OS Received 12/01/2021

A registered clearing agency, like other SROs, cannot prohibit or limit a broker-dealer's or other eligible person's access to services except as prescribed by the clearing agency's rules.[34] Therefore, the action must be based on non-conformity with one of its rules. Accordingly, the notice requirements for prohibitions or limitations under Rule 19d-1(e) and (f) refer exclusively

> The basic objectives of the reporting requirements for other categories of adjudicatory actions are essentially the same as those for disciplinary actions. . . .
>
> * * *
>
> Reports of denials based on a failure to meet minimum qualification standards (Rule 19d-l(e)), such as a failure to pass an examination, [] introduce some special or unique needs in regard to reporting requirements. These actions are not "disciplinary" in the usual sense of that term and generally involve simple fact questions. Further, the SRO should normally have no discretion as to the action it will be required to take.

Id. at 36412.

[34] Section 17A(b)(3), paragraphs (B) and (F) of the Exchange Act require clearing agencies to make participation in their services available to all registered broker-dealers, subject to fair and non-discriminatory qualifications set by each clearing agency. *See* 15 U.S.C. § 78q-l(b)(3)(B) and (F). Sub-section (b)(4)(B) further provides:

> A registered clearing agency may deny participation to, or condition the participation of, any person *if such person* ***does not meet*** *such standards of financial responsibility, operational capability, experience, and competence as are prescribed by the rules of the clearing agency*.

§ 78q-l(b)(4)(B) (emphases added). Thus, the only basis for prohibiting or limiting access to services by a registered clearing agency is *non-conformity* or *non-compliance* with its eligibility, qualification or other standards or requirements under its rules made in accordance with Section 17A(b)(3) and Section 19(b) of the Exchange Act.

OS Received 12/01/2021

to *failures to comply* with SRO standards.[35] Only those limitations are subject to review under Section 19(d)(2).[36]

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[35] Rule 19d-1(e) provides, in pertinent part:

> Any final action of a self-regulatory organization . . . that is taken with respect to any person constituting a . . . limitation of . . . access to services offered by a self-regulatory organization or a member thereof, *and which is based on an* ***alleged failure*** *of any person to*: (1) Pass any test or examination required by the rules of the Commission or such organization; (2) ***Comply*** with other qualification standards established by rules of the Commission or such organization; or (3) ***Comply*** with any administrative requirements of such organization (including failure to pay entry or other dues or fees or to file prescribed forms or reports) not involving charges of violations which may lead to a disciplinary sanction shall not be considered a "disciplinary action" for purposes of paragraph (c) of this rule; but notice thereof shall be promptly filed with the Commission in accordance with paragraph (f) of this section[.]

17 C.F.R. § 240.19d-1(e) (emphases added). The content requirements conform to these limitations. Paragraph (f) provides, in pertinent part:

> Any notice filed pursuant to paragraph (e) of this section shall consist of the following, as appropriate:
>
> * * *
>
> (3) A statement setting forth findings of fact and conclusions as to each alleged ***failure*** of the person *to pass* any required examination, ***comply*** with other qualification standards, or ***comply*** with administrative obligations, and a statement of the organization in support of the resolution of the principal issues raised in the proceeding[.]

§ 240.19d-1(f) (emphases added).

[36] The SEC confirmed the limited scope for notice and jurisdiction of limitations on access to services:

> [N]on-disciplinary matters would be reported to the Commission under Rule 19d-l(e) ***only*** where the SRO has taken a final action as to a *failure to* (1) pass a test, (2) *comply* with qualification standards, or (3) *comply* with administrative requirements. . . .

Rule 19d-1 Adopting Release, 42 Fed. Reg. at 36412 (emphases added).

The cases cited by Lek invoking jurisdiction under Section 19(d) are consistent with this restriction—each includes explicitly or implicitly allegations by the SRO of *non-eligibility* or *non-compliance* with its rules in limiting access to services. In *William Higgins*, the New York Stock Exchange ("NYSE") denied installation of a direct telephone line between customers and a floor broker because the NYSE said its policies prohibited it. The SEC recognized jurisdiction and found the denial was a limitation on access services because the NYSE had no rule limiting such telephonic access. *See William Higgins*, Exchange Act Release No. 24429, 1987 WL 757509, at *14 (May 6, 1987) ("[W]e must set aside any SRO action that imposes a limitation on access *when the action is not taken pursuant to a rule of the SRO*.") (emphasis added). In *SIFMA,* NYSE Arca and NASDAQ denied market data to industry participants who were unwilling to pay the fees for those services required by rules promulgated under Section 19(b)(3) of the Exchange Act. *See SIFMA*, Admin. Proc. Nos. 3-15450, 3-15351, Exchange Act Rel. No. 72182, at 6–9 (May 16, 2014). Similar to *Higgins*, the SEC took the appeal based on the limited authority behind the rules, which were not subject to public comment or pre-approved by the Commission under Section 19(b)(3). *Id.* at 17.

In contrast, the NSCC and DTC base their actions on rules promulgated under Section 19(b)(2) of the Exchange Act, which afforded opportunity for public comment and were approved by the Commission. The U.S. Court of Appeals for the D.C. Circuit has confirmed Section 19(d) cannot be used to challenge an SRO rule of general application made under Section 19(b). *See NASDAQ Stock Mkt.*, 961 F.3d at 424 (D.C. Cir. 2020) (". . .

OS Received 12/01/2021

2. The Requirements of NSCC Rule 15 and DTC Rule 9(A) Are Standards Applicable to All Members, and Lek Has Complied with Them.

Adequate assurances may be required of a member under NSCC Rule 15 and DTC Rule 9(A) as part of the Clearing Agencies' risk-management requirements. The rules apply to all members. Assurances may be necessary based on ongoing monitoring to address a risk of default by a specific member to the high level of assurance required by Rule 17Ad-22. The assurances required of Lek were based on its weakened financial condition described in the DTCC Correspondence. Other members in the same position under the same circumstances would be subject to the same requirements under the rules. As stated above, Lek has complied with the Lek Assurances. Accordingly, the Clearing Agencies have not taken any action against Lek for not complying with them, and no notice has been made or is required to that effect.

The Application itself does not allege any action by the NSCC or DTC for Lek's non-compliance with the Clearing Agency's rules. On the contrary, Lek complains only of alleged limitations related to *compliance* with the Lek Assurances under NSCC Rule 15 and DTC Rule 9(A). A limitation that stems from compliance with a valid SRO rule is not justiciable under Section 19(d), and the notice provisions under Rule 19d-1 make that clear.

3. The Lek Assurances Are an Integral Part of the Clearing Agencies' Services, Not Limitations on Access to those Services.

The adequate assurances required under NSCC Rule 15 and DTC Rule 9(A) are integral to each Clearing Agency's risk-management rules and procedures required by Exchange Act

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Section 19(d) is not available as a means to challenge the reasonableness of generally-applicable fee rules."). Lek concedes that the Clearing Agencies have the authority to raise its clearing fund deposit and lower its net debit cap under their rules. *See* Lek Application at 2 (conceding "the NSCC may have the authority to set Minimum Required Fund Deposits generally," and the DTC "may have the authority to reduce (or increase) Net Debit Caps generally"); *see also* Lek Br. at 3–4. NSCC Rule 15 and DTC Rule 9(A), the bases on which those actions were taken, apply to all participants.

OS Received 12/01/2021

Section 17A(b)(3)(F) and Rule 17Ad-22(e).[37] They work in tandem with the margin requirements under NSCC Rule 4 and Procedure XV,[38] and the Net Debit Cap and other parameters established under the DTC Rules and the Settlement Service Guide.[39] Like the Required Fund Deposit and Net Debit Cap administered formulaically under Procedure XV and the Settlement Service Guide, the assurances under NSCC Rule 15 and DTC Rule 9(A) are necessary to mitigate clearance and settlement risk in special circumstances.[40] Accordingly, NSCC and DTC rules explicitly distinguish between adequate assurances under the rule and limitations on access to services, which may be imposed under other provisions.[41]

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[37] *See generally* 15 U.S.C. §17A(b)(3)(F); 17 C.F.R. § 240.17Ad-22(e); *see also, e.g.*, *Self-Regulatory Organizations; Proposed Rule Change*, Release No. 34-15551 (Feb. 6, 1979), 44 Fed. Reg. 9820, 9821 (Feb. 15, 1979) (proposing NSCC Rule 15 to "centralize and formalize [NSCC]'s existing, authorized surveillance functions by clarifying and consolidating those rights of [NSCC] to receive assurances from its members of their financial responsibility and ability to fulfill their obligations to the [NSCC]'s facilities and operations"); SEC, *Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Modify the DTC Settlement Service Guide to Make Technical Revisions to Clarify and Provide Enhanced Transparency with Respect to the Calculation and Adjustment of Required Participants Fund Deposits*, Release No. 34-80762 (May 24, 2017), 82 Fed. Reg. 25038, 25039 (May 31, 2017) ("If DTC becomes concerned with a [member's] operational or financial soundness, DTC may require adequate assurances of financial or operational capacity from the Participant, as a risk mitigant….")

[38] *See* NSCC Rule 4, Sec. 1 ("Each Member shall make and maintain on an ongoing basis a deposit to the Clearing Fund. The amount of each Member's required deposit shall be determined by [NSCC] in accordance with Procedure XV and other applicable Rules and Procedures (the 'Required Fund Deposit'). The minimum Required Fund Deposit . . . shall be $250,000. [NSCC] may require any such Member to deposit additional amounts to the Clearing Fund pursuant to Rule 15.").

[39] *See* DTC Rule 1; DTC Settlement Service Guide at 65 *et seq*.

[40] The Lek Assurances under NSCC Rule 15 and DTC 9(A) are no less risk-management controls because they involve an element of discretion on the part of NSCC and DTC officials in establishing the Required Fund Deposit and Net Debit Cap.

[41] NSCC Rule 15 explicitly distinguishes between adequate assurances and limitations on access to services, which may be imposed under other provisions. NSCC Rule 15, Section 4, provides, in pertinent part:

> A participant's *failure to furnish information or otherwise comply with the requirements of this Rule* may subject the participant to . . . *restriction on access to the Corporation's services pursuant to Rule 46* . . . amongst other rights of the Corporation as provided under these Rules.

(emphases added). Because adequate assurances are not limitations on access to services, neither NSCC Rule 15 nor DTC Rule 22 provide for a hearing with respect to them. *See supra* n.32.

OS Received 12/01/2021

The Clearing Agencies apply their risk-management controls to all participants numerous times daily, including, where authorized by their rules, raising and lowering the various forms of financial assurances to secure the Clearing Agencies and their members against risk.[42] If they were limitations on access to services, instead of delivery of the services themselves, the Clearing Agencies would be filing notices all day long, and every Required Fund Deposit, Net Debit Cap determination, credit assessment and other risk-management function under their rules, affecting myriad members, would be subject to a hearing and SEC review. This clearly is not what is intended by the notice and jurisdictional limits under Section 19(d) and Rule 19d-1(e).

4. Lek's Limitations Stemming from Compliance with NSCC Rule 15 and DTC Rule 9(A) Are Not "Limitations on Access to Services *Offered* by" the Clearing Agencies.

The "limitations" that Lek complains of in its Application result from having to comply with the risk-mitigation requirements under NSCC Rules 15 and DTC Rule 9(A). Those effects, however, are inherent in the services NSCC and DTC provide to all members, which must include protections against the risk of default by each member with a very high level of assurance under Rule 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(iii). In this regard, the Clearing Agencies' rules may have ancillary effects in limiting the business members can do through the Clearing Agencies.[43] That does not make the limitations justiciable under Section 19(d). Lek is

[42] *See, e.g.*, The Depository Trust Company, *Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures*, at 37, 40 (Dec. 31, 2020) (listing various ongoing and daily credit and market risk-management measures implemented by DTC).

[43] The same is true of all SROs' rules: FINRA and the exchanges have innumerable rules that necessarily limit the business members can do, from additional margin requirements that curtail customer trades to time limits on business hours, halts and suspensions that stop trading altogether. *See, e.g.*, FINRA Rule 4210(f)(8) (authorizing imposition of higher margin requirements); NYSE Rule 7.1 (setting business hours and authorizing trading halts and suspensions).

OS Received 12/01/2021

not entitled to "unlimited" services from NSCC and DTC. It is entitled to clearance and settlement services "offered by" them. And neither NSCC nor DTC *offer* clearance and settlement services separate and apart from the risk-management provisions contained in NSCC Rule 15 and DTC Rule 9(A) and other Clearing Agency rules required by Section 17A(b)(3)(F) and Rule 17Ad-22.

CONCLUSION

Lek's Application should be rejected. There is no jurisdiction for review of the matter under Section 19(d) of the Exchange Act.

Respectfully submitted,

New York, NY
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OS Received 12/01/2021

CERTIFICATE OF SERVICE

I, Adam Deming, certify that on this 1st day of December 2021, in accordance with SEC Rule of Practice 150, I caused a copy of National Securities Clearing Corporation and the Depository Trust Company's Response Seeking Dismissal of Lek Securities Corporation's Application for Review under Exchange Act Section 19(d) in the *Matter of Lek Securities Corporation*, Administrative Proceeding No. 3-20543, to be served on the following via email:

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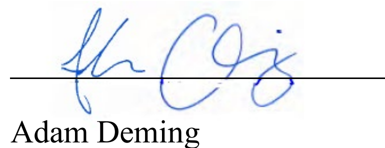

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