

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2008013791601**

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

RE: Fidelity Brokerage Services, LLC, Respondent
CRD No. 7784 and
Fidelity Investments Institutional Services Company, Inc., Respondent
CRD No. 17507

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Fidelity Brokerage Services, LLC ("Fidelity Brokerage Services") and Fidelity Investments Institutional Services Company, Inc. ("Fidelity Investments Institutional Services") (collectively, the "Fidelity Broker-Dealers" or "Respondents") submit 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 Respondents alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondents hereby accept and consent, 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:

OVERVIEW

The Fidelity Broker-Dealers are privately-held, FINRA-registered firms that are headquartered in Boston, Massachusetts (Fidelity Brokerage Services) and Smithfield, Rhode Island (Fidelity Investments Institutional Services).

Fidelity Brokerage Services has approximately 170 branch offices and provides investment and other services to retail customers. Fidelity Investments Institutional Services markets Fidelity Advisor Funds and other Fidelity managed products through third party financial intermediaries, including broker-dealers, insurance companies, banks and registered investment advisors (collectively, the "Selling Intermediaries"). During the period December 2006 through December 2008 (the "Relevant Period"), Fidelity Investments Institutional Services also marketed Fidelity funds to retirement plan sponsors and plan participants.

During the Relevant Period, the Fidelity Broker-Dealers marketed, sold and/or wholesaled shares in the Fidelity Ultra Short Bond Fund (the "Fund"), which is an income mutual fund. In connection with such activities, the Fidelity Broker-Dealers created advertising, training and/or wholesaling materials (collectively, the "Sales Materials") for the Fund. Certain of these materials were provided to public customers and retail sales firms, used internally by the Fidelity Broker-Dealers or used for institutional purposes within the Selling Intermediaries during the Relevant Period.

Also during the Relevant Period, the Fund invested in large amounts of risky and high-yielding asset and mortgage-backed securities. These included securities that were backed by, among other things, sub-prime mortgages and credit card and auto loan receivables. The Fund's annual reports and certain mutual fund guides that were distributed by the Fidelity Broker-Dealers disclosed that the Fund was investing in these securities. They also provided a summary breakdown of their credit ratings.

In the spring of 2007, the "sub-prime crisis" began and negatively affected the financial markets. In mid-June of 2007, the Fund's net asset value ("NAV") began to decrease and it became apparent that the Fund was not an appropriate investment for conservative investors who were seeking the preservation of capital.

Despite the foregoing, the Fidelity Broker-Dealers failed to timely update certain of the Sales Materials. For example, as they did prior to the aforementioned events, many of these materials stated that the Fund invested in "high-credit quality" fixed-income securities. They further stated that the Fund was therefore low risk and appropriate for conservative investors who sought the preservation of capital. Further, certain of the materials contained promises of future performance and stated, among other things, that the Fund was a "short-term savings option" and a "cash alternative."

Based on the foregoing, as well as the other deficiencies that are described below, the Fidelity Broker-Dealers violated NASD Rules 2210 and 2110 and FINRA Rule 2010 in that the Sales Materials contained statements that were unwarranted, misleading, not balanced or that failed to provide a sound basis by which to evaluate the Fund.¹ Also, by distributing certain of these materials that were for internal or institutional use only, Fidelity Investments Institutional Services violated NASD Rules 2211 and 2110 and FINRA Rule 2010.

Further, as described below, the Fidelity Broker-Dealers violated NASD Rules 3010(a) and (b) and 2110 and FINRA Rule 2010 by failing to establish, maintain and enforce supervisory systems that were reasonably designed to achieve and monitor compliance with applicable laws, regulations and rules concerning the creation of advertising, training and wholesaling materials for the Fund.

¹ NASD Rule 2110 applies to conduct that occurred prior to December 15, 2008. That rule is now known as FINRA Rule 2010, which applies to conduct occurring on such date and thereafter.

BACKGROUND

The Fund, the Prospectus and the Sales Materials

The Fund was first offered to the public in August of 2002. Like many ultra-short bond funds, the Fund has, since its inception, sought to provide a higher level of income than that provided by a money market fund while maintaining low volatility and risk.

The Fund's prospectus (the "Prospectus") was prepared by its manager and was updated annually. It states that the Fund's objective was "to obtain a high level of current income consistent with the preservation of capital." The Prospectus also states that the fund manager "normally invests at least 80% of the [F]und's assets in investment-grade debt securities (those of medium and high quality) of all types... ."

As also disclosed in the prospectus, the Fund held a position in the Fidelity Central Fund (the "Central Fund") during the Relevant Period. Shares in the Central Fund could only be purchased by other Fidelity funds. During the Relevant Period, the Central Fund invested in the same type of structured and other products as did the Fund and sought "to obtain a high level of current income consistent with preservation of capital by investing in U.S. dollar money market and investment-grade securities."

During the Relevant Period, the Fidelity Broker-Dealers created the "Sales Materials." Certain of these materials were provided by Fidelity Brokerage Services to public customers or were used internally by such broker-dealer. Further, Fidelity Investments Institutional Services also used certain of the materials internally and distributed certain of them to the Selling Intermediaries.

The Sales Materials included fact sheets (some of which are called "spotlight reports"), brochures, mutual fund guides, training materials, product updates and overviews, yield and return information summaries, product guides, quarterly reviews, and information posted on the web and intranet sites of the Fidelity Broker-Dealers.

The Fund's Asset and Mortgage-Backed Investments, Its Increasing Returns and the Sub-Prime Crisis

As disclosed in the annual reports for the Fund, as of January 31, 2003, the Fund had approximately 41% of its portfolio in asset or mortgage-backed securities. By the end of 2005, this percentage increased to almost 73%.

As the Fund's position in structured products increased, so did its return and the number of shares of the Fund that were sold to investors. Between June 2005 and mid-June 2007, the Fund's NAV ranged from \$9.97 to \$10.04.

Also, for the 12 months ending July 31, 2006, the return of the Fund increased to approximately 4.25% from the roughly 2% return for 2003. For the one-year period ending March 31, 2007, the Fund had a one-year return of approximately 4.75%. For 2006 and 2007, customers invested approximately \$612 million and \$349 million in the Fund, respectively.

The sub-prime crisis began in early 2007. At such time, interest rates began to rise and housing prices began to decrease. Also, the U.S. mortgage market experienced an increasingly large number of delinquencies and defaults. Thereafter, some of the largest mortgage lenders, particularly those with sub-prime exposure, started to reveal enormous losses. Also, the Fund's performance began to decline. From mid-June to mid-August of 2007, the Fund's NAV dropped from \$9.97 to \$9.50 per share.

At such time, the fund manager did not substantially reduce the Fund's holdings of asset and mortgage-backed securities, which as of the end of the third quarter of 2007 constituted 81% of the Fund's portfolio. A July 2007 shareholder update that was issued concerning the Fund states that the Fund's positions in such securities were not reduced at such time because the manager believed that the higher-rated sub-prime securities would ultimately return to full value.

Subsequently, the value of the Fund's portfolio assets continued to decline, at least in part, as a result of a further drop in the market-value of its asset and mortgage-backed holdings. By late April of 2008, the Fund's NAV had fallen to \$8.25. The Fund's 2007 annual report stated that the Fund's "significant underperformance stemmed largely from its sizable exposure to subprime mortgage securities."

In the months that followed, most of the Fund's portfolio (approximately 90%) was moved to cash. Nonetheless, as a result of its continued exposure to some asset and mortgaged-backed securities, the Fund's returns were negative from mid-2007 through mid-2008. For example, its one-year performance figure for July 31, 2008 was -12.42%.

Moreover, during 2008, purchases of the Fund's shares dropped substantially. For example, for the first half of 2008, such purchases decreased to \$58 million.

During late December of 2008, the Fund's NAV dropped to \$8.11.

VIOLATIVE CONDUCT

Examples of Violative Sales Materials

An internal-use-only Fidelity Investments Institutional Services spotlight report dated December 31, 2006 states that "over time, the Central Fund will pound cash."

An internal-use-only Fidelity Investments Institutional Services spotlight report updated as of the second quarter of 2007 states that the Fund is a "cash" and "short-term" alternative that "[p]rovides performance with no surprises." Despite the commencement of the sub-prime crisis, this report also states, as stated in prior reports, that the Fund is "[c]onservative" and that its objective is to "obtain a high level of current income consistent with preservation of capital." Additionally, it states that "[t]he [F]und provides greater total return potential compared with other short term savings options."²

² Subsequent to the second quarter of 2007, the Fund was referred to in the Sales Materials as a "highly diversified floating rate investment-grade bond fund" rather than a "highly diversified cash alternative."

A Fidelity Brokerage Services internal-use-only fixed-income focus list dated August of 2007 states that the Fund is a “solid, lower risk option, ideal for customers holding cash for short-term goals such as purchasing a home or a car.”

An internal-use-only Fidelity Investments Institutional Services spotlight report updated as of the third quarter of 2007 still states, as in prior reports, that the objective of the fund was to achieve a “high level of current income consistent with [the] preservation of capital.” The report failed to provide a balanced presentation of the risks associated with the Fund and its investment in asset and mortgage-backed securities, including the impact of the sub-prime crisis on such securities.

In 2007 and 2008, Fidelity Brokerage Services produced publicly distributed fact sheets that contained graphic fulcrums intended to depict the Fund’s relative risk, based on past performance and a mathematical algorithm, as one measure of its volatility. Prior to and during early 2007, the fulcrums portrayed the investment as being close to the lowest amount of risk possible. Beginning in mid-2007 and continuing through 2008, by virtue of the Fund’s poor performance and its effect on the mathematical algorithm, the fulcrums reflected risk at a higher level than in past fact sheets. However, they failed to adequately consider the Fund’s recent volatility caused by the sub-prime crisis, and thus indicated that Fund was still “low” risk.

Further, despite the effect of the sub-prime crisis on the Fund’s portfolio investments, these fact sheets, as in prior ones, continued through the third quarter of 2008 to identify target investors as, among others, those who were “conservative.”

The disclosure language in a Fidelity Investments Institutional Services product guide issued for the first quarter of 2008 was not updated to reflect the impact of the sub-prime crisis on the Fund and therefore failed to adequately provide a balanced presentation of the risks associated with the Fund.

Advertising Violations

NASD Rule 2210(d)(1)(A) provides, among other things, that all member communications with the public must be fair and balanced, must provide a sound basis for evaluating the facts and must not omit material information which would cause the communications to be misleading. Moreover, NASD Rule 2210(d)(1)(B) provides, among other things, that no member may make an unwarranted or misleading statement in any communication with the public. This rule also provides that no member may publish, circulate or distribute any public communication that the member knows, or has reason to know, contains any untrue statement of a material fact.

NASD Rule 2211(d)(1) provides, among other things, that institutional sales material is subject to the content standards and applicable interpretative guidance of Rule 2210(d)(1).

NASD Rule 2110, which was superseded by FINRA Rule 2010 in December 2008, states that “[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.” A violation of the aforementioned advertising rules is also a violation of NASD Rule 2110.

As set forth above, certain of the publicly distributed, internal-use-only and/or institutional-only-use Sales Materials:

- Failed to provide a sound basis for evaluating the risks relating to the Fund and its investment in asset and mortgaged-backed securities, including that the Fund's NAV could fluctuate significantly if these securities were to decrease in value.
- Continued to state after mid-2007 that the Fund's portfolio holdings were of "high credit quality," when in fact such holdings also included: (1) medium and lower-graded products, and (2) risky products that were backed by, among other things, sub-prime mortgages and credit card and auto loan receivables.
- Failed to timely update certain of the Sales Materials to accurately portray the negative impact of the sub-prime crisis on the value of the Fund's portfolio investments and, thus, its shares.
- Mischaracterized the Fund as a short-term savings option appropriate for customers who sought to invest funds needed to purchase a home or automobile.
- Contained unqualified promises of positive future performance and misleadingly implied that the Fund's manager could control such performance by stating that the Fund "[p]rovides performance with no surprises" and by quoting a Fidelity employee that the Fund's investment in the Central Fund was a "cash alternative" that "will pound cash."

Accordingly, the Fidelity Broker-Dealers violated NASD Rules 2210 and 2110 and FINRA Rule 2010 by distributing certain Sales Materials that were unbalanced and misleading, contained unwarranted statements and failed to provide a sound basis by which to evaluate the risks of the Fund. In addition, by distributing certain of the forgoing materials to the Selling Intermediaries, Fidelity Investments Institutional Services violated NASD Rule 2211.

Supervisory Violations

NASD Rule 2211(b)(1)(B) provides, in part, that "[e]ach member shall establish written procedures that are appropriate to its business, size, structure, and customers for the review by a registered principal of institutional sales material used by the member and its registered representatives. Such procedures should be in writing and be designed to reasonably supervise each registered representative. Where such procedures do not require review of all institutional sales material prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing institutional sales material, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and adhered to."

NASD Rule 3010(a) requires firms to establish and maintain a supervisory system reasonably designed to achieve compliance with the applicable securities laws and regulations and industry rules.

NASD Rule 3010(b)(1) requires that “[e]ach member shall establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals and other associated individuals that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD.”

During the Relevant Period, the Fidelity Broker-Dealers had procedures in place with respect to the review and approval of the Sales Materials. However, the procedures were not reasonably designed to achieve and monitor compliance with the above-mentioned laws, regulations and rules. Specifically, the procedures generally required that the materials be approved by a registered principal prior to use. However, they did not contain an appropriate system of follow-up and review that was reasonably calculated to ensure that this review was adequate.

Moreover, the Fidelity Investments Institutional Services Spotlight Reports were created and used internally. As such, the firm had supervisory procedures concerning such documents that did not require that they be approved by a registered principal prior to use. However, in violation of NASD Rule 2211(b)(1)(B), the procedures did not provide for adequate surveillance and follow-up in order to ensure that they were being implemented and adhered to.³

As a result of the foregoing, violative Sales Materials were created and used internally by the Fidelity Broker-Dealers and distributed to the public and/or the Selling Intermediaries for institutional use during the Relevant Period. This was despite the fact that, prior to and during the Relevant Period, FINRA had issued guidance to its members that highlighted the risks associated with bonds, bond funds and structured products and detailed the supervisory responsibilities of its members with respect thereto.⁴

In sum, the Fidelity Broker-Dealers failed to establish, maintain and enforce adequate supervisory systems, including systems of follow-up and review, which were reasonably designed to achieve compliance with NASD and FINRA rules. As a result, the Sales Materials failed to provide an accurate and balanced presentation concerning the nature, holdings and risks of an investment in the Fund. Accordingly, the Fidelity Broker-Dealers violated NASD Rules 3010(a) and (b), 2110 and 2211(b)(1)(B), and FINRA Rule 2010.

B. Respondents also consent to the imposition of the following sanctions:

³ Subsequent to the Relevant Period, Fidelity Investments Institutional Services enhanced its policies regarding the review of institutional-use-only sales literature so that it is now reviewed in the same manner as other sales literature.

⁴ See, e.g., Notice to Members (“NTM”) 93-73, *Guidelines Regarding Communications with the Public About Collateralized Mortgage Obligations (CMOs)*, Oct. 1993; NTM 95-80, *NASD Further Explains Members’ Obligations and Responsibilities Regarding Mutual Funds Sales Practices*, Sept. 1995; NTM 03-71, *NASD Reminds Members of Obligations When Selling Non-Conventional Investments*, Sept. 2003; NTM 04-30, *Sales Practice Obligations, NASD Reminds Firms of Sales Practice Obligations In Sale of Bonds and Bond Funds*, Apr. 2004; NTM 05-26, *NASD Recommends Best Practices for Reviewing New Products*, Apr. 2005; and NTM 05-59, *NASD Provides Guidance Concerning the Sale of Structured Products*, Sept. 2005.

A censure and a fine in the amount of \$375,000, which is to be paid jointly and severally by them.

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

Respondents specifically and voluntarily waive any right to claim that Respondents are 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

Respondents specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against Respondents;
- 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, Respondents specifically and voluntarily waive 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.

Respondents further specifically and voluntarily waive 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

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

Respondents understand that they 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 Respondents, certifies that a person duly authorized to act on Respondents' 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 the undersigned, on behalf of Respondents, 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 Respondents to submit it.

June 27, 2012
Date

June 27, 2012
Date

FIDELITY BROKERAGE SERVICES, LLC

By: [Signature]
NORMAN L. ANTHONY, Senior VP, Chief Compliance Officer

FIDELITY INVESTMENTS INSTITUTIONAL SERVICES, INC.

By: [Signature]
SCOTT E. COULT, PRESIDENT, FIIIS

Reviewed by:

[Signature]

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Accepted by FINRA:

7/12/12
Date

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

Susan Light

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