

**FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA)
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2007007126901**

**To: Department of Enforcement
Financial Industry Regulatory Authority**

**Re: Scottrade, Inc.
Member (CRD No. 8206)**

Pursuant to FINRA Rule 9216 of the FINRA Code of Procedure, Scottrade, Inc. (Scottrade) 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 Scottrade alleging violations based on the same factual findings described herein.

I. ACCEPTANCE AND CONSENT

- A. Scottrade 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

Scottrade has been a member of FINRA since May 1980. Scottrade conducts a general securities business from its main office located in St. Louis, Missouri. During all periods mentioned herein, Scottrade was a registered broker-dealer with the United States Securities and Exchange Commission and a member of FINRA, which registration and membership remain currently in effect.

Relevant Prior Disciplinary History

Scottrade has been the subject of one FINRA disciplinary action that is relevant to this matter. In November 2004, Scottrade was censured and fined \$250,000 for Regulation T violations that occurred in customer cash accounts from at least January 1, 2001 through at least September 30, 2001. See AWC No. C04040062.

Overview

During the period of February 2006 through October 2007, Scottrade violated pattern day trading margin rules by allowing margin-account customers who had been designated as "pattern day traders" – that is, executing four or more day trades within five business days – to day trade after their accounts fell below \$25,000 in equity. Specifically, Scottrade permitted customers in 11,708 margin accounts through which pattern day trading was being conducted to execute 171,910 day trades of securities when the equity in the relevant account was

000074095 2010

below \$25,000. Scottrade's conduct violated NASD Conduct Rules 2520(f)(8) and 2110.

In addition, during the period of February 2006 through January 2007, Scottrade, in 65 separate instances in customer cash accounts, failed to timely obtain from its customers sufficient cash payment or from its primary regulator an extension of time within which to receive a sufficient cash payment to fully fund a securities purchase, and did not then promptly cancel or liquidate the transaction within the period specified by Federal Reserve Regulation T. Scottrade's conduct violated Section 7 of the Securities Exchange Act of 1934, Section 220.8 of Regulation T, and NASD Conduct Rule 2110.

Facts and Violative Conduct

NASD Conduct Rule 2520(f)(8) Violations

On September 28, 2001, NASD day trading margin rules became effective through amendments to NASD Conduct Rule 2520. See NASD Notice to Members 01-26. As amended, NASD Conduct Rule 2520 defines "day trading" as buying and selling, or selling and buying, the same security on the same day in a margin account. The Rule defines a "pattern day trader" as one who executes four or more day trades within five business days. Significantly, for the purposes of this matter, Rule 2520 requires a pattern day trader to have a minimum of \$25,000 equity in his or her margin account.

During the period of February 2006 through October 2007 (the relevant period), Scottrade did not comply with Rule 2520(f)(8)'s requirement that a pattern day trader have minimum equity in their account of \$25,000. During the relevant period, Scottrade permitted customers, in 11,708 margin accounts that met the definition of pattern day trader, to execute a total of 171,910 day trades when the equity in the account was less than \$25,000.

Scottrade's violations resulted from its permitting pattern day traders to continue to day trade after their accounts fell below \$25,000. During the relevant period, Scottrade used a pattern day trading report (PDTR) to identify a margin account customer who met the definition of pattern day trader and whose account fell below \$25,000 in equity. Once Scottrade identified, through the PDTR, a margin account customer who met the definition of pattern day trader under Rule 2520(f)(8), and that customer's account fell below \$25,000 in equity at the close of trading on a given day, Scottrade would send the customer a written notification. The notification would advise the customer that the customer's account activity met the definition of pattern day trader, and would inform the customer of the requirement that the customer have at least \$25,000 equity in the account prior to trading, and that the customer had to restore the equity in the account back to the \$25,000 minimum before trading. The written notification advised the margin account customer that the foregoing could be accomplished

by, among other things, depositing cash or securities in the margin account to reach the \$25,000 threshold.

However, throughout the relevant period Scottrade did not preclude or restrict the customer's day trading activities when the customer failed to promptly deposit cash or securities in the account to restore the equity in the account back to the \$25,000 minimum, as required by Rule 2520(f)(8). Rather, Scottrade treated the first written notification to customers of the \$25,000 minimum equity requirement for pattern day trading accounts as a warning, thereby giving the pattern day-trading customer an exemption the first time the customer's account fell below \$25,000. This process effectively allowed the customer to continue day trading without meeting the \$25,000 minimum account equity requirement set forth in Rule 2520(f)(8).

If the customer appeared on the PDTR a second time, Scottrade sent the customer a second written notification. This written notification again instructed the customer that, among other things, the customer had to take steps to restore the equity in the account back to the \$25,000 minimum within five business days. For the customer who received the second written notification and did not restore the equity in the account back to \$25,000 within five business days, prior to August 2006, Scottrade removed margin privileges and converted the account to a cash account. The customer was allowed to reopen the margin account after the equity in the account returned to \$25,000.

In August 2006, Scottrade changed its process for customers who appeared a second time on the PDTR, to whom a second written communication was sent, and who did not restore the equity in the account back to \$25,000 within five business days. From August 2006 to the end of the relevant period, such a customer was restricted to trading on a cash-only basis for 90 days. After the 90-day restriction passed, if the customer wanted to have margin privileges reinstated, the customer was required to submit a written communication, requesting that margin be reinstated, describing the customer's intended future trading activities, and promising that he would not engage in pattern day trading if the customer did not have \$25,000 in equity in the account.

For a margin customer who appeared on the PDTR a third time and did not restore the equity in the account back to \$25,000 within five business days, prior to August 2006 Scottrade permanently removed margin privileges. After August 2006, if Scottrade restored the customer's margin privileges (after the customer submitted the above-referenced communication to Scottrade) and the customer appeared on the PDTR a third time, the margin privileges were removed immediately and Scottrade considered the customer's activities and conduct in the event the customer ever requested that margin privileges be reinstated.

Scottrade's conduct violated NASD Conduct Rules 2520(f)(8) and 2110.

Violations of Section 7 of the Securities Exchange Act and Section 220.8 of Regulation T

Section 7(c) of the Exchange Act provides, in relevant part, as follows:

It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer - on any security (other than an exempted security) ... in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System ... shall prescribe.

Section 220.8(a)(1)-(2) of Regulation T, promulgated by the Board of Governors of the Federal Reserve System provides, in relevant part, as follows:

(a) *Permissible Transactions.* In a cash account, a creditor, may:

- (1) Buy for or sell to any customer any security or other asset if: (i) There are sufficient funds in the account; or (ii) The creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment.
- (2) Buy from or sell for any customer any security or other asset if: (i) The security is held in the account; or (ii) The creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account

Section 220.8 of Regulation T specifies a time period pursuant to which a broker-dealer must obtain payment from a customer, or cancel or liquidate the trade. "A creditor shall promptly cancel or otherwise liquidate a transaction or any part of a transaction for which the customer has not made full cash payment within the required time." An investor is given a maximum of five business days to pay for securities in a cash account. See, e.g., FINRA Information Notice, December 21, 2007 ("Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within five business days from the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified.").

Scottrade did not comply with the foregoing requirements of Section 7(c) and Section 220.8 of Regulation T. During the period of February 2006 through January 2007, Scottrade, in 65 separate instances in customer cash accounts, failed to obtain from the customer sufficient cash payment, or otherwise promptly cancel or liquidate the transaction within the period specified by Federal Reserve Regulation T. During this period of time, a period in which Scottrade executed 13-14 million transactions in approximately 1.25 million cash accounts, the vast majority of Scottrade's business was conducted by on-line customers. Scottrade required those customers to have full cash on deposit equal to the estimated cost of the securities being purchased before the customer's order was accepted. Cash customers who placed orders with Scottrade representatives, rather than entering the orders online, were also generally required to have cash on deposit equal to the estimated cost of the securities being purchased before the customer's order was accepted; however, in certain circumstances this requirement was waived.

In certain instances, customers were required to deposit additional funds to cover the cost of the purchase of securities. For example, Scottrade's estimate of the cost of the customer's purchase transaction could be lower than the price of the securities order at the time Scottrade executed the order for the customer, which would require an additional deposit.

During this period, in the 65 separate instances at issue, Scottrade did not comply with Regulation T because it failed to obtain from the customer sufficient cash payment, or otherwise promptly cancel or liquidate the transaction within the period specified. Scottrade's practice during this period, when a customer did not have sufficient funds in their cash account to cover the cost of the transaction, was to send the customer a sellout letter. Scottrade issued 370 sellout letters to customers from February 2006 to January 2007. In the 65 instances at issue in this matter, Scottrade sent the cash account customers a sellout letter on the due date (the Regulation T date or the extended Regulation T date), advising the customers that they were required to provide payment to Scottrade within two business days – i.e., by dates which were beyond the Regulation T date.

Scottrade's actions had the effect of allowing these customers additional days beyond those permitted or contemplated by Section 220.8. As a consequence, Scottrade received payment from the customer in many of these 65 instances one to three business days after the deadline prescribed by Regulation T. However, in one instance Scottrade received payment 26 days late and in another instance Scottrade received payment 29 days late.

Scottrade's conduct violated Section 7 of the Securities Exchange Act of 1934, Section 220.8 of Regulation T, and NASD Conduct Rule 2110.

B. Scottrade also consents to the imposition of the following sanctions:

1. a censure; and
2. a fine of \$200,000.

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

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

Scottrade 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.

II. WAIVER OF PROCEDURAL RIGHTS

Scottrade 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 National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Scottrade 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.

Scottrade 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

Scottrade 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 Scottrade; and
- C. If accepted:
 - 1. this AWC will become part of Scottrade's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Scottrade;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Scottrade's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. Scottrade 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. Scottrade 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 Scottrade's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Scottrade may attach a Statement of Corrective Action to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Scottrade 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.

I, on behalf of Scottrade, certify that a person duly authorized to act on Scottrade's behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that I have 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 me or Scottrade to submit it.

SCOTTRADE, INC.

Date:

2/8/10

By:

(Authorized personnel)

General Counsel

Reviewed by:

Counsel for Scottrade, Inc.

Accepted by FINRA:

Date _____

2-18-2010

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

Jeffrey A. Ziesman, Deputy Regional Chief Counsel
120 West 12th Street, Suite 800
Kansas City, MO 64105
Telephone: (816) 802-4712
Facsimile: (816) 421-4519
Email: jeff.ziesman@finra.org