

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of
LEK SECURITIES CORPORATION
For Review of Actions Taken by
The National Securities Clearing Corporation and
the Depository Trust Company
File No. 3-20543

**LEK SECURITIES CORPORATION'S REPLY BRIEF ON THE
COMMISSION'S JURISDICTION OVER THIS APPEAL**

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As stated in the Lek Securities Corporation's ("LSC") Opening Brief ("LSC Brief"), LSC believes that the Commission has jurisdiction to review the Limiting Sanctions because, in imposing them, the DTCC Entities limited LSC's access to the services they provide to LSC as a member of each DTCC Entity and, alternatively, because the Limiting Sanctions constitute final disciplinary sanctions under DTC and NSCC Rules.¹

Although the DTCC December 1, 2021 Brief ("DTCC Brief") frames the Limiting Sanctions as "adequate assurances" under NSCC Rule 15 and DTCC Rule 9(A), the DTCC Entities' application of their rules were based on either an incorrect understanding of the facts, or false assumptions, or both. The DTCC Entities were informed of the correct facts in advance of imposing the Limited Sanctions by LSC, yet the DTCC Entities imposed the Limiting Sanctions anyway. These actions should be subject to review by the Commission. The DTCC Entities do not have unfettered discretion to act against the interests of a member. Nor can they expect deference from the Commission when they arbitrarily limit a member's access to their services without a rational basis.

ARGUMENT

I. There Was No Rational Basis for the DTCC Entities to Impose the Limiting Sanctions.

The DTCC Entities have the authority to manage risk among participants. They do not, however, have authority to take actions that impose onerous burdens and significant costs on their participants without a rational basis for doing so.

The DTCC Brief states that the Required Fund Deposit and the Net Debit Caps are risk-management controls under NSCC Rule 15 and DTC Rule 9(A). NSCC Rule 15, Section 2(a)

¹ Capitalized terms not defined herein shall have the meanings ascribed in the LSC Brief.

provides, in pertinent part: “Each Member... shall furnish [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*” (emphasis added). DTC Rule 9(A), Section 2 provides that “At the request of [DTC], a Participant or Pledgee shall immediately furnish the [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 the [DTC] deems necessary *for the protection of [DTC], other Participants or Pledgees, including deposits to the Participants Fund; provided, however, that any such conditions shall not be inconsistent with any applicable laws or rules or regulations of regulatory bodies having jurisdiction over the Participant or Pledgee*” (emphasis added).

Neither NSCC Rule 15 nor DTC Rule 9(A) grants the respective DTCC Entities unfettered authority to impose adequate assurances or risk controls that are untethered to existing facts or circumstances. Rather, these actions can only be taken for the legitimate protection of the DTCC Entities and its participants. As discussed in the Application and LSC Brief, the Limiting Sanctions were imposed based on incorrect assumptions and an inaccurate understanding of LSC’s operation. For example, LSC’s liquidity increased after the elimination of LSC’s credit line with BMOH, by virtue of LSC’s increase in its line of credit with Lakeside and the establishment of a promissory note program from LSC’s parent. Its regulatory capital remained at all times above the requirements imposed by the DTCC Entities. LSC corrected these misunderstandings in the letters referenced in the LSC Brief and above, but the DTCC

Entities imposed the Limiting Sanctions anyway. There is no rational basis for them to have done so. LSC's regulatory capital and liquidity strengthened or remained the same throughout the relevant period.

The DTCC Brief emphasizes that the DTCC Entities must manage the "legal, credit, liquidity, operational, business, custody and other risks borne by the Clearing Agencies" and their credit exposures to each member, and that NSCC must have a "risk-based margin system" designed to cover potential future exposure to members.² LSC does not disagree. Since, however, LSC's regulatory capital and liquidity were not weakened, there was no need, and no rational basis, for the DTCC Entities to impose the Limiting Sanctions.

The DTCC Brief also cites the NSCC requirement in Rule 15 that "each Member... shall furnish to [NSCC] such adequate assurances of its financial responsibility and operational capacity" as requested by NSCC. LSC has done so and in so doing clarified the condition of its regulatory capital and liquidity that the DTCC Entities had expressed concern about. The DTCC Brief describes the "principal reasons" for the Limiting Sanctions were the "apparent deterioration of, and uncertainty around, [LSC]'s liquidity resources."³ But there was no "deterioration" in LSC's liquidity position, and LSC's responses to the DTCC Entities' requests should have clarified any "uncertainty."

The DTCC Brief misleadingly quotes the LSC Brief regarding the DTCC Entities' stated bases for imposing the Limiting Sanctions as if LSC was agreeing with the bases rather than challenging their accuracy.⁴ It then states that "the Application doesn't allege anything more than that [the] Clearing Agencies exercised discretion authorized under NSCC Rule 15 and DTC

² DTCC Brief at 2-4.

³ DTCC Brief at 4-5.

⁴ DTCC Brief at 7.

Rule 9(a), to take actions expressly provided for in the rules, for explicit reasons contemplated by the rules.” This misstates LSC’s position. LSC has also alleged that the discretion exercised by the DTCC Entities lacked a rational basis and that the DTCC Entities failed to acknowledge LSC’s clarifications of the relevant facts. As described in the LSC Brief and above, the bases stated by the DTCC Entities were simply wrong: there was no deterioration or uncertainty in LSC’s liquidity position. The discretion afforded to the DTCC Entities under the Exchange Act cannot be exercised arbitrarily without any factual support.

The DTCC Brief acknowledges that such actions taken to impose adequate assurances should be deferred “so long as there is a rational basis for it within the context of the rule and it is made in good faith.”⁵ The DTCC Entities cite *Heath v. Securities and Exchange Commission* for the proposition that the Commission generally defers to an interpretation by an SRO of its own rules as long as these two requirements—rationality and good faith—are met by the SRO. LSC agrees with the DTCC Entities on the applicable standard to be applied. While LSC does not assert that the DTCC Entities acted in bad faith, it does assert that the Limiting Sanctions have no rational basis in light of the factual errors on which they purport to be based, and the DTCC Entities have not presented one.

When a clearing agency takes an action that is harmful to one of its members and does so without a rational basis, the Commission must be permitted to intervene and review the action, whether or not the clearing agency agrees that the action is reviewable, and whether or not the clearing agency treats the action as a risk management measure, on one hand, or a limitation on access to services or a final disciplinary sanctions, on the other. If the Commission were not allowed to review an action by a clearing agency that a member credibly alleges is without a

⁵ DTCC Brief, p.8, citing *Heath v. SEC*, 586 F.3d 122, 138–39 (2d Cir. 2009).

rational basis, the clearing agency would have unfettered authority. This is not the regulatory regime contemplated by Section 19(d) of the Exchange Act. Rather, Congress intended the Commission to have broad authority to review clearing agency actions that are detrimental to members of the clearing agency. The Commission has obligations pursuant to the Exchange Act to ensure that clearing agencies act rationally in carrying out their statutory obligations.

II. LSC is Challenging the DTCC Entities' Application of NSCC Rule 15 and DTC Rule 9(A), Not the Validity of Either Rule.

The DTCC Brief also states that LSC is effectively challenging the validity of NSCC Rule 15 and DTC Rule 9(A) and that such a process would require LSC to petition for amendment under Rule 192 of the SEC's Rule of Practice. This statement is incorrect. LSC is not challenging the validity of either rule. LSC is challenging the DTCC Entities' tailoring of their rules in this particular instance to LSC by imposing more stringent limits on LSC than on other participants. As set forth above, there was no rational basis for the DTCC Entities to single out LSC by imposing the Limiting Sanctions on LSC.

III. The Commission Has Jurisdiction Because the Limiting Sanctions Constitute Both Limitations on Access to Services and Final Disciplinary Sanctions.

The Commission has jurisdiction over this appeal and should permit the merits of LSC's appeal to be heard. Section 19(d) of the Exchange Act authorizes the Commission to review an action taken by an SRO, including the DTCC Entities, on multiple grounds, including if the action "prohibits or limits any person in respect to access to services offered by such organization or member thereof" or if it "imposes any final disciplinary sanction on any member." For the reasons stated in the LSC Brief, the Commission has jurisdiction on either of those grounds to review the Limiting Sanctions, and that jurisdiction is consistent with the legislative history of Section 19(d), which explains, in relevant part, that the Commission should

have the authority to broadly define the actions an SRO takes against its members for purposes of defining the limits of the Commission's jurisdiction to review such actions.⁶

The DTCC Brief makes three main arguments disputing LSC's position. First, the DTCC Brief appears to assume that an action that the DTCC Entities characterize as an "adequate assurance" or risk management measure cannot also operate as a limitation on access to services. Yet there is nothing in the DTCC Entities' Rules stating that actions that constitute adequate assurance measures and actions that constitute limits to access of services or disciplinary actions are mutually exclusive. When, as here, a given action imposes costs on a participant, if that action has no rational basis, then it can operate as a limitation on access to services or as a final disciplinary sanction on the member, even if the clearing agency, in good faith, did not intend it to.

The DTCC Brief also attempts to argue that LSC's compliance with the Limiting Sanctions means that the Limiting Sanctions did not operate as final disciplinary sanctions within the meaning of the term in the Commission's Rules. This position does not make sense. LSC should not be penalized for complying with the Limiting Sanctions while pursuing the appropriate internal and external channels to challenge the Limiting Sanctions. LSC requires the services provided by the DTCC Entities to operate its business. It chose to comply with the Limiting Sanctions—at a cost—so that it could continue serving its customers.

Finally, the DTCC Entities argue that review by the Commission of actions like the Limiting Sanctions would create too heavy a burden on the DTCC Entities in administering their rules. In the DTCC Brief, the DTCC Entities concede that their actions require a rational basis in

⁶ S. Comm. on Banking, Housing & Urban Affairs, Securities Acts Amendments of 1975, Accompanying S. 249, S. Rep. No. 94-75, at 24 (1975).

order to be granted deference by the Commission. Only the Commission can review the DTCC Entities' actions for that rational basis. Credible allegations from participants that they have been sanctioned or limited by a clearing agency without rational basis must be reviewable by the Commission. Otherwise, there would be no limit on the actions clearing agencies can take with respect to their members, no matter how harmful or arbitrary, as long as they frame their actions as risk management measures and not as limitations on actions to services (or final disciplinary sanctions).

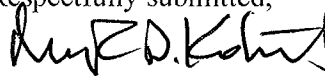
CONCLUSION

The Commission has the necessary jurisdiction to review the DTCC Entities' imposition of the Limiting Sanctions, because they are limitations to LSC's access to services provided by the DTCC Entities, and, alternatively, because they constitute final disciplinary sanctions within the meaning of Section 19(d)(1) of the Exchange Act. The DTCC Entities have framed the Limiting Sanctions as ordinary risk management measures, but they were imposed without a basis in fact. Absent a rational basis for the Limiting Sanctions, they are, at minimum, limitations on access to services that are subject to Commission review and oversight.

Based on the LSC Brief as well as the foregoing, the Commission has jurisdiction over this appeal pursuant to Section 19(d) of the Exchange Act and should permit LSC's appeal to proceed to a review of its merits.

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Respectfully submitted,



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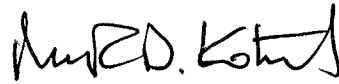
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CERTIFICATE OF SERVICE

I, Mark D. Kotwick, certify that on this 15th day of December 2021, I caused a copy of the Petitioner's Reply Brief on the Commission's Jurisdiction over this Appeal, in the matter of LEK Securities Corporation, Administrative Proceeding No. 3-20543, to be served on the following via email:

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