

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014039663401**

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

RE: E*Trade Clearing LLC, Respondent
CRD No. 25025

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

E*Trade Clearing LLC ("E*Trade Clearing" or the "Firm") has been a FINRA regulated broker-dealer since 1989. E*Trade Clearing's principal place of business is in Jersey City, New Jersey. E*Trade Clearing provides clearing services for its affiliated introducing broker-dealer, E*Trade Securities LLC ("E*Trade Securities"), also a FINRA regulated broker-dealer. E*Trade Clearing and E*Trade Securities are both ultimately owned by E*Trade Financial Corporation. E*Trade Clearing employs approximately 200 registered individuals.

RELEVANT DISCIPLINARY HISTORY

In June 2010, E*Trade Clearing entered into a Letter of Acceptance, Waiver and Consent ("AWC") (AWC No. 2007009471101) that included violations of NASD Rules 3010(a) and (b) and 2110. This violation was based in part on the Firm's failure to establish a system reasonably designed to supervise, and written procedures reasonably designed to prevent and/or correct the following:
(a) erroneous margin interest accrual caused by inaccurate coding of certain

sweep funds (during the period January 17 to July 28, 2006), (b) erroneous margin interest charged to customers who traded options at the time of the Firm's January 2006 conversion of customer accounts acquired from another broker-dealer (during the period January 11 to January 13, 2006), (c) failure to reconcile Depository Trust Corporation ("DTC") positions to account for fractional share differences (during the period June 2006 to January 2007), and (d) failure to deliver physical certificates to customers (during the period January to October 2006). The Firm consented to a censure and a total fine of \$350,000 for these violations, which arose from the Firm's conversion of customer accounts acquired from another broker-dealer.

OVERVIEW

E*Trade Clearing provides clearing services for its affiliated FINRA regulated broker-dealer, E*Trade Securities, whose customers access their accounts through E*Trade Securities' internet-based platform, etrade.com. From March 5, 2007 until November 23, 2010, E*Trade Clearing failed to establish a reasonable supervisory system and written procedures to ensure that etrade.com was displaying the appropriate amount of money a customer can spend without triggering a margin call ("buying power") and the appropriate amount of any outstanding margin call ("margin call due") to online customers who traded certain options. Through the foregoing, E*Trade Clearing violated NASD Rules 3010(a) and 2110 (for conduct from March 5, 2007 through December 14, 2008) and FINRA Rule 2010 (for conduct from December 15, 2008 through November 23, 2010).

Additionally, from late 2010 through December 31, 2014, E*Trade Clearing failed to establish a reasonable supervisory system and written procedures to ensure that etrade.com displayed certain customers' buying power and margin call due consistent with the Firm's back-office books and records computer system. Through the foregoing, E*Trade Clearing violated NASD Rule 3010(a) (for conduct from 2010 through November 30, 2014) and FINRA Rules 3110(a) (for conduct from December 1, 2014 through December 31, 2014) and 2010.

FACTS AND VIOLATIVE CONDUCT

NASD Rule 3010(a), which was effective from March 5, 2007 through November 30, 2014, and FINRA Rule 3110(a), which was effective from December 1, 2014 through December 31, 2014, require, in pertinent part, that firms establish and maintain a supervisory system, including written procedures, that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules.

NASD Rule 2110, which was effective from March 5, 2007 through December 14, 2008, and FINRA Rule 2010, which was effective from December 15, 2008

through December 31, 2014, require that members “observe high standards of commercial honor and just and equitable principles of trade.”

*E*Trade Clearing’s Two Computer Systems*

E*Trade Clearing uses two different computer systems to calculate a customer’s margin requirement and the resulting buying power. The Firm’s back-office system re-calculates a customer’s positions, and the resulting margin requirements, at the end of each day. Information generated by the Firm’s back-office system is maintained as the Firm’s official books and records. Margin calls issued to Firm customers are based on calculations from the back-office system, and are issued based on a customer’s positions at the end of each day.

In contrast, the Firm’s real-time, customer-facing system calculates the information displayed on etrade.com and continuously recalculates a customer’s positions based on both a customer’s real-time activity and market movements. The information calculated by the customer-facing system includes a customer’s buying power and the outstanding amount of any margin call issued to a customer and is ultimately displayed to customers on E*Trade Securities’ website, etrade.com. Although margin calls are issued based on information calculated by the back-office system after the market closes, the customer-facing system will use real-time information to recalculate the buying power that is displayed to the customer, as well as any margin call amount due that is displayed to the customer.

*E*Trade Clearing Did Not Display the Higher House Maintenance Requirements in Certain Situations.*

On March 5, 2007, E*Trade Clearing implemented special equity maintenance requirements (“house requirements”) higher than the minimum regulatory equity maintenance requirements (“exchange requirement”) for a few options series traded by its customers on margin. The options series with higher house requirements were disclosed on etrade.com.

From March 5, 2007 until November 23, 2010, for customers who traded the options series with a higher house requirement, the Firm’s customer-facing system failed to display buying power and margin call amounts that reflected the higher house requirements after the customer placed a trade. Once a trade was placed through etrade.com, the Firm’s customer-facing system would recalculate a customer’s buying power and margin call amount without using the higher house requirement in its recalculation. The Firm’s customer-facing system would use the lower exchange requirement to calculate buying power and margin call information that would be displayed to the customer from that point forward until the end of the trading day. Thus, for these customers, the etrade.com website would display overstated buying power and understated margin call due amounts throughout the remainder of the day.

Although E*Trade Clearing had identified this problem shortly after implementing the higher house requirements in March 2007, it failed to correct the issue until November 23, 2010, after FINRA noted the issue during the Firm's annual examination in 2010.

*E*Trade Clearing Uses Different Pairing Logic to Calculate Margin for Complex Options Strategies.*

From late 2010 through December 31, 2014, for customers who traded certain kinds of highly complex option strategies, E*Trade Clearing's customer-facing and back-office systems were calculating certain customers' buying power differently. As a result, customers saw different buying power on etrade.com than was used by the Firm in its back-office system to issue margin calls. This difference applied to customers who engaged in three- and four-legged complex options strategies and, for most of these customers, meant that they would see a lower buying power on etrade.com than what the Firm was using to issue margin calls. The difference in the margin calculated by the Firm's two computer systems was the result of the two systems using different sets of principles to determine how different option positions would be paired ("pairing logic").

Shortly after it rolled out its complex options trading service, certain options customers notified the Firm that the buying power figure they independently calculated was different than the buying power displayed in their E*Trade accounts. E*Trade Clearing made manual adjustments to the buying power in those customers' accounts. However, the Firm did not implement a systemic remedy until after FINRA noted the issue during the Firm's annual examination in 2013.

*E*Trade Clearing's Supervision of its Customer-Facing System from 2007 to 2014.*

E*Trade Clearing's supervisory system did not ensure that buying power or margin call amount due was calculated similarly between the Firm's two computer systems. Other than testing done during the initial implementation of the customer-facing system, E*Trade Clearing failed to monitor the customer-facing system to ensure that it was synchronized with the back-office system or to ensure that the customer-facing system was calculating customers' buying power or margin call amounts the same as the back-office system.

Additionally, from 2007 through 2014, the Firm failed to have any system, including written policies or procedures, to review the information displayed on the Firm's customer-facing system to ensure that it was calculating buying power or margin call amounts that took into account higher house margin requirements or to ensure that it was using similar pairing logic as the Firm's back-office system.

Through the foregoing, the Firm violated NASD Rules 3010(a) and 2110 from March 5, 2007 through December 14, 2008; NASD Rules 3010(a) and FINRA Rule 2010 from December 15, 2008 through November 30, 2014; and FINRA Rules 3110(a) and 2010 from December 1, 2014 through December 31, 2014.

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

A censure and a \$350,000 fine.

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 the Firm; 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 the Firm;
 - 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 the Firm'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 the Firm 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.

E*Trade Clearing LLC, Respondent

9/21/15
Date (mm/dd/yyyy)

Reviewed by:

Marc Greenwald
Marc Greenwald
Quinn Emanuel Urquhart & Sullivan, LLP
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Accepted by FINRA:

10/5/15
Date

By: James E. Ballou, Jr.
SVP and General Counsel Brokerage
E*TRADE Financial Corporation

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

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