

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
No. 2015047064901**

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

RE: First Clearing, LLC (now known as Wells Fargo Clearing Services, LLC), Respondent
CRD No. 17344

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, First Clearing, LLC ("First Clearing," the "Firm" or "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

First Clearing was a member of FINRA from May 1986 to November 2016. The Firm was headquartered in St. Louis, Missouri, and, as of October 2016, employed approximately 471 registered representatives and approximately 2,321 non-registered fingerprint persons. The Firm cleared transactions for introducing broker-dealers. In November 2016, First Clearing merged with an affiliate to become Wells Fargo Clearing Services, LLC.

RELEVANT DISCIPLINARY HISTORY

The Firm has no relevant disciplinary history.

OVERVIEW

From January 1, 2014 to February 29, 2016 (the "Relevant Period"), First Clearing failed to maintain in a "good control location" over \$1 billion worth of customer assets held in IRA accounts at the Firm, in violation of Section 15(c) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 15c3-3. The IRA accounts contained a total of approximately 450 different uncertificated alternative investments. Although First Clearing was the custodian of the

IRA accounts, the uncertificated securities were physically held at the product sponsors. For the product sponsors to be deemed a good control location under Exchange Act Rule 15c3-3, First Clearing first would have to obtain written assurances from the product sponsors that the uncertificated securities were free of any liens or other encumbrances that could subject the securities to third-party claims. First Clearing, however, failed to obtain these required written assurances from the product sponsors.

Additionally, in counting and verifying these securities, the Firm failed to record “unresolved differences” between values reflected on its stock record versus values reflected on sponsor records, in violation of Exchange Act Rule 17a-13 and FINRA Rule 4522, a deficiency leading to inaccurate customer reserve and net capital computations under Exchange Act Rules 15c3-3 and 15c3-1, respectively, and to related books and records deficiencies under Exchange Act Rule 17a-3 and FINRA Rule 4511. Finally, First Clearing failed to establish, maintain and enforce written procedures reasonably designed to protect customer assets, in violation of NASD Rule 3010 and FINRA Rule 3110.

FACTS AND VIOLATIVE CONDUCT

1. The Firm Failed to Maintain Over \$1 Billion Worth of Customer Assets in a Good Control Location

During the Relevant Period, the Firm failed to maintain in a “good control location” over \$1 billion worth of customer assets held in IRA accounts at the Firm. The IRA accounts contained a total of approximately 31,000 positions in approximately 450 different uncertificated alternative investments (such as limited partnerships, REITS and direct placement programs, among others), with a market value of \$1.13 billion.

Although First Clearing was the custodian of the IRA accounts, the uncertificated securities were physically held at the product sponsors in the name and tax payer identification number of First Clearing in its capacity as the IRA custodian.

Under Exchange Act Rule 15c3-3(b)(1), broker-dealers that hold securities for the accounts of their customers are required to maintain physical possession or control of all customer fully-paid and excess margin securities. This means that broker-dealers must have securities in their physical possession or in their name for the benefit of their customers at one of the several “control locations” identified by Rule 15c3-3(c). Because uncertificated securities cannot be physically held in a broker-dealer’s possession, the broker-dealer must establish that the uncertificated securities are lodged in what are generally referred to as “good control locations.” Under Rule 15c3-3(c), good control locations include registered securities clearing agencies, designated foreign financial institutions and U.S. banks. They also include “such other locations as the Commission shall upon application from a broker or dealer find and designate to be adequate for the protection of customer securities.”¹

The Commission has allowed broker-dealers to use certain entities as good control locations for uncertificated securities, subject to certain conditions. In a No-Action Letter, the Commission

¹ Exchange Act Rule 15c3-3(c)(7).

addressed one such application involving uncertificated private limited partnership units.² There, the Commission stated that the broker-dealer may treat the general partner as a good control location for purposes of Rule 15c3-3(c)(7), provided that, among other things, the broker-dealer obtain written assurances that the uncertificated securities are not subject to “any right, charge, security interest, lien, or claim of any kind in favor of the general partner or any person claiming through the general partner.”³

These written assurances are commonly referred to as “no-lien letters.” Broker-dealers generally obtain a hardcopy version of a no-lien letter from the sponsor of the securities, its transfer agent or other record keeper. The purpose of a no-lien letter is to provide an assurance that the uncertificated security is free of any encumbrance that could subject the security, or part of the security, to third-party claims.

During the Relevant Period, First Clearing, failed to obtain no-lien letters from product sponsors of the uncertificated alternative investments. First Clearing therefore failed to maintain these securities in a good control location.

Based on the foregoing, First Clearing violated Exchange Act Rule 15c3-3 and FINRA Rule 2010.

2. The Firm Failed to Record Unresolved Differences in Asset Values, Resulting in Inaccurate Net Capital and Customer Reserve Computations

a. First Clearing’s Security Counts

Under Exchange Act Rule 17a-13(b), a broker-dealer must, at least once in each calendar quarter-year, count and verify all securities subject to the broker-dealer’s control or direction, but not in the broker-dealer’s physical possession, and compare the results of the count and verification with the broker-dealer’s records. The broker-dealer then must record on its books and records all “unresolved differences” setting forth the security involved and the date of comparison in a security count “difference account” no later than seven business days after the date of each quarterly security count, verification and comparison. FINRA Rule 4522(a) requires each member subject to Rule 17a-13 to make the same counts, verifications and entries required by Rule 17a-13 at least once per month.

During the relevant period, First Clearing performed the security counts required by Rule 17a-13 and FINRA Rule 4522 with respect to the \$1 billion worth of uncertificated securities held by the product sponsors. The Firm compared the value of the uncertificated securities as reflected on its stock record to the value of these securities reflected on the product sponsors’ IRA account statements, and reconciled the differences.

In some instances, where the product sponsors only distributed position information on a 45-day or longer basis, First Clearing identified unresolved differences in asset values. For example,

² Exchange Act Rule 15c3-3(c)(7)/051 (citing *Charles Schwab & Co., Inc.*, 1997 SEC No-Act. LEXIS 791 (July 30, 1997)).

³ *Id.*

during the period September 2015 through February 2016, the value of the uncertificated alternative assets on the Firm's books and records exceeded the value of these same securities as reflected on the sponsor records by an average of \$20.7 million per month. First Clearing, however, failed to record these unresolved differences in a "difference account," as required by Rule 17a-13(b)(5) and FINRA Rule 4522(b)(2).

Based on the foregoing, First Clearing violated Exchange Act Rule 17a-13 and FINRA Rules 4522 and 2010.

b. First Clearing's Customer Reserve and Net Capital Computations

First Clearing failed to take into account the "unresolved differences" arising from its periodic securities count when computing customer reserves under Rule 15c3-3 and computing net capital under Rule 15c3-1.⁴

Under Rule 15c3-3, a broker-dealer must perform a weekly computation of customer reserves. The amount of cash and/or qualified securities required to be maintained in the Customer Reserve Account is computed using a formula set forth in Exhibit A to Rule 15c3-3.⁵ The formula lists specific debits and credits to be applied to customer accounts. When credits exceed debits, the broker-dealer must deposit the net difference in the Customer Reserve Account. One of the credits in the formula is the "market value of short security count differences." During the relevant period, First Clearing, in computing customer reserves, failed to list as a credit the "market value of short security count differences" arising from its periodic security counts of the uncertificated securities held in customer IRA accounts. The Firm's failure to include the unresolved differences as a credit in the customer reserve formula resulted in the Firm's computation of inaccurate customer reserves.

First Clearing also failed to take into account "unresolved differences" arising from its periodic securities counts when computing its net capital under Exchange Act Rule 15c3-1. This rule requires a member to maintain sufficient net capital to protect against insolvency. Under Rule 15c3-1(c)(2), "net capital" is defined to mean "the net worth of a broker or dealer, adjusted by" various specified factors. One of these factors is "unresolved differences" in asset values arising from the Firm's periodic security counts.

In assessing its net capital under Rule 15c3-1, the Firm is required to deduct from its net capital the market value of all "securities differences ... unresolved after discovery" pursuant to a schedule of percentages set forth in the rule. During the relevant period, First Clearing failed to deduct from its net capital any percentage of the unresolved differences in asset values arising from its periodic security counts of uncertificated securities held in customer IRA accounts. This failure resulted in an inaccurate assessment of the Firm's net capital.

⁴ The Firm's failures, however, did not result in insufficient customer reserves or have a material effect on the Firm's net capital requirements.

⁵ Exchange Act Rule 15c3-3, Exhibit A: "Formula for determination of customer and PAB account reserve requirements of brokers and dealers under Rule 15c3-3."

By failing to include in its net capital and customer reserve computations unresolved differences arising from its securities counts of uncertificated alternative investments held in customer IRA accounts, the Firm's books and records relating to these computations were also inaccurate in violation of Exchange Act Rule 17a-3, which requires the Firm to keep certain books and records relating to its business, and FINRA Rule 4511, which requires broker-dealers to make and preserve records in accordance with applicable Exchange Act rules.

Based on the foregoing, First Clearing violated Exchange Act Rules 17a-3, 15c3-1 and 15c3-3 and FINRA Rules 4511 and 2010.

3. The Firm's Supervisory System was not Reasonably Designed

NASD Rule 3010(b) and FINRA Rule 3110(b) require a member firm to 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 applicable FINRA rules.⁶

During the relevant period, the Firm's written supervisory procedures did not contain provisions for the regulatory treatment of uncertificated alternative investments held in customer IRA accounts, including provisions relating to (1) securities counts and verifications under Rule 17a-13 and FINRA Rule 4522; (2) deductions from the Firm's net capital of the applicable percentage of the market value of securities differences under Rule 15c3-1(c)(2); and (3) additions of the market value of securities differences as a credit in the formula for computing customer reserves under Rule 15c3-3.

Based on the foregoing, the Firm violated NASD Rule 3010(b) and FINRA Rules 3110(b) and 2010.

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

1. Censure; and
2. Fine in the amount of \$750,000.

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.

⁶ FINRA Rule 3110 replaced NASD Rule 3010, effective July 1, 2015.

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 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 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 Respondent to submit it.

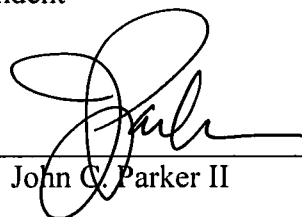
22 Nov 16

Date (mm/dd/yyyy)

FIRST CLEARING, LLC

Respondent

By: _____



John C. Parker II

Chief Operating Officer

Wells Fargo Clearing Services, LLC
as Successor

Reviewed by:

Nicholas T. Chapekis

Senior Company Counsel

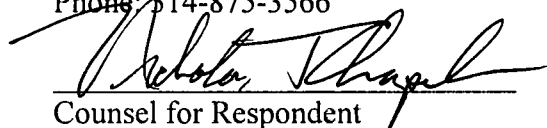
Wells Fargo & Company Law Department

MAC H0004-123

One North Jefferson Avenue

St. Louis, MO 63103

Phone: 314-875-3566



Counsel for Respondent

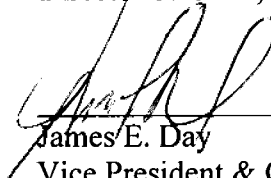
Accepted by FINRA:

12/2/16

Date

Signed on behalf of the

Director of ODA, by delegated authority



James E. Day

Vice President & Chief Counsel

FINRA Department of Enforcement

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