

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20100237091 01**

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

RE: J.P. Morgan Clearing Corp. ("JPM Clearing" or the "Firm"), Respondent
BD No. 28432

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

JPM Clearing has been registered with the Securities and Exchange Commission and has been a member of FINRA since 1991. The Firm was formerly known as Bear, Stearns Securities Corp. ("Bear Stearns") and became known as JPM Clearing (BD No. 28432) in October 2008 when JP Morgan Chase & Co. completed its acquisition of Bear Stearns. JPM Clearing is a subsidiary of J.P. Morgan Securities LLC (BD No. 79). The Firm's principal place of business is in Brooklyn, New York. JPM Clearing employs approximately 355 registered representatives working out of five branch offices. The Firm offers securities clearing, custody, settlement, and lending services to traders, hedge fund managers, broker-dealers, and investment advisors.

RELEVANT DISCIPLINARY HISTORY

JPM Clearing has no relevant disciplinary history.

OVERVIEW

From January 31, 2009 through October 2009 (the "Relevant Period"), JPM Clearing included non-margin equity securities in certain portfolio margin accounts and improperly applied "strategy-based" maintenance margin requirements that were not permitted for positions held in a portfolio margin account. Because non-margin equity securities could not be held within a portfolio margin account unless the Firm applied a 100 percent regulatory maintenance requirement on a daily basis, the accounts at issue were under-margined. As a result, the Firm violated NASD Rule 2520(g)(7) and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

A. Background Concerning the Portfolio Margin Rule

Prior to permitting portfolio margining, NASD and NYSE margin rules prescribed minimum maintenance margin requirements for customer accounts held by members based on position or "strategy-based" requirements. This methodology applied prescribed margin percentage requirements to each security position and/or strategy, either long or short, held in a customer's account. Effective April 2007, NASD and NYSE began expanded operation of an SEC-approved portfolio margin program on a pilot basis under NASD Rule 2520(g) and NYSE Rule 431(g), respectively. That pilot program became permanent effective August 1, 2008.

Portfolio margining is "a margin methodology that sets margin requirements for an account based on the greatest projected net loss of all positions in a product class or group using computer modeling to perform risk analysis using multiple pricing scenarios."¹ In order to qualify for a portfolio margin account, a customer had to meet certain minimum equity guidelines. Broker-dealers used the Theoretical Intermarket Margining System ("TIMS"), developed by the Options Clearing Corporation ("OCC"), to compute the baseline margin requirements for portfolio margin accounts.

The NASD portfolio margin rule in effect during the Relevant Period, NASD Rule 2520(g)(7)(D), stated in relevant part:

Positions other than those listed in Paragraph (g)(6)(B)(i) above are not eligible for portfolio margin treatment. However, positions not eligible for portfolio margin treatment (except for ineligible related instruments) may be carried in a portfolio margin account, provided the member has the ability to apply the *applicable* strategy-based margin requirements promulgated under this Rule. (Emphasis added).

¹ NASD Notice to Members (NTM) 07-11, February 2007, at 2.

NASD Rule 2520(g)(6)(B)(i) included "margin equity securities" as eligible products for portfolio margin. The term margin security and margin equity security were defined through Regulation T of the Board of Governors of the Federal Reserve System ("Reg T") and included, for example, securities listed on a national securities exchange.¹ Pursuant to Reg T, certain securities could not be purchased on margin including, for example, foreign securities that are not deemed to be "foreign margin stock"² and securities that are not traded on a national securities exchange, such as those quoted on the Pink Sheets. These "non-marginable" securities were therefore required under Reg T to be 100% funded by an investor's own cash. Holdings in non-marginable securities could not add to an investor's buying power.

NASD Rule 2520(g)(7) permitted securities "not eligible for portfolio margin treatment" to be carried in portfolio margin accounts (albeit under applicable strategy-based requirements). The Rule, however, did not change the existing Reg T requirement that non-margin securities (i.e., securities that did not meet the Reg T definition of "margin securities") could not be owned on margin (i.e., had to be fully paid for by the customer). Thus, members could carry non-marginable securities in portfolio margin accounts but could not "apply the applicable strategy-based margin requirements" that could have been applied had those securities been held in a strategy-based account.

FINRA clarified this position in guidance entitled "Portfolio Margin Frequently Asked Questions" (the "FAQs"), updated on FINRA's website in June 2008. The FAQs' guidance as to non-margin equity securities states, in relevant part:

How would a non-margin equity security be handled in a portfolio margin account?

A customer is not permitted to obtain a risk-based margin value for a non-margin security in a portfolio margin account. However, a non-margin equity security, whether held in a portfolio margin account, cash account, strategy-based margin account, must have a 100 percent regulatory maintenance requirement applied

The FAQs further explained that this position was to preclude the possibility of a customer purchasing a non-margin equity security in a cash account, transferring the security to a portfolio margin account and then using the excess margin for withdrawals or additional transactions.

¹ Section 220.2 of Reg T defined "margin security" to include any security registered or having unlisted trading privileges on a national securities exchange and defined "margin equity security" as a margin security that is an equity security (as defined in Section 3(a)(11) of the Securities and Exchange Act of 1934).

² Section 220.2 of Reg T defined "foreign margin stock" as a foreign security that is an equity security that: (1) appears on the Board's periodically published List of Foreign Margin Stocks; or (2) is deemed to have a "ready market" under SEC Rule 15c3-1 (17 CFR 240.15c3-1) or a "no-action" position issued thereunder.

B. JPM Clearing Included Non-Marginable Securities in Certain Portfolio Margin Accounts and Improperly Applied Strategy-Based Maintenance Margin Requirements That Were Not Permitted for Positions Held in a Portfolio Margin Account

On March 28, 2007, JPM Clearing's predecessor firm, Bear Stearns, was approved to engage in portfolio margining as part of the pilot program, effective April 2, 2007. In 2008, the portfolio margin accounts moved to JPM Clearing. As of April 2009, JPM Clearing maintained over 250 portfolio margin accounts.

During a routine Financial and Operational examination of the Firm (the "Examination") conducted in 2009, FINRA Staff found that the Firm was extending credit on non-eligible securities in portfolio margin accounts in contravention of the Rule. More specifically, FINRA Staff found that the positions it sampled were non-eligible securities being carried in portfolio margin accounts and that the Firm was using "strategy-based" maintenance margin requirements to extend credit on such positions. FINRA Staff found that 100% of these non-eligible securities positions were non-margin securities. The sampled securities were all positions identified on the Pink Sheets website but not listed on any national securities exchange. Eighteen of the twenty positions were foreign securities not traded on the FTSE World Index ("Grey Market" stocks).³ The other two positions were securities quoted on the Pink Sheets, which were valued at approximately \$166 million. FINRA Staff found that the Firm extended credit on all of the sampled non-margin securities.

Specifically, in connection with the Examination, in August 2009 FINRA Staff asked the Firm to run a TIMS calculation taking a 100% requirement on all non-eligible securities. According to the Firm's TIMS calculation, the Firm extended credit on non-margin securities that were carried in 13 portfolio margin accounts; the largest three of those accounts had a combined deficiency of over \$215 million. Extending credit on these non-margin securities caused the Firm's portfolio margin accounts to be under-margined.

JPM Clearing applied strategy-based requirements to non-marginable securities in its portfolio margin accounts until November 2009. Because NASD Rule 2520(g) did not allow firms to extend credit or apply strategy-based margin requirements to non-marginable securities, the Firm's extension of credit on non-marginable securities in portfolio margin accounts during the Relevant Period violated NASD Rule 2520(g) and FINRA Rule 2010.

³ "Grey Market" securities were defined on the Pink Sheets website as securities for which there were no market makers, and where the securities were not listed, traded or quoted on any stock exchange, the OTCBB or the Pink Sheets.

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

- Censure; and
- Fine of \$200,000.

Respondent agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are 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(s) 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;
- 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 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.

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 it; 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 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. 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 my: (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 have 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.

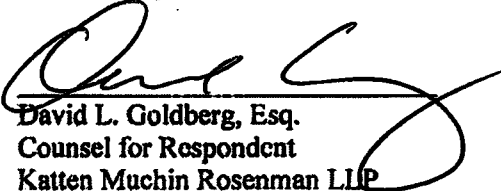
12-17-13
Date (mm/dd/yyyy)

Respondent J.P. Morgan Clearing Corp.

By: Jessica Hertzner

Title: Managing Director

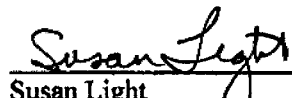
Reviewed by:


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Accepted by FINRA:

12/31/13
Date

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


Susan Light
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FINRA Department of Enforcement
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