

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013036767101**

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

**RE: J.P. Morgan Clearing Corp, Respondent
~~Member Firm~~
CRD No. 28432**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, J.P. Morgan Clearing Corp. ("Respondent" 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

- 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

The Firm has been a member of FINRA since 1991. It is a subsidiary of J.P. Morgan Securities, LLC and its principal place of business is in Brooklyn, New York. The Firm acts as a carrying and clearing broker-dealer and provides customer financing, securities lending, and related services for traders, investment advisors and fund managers.

The Firm's predecessor, Bear Stearns Securities Corp., was acquired by JPMorgan Chase in connection with its 2008 purchase of the Bear Stearns Companies, Inc. Its name was changed to J.P. Morgan Clearing Corp. in October 2008. As of November 30, 2014, the Firm's excess net capital was approximately \$5.4 billion. The Firm's year to date gross revenues through November 30, 2014 were approximately \$2.1 billion.

RELEVANT DISCIPLINARY HISTORY

The Firm has no relevant disciplinary history.

OVERVIEW

During the period from approximately October 2008 to July 2012, the Firm inaccurately reported the total of its customer debit balances in securities margin accounts, and the total of its customer free credit balances in cash accounts and securities margin accounts.¹ The Firm excluded certain balances that it was supposed to include requiring upward adjustments of \$15 billion in customer free credit balances and \$2 billion in customer debit balances for July 2012. The Firm also included certain balances that it was supposed to exclude requiring downward adjustments of \$20.7 billion in customer free credit balances and \$9.7 billion in customer debit balances for July 2012. By such conduct, the Firm violated FINRA Rule 4521(d) during the period February 2010 to July 2012, and violated Incorporated NYSE Rules 421(2) and 421.40 from October 2008 to February 2010. In addition, the Firm violated FINRA Rule 2010 from December 15, 2008 until July 2012, and, previously, violated NASD Rule 2110 from October 2008 to December 14, 2008 by failing to observe high standards of commercial honor and just and equitable principles of trade.

The Firm's systems for preparing the required FINRA reports on the information were inadequate. The systems had not kept pace with changes in the Firm's business over the years and had been in use at least since October 2008. In addition, the Firm's written procedures were inadequate. The Firm thus also violated NASD Rules 3010(a) and (b) and 2110 for the period of October 2008 to December 14, 2008 and violated NASD Rules 3010(a) and (b) and FINRA Rule 2010 for the period of December 15, 2008 to July 2012.

In mid-2012, the Firm became concerned that the totals it had reported under Rule 4521(d) (\$65.6 billion) were disproportionately high compared to the industry as a whole – more than 20 percent of the aggregate published debit balances. The Firm self-reported the matter to FINRA and subsequently provided certain corrected figures at FINRA's request as to each of the balances in question. The Firm then implemented new systems and procedures for preparation of its Rule 4521 Reports.

In January 2015, the Firm again self-reported that it had incorrectly excluded two additional categories of customer balances from its Rule 4521 Report for each of the months during the period May 2014 to November 2014, in violation of FINRA Rules 4521(d) and 2010. While comparing and validating information obtained from its new system that the Firm had installed for preparing the Rule 4521 Report, Firm personnel failed to make certain manual adjustments to the reported balances for the two additional categories as required under the new system. The Firm's written procedures failed to provide adequate guidance as to the specific manual steps

¹ A debit balance is generally defined as the credit extended to a customer by the broker-dealer, while a free credit balance is generally comprised of funds that are awaiting reinvestment.

that were required, and this caused the failure by Firm personnel to make the required manual adjustments. The Firm thus failed to establish, maintain and enforce adequate written supervisory procedures during the period May 2014 to November 2014, in violation of NASD Rule 3010 (b) and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Applicable Requirements

FINRA Rule 4521(d), effective February 8, 2010, provides that, unless otherwise permitted by FINRA in writing, each member carrying margin accounts for customers is required to submit monthly, on a settlement date basis as of the last business day of the month: (1) the total of all debit balances in securities margin accounts, and (2) the total of all free credit balances in all cash accounts and all securities margin accounts. FINRA publishes such information in aggregate amounts for the industry as a whole.

FINRA Rule 2010 and its predecessor, NASD Rule 2110, require that "a member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."² A violation of FINRA Rule 4521(d) also constitutes a violation of these provisions.

Prior to Rule 4521(d) becoming effective, NYSE and dual member firms carrying margin accounts for customers were required to submit similar information to the NYSE on Form R-1, pursuant to Incorporated NYSE Rules 421(2) and 421.40.³ The NYSE then published the information on an aggregate basis.⁴

Inaccurate Reporting of Information

During the period February 2010 to July 2012, the Firm inaccurately reported information to FINRA under FINRA Rule 4521(d) concerning the total of all customer debit balances in securities margin accounts, and the total of all customer free credit balances in cash accounts and securities margin accounts.

Previously, from October 2008 to February 2010, the Firm inaccurately reported such information to the NYSE under Incorporated NYSE Rules 421(2) and 421.40.

² FINRA Rule 2010 superseded NASD Rule 2110 effective December 15, 2008.

³ Incorporated NYSE Rule 421 provided that "Member organizations...shall submit, as required by the Exchange, periodic reports with respect to... (2) Customers' debit and credit balances." Incorporated NYSE Rule 421.40 set forth the requirement that firms file Forms R-1 and specified the information that such forms were required to contain.

⁴ FINRA Rule 4521(d) superseded Incorporated NYSE Rules 421(d) and 421.40. When FINRA Rule 4521(d) became effective, the Form R-1 was discontinued, and FINRA member firms carrying margin accounts are now required to report the information to FINRA on the Customer Margin Balance Form. See Regulatory Notice 10-08 (February 2010).

For the period June 2011 to July 2012, the approximate inaccurate reported margin debit balances ranged from \$53.7 billion to \$68.7 billion. The corrected margin debit figures, submitted by the Firm at FINRA's request after the Firm self-reported this matter in mid-2012, ranged from \$61.7 billion to \$80.9 billion. The corrected margin debit figures differed from the original figures by between \$1.9 billion and \$14.5 billion, or between three and 27 percent.

The approximate inaccurate total free credit balances in cash accounts and in margin accounts originally reported by the Firm for that same period ranged from \$30.9 billion to \$46.2 billion. The corrected total free credit balance figures submitted by the Firm ranged from \$33.5 billion to \$39.9 billion. The corrected free credit balance figures differed from the original figures by between \$8.6 billion and \$0.3 billion, or between one and twenty percent.

The Firm also reported the revised free credit balance figures separately for free credit balances in cash accounts and for free credit balances in securities margin accounts, as required under Rule 4521(d). Month to month, the revised figures for these two categories by themselves, in comparison to the originally reported figures for such categories, represented a substantial decrease in free credit balances in cash accounts and a substantial increase in free credit balances in margin accounts.

The inaccurate free credit balances just in cash accounts originally reported by the Firm ranged from less than a hundred million dollars to \$21.9 billion. The corrected figures for credit balances in the cash accounts differed from the original figures by as much as 99 percent. The original free credit balances just in margin accounts ranged from \$19.5 billion to \$30.8 billion. The corrected figures for free credit balances just in margin accounts differed from the original by amounts ranging from 11.1 percent to in one instance, to over 100 percent in another.

Causes of the Reporting Failures

During the period October 2008 to July 2012, in order to obtain information for the Rule 4521(d) Report and its predecessor, the Firm obtained information from its records related to accounts that were recognized as customer accounts. The Firm used a Management Information Systems report (the "MIS Report,") which "mapped" accounts as customer or non-customer accounts using account prefixes. This report should have included the universe of customer accounts. However, as the Firm's business evolved, the account mapping grew stale, and the Firm did not adjust the account mapping for the MIS Report to reflect alterations in the Firm's business. In addition, apart from the mapping issue, certain computer files used to calculate margin balances contained flaws in logic that caused the Firm to misidentify certain account balances.

During the period October 2008 to July 2012, as a result of the problems with the MIS Report and the Firm's computer files, there were several areas in which the firm had erroneously *excluded* balances from its calculations and also erroneously *included* balances that should have been excluded.

Erroneously Excluded Balances

Originally, Firm accounts with a certain prefix were not used for customer business, and therefore were not mapped as customer accounts for purposes of reporting under Rule 4521(d) or its predecessors. The Firm subsequently began to use accounts with that prefix as customer accounts, but the Firm did not modify the MIS Report to reflect that change. Also, the Firm erroneously excluded margin debit balances greater than 25 percent of the Firm's tentative net capital and incorrectly excluded the free credit balances in clients' margin accounts when such accounts also reflected short balances. The fact that the accounts had short balances should not have been considered in determining the Firm's reportable free credit balances.⁵ The Firm's improper exclusion of certain balances required upward adjustments totaling \$15 billion in free credit balances and \$2 billion in margin debit balances in the Firm's reported numbers for July 2012.

Erroneously Included Balances

The account number ranges for certain suspense accounts at the Firm were used for customers. The Firm decided to use such accounts as non-customer related suspense accounts, but it did not make the necessary adjustments to the MIS Report and therefore incorrectly classified the accounts as customer accounts. Also, the Firm erroneously included certain accounts with encumbered balances in the calculation of free credit balances, and also included commodity customer balances within the reported amounts, when only securities balances should have been included. Further, certain accounts of Firm affiliates held balances from short positions that were included, but information regarding short positions was not required to be reported on the Rule 4521(d) Report. The Firm's improper inclusion of certain balances required downward adjustments of \$20.7 billion in free credit balances and \$9.7 billion in margin debit balances for July 2012.

Based on the foregoing, during the period from February 2010 (when Rule 4521(d) became effective) to July 2012, the Firm violated FINRA Rule 4521(d). Previously, from October 2008 to February 2010, the Firm violated Incorporated NYSE Rules 421(2) and 421.40. In addition, during the period December 15, 2008 to July 2012, the Firm violated FINRA Rule 1010, and from October 2008 to December 14, 2008, the Firm violated NASD Rule 2110.

Additional Violations

In January 2015, the Firm self-reported that it had incorrectly excluded two additional categories of balances from its Rule 4521 Report for each of the months during the period May 2014 to November 2014.

The Firm reported that it failed to include margin debit balances from a set of approximately 40 customer accounts serviced from a particular branch. This caused the Firm's debit balance figures to be understated by a monthly average of 2.2 percent, or \$2.1 billion, for the period May 2014 to November 2014. The Firm's original reported debit balance figures for this period

⁵ See Regulatory Notice 10-08, *supra* at 2.

ranged between \$ 87.7 billion and \$99.5 billion. The revised figures ranged between \$89.8 billion and \$101.6 billion during this period.

The Firm also reported that it incorrectly excluded certain balances that were considered customer balances although they belonged to affiliates. This caused the Firm's margin account credit balance figures to be understated by a monthly average of approximately 0.5 percent, or approximately \$180 million. The original margin account credit balance figures reported by the Firm for this period ranged from \$31.3 billion to \$33.5 billion. The revised figures reported by the Firm for this period ranged from \$31.4 billion to \$33.6 billion.

By reason of the foregoing, the Firm violated FINRA Rules 4521 and 2010 with respect to its 4521 filings during the period May 2014 to November 2014.

Supervision

NASD Rule 3010(a) required that "[e]ach member shall 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 [FINRA] Rules." NASD Rule 3010 (b) required that "[e]ach member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages ... that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules of [FINRA]."

During the period October 2008 to July 2012, the Firm failed to establish and maintain an adequate system to supervise Firm personnel with respect to determining correctly which balances should be reported under Rule 4521(d) and which should be excluded. Instead, the information generated through the MIS Report did not keep up with changes to the Firm's business. The account mapping for the MIS Report grew stale and, as a result, the MIS Report produced information which rendered the numbers submitted by the Firm to FINRA (and previously to the NYSE) inaccurate. In addition, certain computer files, provided by the Firm's vendor and used to calculate margin balances, contained flaws in logic that caused it to misidentify certain account balances. The Firm thus did not have an adequate system in place to supervise the activities of Firm personnel so as to achieve compliance with regard to this issue. Moreover, Firm personnel responsible for Rule 4521(d) reporting had only a limited understanding of how the MIS Report worked, and were unaware of the MIS Report's shortcomings. The Firm has since put in place a new system that replaced the MIS Report.

Based on the foregoing, the Firm violated NASD Rules 3010(a) and 2110 from October 2008 to December 14, 2008, and violated NASD Rule 3010(a) and FINRA Rule 2010 from December 15, 2008 to July 2012, in that the Firm failed to establish and maintain an adequate supervisory system reasonably designed to achieve compliance with applicable rules which required monthly reporting of the information described herein.

In addition, during the period October 2008 to July 2012 the Firm had in place written supervisory procedures, but they were inadequate in that they did not provide any guidance as to what groups within the Firm should be responsible for preparing the Rule 4521(d) Report, what

role such groups should play, and how the necessary information should be obtained. The procedures also did not provide substantive guidance for determining which balances should be included and which should be excluded, nor did they address the responsibility of Firm personnel with regard to understanding and reconciling month to month fluctuations in the reported balances. The Firm put in place various new written procedures to address these deficiencies.

With respect to the additional violations from May 2014 to November 2014, the Firm's new system required Firm personnel, in comparing and validating the information obtained from the system, to make certain manual adjustments to the reported figures for the two additional categories of balances, in order to ensure that such figures were accurate. However, the Firm's written procedures did not provide adequate guidance as to the specific manual steps that were required. As a result, Firm personnel failed to make these required manual adjustments. The Firm has represented that it has corrected the problems that led to these additional deficiencies.

Based on the foregoing, the Firm violated NASD Rules 3010(b) and 2110 from October 2008 to December 14, 2008, and violated NASD Rule 3010(b) and FINRA Rule 2010 from December 15, 2008 to July 2012 and from May 2014 to November 2014, in that it failed to establish, maintain and enforce written procedures to supervise the types of business in which it engages that were reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD or FINRA rules.

OTHER FACTORS

In determining the appropriate sanction in this matter, FINRA took into consideration that the Firm self-reported to FINRA the matters discussed herein.

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

- (1) A censure;
- (2) A fine of \$500,000; and
- (3) A requirement that within 90 days of approval of this AWC, the Firm provide FINRA with a written certification that the Firm's systems, policies and procedures regarding the preparation and filing of Customer Margin Balance Forms are reasonably designed to ensure compliance with FINRA Rule 4521.

Respondent agrees to pay the monetary sanction 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 it 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;
- 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 Chief Legal Officer, 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 accordance with FINRA Rule 8313;
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 the Firm to submit it.

07/13/2015
Date (mm/dd/yyyy)

J.P. Morgan Clearing Corp.
J.P. Morgan Clearing Corp., Respondent

Teresa Heitsenrether
By: CEO, JPMCC

Reviewed by:

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Accepted by FINRA:

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

7/30/15
Date

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