

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2010023688801**

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

RE: J.P. Morgan Securities LLC, Respondent
BD No. 79

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

I.

ACCEPTANCE AND CONSENT

- A. 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

J.P. Morgan Securities LLC (the "Firm") is a full-service broker-dealer with its primary offices located in New York, New York. It has been member of FINRA since December 17, 1936. In 2008, J.P. Morgan Securities Inc. (operating under BD No. 18718) acquired Bear, Stearns & Co., Inc., ("Bear Stearns") (operating under BD No. 79). On September 19, 2008, Bear Stearns filed a Form BD requesting a name change to J.P. Morgan Securities Inc. J.P. Morgan Securities Inc. changed its name in September 2010 to JP Morgan Securities LLC, with its registration and membership with FINRA in effect under BD No. 79. The Firm has approximately 5,800 branches nationwide.

RELEVANT DISCIPLINARY HISTORY

In NYSE HBD 07-67 (May 3, 2007), the Firm entered into a Stipulation of Facts and Consent to Penalty in which it consented to a censure and fine of \$150,000 for violations of Exchange Act Section 15(c) and Rules 15c3-1 and 15c3-3 thereunder, Exchange Act Section 17(a) and Rule 17a-3 thereunder, and NYSE

Rule 440. The Firm consented to findings that it violated Exchange Act Section 15(c) and Rule 15c3-3 thereunder by improperly computing its Customer Reserve requirement in that it failed to include certain aged un-reconciled suspense items, resulting in a Reserve Account deficiency of approximately \$1.7 billion. The Firm also consented to findings that it violated Exchange Act Rule 17a-3 and NYSE Rule 440 in that, following a system conversion, certain of the Firm's books and records were inaccurate. The Firm was also found to have violated NYSE Rule 416 by submitting an inaccurate Key Operational Indicator (KEOP) Report to the NYSE.

OVERVIEW

During the period from September 2008 through April 2009 (the "Relevant Period"), the Firm's settlement system did not properly account for the cancellation of certain forward settling transactions. This caused incorrect data to be fed to the Firm's sub-ledger and FOCUS Reports. As a result, the Firm filed an inaccurate FOCUS Report for the period ending January 31, 2009 and maintained erroneous books and records, in violation of Section 17(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 17a-3 and 17a-5 thereunder, NASD Rules 3110 and 2110, and FINRA Rule 2010.¹

In addition, the Firm's fixed income settlement system did not reconcile with the Firm's general ledger for hedging portions of two of the Firm's high yield index bond books. These portions of these books were also not captured in the Firm's risk management system, but were incorrectly captured in the risk management infrastructure of a Firm affiliate. As such, the Firm's value at risk ("VaR") calculation was overstated as of January 31, 2009. Moreover, certain Firm Equity to Credit ("E2C") positions were not included within the Firm's VaR calculation. Instead, those E2C positions were incorrectly reflected in the VaR calculation for a different affiliate of the Firm. Such conduct constituted violations of Section 15(c) of the Exchange Act and Rule 15c3-1e(b) thereunder, Section 17(a) of the Exchange Act and Rule 17a-5 thereunder, NASD Rules 3110 and 2110, and FINRA Rule 2010.

The Firm also failed to establish and maintain adequate supervisory review systems during the Relevant Period. Specifically, the Firm failed to monitor for mismatches between its balance sheet and off balance sheet in accounting the cancellation of its forward settling transactions; failed to monitor to ensure that positions were mapped to the correct legal entity; and failed to maintain an adequate exception report to detect the discrepancies between its various internal records. These supervisory deficiencies constituted violations of NASD Rules 3010 and 2110 and FINRA Rule 2010.

¹ FINRA Rule 2010 superseded NASD Rule 2110, effective December 15, 2008. As such, the Firm is charged with violating NASD Rule 2110 from September 2008 through December 14, 2008 and with FINRA Rule 2010 from December 15, 2008 through April 2009.

FACTS AND VIOLATIVE CONDUCT

1. The Firm Failed to Maintain Accurate Books and Records and Filed an Inaccurate FOCUS Report

Exchange Act Section 17(a) and Rule 17a-5 thereunder requires broker-dealers to periodically file accurate FOCUS Reports with the SEC and FINRA. NASD Rule 3110 requires each member to make and preserve books and records in conformity with Rules 17a-3 and 17a-4 of the Exchange Act.

The Firm's fixed income settlement system did not properly account for the cancellation of certain forward settling transactions during the Relevant Period.²

According to generally accepted accounting principles (GAAP), forward settling transactions are not recognized on the face of the balance sheet but are instead accounted for off-balance sheet until the contractual settlement date. During the Relevant Period, the Firm's fixed income settlement system posted all trades to the balance sheet. To account for forward settling transactions, the Firm's fixed income settlement system created a forward adjustment entry to reverse the balance sheet entry for the transaction and then created an off-balance sheet entry for the forward settling transaction. The forward adjustment entry was reversed and re-posted each day by the Firm's fixed income settlement system. When the contractual settlement date occurred, the Firm's fixed income settlement system stopped making the adjusting entry and the trade was accounted for on the balance sheet.

However, the Firm's fixed income settlement system did not properly account for the cancellation of certain forward settling transactions. When a transaction with a future settlement was cancelled, the system continued to post a forward adjustment entry for certain cancelled forward trades. Although the Firm detected this deficiency in September 2008, it did not implement a manual solution until May 2009.

Because the Firm's fixed income settlement system did not properly account for the cancellation of certain forward settling transactions during the Relevant Period, the Firm created erroneous general ledger balances between the trade cancellation and the settlement date. Specifically, as of January 31, 2009, the Firm understated its inventory accounts by \$1.45 billion, overstated the existing trade date receivable account balance by \$983 million, and understated the trade date payable account balance by \$467 million. This inaccurate data was fed to the Firm's sub-ledger and ultimately caused inaccuracies in the Firm's FOCUS Report for the period ending January 31, 2009. In addition, similar inaccurate data was included in Firm's FOCUS Reports in December 2008 and from February 2009 to April 2009.

² A forward settling transaction is a non-standardized contract between two parties to buy or sell an asset at a specified future time at a price agreed-upon today.

Accordingly, the Firm violated Exchange Act Section 17(a) and Rules 17a-3 and 17a-5 thereunder, NASD Rule 3110, NASD Rule 2110, and FINRA Rule 2010.³

**2. The Firm Failed to Map Positions to the Correct Legal Entity
for its VaR Computation**

Exchange Act Section 15c3-1e(b) (Appendix E-Market Risk) requires broker-dealers approved to use VaR⁴ to compute a deduction for market risk as set forth in Appendix E to the rule.⁵ Appendix E sets forth deductions for market and credit risk and establishes the requirements and formulas to be used and performed to determine a broker-dealers' VaR computations. Implicit in the requirements is that the computations be accurately prepared.

The Firm's internal controls and portfolio set-up and reconciliation processes were inadequate, as follows.

A. The Firm Failed to Capture Positions in its VaR Calculation

Hedging portions of Firm high yield index bond books in two risk management books were not captured in the Firm's VaR and Specific Risk calculations. Specifically, as of January 31, 2009, one proprietary book with a \$2.7 billion long market value and a second proprietary book with a \$1.1 billion short market value were not captured in VaR. Instead, the hedging positions for these portfolios were incorrectly captured in the risk management infrastructure belonging to a Firm affiliate.

As a result of this error, the Firm's hedge was not captured in its VaR calculation while the underlying bond position was captured, causing the Firm to overstate its VaR. The Firm calculated that its VaR for January 31, 2009 was overstated by approximately \$864,000.

**B. The Firm's Equity to Credit (E2C) Positions Were not
Comprehended in the Firm's VaR Calculation**

In January 2009, the Firm used a manual process to record its E2C positions in both its General Ledger and in its VaR calculation.⁶ A review of this process for January 30, 2009 disclosed that the E2C positions were not included within the

³ See *n.1, supra*, for the time periods associated with the NASD Rule 2110 and FINRA Rule 2010 charges.

⁴ VaR is a measure of the risk of loss on a specific portfolio of financial assets over a specific time frame.

⁵ Appendices E and G to the net capital rule set forth a program that allows a broker or dealer to use an alternative approach to computing net capital deductions, subject to the conditions described in the Appendices, including supervision of the broker's or dealer's ultimate holding company under the program. The program is designed to reduce the likelihood that financial and operational weakness in the holding company will destabilize the broker or dealer, or the broader financial system. The focus of this supervision of the ultimate holding company is its financial and operational condition and its risk management controls and methodologies.

⁶ The Firm's E2C portfolio primarily held equity positions to hedge the Firm's exposure to single name credit default swaps.

Firm's VaR calculation. Instead, the E2C portfolio was improperly reflected in the VaR calculation for a London affiliate of the Firm. Because the Firm failed to have a review and reconciliation process in place to ensure that the E2C data was fed to the correct legal entity in VaR, the E2C positions were not included in the Firm's VaR calculation.

By preparing inaccurate computations, the Firm violated Exchange Act Section 17(a) and Rule 17a-5 thereunder, Exchange Act Section 15(c) and Rule 15c3-1e(b) thereunder, NASD Rules 3110 and 2110, and FINRA Rule 2010.⁷

3. The Firm Failed to Establish Adequate Supervisory Systems

NASD Rule 3010 requires that each member shall establish, maintain, and enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules.

A. The Firm Failed to Establish Adequate Supervisory Systems to Monitor that Appropriate Adjustments Were Made to Account for the Cancellation of its Forward Settling Transactions

In September 2008, the Firm discovered that the Firm's fixed income settlement system was not properly accounting for the cancellation of certain forward settling transactions. The Firm requested that its vendor implement a solution. Between September 2008 and May 2009, the vendor made several unsuccessful attempts to correct the error. In May 2009, the Firm instituted a manual work-around.

During the Relevant Period, the Firm was on notice of its fixed income settlement system's failures and of its vendor's repeated failures to fix the problem. Nonetheless, the Firm failed to monitor its forward settling transactions to ensure that accurate information was fed to the Firm's sub-ledger and ultimately to the Firm's FOCUS Reports. As a result, the Firm failed to discover erroneous adjustments made for certain cancelled forward settling transactions during the Relevant Period.

B. The Firm Had Inadequate Internal Control and Reconciliation Processes to Capture Positions for its VaR Computation

The Firm failed to have adequate processes to ensure that it mapped certain positions of Firm high yield index bond books and E2C positions to the correct legal entities during the Relevant Period. Indeed, hedge portions of high yield index bond books were mapped to a Firm-affiliated commercial bank and E2C positions were mapped to a London affiliate of the Firm, instead of being mapped to the Firm. As a result, these positions were not included in the Firm's VaR calculation in January 2009.

⁷ See n.1, *supra*, for the time periods associated with the NASD Rule 2110 and FINRA Rule 2010 charges.

C. The Firm Failed to Establish Adequate Supervisory Reports to Detect Discrepancies Between Internal Reports

The Firm relied on a daily exception report (the "Reconciliation Report") to illustrate data flow issues between a front office system and a settlement system. The Reconciliation Report was generated daily by the Firm's middle office system. A comparison between original source data files from the front office system and data in a Firm settlement system revealed that there were eight discrepancies (breaks) in the two position records. Nonetheless, the Firm's Reconciliation Report for January 30, 2009 failed to capture these position breaks.

For these reasons, the Firm violated NASD Rules 3010(a) and 2110 and FINRA Rule 2010.⁸

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

- A censure; and
- A fine in the amount of \$175,000.

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

Respondent 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

Respondent 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;

⁸ See *n l. supra* for the time periods associated with the NASD Rule 2110 and FINRA Rule 2010 charges.

- 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, Respondent specifically and voluntarily waives any right to claim bias or prejudice 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 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

Respondent understands that:

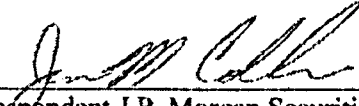
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent'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. 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 finding in this AWC or create the impression that the AWC is without factual basis. Respondent 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: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Respondent 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.

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 has been given a full opportunity to ask questions about it; that Respondent 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 Respondent to submit it.

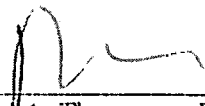
12/16/13
Date (mm/dd/yyyy)


Respondent J.P. Morgan Securities LLC

By: JANE M. COLLINS

Title: MANAGING DIRECTOR

Reviewed by:


David A. Thompson, Esq.
Counsel for Respondent
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212-552-6020

Accepted by FINRA:

12/31/13
Date

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



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