

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2014041721501**

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

RE: J.P. Morgan Clearing Corporation n/k/a J.P. Morgan Securities LLC (Respondent)
Member Firm
CRD No. 79

Pursuant to FINRA Rule 9216, Respondent J.P. Morgan Clearing Corporation, now known as J.P. Morgan Securities LLC, 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 in this AWC.

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 Clearing Corporation became a FINRA member in June 1991. J.P. Morgan Clearing Corporation merged with J.P. Morgan Securities LLC and its membership with FINRA was terminated in December 2016. J.P. Morgan Securities LLC, which is the surviving entity, has been a FINRA member since 1936, and its membership remains in effect. The firm is headquartered in New York, New York, and it has more than 26,000 registered representatives and maintains approximately 5,340 branches. The firm conducts a full-service brokerage business including, among other things, sales and trading, research, and underwriting services.¹

OVERVIEW

The Securities and Exchange Commission adopted Regulation SHO to address concerns regarding persistent failures to deliver and potentially abusive “naked” short selling, e.g.,

¹ For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

the sale of securities that an investor does not own or has not borrowed. A fail to deliver occurs when a seller fails to deliver securities to the buyer when delivery is due. Regulation SHO imposes certain requirements on broker-dealers with respect to sales of equity securities to promote market stability, preserve investor confidence, and increase short sale transparency. These requirements include Regulation SHO Rule 204(a)'s close out provisions and Rule 204(b)'s "penalty box" provision, which restricts short selling in securities when the close out requirement is not satisfied unless the broker-dealer borrows or arranges to borrow the security. Regulation SHO also provides that a broker-dealer may allocate a close out obligation to another broker-dealer pursuant to Rule 204(d). The notice of allocation must be clear as to the allocation of responsibility under Rule 204(d) and quantity of the fail to deliver.

From July 2009 through September 2015, J.P. Morgan sent emails to allocate the responsibility of closing out fail to deliver positions to two introducing broker-dealers in accordance with Rule 204(d). J.P. Morgan's allocation notices, however, did not make reasonably clear that the firm was allocating responsibility for closing out the fails to the introducing broker-dealers. As a result, certain fail to deliver positions the firm sought to allocate were not closed out in a manner required by Rule 204 and securities that were subject to the close out requirement were not put in the penalty box. In addition, rather than looking to its own books and records as required by Rule 204, the firm determined whether to purchase securities to close out a fail by reviewing whether fails were closed out on an account level basis.

J.P. Morgan's supervisory system, including written supervisory procedures (WSPs), was not reasonably designed to achieve compliance with the requirements of Rule 204(d)'s notice provisions, despite the firm's reliance on allocations to close out fails on a daily basis. The firm's WSPs also did not describe how supervisory reviews with respect to Rule 204(a) were documented.

As a result of the forgoing, the firm violated Rule 204, NASD Rules 3010(a) and (b), and FINRA Rules 3110(a) and (b) and 2010.²

FACTS AND VIOLATIVE CONDUCT

J.P. Morgan did not comply with Regulation SHO Rule 204

Rule 204(a) provides that a participant of a registered clearing agency that has a fail at a registered clearing agency, resulting from long or short sale transactions in an equity security, close out such fail by purchasing or borrowing securities of like kind and quantity by no later than the beginning of market open on the settlement date following

² FINRA Rule 3110 superseded NASD Rule 3010 on December 1, 2014.

the settlement date of the transactions that caused the fail. A participant must look to its own books and records to determine if there is a fail to deliver position.

Rule 204(b) provides that if a participant has a fail to deliver position in any equity security at a registered clearing agency and does not close out such fail to deliver position, the participant may not accept a short sale order in the equity security from another person, or effect a short sale in the equity security for its own account, without first borrowing the security, or entering into a bona fide arrangement to borrow the security, also known as pre-borrowing the security. This requirement remains in effect until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.

Under Rule 204(d), if a participant reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or from which it receives trades for settlement, based on such broker's or dealer's short position, the provisions of Rule 204(a) shall apply to the registered broker or dealer that was allocated the fail to deliver position, and not the participant. The notice of allocation must be clear (1) as to the quantity being allocated and (2) that an allocation is being made pursuant to Rule 204(d) such that, upon allocation, all obligations under Rule 204(a) rest solely with the entity to which an allocation is made.

FINRA Rule 2010 provides that a member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.

From July 2009 through September 2015, J.P. Morgan attempted to allocate certain fail to deliver positions caused by two introducing broker-dealers, Firm A and Firm B. To determine whether it needed to purchase securities to close out a fail, J.P. Morgan did not look to its books and records. J.P. Morgan looked to the individual account that caused the fail. If the account had sufficient subsequent purchase activity, J.P. Morgan would not take any further action. By first looking to the individual account activity, rather than the firm's books and records, J.P. Morgan risked that it may not close out a fail to deliver position within the timeframe and in a manner specified under Rule 204.

If J.P. Morgan determined there was an open fail caused by either Firm A or Firm B, it would send the introducing broker-dealer a spreadsheet via email that included the security and the close out date. These email notifications were sent daily, and J.P. Morgan attempted to allocate more than 2,400 fails a month through these emails or more than 100,000 fails during the relevant time period. The email notifications sent by J.P. Morgan, however, did not make reasonably clear that the firm was allocating a close out requirement to the introducing broker-dealer. First, the notices did not state that the fails were being allocated to the recipient. Until January 14, 2015, neither "204(d)" nor "allocation" appeared on the notice. As a result, the introducing brokers understood that they were being provided notices of potential "buy ins," which is when the participant closes out a fail by purchasing the required securities. In response to the email notifications, the introducing broker-dealers would email J.P. Morgan a description of

any actions they intended to take so that J.P. Morgan would not initiate a buy in. The spreadsheets sent from Firm A to J.P. Morgan were titled “potential buyins.”

In addition to failing to state with reasonable clarity that fails were being allocated to the recipient pursuant to Rule 204(d), the email notifications sent to Firm B through September 15, 2015, did not expressly state to Firm B the amount of the fail being allocated to it, based on J.P. Morgan’s understanding that the amount being allocated was in each instance the entire amount of the fail. Therefore, the email notifications did not make reasonably clear the number of shares J.P. Morgan was attempting to allocate to Firm B.

As a result of the flaws in the notices, J.P. Morgan remained responsible for the fails, which were not being closed out in a manner specified by Rule 204. Further because J.P. Morgan had not allocated the fails, it was required to enforce the pre-borrow or penalty box requirements, which it did not do.

By virtue of the forgoing, J.P. Morgan violated Regulation SHO Rule 204 and FINRA Rule 2010.³

J.P. Morgan’s supervisory system with respect to compliance with Rule 204 was unreasonable

FINRA Rule 3110(a)—like its predecessor, NASD Rule 3010(a)—provides that each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

FINRA Rule 3110(b)—like its predecessor, NASD Rule 3010(b)—provides that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

From July 2009 through September 2015, J.P. Morgan did not conduct a reasonable supervisory review of its email notifications to determine whether they provided clear notice of an allocation. J.P. Morgan’s supervisory system with respect to allocations focused on tracking the fail to deliver positions that it had attempted to allocate and did not include a review to determine whether the email notifications achieved compliance with Reg SHO’s notice requirements. In addition, although the firm used a checklist to document its supervisory reviews for compliance with Rule 204(a), J.P. Morgan did not describe this aspect of its supervisory system in the firm’s WSPs.

By virtue of the foregoing, J.P. Morgan violated NASD Rules 3010(a) and (b) and FINRA Rules 3110(a) and (b) and 2010.

³ A violation of Rule 204 also constitutes a violation of FINRA Rule 2010, which requires member firms in the conduct of their business to “observe high standards of commercial honor and just and equitable principles of trade.”

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

- a censure and
- a fine in the amount of \$300,000 (of which \$100,000 shall be allocated to FINRA).⁴

Acceptance of this AWC is conditioned upon acceptance of parallel settlement agreements in the same matter between the Firm and NYSE and the Firm and NYSE American.

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 an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter. The sanctions imposed in this AWC shall be effective on a date set by FINRA.

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 its acceptance or rejection.

⁴ The remainder of the fine shall be allocated evenly between the New York Stock Exchange LLC and NYSE American LLC.

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 action brought by FINRA or any other regulator against Respondent;
 - 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 its subject matter 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 testimonial obligations or 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.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's 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 the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than

the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

August 6, 2021

Date

William H. Freilich

J.P. Morgan Securities LLC
Respondent

Print Name: William H. Freilich

Title: Chief Legal Officer

Reviewed by:

Bruce Newman

Bruce Newman, Esq.
Counsel for Respondent
Wilmer Cutler Pickering Hale and Dorr LLP
7 World Trade Center
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New York, New York 10007

Accepted by FINRA:

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

August 20, 2021

Date

Elisabeth Grippando

Elisabeth Grippando
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