

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2021071987001**

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

RE: Fidelity Brokerage Services LLC (Respondent)
Member Firm
CRD No. 7784

Pursuant to FINRA Rule 9216, Respondent Fidelity Brokerage Services LLC (Fidelity) 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 accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

Fidelity has been a FINRA member since 1979. The firm primarily provides self-directed online brokerage services. Fidelity is headquartered in Smithfield, Rhode Island and has more than 550 branch offices and more than 28,000 registered representatives.¹

OVERVIEW

From May 2017 through April 2022, Fidelity did not exercise reasonable due diligence before approving customers to trade options. During this period, the firm used an automated, electronic system to screen customers' online applications to trade options, after which a principal at the firm reviewed and then approved or disapproved customer accounts for options trading. Flaws in the firm's system for reviewing options trading applications resulted in customers being approved for options trading who did not satisfy the firm's eligibility criteria or who submitted successive applications with materially different information concerning their finances and/or investment experience that raised red flags that the level of options trading the customer sought was inappropriate for them. As a result, the firm violated FINRA Rules 3110, 2360, and 2010.

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

FACTS AND VIOLATIVE CONDUCT

FINRA Rule 2360(b)(16)(B) requires that, in approving accounts for options trading, firms “exercise due diligence to ascertain the essential facts relative to the customer,” including the customer’s age, income, net worth, liquid net worth, investment objectives, and investment experience and knowledge. The Rule further requires that, “[b]ased upon such information,” a principal at the firm—either a Registered Options Principal or a General Securities Sales Supervisor—“specifically approve or disapprove in writing the customer’s account for options trading.” In determining whether and to what extent to approve an account for options trading, a firm shall consider the information provided by the customer “together with the other information available” to the firm.

FINRA Rule 3110(a) requires a member firm to “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) requires a member firm 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.”

A violation of FINRA Rule 3110 or Rule 2360 also constitutes a violation of FINRA Rule 2010, which requires firms to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.

1. Fidelity did not have a system reasonably designed to review and approve options applications.

Fidelity’s written supervisory procedures (WSPs) specified that a “careful evaluation of each options application is necessary in order to ensure that approved customers are given an appropriate level of options trading.” The WSPs further required that the principals responsible for approving customers for options trading “be alert to a customer initiating a pattern of reapplying for options trading by frequently increasing his or her financial or experience information in order to meet the approval standards.” However, prior to April 2022, Fidelity did not implement a system reasonably designed to detect when the information supplied by a customer on an options trading application materially differed from other information the customer had previously provided to the firm or to ensure that a customer’s claimed investment experience was consistent with his or her age.

Fidelity used an automated system during the relevant period to screen customers’ online applications to trade options. If that process determined that customers met Fidelity’s eligibility criteria, the system assembled the application data in composite form and sent it in batches for manual review by a firm principal. However, the automated system considered only information that a customer provided in his or her most recent options trading application (such as his or her investment experience, income, liquid net worth, and net worth), and did not compare such information to other information previously provided to the firm.

During the relevant period, Fidelity required that all customers seeking approval to trade options have at least one year of investment experience and Fidelity's policies only considered experience after a customer was 18 years old. As such, any customer under the age of 19 who applied for options trading could not have attained the one year of investment experience that Fidelity required for its customers to trade options. Nonetheless, prior to February 2021, Fidelity's automated system promoted applications for batch review by a principal based on customers' representations that they had at least one year of investment experience—even if the customers were younger than 19 years old. In addition, prior to April 2022, Fidelity's automated system did not consider customers' prior options applications to determine if they contained materially different information from what the customer recently provided.

Fidelity's process for principal review of options applications was also flawed. Principal reviewers were not required to consider if a customer had submitted multiple applications. Fidelity's system also did not require comparison of the information provided by a customer on his or her most recent options application with what the customer had previously represented to the firm.

2. Fidelity approved certain customers for options trading who did not satisfy the firm's eligibility criteria or whose accounts contained red flags that the requested level of options trading was not appropriate for them.

During the relevant period, Fidelity approved certain customers for options trading who did not meet the firm's eligibility criteria or whose applications contained red flags that options trading, or a specified level of options trading, was not appropriate. Of such customers, only a small number actually traded options at levels for which they were not eligible under the firm's eligibility criteria.

First, the firm approved approximately 400 customers under the age of 19 to trade options, even though the firm's eligibility criteria required that customers have at least one year of investment experience (and Fidelity considered such trading experience to begin when customers turned 18).

In addition, the firm approved other customers for options trading authority based on information that was materially inconsistent with what those customers had previously told the firm. For example:

- A customer submitted four applications to trade options over two days in April 2021, when the customer was 21 years old. In his first application, the customer reported an annual income of \$20,000 and a net worth of less than \$50,000. Fidelity granted the customer's first application at Level 1. The customer then submitted three additional applications with differing information requesting a higher level of options trading. Fidelity denied the customer's second and third applications because the financial information provided by the customer did not satisfy the firm's eligibility criteria. However, Fidelity approved the customer's

fourth application to trade options at Level 2, in which the customer stated that his income was greater than \$100,000 and his net worth was greater than \$500,000, without conducting additional due diligence to verify the income and net worth reflected on his fourth application.

On its own initiative in February 2021, and continuing through April 2022, Fidelity made numerous enhancements to its system for approving customers for options trading, including, among others, implementing an automated age check to its online application screening process to ensure that a customer's investment experience is consistent with his or her age, limiting how often customers can submit applications for options trading authority in a given time period, requiring and reminding customers to certify that information submitted on an options applications is accurate, and enhancing its verification processes for customers who make material changes to their financial or investment experience in a given time period.

As a result of the foregoing, the firm violated FINRA Rules 3110, 2360, and 2010.

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

- a censure and
- a fine in the amount of \$900,000.

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 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.

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 right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.

- 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.

September 26, 2023

Date

Gail Merken

Fidelity Brokerage Services LLC
Respondent

Print Name: Gail Merken

Title: Chief Compliance Officer

Reviewed by:

Timothy P. Burke

Timothy P. Burke
Counsel for Respondent
Morgan, Lewis & Bockius LLP
One Federal St.
Boston, MA 02110-1726

Accepted by FINRA:

October 2, 2023

Date

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

Karen C. Daly

Karen C. Daly
Principal Counsel
FINRA
Department of Enforcement
1601 Market Street, Suite 2700
Philadelphia, PA 19103