

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT  
No. 2016051352401**

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

RE: First Clearing, LLC (now known as Wells Fargo Clearing Services, LLC) (Respondent)  
Member Firm  
CRD No. 19616

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent First Clearing 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**

First Clearing was a FINRA member from May 1986 to November 2016. During the relevant period, April 2016 through October 2016, First Clearing provided clearing services for 75 firms and approximately 8.2 million customer accounts. In November 2016, First Clearing merged with Wells Fargo Advisors, LLC, to become Wells Fargo Clearing Services, LLC. Shortly afterward, First Clearing filed a Form BDW terminating its FINRA registration.

Respondent does not have any relevant disciplinary history.

**OVERVIEW**

From April 2016 through October 2016, First Clearing distributed 6,851 account statements to customers containing valuation information for one or more Direct Participation Programs (DPPs) or Real Estate Investment Trusts (REITs) that did not comply with NASD Rule 2340(c).<sup>1</sup> The firm sent these statements containing

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<sup>1</sup> Subsequent to the conduct at issue in this matter, NASD Rule 2340 was superseded by FINRA Rule 2231 (effective May 8, 2019).

noncompliant valuations to more than 2,300 customers. During the same period, First Clearing failed to establish and maintain a supervisory system and written supervisory procedures reasonably designed to ensure that its customer account statements reflected DPP and REIT prices derived from a valuation methodology allowed by NASD Rule 2340(c). For the same reasons, the firm also failed to maintain accurate books and records relating to monthly and quarterly statements for customer accounts containing DPPs and REITs.

Through this conduct, First Clearing violated NASD Rule 2340(c) and FINRA Rules 3110(a) and (b), 4511, and 2010.

### **FACTS AND VIOLATIVE CONDUCT**

This matter originated from a customer complaint made in August 2016 to FINRA's Senior Help Line regarding inconsistent values reflected on her account statements regarding a REIT she had previously purchased.

**Between April 2016 and October 2016, First Clearing distributed more than 6,800 customer account statements containing valuations that did not comply with the requirements of NASD Rule 2340(c).**

Beginning with amendments that took effect on April 11, 2016, NASD Rule 2340(c) required FINRA members to use either of two approved methodologies when providing per-share estimated values for DPP and unlisted REIT securities on customer account statements. In Regulatory Notice 15-02, issued in January 2015, FINRA notified its members that the Securities and Exchange Commission approved this rule change.

According to Regulatory Notice 15-02, one reason for the April 2016 rule change was to "require general securities members to provide more accurate per share estimated values on customer account statements" by using either the "net investment methodology" or the "appraised value methodology." The net-investment methodology derives an estimated per-share value from the amount of a DPP or REIT offering's proceeds that remain available for investment, either as stated in the offering prospectus or based on another equivalent disclosure. The appraised-value methodology, by comparison, draws on the appraised valuation disclosed in an issuer's most recent periodic or current report filed with the SEC.

First Clearing convened an internal working group in the second half of 2015 to address the rule change. During that process, it learned that it might encounter potential difficulties in obtaining compliant estimated values for certain DPP and REIT securities upon implementation of the rule and worked to address that possibility.

During the first few months of 2016, First Clearing obtained much of its valuation data regarding DPP and REIT securities from third-party vendors. On April 18, 2016, one of the firm's third-party valuation vendors sent First Clearing a letter identifying several dozen DPP and REIT securities for which it was unable to provide rule-compliant, per-share estimated values. A few days later, that vendor provided First Clearing with April 2016 valuation data, which included zeros as valuations for those DPPs and REITs for

which compliant valuations were unavailable. Those zeros fed directly into the system First Clearing used to generate customer-account statements at the end of each month.

When First Clearing created its customer account statements at the end of April 2016, however, the firm's security pricing team manually overrode the zeros that the firm's third-party valuation vendor had provided for 33 DPP and REIT securities, and instead populated the April 2016 statements for customers holding those securities with the valuations that the vendor supplied for those positions the previous month—i.e., before the rule change. Thus, rather than learning that compliant valuations were not available, customers who owned one or more of the affected DPPs or REITs received account statements showing outdated valuations for those holdings. Because those earlier valuations did not derive from either the net-investment or appraised-value methodology, they did not comply with Rule 2340(c). In one example, an erroneous account statement showed the per-share estimated value of a customer's REIT at \$14.72, when the security's rule-compliant per-share valuation at the time was approximately \$0.90.

First Clearing's distribution of monthly and quarterly customer account statements with noncompliant valuations for some DPP and REIT securities continued through October 2016, although the number of securities with noncompliant valuations appearing on such statements declined to either five or six per month after May 2016, as First Clearing no longer held certain DPP and REIT positions with non-compliant valuations on its books.

Overall, from April 2016 through October 2016, First Clearing sent 6,851 monthly and quarterly account statements to 2,390 account holders containing valuations for 33 discrete DPP and REIT securities that did not comply with the requirements of NASD Rule 2340(c).

Therefore, First Clearing violated NASD Rule 2340(c) and FINRA Rule 2010.<sup>2</sup>

**Between April 2016 and October 2016, First Clearing failed to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to ensure compliance with NASD Rule 2340(c).**

FINRA Rule 3110(a) provides that each member “shall establish and maintain a system to supervise the activities of each associated person that is reasonable designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.”

In addition, Rule 3110(b)(1) requires each FINRA member to “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.”

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<sup>2</sup> FINRA Rule 2010 requires members to “observe high standards of commercial honor and just and equitable principles of trade.” A violation of NASD Rule 2340 is inconsistent with high standards of commercial honor and just and equitable principles of trade, and is, therefore, also a violation of FINRA Rule 2010.

From April 2016 through October 2016, First Clearing did not have a supervisory system or written procedures reasonably designed to achieve compliance with NASD Rule 2340(c). During that time, the firm failed to ensure that appropriate supervisory personnel oversaw and reviewed the security pricing team's activities regarding DPP and REIT securities. In particular, First Clearing failed to require any supervisory review of instances in which the security pricing team manually overrode vendor-supplied valuation data for DPPs and REITs.

Therefore, First Clearing violated FINRA Rules 3110(a), 3110(b), and 2010.

**First Clearing violated FINRA Rule 4511, which requires FINRA members to keep accurate books and records.**

FINRA Rule 4511 requires member firms to "make and preserve books and records," and that obligation embodies the requirement that those records be accurate. Here, from April 2016 through October 2016, First Clearing failed to maintain accurate books and records when it created and distributed 6,851 monthly and quarterly account statements that contained noncompliant valuations for DPP and REIT securities.

Therefore, First Clearing violated FINRA Rules 4511 and 2010.

B. First Clearing also consents to the imposition of the following sanctions:

- a censure; and
- a fine of \$300,000.

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 an inability 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.

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 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 Respondent, 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 it 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 herein and the prospect of avoiding the issuance of a complaint, has been made to induce it to submit it.

October 16, 2020

Date

First Clearing, LLC, n/k/a Wells Fargo  
Clearing Services, LLC  
Respondent

By: Kelly Metz

Print Name: Kelly Metz

Title: Head of Wealth & Investment Management Brokerage Operations

Reviewed by:

Jeff Kalinowski

Jeff Kalinowski  
Counsel for Respondent  
First Clearing, LLC, n/k/a Wells  
Fargo Clearing Services, LLC  
One North Jefferson Ave.  
St. Louis, Missouri 63103

Accepted by FINRA:

November 4, 2020

Date:

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

*Adam Walker*

Adam B. Walker, Senior Counsel

FINRA

Department of Enforcement

120 W. 12<sup>th</sup> St., 8<sup>th</sup> floor

Kansas City, Missouri 64105