

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2015047091401**

TO: Department of Enforcement
Financial Industry Regulatory Authority (“FINRA”)

RE: J.P. Morgan Securities LLC, Respondent (BD No. 79),
as successor to J.P Morgan Clearing Corp. (BD No. 28432)

Pursuant to FINRA Rule 9216 of FINRA’s Code of Procedure, J.P. Morgan Securities, LLC (“JPMS” or the “Firm”), as successor to J.P. Morgan Clearing Corp. (“JPMCC”), submits this Letter of Acceptance, Waiver and Consent (“AWC”) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The Firm hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

JPMCC, then known as Bear Stearns Securities Corporation, became a member of FINRA on June 25, 1991. JPMCC was a subsidiary of JPMS, and its principal place of business was Brooklyn, New York. JPMCC acted as a carrying and clearing broker-dealer and provided securities clearing, custody, settlement, and lending services. JPMCC merged with JPMS on October 1, 2016. As of September 2016, one month before the merger, JPMCC had 3 branch offices and approximately 220 registered representatives.

JPMS is the surviving entity, and it took on the business operations of JPMCC. JPMS is a full-service broker-dealer headquartered in New York, New York. JPMS has been a FINRA member since 1936.

RELEVANT DISCIPLINARY HISTORY

JPMCC has no relevant disciplinary history with the Securities and Exchange Commission, any state securities agency, FINRA, or any other self-regulatory

organization.

OVERVIEW

From March 2008 through June 2016 (the “Relevant Period”), JPMCC carried and cleared securities for domestic and international retail and institutional customers. During this time, it maintained electronic systems intended to meet its possession or control obligations. These electronic systems were legacy systems from Bear Stearns Securities Corporation and were not materially altered. During the Relevant Period, the systems had design flaws and coding and data errors that led JPMCC to fail to segregate customers’ foreign and domestic securities in good control locations. As a result, JPMCC failed to promptly obtain and thereafter maintain physical possession or control of its customers’ fully-paid and excess margin securities, creating deficits in securities valued at hundreds of millions of dollars during the Relevant Period. By reason of the foregoing, JPMCC violated Section 15 of the Securities Exchange Act of 1934 (“SEA”) and Rule 15c3-3(b) promulgated thereunder.

The above failures were caused by JPMCC’s lack of systems and procedures reasonably designed to ensure its compliance with the SEA’s possession or control requirements. Due to the lack of reasonable supervision, the numerous design flaws in the possession or control systems went undetected and led to global segregation deficiencies during the Relevant Period. By reason of the foregoing, JPMCC violated NASD Rule 3010 (for the time period prior to December 1, 2014) and FINRA Rule 3110(a) (for the time period on and after December 1, 2014).

The above conduct also constitutes a violation of NASD Rule 2110 (for the time period prior to December 15, 2008) and FINRA Rule 2010 (for the time period on and after December 15, 2008).

FACTS AND VIOLATIVE CONDUCT

A) JPMCC Failed to Promptly Obtain and Thereafter Maintain Physical Possession or Control of all Customer Fully-Paid and Excess Margin Securities

SEA Rule 15c3-3, known as the Customer Protection Rule, is aimed at protecting customers’ funds and securities. The possession or control provisions of Rule 15c3-3 require broker-dealers to protect securities that customers leave in the firm’s custody. Rule 15c3-3(b) requires broker-dealers to promptly obtain and thereafter maintain physical possession or control of all customers’ fully-paid and excess margin securities.¹ To comply with the Rule, broker-dealers segregate or

¹ Fully paid securities are those for which a customer has made full payment. Margin securities are securities for which a customer has not made full payment and has received credit for a portion of the purchase price. “Excess margin securities” are securities in a customer’s account that have a market value in excess of 140 percent of the total of the debit balances in the customer’s account or accounts with the broker-dealer.

“lock up” customers’ fully paid and excess margin securities in a “good control location” separate from the broker-dealer’s own assets.

Violations of Rule 15c3-3 are also violations of NASD Rule 2110 and FINRA Rule 2010, which superseded NASD Rule 2110 on December 15, 2008, which require FINRA member firms to “observe high standards of commercial honor and just and equitable principles of trade.”

Throughout the Relevant Period, in order to comply with the Customer Protection Rule, JPMCC had computer systems that calculated its possession or control obligations. The systems issued instructions to depositories and custodial banks to move customer securities to good control locations pursuant to its calculations. The systems also calculated the extent to which JPMCC had securities beyond the amount it was required to segregate, so that JPMCC could release those securities from segregation and use those securities. However, these systems did not work as anticipated.

By failing to move securities to a good control location or maintain them in a good control location, the Firm created deficits of hundreds of millions of dollars. As a result, shares that should have been segregated were made available for the Firm’s use.

1. International Deficits

During the Relevant Period, JPMCC failed to segregate certain international securities in customer accounts as the result of coding and data errors that affected particular countries. JPMCC’s possession or control systems calculated its segregation obligations and issued instructions for securities to be moved to good control locations. However, because of errors relating to coding or bank account instructions, these movements were not executed. For example,

- In June 2012, JPMCC made a coding change in its segregation systems specific to Italian securities. That change introduced an error into the code. As a result, no instructions to move Italian securities to good control locations were implemented between June 2012 and April 2014. During that period, JPMCC failed to segregate Italian securities with an average daily value of approximately \$44 million. Because of this failure, on a sample day, April 23, 2014, JPMCC created a deficit in 81 Italian securities with a value of approximately \$146 million.
- From April 2010 through May 2014, as a result of a data entry error, no instructions to move Nigerian securities to good control locations were implemented. For example, because of this failure, on June 30, 2014, JPMCC created a deficit in 16 Nigerian securities with a value of approximately \$120 million.

- In addition, during the Relevant Period, similar but distinct data and coding errors affected securities in Sri Lanka, Turkey, Zambia, Venezuela, and the United States territory, Puerto Rico. Those errors caused JPMCC to fail to move securities in those countries to good control locations throughout the Relevant Period. Because of this failure, JPMCC created deficits in securities in accounts held in these countries, ranging from tens of thousands to hundreds of thousands of dollars (and in at least one case over \$1 million) a day.

During the Relevant Period, JPMCC also had design flaws in its segregation systems that affected international securities. For example,

- From March 2008 through September 2014, JPMCC's segregation systems did not ensure that customer securities held in certain foreign clearance accounts were moved to a good control location in a timely manner. Although JPMCC's systems identified shares in foreign clearance accounts for segregation, the systems did not verify that those shares were moved. Instead, JPMCC's systems were coded to assume that the shares had moved as if the instruction was accomplished. Often, as the result of this flaw and the lags created by time zone differences and local holidays, shares in foreign clearance accounts that should have been segregated appeared available for JPMCC's use and could have been used by JPMCC. For example, as a result of this system flaw, on May 1, 2014, JPMCC created a deficit in 27 foreign securities totaling approximately \$30 million.
- From March 2008 through June 2016, JPMCC's segregation systems contained logic that assumed that instructions to transfer foreign securities to or from a good control location had occurred. The systems did not account for any canceled instructions. As a result, the systems made their calculations on the basis of anticipated segregation movements rather than the actual figures in the clearance and custody accounts. On occasion, this design flaw caused JPMCC to create deficits. For example, on May 5, 2016, JPMCC's safekeeping account was improperly overstated by 700 shares of a Japanese security. The overstatement was due to a failed segregation instruction from a previous day. In reliance on that prior segregation, JPMCC's systems instructed a segregation release of 100 shares of the security. Because the instruction to move the 700 securities had failed and JPMCC's systems did not account for that failure, JPMCC created a deficit of 100 shares in the Japanese security.

JPMCC also had other failures to obtain and maintain possession or control of international securities. For example,

- In 2015, JPMCC incorrectly coded a clearance account in the Italian market as a good control location for possession or control purposes.

However, JPMCC did not have a representation letter from the clearing firm stating that no liens would be placed on the securities in that account. As a result, that account was not a good control location, and securities held in that account could have been subjected to claims or liens.

- Also in 2015, JPMCC used a Turkish account with a minimum quantity requirement of 100,000 shares. JPMCC did not instruct movements in that account to a good control location when the amount of securities to be locked up was less than 100,000 shares. For example, JPMCC failed to move securities in Turkey to a good control location on three occasions between April 13 and April 17, 2015, and created daily deficits of approximately 95,000 shares.

2. Domestic Deficits

During the Relevant Period, JPMCC also failed to segregate domestic securities in customer accounts as the result of design flaws in its optimization engine.

From at least 2008 through April 2015, JPMCC's optimization engine contained a design flaw that treated securities recalled from a depository bank loan as available to meet JPMCC's segregation requirements. This allowed other securities to be released from segregation. The released securities, therefore, could have been used as collateral to finance JPMCC's intraday activity. As a result, when the system assumed that it segregated the recalled securities, it instead created intraday deficits. Because JPMCC's deficit reports did not capture these intraday deficits, since all of the pledged securities were returned and segregated by the end of the day, JPMCC did not maintain an effective control to detect an ongoing issue. Because of this failure, in the sample period from April 6, 2015 through April 8, 2015, JPMCC created seven intraday deficits totaling \$12.7 million.

By reason of the foregoing, JPMCC violated Section 15 of the Securities Exchange Act and Rule 15c3-3(b) promulgated thereunder and NASD Rule 2110 (for the period prior to December 15, 2008) and FINRA Rule 2010 (for the period on and after December 15, 2008.)

B) JPMCC Failed to Adequately Supervise its Activities Related to the Possession or Control Requirements of Rule 15c3-3

NASD Rule 3010(a) and FINRA Rule 3110(a), which superseded NASD Rule 3010(a) on December 1, 2014, require firms to establish and maintain supervisory systems reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

Violations of NASD Rule 3010(a) and FINRA Rule 3110(a) are also violations of NASD Rule 2110 and FINRA Rule 2010, which superseded NASD Rule 2110 on

December 15, 2008. Those Rules require FINRA member firms to “observe high standards of commercial honor and just and equitable principles of trade.”

During the Relevant Period, JPMCC did not have a reasonable supervisory system in place to ensure its compliance with the possession or control requirements of Rule 15c3-3.

JPMCC did not have a reasonable process in place to ensure that its possession or control systems were working properly. For example, JPMCC’s possession or control function was carried out by disparate individuals in different groups who did not effectively communicate with each other about the company’s overall compliance with its Rule 15c3-3 obligations. As a result, there was no comprehensive review or analysis of segregation failures caused by system failures or human error, and often the root cause of these failures was never identified or resolved.

In addition, the tools JPMCC created to identify compliance with possession or control requirements were not reasonably designed to identify trends or ongoing problems with its possession or control systems. For example, JPMCC’s primary report used to assess segregation deficits only identified new or increased deficits rather than aged or aging deficits. As a result, those deficits that were recurring or never resolved were not flagged or addressed by JPMCC.

JPMCC also did not have reasonable procedures in place to test its segregation processes, which had been in place since 2008. JPMCC did not conduct periodic independent reviews of the automated daily segregation or of the segregation function across the more than 60 countries where JPMCC held customer securities. JPMCC did not test its possession or control systems in countries where accounts were newly established and did not test whether certain static data changes negatively impacted its possession or control systems. As a result, JPMCC did not identify the failures to segregate customer securities over many years in Italy, Nigeria, Sri Lanka, Turkey, Puerto Rico, Zambia, and Venezuela.

By reason of the foregoing, JPMCC violated NASD Rule 3010(a) (for the period before December 1, 2014) and FINRA Rule 3110(a) (for the period on and after December 1, 2014) through the end of the Relevant Period and NASD Rule 2110 (for the period prior to December 15, 2008) and FINRA Rule 2010 (for the period on and after December 15, 2008.)

OTHER FACTORS

In resolving this matter, FINRA has recognized JPMCC’s extraordinary cooperation. JPMCC promptly took action and remedial steps to correct the violative conduct, including: (1) unilaterally engaging an independent consultant; (2) undertaking a comprehensive possession or control review and disclosing to FINRA newly identified possession or control issues; (3) creating a new

experienced team responsible for the possession or control process; and (4) designing and implementing new monitoring tools and systems.

Starting in January 2012, JPMCC also undertook to over-reserve hundreds of millions of dollars weekly in cash deposits in an effort to protect customers from loss due to the unaccomplished segregation of international securities.

- B. The Firm also consents to the imposition of the following sanctions:
1. A censure; and
 2. a fine in the amount of \$ 2.8 million.

The Firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. The Firm has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

The Firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

The Firm specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firm specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other

consideration of this AWC, including acceptance or rejection of this AWC.

The Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

The Firm understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. the Firm may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it may not deny the charges or make any statement that

is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of J.P. Morgan Securities LLC, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and had been given a full opportunity to ask questions about it; that the Firm agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

12/18/2017
Date (mm/dd/yyyy)

J.P. Morgan Securities LLC

By:
Name:
Title:


William T. Freilich
Managing Director

Reviewed by:

Elizabeth H. Baird
Counsel for Respondent
Morgan Lewis & Bockius LLP
1111 Pennsylvania Avenue, NW
Washington, DC 20004-2541
Tel: (202) 373-6561

is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

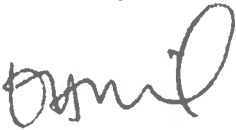
The undersigned, on behalf of J.P. Morgan Securities LLC, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and had been given a full opportunity to ask questions about it; that the Firm agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

Date (mm/dd/yyyy)

J.P. Morgan Securities LLC

By: _____
Name:
Title:

Reviewed by:



Elizabeth H. Baird
Counsel for Respondent
Morgan Lewis & Bockius LLP
1111 Pennsylvania Avenue, NW
Washington, DC 20004-2541
Tel: (202) 373-6561

Accepted by FINRA:

12/27/2017
Date

Signed on behalf of the
Director of ODA, by delegated authority

Susan Light

Susan Light
Senior Vice President & Chief Counsel
FINRA Department of Enforcement
One World Financial Center
200 Liberty Street
New York, NY 10281-1003
Tel: (646) 315-7333

ELECTION OF PAYMENT FORM

J.P. Morgan Securities LLC intends to pay the fine set forth in the attached Letter of Acceptance, Waiver and Consent by the following method (check one):

- A personal, business or bank check for the full amount;
- Wire transfer;
- Credit card authorization for the full amount;¹ or
- The installment payment plan (only if approved by FINRA staff and the Office of Disciplinary Affairs).²

Respectfully submitted,

12/8/2017
Date (mm/dd/yyyy)

J.P. Morgan Securities LLC

By:
Name:
Title:


William H. Frellich
Managing Director

¹ You may pay a fine of \$50,000.00 or less using a credit card. Only Mastercard, Visa and American Express are accepted for payment by credit card. If this option is chosen, the appropriate forms will be mailed to you, with an invoice, by FINRA's Finance Department. Do not include your credit card number on this form.

² The installment payment plan is only available for fines of \$5,000 or more. Certain interest payments, minimum initial and monthly payments, and other requirements apply. You must discuss these terms with FINRA staff prior to requesting this method of payment.