

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT**

NO. ~~200701114046~~ *2007011145701*
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TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Bear Stearns & Co. Inc., n/k/a J.P. Morgan Securities, Inc., Respondent
CRD No. 79

Pursuant to Rule 9216 of FINRA Code of Procedure, Bear Stearns & Co. Inc., n/k/a J.P. Morgan Securities, Inc. ("Bear Stearns" or "the Firm") 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 Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

The Respondent 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

Bear Stearns n/k/a J.P. Morgan Securities, Inc. (CRD No. 79) has been a FINRA member since 1936. On or about October 1, 2008, it changed its name from Bear Stearns & Co. to J.P. Morgan Securities, Inc., after the acquisition in or about May 2008 of The Bear Stearns Companies, Inc. by JPMorgan Chase & Co. J.P. Morgan Securities currently is based in New York, New York. It has approximately 221 branch offices and approximately 6,602 registered representatives, and provides a full range of brokerage services to its customers.

The conduct at issue in this AWC relates to the time period before the acquisition and name change. Accordingly, for the sake of clarity, the Firm shall be subsequently referred to herein as "Bear Stearns."

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OVERVIEW

From July 2000 to early 2007 (the "Relevant Period"), Bear Stearns did not adequately establish and maintain a supervisory system to address the sale of alternative investments such as a hedge fund of funds within its retail brokerage operation, known as the Private Client Services Department ("PCS"). Enforcement's investigation uncovered deficiencies in the Firm's supervisory system including inadequate supervision of the sale and distribution of an affiliated hedge fund of funds; inadequate supervision, approval, and recording of private securities transactions; and disseminating misleading advertising materials for an affiliated hedge fund of funds that utilized hypothetical returns pre-dating the formation of the fund and that failed to adequately disclose risks.

FACTS AND VIOLATIVE CONDUCT

Background

As part of an examination relating to hedge funds, the United States Securities and Exchange Commission ("SEC") sent an inquiry to a hedge fund, requesting documents and information regarding its practices, including the use of broker-dealers that refer potential investors to the hedge fund. Upon receipt of the documents, the SEC Staff conducted a review and discovered payments to third parties, including a registered representative (the "RR") at Bear Stearns, who was also President of an affiliated registered investment advisor ("RIA"). The RR had received solicitation fees under a cash solicitation arrangement for referring Mosaique Multi-Strategy Fund ("Mosaique"), a Bear Stearns affiliated hedge fund of funds, and others to invest in the hedge fund. The SEC deferred the investigation to NYSE Regulation, Inc., which was concurrently investigating the RR for private securities transactions.¹ The investigation was thereafter handled at FINRA.

Bear Stearns Failed to Have an Adequate Supervisory System to Monitor the Distribution of a Hedge Fund of Funds

In 2000, Bear Stearns approved the formation of Mosaique Capital Management ("MCM"), a registered investment advisor, to advise Mosaique, a hedge fund of funds. Through MCM and Mosaique, the Firm offered Bear Stearns' retail customers the opportunity to invest in a portfolio of unaffiliated hedge funds. Bear Stearns owned 25% of MCM. MCM operated under the supervision of Bear Stearns.

From its inception until Mosaique's liquidation beginning in February 2006, the Firm's broker-dealer retail branch system served as a distribution channel for Bear Stearns' RRs to solicit their retail customers to invest in Mosaique. In total, 34 -RRs solicited and sold Mosaique to their retail customers and Mosaique's assets grew to approximately \$375 million. Those RRs who successfully solicited customers to invest in the hedge fund of funds received a referral or

¹ The RR who was subject of Enforcement's initial investigation regarding this matter was determined to have engaged in private securities transactions in violation of NASD Rules 3040 and 2110. See AWC No. 20070094194.

solicitation fee. These fees were continuing, paid quarterly to the RRs, for as long as the referred customers remained invested.

From 2001 through 2006, MCM charged Mosaique investors approximately \$1.5 million in solicitation fees that were paid to RRs. The solicitation fees, however, should not have been paid by Mosaique investors. The disclosure documents stated that the solicitation fees were the responsibility of the management company, MCM. For example, the original Mosaique Private Placement Memoranda ("PPM") stated that "[s]uch commissions or fees are the sole responsibility of Manager and the Company [i.e. MCM] and investors will have no obligation with respect thereto." Later versions of Mosaique PPMs stated "[MCM] reserves the right to sell ... interests through banks and registered broker-dealers and to pay a fee or commission thereon. Any such fee or commission will be paid solely by the Manager, and no portion will be paid by [Mosaique]."

Despite the statements in the Mosaique PPM that customers would not pay the solicitation fees, those fees, were charged to investors as administrative expenses during a five year period. The charges for the solicitation fees were included in MCM's books in the maximum amount of administrative expenses permitted by the PPM for each quarter over a five year period. At the end of each year, Bear Stearns received financial statements that indicated the high level of administrative expenses (i.e., that they were at the maximum amount allowed), but Bear Stearns did not detect this activity during the relevant period. Bear Stearns received a portion of the fees and Bear Stearns' customers were improperly charged for those fees, thereby reducing their investor returns.

In July 2007, after learning that customers had been charged for the solicitation fees, Bear Stearns began the process of voluntarily returning the funds to investors in Mosaique. Bear Stearns returned to investors approximately \$1.5 million in administrative fees improperly charged, which included the return investors in Mosaique would have received had their funds not been improperly charged the fees described above.

Bear Stearns violated NASD Rules 3010 and 2110 for failing to properly supervise its sales of alternative investment products by failing to establish and maintain adequate supervisory systems within PCS to supervise RRs sales of a hedge fund of funds to retail customers.

Bear Stearns Failed to Have Adequate Supervisory Systems and Procedures in Place to Supervise, Approve and Record Private Securities Transactions.

In 1999, Bear Stearns approved the formation of an RIA that allowed one of the Firm's RRs to offer Firm retail customers investments with outside investment managers including hedge funds unaffiliated with the Firm. In September 2000, Bear Stearns signed an Operating and Administrative Services Agreement (the "RIA Agreement") with the RR allowing the RIA to operate from a Firm office in which the RR was also conducting his brokerage business.

Bear Stearns permitted some retail customers to invest in unaffiliated hedge funds recommended by the RR. Although the RIA Agreement stated that Bear Stearns would be responsible for,

among other things, "regulatory compliance oversight," the Firm failed to take adequate steps to supervise the private securities transactions that the RIA engaged in for Bear Stearns' retail customers.

The RIA's business model involved contracting with an outside consulting firm that evaluated unaffiliated investment managers that the RIA invested its customers' funds. The RIA received from its customers an asset based advisory fee for managing the client assets as a result of allocating each client's funds to various outside, unaffiliated investment managers. While Bear Stearns approved the RIA's business model and permitted this business activity, it did not establish adequate written policies and procedures as required by NASD Rule 3040. As set forth in Notice to Members ("NTM") 96-33, the RIA was required to request and receive written approval to engage in private securities transactions for each client. Two of the RIA's customers invested in two unaffiliated hedge fund but the RIA did not request written approval for these transactions from Bear Stearns, and Bear Stearns failed to take steps to adequately supervise, approve, and record the private securities transactions on its books and records.

Therefore, Bear Stearns violated NASD Rules 3040(c) and 3110 by failing to supervise the private securities transaction described above, and Section 17(a) of the Securities Exchange Act of 1934 and SEA Rule 17a-3 thereunder by failing to record such transactions on its books and records.

Bear Stearns Disseminated Hedge Fund Sales Materials That Failed to Include All Investment Risks, and Employed Hypothetical Returns

Bear Stearns participated in the creation of, and disseminated through its RRs, PowerPoint presentations ("Marketing Material") that introduced Mosaïque to investors. The Firm has represented that this Marketing Material was initially used in 2001 and 2002. The Marketing Material contained hypothetical returns until sometime around 2003, while other Marketing Material was used through February 2006.

i. The Marketing Material Employed Hypothetical Returns

Marketing Materials disseminated by Bear Stearns RRs, which included hypothetical performance figures for periods that pre-dated the formation of Mosaïque, were used in a manner that created the impression that Mosaïque's investment history and track record were longer than they actually were.

Specifically, while Mosaïque did not begin trading operations until December 2000, the Marketing Material displayed performance information for Mosaïque dating back to 1997. These hypothetical performance results were based on back-tested performance results from hedge funds ultimately selected by MCM. The use of these hypothetical returns was improper as they were created with the benefit of hindsight, not actual performance. In addition, presenting performance results prior to the date the fund commenced operations is improper as it overstates the performance history. Until 2003, two years after Mosaïque began operations, the Marketing Materials continued to reflect the hypothetical, back-tested performance combined with actual performance of the fund.

Bear Stearns violated NASD Rule 2210(d)(1)(B) when its RRs used Marketing Materials which contained hypothetical returns in the Marketing Materials used for Mosaïque.

Furthermore, once Mosaïque had established a track record, the Marketing Material continued to use hypothetical performance combined with actual performance of the fund. This combination created the impression of a long-term and continuous track record for a fund that actually had a shorter operating history. Therefore, the Firm also violated NASD Rule 2210(d)(1)(A) when its RRs used Marketing Materials that did not provide a sound basis for evaluating the facts with respect to any product or service.

ii. The Marketing Material Did Not Provide Adequate Risk Disclosure

In addition, the Marketing Material was required to be fair and balanced pursuant to NASD Rule 2210(d)(1)(A). The Marketing Material failed to satisfy these requirements. In particular, since the Marketing Material was used to sell interests in hedge funds, it should have included (but did not) pertinent and obvious risk disclosures including that hedge funds often engage in leveraging and other speculative investment practices that may increase the risk of investment loss; can be highly illiquid; are not subject to the same regulatory requirements as mutual funds; and often charge high fees.

Bear Stearns violated NASD Rule 2210(d)(1)(A) when its RRs used Marketing Materials that failed to make adequate disclosure of the risks involved in investing in a hedge fund of funds.

iii. The Marketing Material Made Exaggerated or Unwarranted Statements

The following statements appeared in some of the Marketing Material: "Managers deploy large amounts of capital, that enable them to buy the required quantities of securities necessary for successful investing" and "[t]his can be achieved through a balanced and diversified portfolio of absolute return non-correlated strategies that are focused on capital preservation and growth" (as related to the fund's investment objective). These statements were unwarranted as they were promissory of future results. The Marketing Material also stated that, "[RR]...is an active member of the N.A.S.D.," a statement that was inaccurate.

Bear Stearns violated NASD Rule 2210(d)(1)(B) by making exaggerated or unwarranted claims.

VIOLATIONS

As a result of the conduct described above, Bear Stearns' violated the following rules:

- i. Bear Stearns violated NASD Rules 3010 and 2110 for failing to supervise its sales of alternative investment products by failing to establish and maintain adequate supervisory systems within PCS to supervise RRs sales of a hedge fund of funds to retail customers;

- ii. Bear Stearns violated NASD Rules 3040(c) and 3110, and Section 17(a) of the Securities Exchange Act of 1934 and SEA Rule 17a-3 thereunder by failing to supervise private securities transactions and record such transactions on its books and records;
- iii. Bear Stearns violated NASD Rule 2210(d)(1)(B) when its RRs used Marketing Materials which contained hypothetical returns relating to a hedge fund of funds;
- iv. Bear Stearns violated NASD Rule 2210(d)(1)(A) when its RRs used Marketing Materials that failed to make adequate disclosure of the risks involved and a sound basis for investing in a hedge fund of funds; and
- v. Bear Stearns violated NASD Rule 2210(d)(1)(B) when its RRs used Marketing Material that made exaggerated or unwarranted claims.

SANCTIONS

The Firm consents to the imposition of the following sanctions:

- 1. A censure; and
- 2. A fine of \$500,000.

Bear Stearns specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this manner.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Bear Stearns 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 SEC and a U.S. Court of Appeals.

Further, Bear Stearns 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.

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 Bear Stearns; 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 it;
 - 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about my 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. 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 right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. Bear Stearns may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Bear Stearns 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 Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and have been given a full opportunity to ask questions about it; 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 the Firm to submit it.

7-30-09
Date

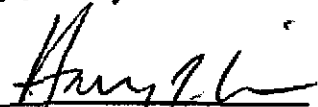


J.P. Morgan Securities, Inc.,

By: David Weintraub
Managing Director

BARRY SOMMER
Managing Director

Reviewed by:

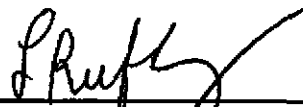

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Accepted by FINRA:

8/6/09

Date

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



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