

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20070094711-01**

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

RE: E*Trade Clearing LLC (CRD No. 25025), Respondent

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, the Respondent 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 the Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. E*Trade Clearing LLC ("E*Trade Clearing" or the "Firm"), a member 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

E*Trade Clearing became a FINRA member firm on December 14, 1989. E*Trade Clearing's principal place of business is Jersey City, New Jersey. E*Trade Clearing provides clearing services for affiliated broker-dealers, including E*Trade Securities LLC ("E*Trade Securities").

RELEVANT DISCIPLINARY HISTORY

E*Trade Clearing has no relevant disciplinary history.

OVERVIEW

This matter involves supervisory and operational violations at E*Trade Clearing during the period October 2004 to September 2006. Many of these violations relate to the Firm's failure to adequately prepare for and respond to various operational changes and conversions, including a January 2006 conversion in which the Firm acquired approximately 557,000 customer accounts from

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Harrisdirect LLC (the "January 2006 conversion") and a May 2006 conversion in which the Firm acquired approximately 276,000 customer accounts from BrownCo (the "May 2006 conversion").

FACTS AND VIOLATIVE CONDUCT

As described below, E*Trade Clearing violated: (1) NASD Rules 3010(a) and (b) and Rule 2110 for various failures to supervise; (2) Regulation S-P, and NASD Rules 2340 and 2110 for erroneously mailing customer account statements; (3) NASD Rule 2110 for liquidating fractional shares in customer accounts without authorization; (4) NYSE Rule 351(d) and NASD Rule 2110 for repeatedly failing to accurately report customer complaints; and (5) Exchange Act Rule 15c3-3(b) and NASD Rule 2110 for failing to segregate long positions in suspense accounts.

1. Supervisory Violations – NASD Rules 3010(a) and (b) and Rule 2110

NASD Rule 3010(a) requires that members "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD Rules."

NASD Rule 3010(b) requires firms to "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and . . . that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD."

E*Trade Clearing violated NASD Rules 3010(a) and (b) and Rule 2110 by: (a) erroneously charging margin interest to approximately 3,675 customers holding certain sweep funds for a period of six months; (b) erroneously charging margin interest to approximately 333 converting customers who traded options at the time of the January 2006 conversion; (c) failing to review and reconcile DTC positions for a period of eight months; and (d) failing to ensure the prompt delivery of physical certificates for a period of ten months, where customers had pending dividends or unsettled positions in their accounts.

a. Erroneous Margin Interest Accruals Caused by Inaccurate Coding of Certain Sweep Funds

On January 17, 2006, E*Trade Clearing introduced several new money market sweep funds. When entering certain back-office processing instructions relating to three of these funds, the Firm made an error, which resulted in the system failing to recognize these fund positions. As a result, when customers who held these funds withdrew cash, wired funds, or wrote checks from their accounts, they were erroneously charged margin interest for that day.

In July 2006, E*Trade Clearing became aware of this coding error and corrected the problem, but did not identify or reimburse affected customers until November 2006, when regulators questioned the Firm about the issue. In March 2007, approximately eight months after identifying and correcting the problem, the Firm reimbursed 3,675 affected customers a total of \$43,938.57 in erroneous margin interest charges.

E*Trade Clearing violated NASD Rules 3010(a) and (b) and Rule 2110 in that from January 17, 2006 to July 28, 2006, the Firm failed to establish a system reasonably designed to supervise, and written procedures reasonably designed to prevent and/or correct erroneous margin interest accruals in customer accounts holding certain money market sweep funds.

b. Erroneous Margin Interest Charged to Converting Customers who Traded Options at the Time of the January 2006 Conversion

Prior to the January 2006 conversion, E*Trade Securities, the introducing broker, informed converting customers that normal trading, including options trading, would commence on January 11, 2006. However, customers' cash positions were not transferred to the Firm until January 17, 2006. Because options settle on a T+1 basis, converting customers who traded options on January 11 and 12, 2006 who had sufficient cash in their accounts pre-conversion, incurred margin interest when their options trades settled before their cash positions were transferred to the Firm.

On January 13, 2006, one of these converting customers complained to E*Trade Clearing that he was erroneously charged margin interest for options transactions at the time of the January 2006 conversion. In response, the Firm's customer service area credited him the interest charges and noted that the "client had cash in acct for period and int[erest] charged was due to conversion."

In October 2009, contrary to several previous representations E*Trade Clearing determined that the complaining customer was, in fact, improperly charged margin interest and was entitled to reimbursement for the improper charges. The Firm also determined that an additional 332 customers had been charged margin interest in connection with options transactions during the same two-day period. In December 2009, nearly four years after the January 2006 conversion, the Firm credited all affected customers in amounts ranging from less than one dollar to over \$250, for a total amount of \$2,425.06.

E*Trade Clearing violated NASD Rules 3010(a) and (b) and Rule 2110 in that in January 2006, it failed to establish a system reasonably designed to supervise, and written procedures reasonably designed to prevent and/or correct, erroneous margin interest charges to converting customers who traded options at the time of the January 2006 conversion and had available cash in their accounts.

c. Failure to Reconcile DTC Positions

From June 2006 to January 2007, E*Trade Clearing failed to designate an employee to review, reconcile, and resolve fractional share differences between its DTC position and the actual quantity of securities on deposit at the DTC. As of November 1, 2006, the DTC suspense account reflected 86 differences, of which 70 (market value of \$13,000) were fractional share differences that had been in the account since June 2006.

E*Trade Clearing violated NASD Rules 3010(a) and (b) and Rule 2110 in that from June 2006 to January 2007, it failed to establish a system reasonably designed to supervise, and written procedures reasonably designed to ensure, the review and reconciliation of fractional share differences with the DTC.

d. Failure to Deliver Physical Certificates

FINRA's review of 73 customer complaints revealed that approximately 16 (or 22% of the sample) alleged the failure to timely receive requested stock certificates from the Firm. From January to October 2006, E*Trade Clearing's systems failed to accept delivery instructions if customers had pending dividends or unsettled positions in their accounts. In such situations, delivery of the shares to the transfer agent was not promptly made and customers were not notified that there was a problem with their requests.

From January to October 2006, E*Trade Clearing violated NASD Rules 3010(a) and (b) and Rule 2110 in that it failed to establish a system reasonably designed to supervise, and written procedures reasonably designed to ensure, the prompt transfer of physical certificates to customers.

2. Erroneous Mailing of Customer Account Statements – Regulation S-P and NASD Rules 2340 and 2110

Rule 30 of Regulation S-P provides that "[e]very broker, dealer . . . registered with the Commission must adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information. These written policies and procedures must be reasonably designed to: (1) Insure the security and confidentiality of customer records and information; (2) Protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) Protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer." See 17 C.F.R. § 248.30.

Pursuant to NASD Rule 2340, "member[s] shall, with a frequency of not less than once every calendar quarter, send a statement of account ('account statement') containing a description of any securities positions, money balances, or account activity to each customer whose account had a security position, money balance,

or account activity during the period since the last such statement was sent to the customer.”

In February 2006, the Firm disclosed to FINRA that, due to a data entry error made at the Firm’s outside back-office service provider related to the mailing of account statements, E*Trade Clearing failed to mail January 2006 account statements to 2,530 customers, over 95% of whom had converted their accounts to the Firm at the time of the January 2006 conversion. The statements in question were instead sent to 335 different customers, who received envelopes containing their own account statements and the January 2006 account statements of certain other customers. The Firm determined that no customer user names, passwords, Social Security or Tax ID numbers were disclosed or otherwise compromised.

E*Trade Clearing’s failure to accurately mail January 2006 account statements, which affected 2,865 customers, violated Regulation S-P, and NASD Rules 2340 and 2110.

3. Unauthorized Liquidation of Fractional Shares – NASD Rule 2110

NASD Rule 2110 requires members to observe high standards of commercial honor and just and equitable principles of trade.

On or around December 30, 2005, as part of its efforts to clear a backlog of pending customer requests to liquidate fractional shares, the Firm’s outside back-office service provider implemented an automated solution that began liquidating fractional shares in all customer accounts. By the time the Firm discovered the error on January 5, 2006, approximately 46,000 accounts had already been affected by the unauthorized liquidations. In February 2006, the Firm reversed all erroneous liquidations, totaling approximately \$1,401,826.39 and averaging approximately \$29.93 per account.

E*Trade Clearing violated NASD Rule 2110, in that from December 30, 2005 to January 5, 2006, it liquidated fractional shares in approximately 46,000 customer accounts without customer authorization.

4. Failure to Accurately Report Customer Complaints – NYSE Rule 351(d) and NASD Rule 2110

NYSE Rule 351(d) requires each member firm to report to the NYSE statistical information regarding customer complaints relating to such matters as may be specified by the NYSE.

FINRA’s review of 97 customer complaints E*Trade Clearing reported for the period October 2004 to September 2005 revealed that 11 (or approximately 11% of the sample) were not properly reported to the NYSE: four were submitted in

the wrong quarter, two were submitted with the wrong problem code, and five were submitted with the wrong product code.

During FINRA's subsequent examination of E*Trade Clearing, examiners found that E*Trade Clearing had failed to accurately report customer complaints. Specifically, for the period October 2005 to June 2006, the Firm reported 6,156 operational complaints, approximately 4,000 of which related to the January and May 2006 conversions. FINRA's review of 73 of those complaints revealed that 16 (or approximately 22% of the sample) were not properly submitted to the NYSE. E*Trade Clearing failed to: acknowledge the receipt of ten complaints within 15 business days; report three complaints in the correct quarter; and accurately report the problem code for three complaints. In addition, in September 2006, the Firm disclosed to FINRA that due to a manual processing error which was subsequently corrected, it had failed to report an additional 34 complaints to the NYSE during the same 9-month period.

E*Trade Clearing violated NYSE Rule 351(d) and NASD Rule 2110, in that from October 2004 to June 2006, the Firm repeatedly failed to report all customer complaints accurately and in a timely manner.

**5. Failure to Segregate Long Positions in Suspense Accounts –
Exchange Act Rule 15c3-3(b) and NASD Rule 2110**

Exchange Act Rule 15c3-3(b) requires a broker-dealer to promptly obtain and thereafter maintain the physical possession or control of all fully-paid securities and excess margin securities carried by it for customers. This rule requires a firm to segregate fully paid for customer securities from non-fully paid for customer securities and/or firm securities for the protection of the customer.

In connection with the Firm's conversion to a new back office system in September 2004, a functionality that impacted the segregation of long positions in suspense accounts was not activated as required. As a result, from September 2004 to September 2006, E*Trade Clearing's possession and control system failed to issue segregation instructions on long positions in suspense accounts. The value of long positions in suspense accounts as of July 31, 2006 was \$3.5 million, and as of November 30, 2006 was \$6.3 million.

From September 2004 to September 2006, E*Trade Clearing violated Exchange Act Rule 15c3-3 and NASD Rule 2110 in that it failed to segregate long positions in suspense accounts.

B. E*Trade Clearing also consents to the imposition of the following sanctions:

- A Censure; and
- A fine in the amount of \$350,000.

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

E*Trade Clearing 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

E*Trade Clearing specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- 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, E*Trade Clearing 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.

E*Trade Clearing 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

E*Trade Clearing 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 E*Trade Clearing; and**
- C. If accepted:**
 - 1. this AWC will become part of E*Trade Clearing's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against E*Trade Clearing;**
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about E*Trade Clearing'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. E*Trade Clearing 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. E*Trade Clearing 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 right of E*Trade Clearing to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.**
- D. E*Trade Clearing may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. E*Trade Clearing 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 the E*Trade Clearing, certifies that a person duly authorized to act on its 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 E*Trade Clearing has 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 E*Trade Clearing to submit it.

5/5/2010
Date (mm/dd/yyyy)

E*Trade Clearing LLC

By: James E. Ballou Jr.

Print Name: James E. Ballou Jr.

Title: General Counsel, E*Trade Brokerage Holdings, Inc.

Reviewed by:

Pat S. Conti

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Accepted by FINRA:

5/10/10
Date

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

Linda Riefberg

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