

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2005001306301**

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

RE: J.P. Morgan Securities, Inc. ("JP Morgan") (BD No. 18718)

Pursuant to NASD Rule 9216 of FINRA Code of Procedure, Respondent JP Morgan submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II 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.

Respondent understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by FINRA's Department of Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), pursuant to Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
3. If accepted:
 - a. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA against Respondent;
 - b. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - c. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with Rule 8310 and IM-8310-2; and
 - d. Respondent 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 allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in

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this provision affects Respondent's testimonial obligations or right to take legal positions in litigation in which FINRA is not a party.

Respondent also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

JP Morgan has been a member of FINRA (f/k/a National Association of Securities Dealers or NASD) since April 1987 and a member of the New York Stock Exchange since January 1987. JP Morgan operates a general securities business. JP Morgan has been the subject of three relevant formal disciplinary actions.

In June of 2005, JP Morgan was censured and fined \$160,000 by FINRA for violating Municipal Securities Rulemaking Board ("MSRB" or "Board") Rule G-14 by failing to timely report municipal securities customer and inter-dealer transactions to the MSRB, and for violating MSRB Rule G-27 by failing to adequately supervise and monitor its trade reporting to ensure compliance with Rule G-14.

In August of 2005, JP Morgan was censured and fined \$100,000 by FINRA for violating MSRB Rule G-36 by failing to submit official statements and other documents to the MSRB in a timely manner pursuant to MSRB Rule G-36, and for violating MSRB Rule G-27 by failing to adequately monitor its underwriting filings.

In January of 1998, JP Morgan was censured and fined \$25,000 by FINRA for violating MSRB Rule G-36 by failing to submit official statements to the MSRB in a timely manner pursuant to MSRB Rule G-36.

I.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Formal Complaint issued specifying the allegations against it;
- B. To be notified of the Formal 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 NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

Respondent further specifically and voluntarily waives any right to claim that a person violated the *ex parte* prohibitions of Rule 9143 or the separation of functions prohibitions of 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.

II.

ACCEPTANCE AND CONSENT

A. Findings

Respondent hereby accepts and consents, without admitting or denying the allegations or 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 and Summary

This matter involves violations of MSRB Rule G-38¹ by JP Morgan in MSRB filings during the period from January 1, 2002 through June 30, 2004. During that period, Rule G-38 required that firms disclose, among other things, municipal securities business obtained or retained by particular consultants and payments made to specific consultants connected to particular municipal securities business. Despite these requirements, JP Morgan failed to disclose in quarterly Form G-37/38 reports filed with the MSRB that numerous consultants had obtained or retained particular municipal securities business for the firm and that JP Morgan had made payments to consultants connected with particular municipal securities business. During the same time period, JP Morgan also failed to adopt, maintain and enforce procedures reasonably designed to ensure compliance with

¹ Former MSRB Rule G-38 governed the conduct at issue and was superseded effective August 29, 2005. Current Rule G-38 prohibits payment by a municipal securities dealer to any unaffiliated person for solicitation of municipal securities business on behalf of the dealer. *See Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to the Proposed Rule Change Relating to Solicitation of Municipal Securities Business under MSRB Rule G-38*, Release No. 34-52278, 70 FR 49342 (August 23, 2005). This matter involves violations of the disclosure requirements of former Rule G-38 but does not involve violations of current Rule G-38's prohibitions. All references herein to Rule G-38 are to the former Rule G-38 unless otherwise noted.

the reporting requirements of Rule G-38, in violation of MSRB Rule G-27.

As disclosed in its quarterly forms G-37/G-38, over the course of the two-and-a-half year period from January 1, 2002 through June 30, 2004, JP Morgan paid a total of approximately \$7.15 million, consisting of approximately \$6.8 million in consulting fees and \$365,000 in expenses, to approximately 40 consultants retained in connection with its municipal securities business. In quarterly Forms G-37/G-38 filed with the MSRB for that same period, however, the firm inaccurately reported that these consultants had not obtained or retained any municipal securities business for the firm. JP Morgan also failed to report that any of the payments made to each of the approximately 40 consultants were connected with particular municipal securities business awarded to the firm.²

In fact, at least 70 municipal securities offerings underwritten by JP Morgan during this period were obtained by at least 16 different JP Morgan consultants. In addition, during the same period, the firm made at least six payments totaling \$775,000 to four of JP Morgan's consultants that were connected to particular municipal securities business. By failing to report this information on MSRB Form G-37/G-38, JP Morgan violated MSRB Rule G-38.

In addition, JP Morgan failed to file its quarterly Form G-37/G-38 reports in the correct format until June 30, 2003. Instead, JP Morgan filed the reports on an out-of-date version of the form that did not reflect the applicable reporting requirements for Rule G-38. In fact, even when JP Morgan began to file its quarterly reports on the correct form, it failed to adopt procedures, or to update its current written procedures, to reflect the actual disclosure requirements of the rule. In addition, JP Morgan's written procedures contained no standards for review of the quarterly Form G-37/G-38 filings prior to their submission to the MSRB, and the firm had no procedures designed to ensure that Forms G-37/G-38 were filed with the consultant and payment information described above required by Rule G-38. JP Morgan thus failed to adopt, maintain and enforce procedures reasonably designed to ensure compliance with Rule G-38.

MSRB Rule G-38 and Form G-37/G-38

During the time period at issue here, MSRB Rule G-38 required each broker, dealer and municipal securities dealer to submit to the MSRB quarterly reports containing specified information about consultants³ engaged by the firm to communicate with issuers in exchange for payment. The rule required that the "reports must be sent to the Board on Form G-37/G-38." Among other things, Rule G-38(e) required that firms disclose on Form G-37/G-38 "Municipal securities business obtained or retained by consultant (list

² During the period, JP Morgan underwrote approximately 950 municipal securities offerings, and disclosed in its MSRB filings the identities of the approximately 40 consultants it used to communicate with municipal securities issuers and the total amounts it paid to these consultants.

³ Rule G-38(a)(1) defines consultant as "any person used by a broker, dealer or municipal securities dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on behalf of such broker, dealer or municipal securities dealer where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the broker, dealer or municipal securities dealer or any other person...."

each such business separately and if applicable, indicate dollar amounts paid to consultant connected with particular municipal securities business).” The prior version of the relevant form required disclosure of “dollar amounts paid to consultants connected with municipal securities business (each such business and amount must be separately identified).”

JP Morgan Violated MSRB Rule G-38 By Inaccurately Reporting That No Municipal Securities Business Had Been Obtained or Retained By Its Consultants and By Inaccurately Reporting That It Had Made No Payments To Its Consultants Connected With Particular Municipal Securities Business

From January 1, 2002 until June 30, 2004, JP Morgan engaged approximately 40 consultants to communicate directly or indirectly with municipal securities issuers on JP Morgan's behalf. During this period, JP Morgan paid these consultants approximately \$7.15 million. This amount consisted of approximately \$6.8 million in consulting fees, including approximately \$2.5 million in bonuses, and approximately \$365,000 in expenses. Despite the extensive use of consultants as identified in its quarterly MSRB filings, however, JP Morgan failed to disclose on Form G-37/G-38 any instances where a consultant obtained or retained municipal securities business on JP Morgan's behalf. The firm also failed to disclose that any portion of the \$7.16 million in fees and bonuses paid to the consultants during the period was connected to any municipal securities business obtained by the firm. In fact, in every Attachment to Form G-37/G-38 filed on the ten quarterly reports during the period, the firm reported that it paid “\$0” to consultants connected to particular municipal securities business and that the amount of municipal securities business obtained or retained by consultants was “\$0.”

These statements were not accurate. JP Morgan repeatedly used consultants to obtain or retain particular municipal securities business and made numerous payments to consultants connected to particular transactions. In fact, JP Morgan used at least 16 consultants to obtain or retain at least 70 offerings of municipal securities for the firm during the time period at issue here.

For example, JP Morgan paid consultant S&A to communicate on JP Morgan's behalf with city administrators about a particular municipal refinancing in 2003. S&A introduced JP Morgan investment bankers to city administrators and also advised JP Morgan about whom to include as a member of the team or pool of underwriters. JP Morgan was awarded the refinancing and an internal memo noted that while the local JP Morgan office “develop[ed] the concept and won over the City staff, we would not have been lead on the...trade without [S&A].” Despite this, JP Morgan failed to identify S&A's role in obtaining the refinancing on the Attachment to Form G-37/G-38 for S&A. Indeed, none of the Attachments to Form G-37/G-38 for S&A even identified the state or city involved as a geographic area in which S&A was working on behalf of JP Morgan, as also required by MSRB Rule G-38.

In another example, on the Attachment to Form G-37/G-38 which identified STM as a consultant used by JP Morgan in 2003, JP Morgan failed to disclose the role consultant STM played in obtaining three particular underwritings. STM not only introduced JP Morgan bankers to the issuers for these transactions, but also routinely contacted and attended meetings with the issuers. STM also informed JP Morgan about financing requirements for the transactions, worked on presentations to issuers with the investments bankers, and set up appointments with the chief financial officers, executive directors, and board members of the issuers. In an internal review of STM's performance for the year, STM was described as having "done very well for this year" specifically listing the three new underwritings as illustrative of STM's work for JP Morgan. Although JP Morgan recognized STM's role in the successful award of the offerings in internal documents, JP Morgan did not disclose STM's role in obtaining the underwritings on the Attachments to Form G-37/G-38 for STM.

In addition, JP Morgan's internal records revealed at least six instances where JP Morgan paid consultants discretionary year-end bonuses, totaling at least \$775,000, connected to particular municipal securities business the consultants helped obtain. JP Morgan, however, failed to disclose that these payments were connected to particular municipal securities transactions on the Forms G-37/G-38 filed with MSRB. Consultant S&A, for example, was paid a \$75,000 bonus in December of 2003 related to its work on the refinancing discussed above. In calculating the bonus, an internal JP Morgan memorandum noted that the \$75,000 figure represented "3% of the revenue line [S&A] help[ed] produce." Despite this, JP Morgan failed to disclose the \$75,000 payment made to S&A in connection with the underwriting on the Attachment to Form G-37/G-38. Similarly, JP Morgan paid a \$50,000 bonus to STM in December of 2003 and identified the three underwritings as "revenues. . . attached to her name." An internal e-mail from one of the investment bankers who worked on the transactions noted that one "deal alone was [worth] about 1.2" million dollars to the firm. JP Morgan failed, however, to disclose the payment to STM on the Attachment to Form G-37/G-38 for STM.

As described above, JP Morgan violated Rule G-38 by inaccurately reporting that no municipal securities business had been obtained or retained by consultants in ten quarterly reports filed with the MSRB during the period beginning January 1, 2002, and ending June 31, 2004. JP Morgan also violated Rule G-38 by failing to report its payments made to consultants in connection with particular municipal securities business in quarterly reports filed with the MSRB for the periods ending December 31, 2003, and June 30, 2004.

JP Morgan Violated MSRB Rule G-38 By Failing to File Rule G-38 Quarterly Reports On the Required Form G-37/G-38

JP Morgan also failed to file its quarterly reports on the correct Form G-37/G-38. Rule G-38 was amended in December of 1999. The revised Attachment to Form G-37/G-38 set forth certain new reporting requirements, including the requirement that firms disclose "municipal securities business obtained or retained" by each consultant and that firms list

each such business separately.⁴ The revised rule retained the requirement that firms disclose "dollar amounts paid to [each] consultant connected with particular municipal securities business." The amendment to Rule G-38 was not effective until April 1, 2000, in order to provide "a diligent dealer with enough time to gather and report the information currently required by the Board's rules . . ."⁵

Despite the new form and new disclosure requirements, JP Morgan continued to submit its Rule G-38 quarterly reports on the outdated version of Form G-37/G-38 for more than three years, up to and including the quarterly report filed for June 30, 2003. As a result of failing to file its quarterly reports with the MSRB on the prescribed Form G-37/G-38 during this period, JP Morgan violated Rule G-38.

Moreover, as described above, by using the wrong form, the firm failed to disclose instances where a consultant obtained or retained specific municipal securities business as well as payments made to consultants connected with particular municipal securities business obtained by the consultant. Instead, JP Morgan continued to file its quarterly reports consistent with past practice, without providing the consultant and payment information, as required by the new form. In addition, even after the firm began using the correct form in 2003, it neither reported the specific business obtained each of by its consultants nor accurately reported the payments made to its consultants connected with particular municipal securities business, as described above.

MSRB Rule G-27

MSRB Rule G-27 requires each broker, dealer and municipal securities dealer to "supervise the conduct of the municipal securities activities of the dealer and its associated persons to ensure compliance" with MSRB rules. It also requires each broker, dealer and municipal securities dealer to "adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance" with MSRB rules, and to "revise and update its written supervisory procedures as necessary to respond to changes in [MSRB] or other applicable rules and as other circumstances require."

JP Morgan Violated MSRB Rule G-27 By Failing to Adopt, Maintain and Enforce Procedures Reasonably Designed to Ensure Compliance With the Reporting Requirements of MSRB Rule G-38

During the time period at issue here, JP Morgan failed to adopt, maintain and enforce written procedures that were reasonably designed to ensure compliance with the applicable reporting requirements of Rule G-38. As noted above, among other things, Rule G-38 required firms to disclose two items about their use of consultants: (1) municipal securities business obtained or retained by each consultant, and (2) any dollar

⁴ See SEC Order Granting Approval to Proposed Rule Change Relating to Rule G-38, on Consultants, Release No. 34-42205, 64 FR 69808 (December 14, 1999).

⁵ *Id.*

amounts paid to each consultant connected with particular municipal securities business. However, the firm's compliance manual for municipal securities addressed only the second requirement. As implemented by the firm, moreover, the firm's procedures did not require disclosure of payments made to consultants unless the consultants were paid a percentage of a specific municipal securities underwriting. In its MSRB filings, the firm maintained that it did not pay consultants in this manner, even though it paid consultants in connection with particular municipal securities business on a number of occasions. The firm's inadequate procedures resulted in a failure to disclose at least 70 municipal securities offerings obtained or retained by consultants, and at least six payments to consultants connected with particular municipal securities business, both of which should have been specifically disclosed pursuant to Rule G-38.

JP Morgan's procedures for supervisory review relating to Rule G-38 compliance were also deficient during this time period. JP Morgan's supervisory procedures required that the Senior Managing Director of the Public Finance Department review information to be disclosed in compliance with Rule G-38 with the firm's Compliance Department. The procedures, however, did not identify the sources of information that should be consulted or considered, the steps that should be taken in preparing the firm's Form G-37/G-38 quarterly reports, or any review that should be performed of that information. The procedures also did not set forth any process reasonably designed to ensure that the required information was obtained and did not provide any criteria or guidance for determining the accuracy and completeness of the information relating to consultants contained in Form G-37/G-38 prior to submission to the MSRB.

The firm's procedures proved inadequate to supervise the conduct of JP Morgan's municipal securities reporting obligations under Rule G-38. In fact, there was no overall supervision of the Rule G-38 reporting process, and no individual at the firm was responsible for the oversight or supervision of the completion of the quarterly reports to ensure that the information disclosed was accurate and complete.

Based on the foregoing, JP Morgan failed to adopt, maintain and enforce procedures reasonably designed to ensure compliance with the reporting requirements of MSRB Rule G-38 for the period beginning January 1, 2002 and ending June 30, 2004. JP Morgan therefore violated MSRB Rule G-27.

B. Sanctions

Respondent also consents to the imposition, at a maximum, of the following sanctions:

- 1) A censure;
- 2) A fine of \$500,000; and
- 3) Within 60 days of the issuance of this AWC, an officer of JP Morgan shall certify to FINRA that the firm has reviewed its procedures regarding

compliance with MSRB Rule G-38 in its current form and has established systems and procedures reasonably designed to achieve compliance with its prohibitions and reporting requirements. JP Morgan shall provide FINRA with a detailed description of the review conducted, its systems and procedures, and any changes to its systems and procedures including a copy of any applicable written procedures.

III.

OTHER MATTERS

- A. Respondent understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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.
- B. Respondent agrees to pay any monetary sanctions imposed on it upon notice that this AWC has been accepted and that such payments are due and payable.
- C. Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

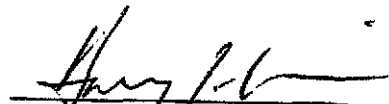
The undersigned certifies on behalf of Respondent that it has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce them to submit it.

9-11-07 By: Carlos Hernandez
Date

Name: Carlos M. Hernandez

Title: President and CEO, J.P. Morgan Securities Inc.

Reviewed by:


Counsel for Respondent

Accepted by FINRA:

12/12/07
Date


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