

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 20140403261-01**

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

RE: Wells Fargo Securities, LLC, Respondent  
Broker-Dealer  
CRD No. 126292

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Wells Fargo Securities, LLC ("WCHV", 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**

WCHV has been a member of FINRA since May 29, 2003, and its registration remains in effect. WCHV does not have any relevant disciplinary history.

**SUMMARY**

In connection with Matter No. 20140403261, FINRA Department of Market Regulation staff ("staff") conducted a review of WCHV's reporting of conventional (a/k/a Over the Counter ["OTC"]) options to the Large Options Positions Report ("LOPR")<sup>1</sup> for compliance with options reporting rules. Staff found that in early 2008, after WCHV had executed a large OTC options trade, the Firm conducted a review of OTC LOPR obligations, and ultimately decided to develop the necessary systems for the reporting of the OTC options trades that WCHV intermediated and had not been reporting. However, following certain business combinations in the fall of 2008, the Firm's OTC LOPR project was never fully developed or implemented, and WCHV's reporting of OTC

---

<sup>1</sup> The LOPR is a list of large customer options positions (200 or more contracts) required to be provided by the Firm.

options positions did not occur until after the Firm became self-clearing in mid-2014. At that time, the Firm conducted an additional review of its OTC LOPR obligations and developed the necessary systems for such reporting. As a result of the Firm's failure to report required OTC options positions, staff detected failures to report and misreports to the LOPR, position limit overages, failures to comply with options exercise rules, and related supervisory deficiencies. Specifically, staff's investigation found that WCHV had failed to report, or had inaccurately reported, a significant number of instances to the LOPR as required by pertinent rules during the period from at least January 2008 through March 2017 (the "Review Period"). Furthermore, until 2014, WCHV failed to have any system of supervision to ensure compliance with conventional options positions reporting obligations to the LOPR and had deficient written supervisory procedures.

## **FACTS AND VIOLATIVE CONDUCT**

### **Reporting of Options Positions**

1. The OTC options market differs from the listed options markets in several respects. The most significant distinction is that listed options transactions clear through a central source (i.e., The Options Clearing Corporation ["OCC"]) so that trade and position information is readily available for comparison, while there is no independent source of data for comparison with OTC options transactions. OTC derivative transactions are written directly between two parties, are not listed on any exchange, and are not cleared through the OCC. Since January 19, 2010, firms have been required to submit large options positions to the OCC for inclusion in the LOPR file submitted to the exchanges, as specified in FINRA Notice to Members ("NTM") 09-47.
2. LOPR data is used extensively by FINRA and self-regulatory organizations to identify holders of large option positions who may be, among other things, attempting to manipulate the market or otherwise violate securities rules and regulations.
3. The accuracy of LOPR data is essential for the analysis of potential violations related to, among other things, insider trading, position limits, exercise limits, front-running, capping and pegging, mini-manipulation, and marking-the-close.
4. During the Review Period until August 19, 2014, WCHV failed to report all of its reportable conventional options positions due to the Firm's failure to develop and implement a LOPR system after determining that the Firm had been failing to report certain options positions for an unknown but significant period of time because of the Firm's erroneous belief that the positions were not reportable. During a sampled period between January 2010 and August 2014, WCHV failed to report 60,808 conventional options positions in 18,868,889 instances<sup>2</sup> to the LOPR.

<sup>2</sup> An "instance" is a single failure to report, or inaccurately report, a given option position. The number of instances is determined by multiplying a given reportable position by the number of trade dates the position had not been reported or had been reported incorrectly.

5. Additionally, after identifying and remediating the Firm's failure to report reportable conventional options positions to LOPR, staff determined that during the Review Period, WCHV still failed to accurately report an unknown but significant number of conventional options positions to the LOPR. Specifically, as a result of staff's extensive review and information provided by the Firm, it was estimated that the Firm had additional errors when reporting such options positions in a variety of the required LOPR data fields (e.g., Acting In Concert Identification Number, Tax Identification, and Account Address), totalling at least 73,026 instances during a sampled period between August 19, 2014 and July 23, 2015, and the Firm self-detected that it had failed to report certain exotic or complex conventional option positions from June 30, 2014 through February 8, 2016.
6. The conduct described in paragraphs four and five above constitutes violations of NASD Rule 2860(b)(5) (for the period prior to February 17, 2009) and FINRA Rule 2360(b)(5) (for the period after February 16, 2009).

#### Position Limits

7. Staff conducts position limit reviews to detect violations of FINRA Rule 2360(b)(3), which prohibits a firm from establishing an option position, or allowing a customer to establish an option position, in excess of the allowable limit. An excessively large option position may disrupt the marketplace by allowing the option holder to influence the price of the option or underlying security. Position limits also protect firms and customers from overexposure to price fluctuations in one product. Positions are calculated by reviewing the OTC LOPR and aggregating the long calls and short puts ("bullish") and aggregating the long puts and short calls ("bearish"); unless the firm has been approved for delta hedging, these positions are not netted, and the limit is applied to both the bullish and bearish positions separately. A firm or individual may effectively reduce the position that is applied toward the limit, if the position is hedged, as defined by rule; applicable hedges include long or short stock or certain option spreads. It is a violation of the position limit rules if the net position after removing any applicable hedges, the net unhedged quantity, exceeds the position limit. A firm can also apply to the FINRA Market Regulation Department to request an increase of the position limit ("IOPL")<sup>3</sup> if activity in the underlying meets certain criteria as specified in NASD Notice to Members 07-03.
8. During the Review Period, WCHV and a customer exceeded the OTC position limit by 25% for at least 461 trading dates in options related to one security, and by 40% for two trading dates in options related to another security. These violations had not been detected by the Firm because of its LOPR-related deficiencies.

---

<sup>3</sup> A firm must file an IOPL request no later than the close of business on the next business day on which the transaction or transactions requiring such limits occurred. An IOPL is valid for one year from the day it is filed with FINRA Market Regulation Department.

9. The conduct described in paragraph eight above constitutes a violations of NASD Rule 2860(b)(3) (for the period prior to February 17, 2009) and FINRA Rule 2360(b)(3) (for the period after February 16, 2009).

#### Options Exercises

10. FINRA Rule 7230(A) requires certain information to be submitted when members report transactions in designated securities to the FINRA Trade Reporting Facility ("TRF"). Specifically, transactions effected pursuant to the exercise of a physically settled OTC option should be reported by submitting a non-tape report with a special trade report modifier (.RX) to denote that the transaction is reported for regulatory transaction fee assessment purposes. According to FINRA Rule 7230(A), transactions effected pursuant to the exercise of an OTC option are assessed a regulatory fee in accordance with Section 3 of Schedule A to the FINRA By-Laws.
11. During the Review Period, WCHV failed to report an unknown, although small, number of physically settled OTC exercises to the FINRA TRF with a .RX modifier.
12. The conduct described in paragraph eleven above constitutes separate and distinct violations of FINRA Rule 7230(A).

#### Supervision

13. Pursuant to the former NASD Rule 3010, now FINRA Rule 3110,<sup>4</sup> broker-dealers must provide for appropriate supervisory control of the organization, including a separate system of follow-up and review, to achieve compliance with FINRA and NASD rules, and with securities laws and regulations. Broker-dealers are required to provide for appropriate written procedures of supervision and control that are reasonably designed to achieve compliance with FINRA and NASD rules and compliance with securities laws and regulations. FINRA Rule 2010 requires a broker-dealer to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business.
14. During the Review Period until 2014, WCHV failed to maintain any type of system of supervision, including systems of follow-up and review, which were designed to achieve compliance with the rules governing the reporting of conventional options positions to the LOPR system. WCHV also lacked any relevant written supervisory procedures ("WSPs") requiring relevant reviews.
15. During the Review Period, after implementing supervisory systems and WSPs pertaining to the reporting of conventional options to LOPR, WCHV still failed to adequately

---

<sup>4</sup> FINRA Rule 3110 replaced NASD Rule 3010 effective December 1, 2014.

supervise by failing to detect errors in numerous conventional options positions reported to the LOPR.<sup>5</sup>

16. Additionally, during the Review Period, the Firm did not have an adequate system of supervision, including systems of follow-up and review and relevant WSPs, reasonably designed to achieve compliance with rules related to the exercise of physically settled OTC options.

17. The conduct described in paragraphs 14 through 16 above constitutes a violation of NASD Rules 3010 (for the period prior to December 1, 2014) and Rule 2110 (for the period prior to December 15, 2008), and FINRA Rules 2010 (for the period after December 14, 2008) and 3110 (for the period after November 30, 2014).

#### Other Considerations

In determining to resolve this matter in the manner set forth herein, and in determining the appropriate monetary sanction, FINRA considered the following: (i) the Firm's provision of extraordinary cooperation with this investigation by retaining outside counsel to conduct an extensive review of the Firm's options reporting systems, practices, and procedures, and to report these findings to FINRA; (ii) the Firm's hiring of an independent consultant to conduct a complete review of the Firm's LOPR systems and to identify deficiencies, and correcting the deficiencies identified by the independent consultant; and (iii) the efforts and enhancements made to the Firm's LOPR reporting systems, and supervisory practices and procedures.<sup>6</sup>

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

- (i) a censure;
- (ii) a fine of \$3,250,000; and
- (iii) an undertaking requiring the Firm to review its supervisory systems with respect to the areas described in paragraphs 14 and 15. Within 120 days after the date of the Notice of Acceptance of this AWC, a registered principal of the Respondent, shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a signed, dated letter, or an e-mail from a work-related account of the registered principal to [MarketRegulationComp@finra.org](mailto:MarketRegulationComp@finra.org), providing the following information: (1) a reference to this matter; (2) a detailed representation, including the steps taken to review the Firm's supervisory systems and processes to address the above-described

<sup>5</sup> In lieu of an undertaking, FINRA considered that as a result of the violations at issue in this matter, the Firm made significant enhancements to its LOPR processes and oversight, and implemented enhanced reviews and WSPs for LOPR compliance for conventional options and options exercise.

<sup>6</sup> See Regulatory Notice 08-70 (November 2008).

**deficiencies, and to ensure that the Firm is in fact taking all actions outlined in its processes and procedures; and (3) the date any revised systems were implemented.**

Respondent agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. It 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(s) 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 the Firm;
- 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 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. The Firm 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 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 the Firm to submit it.

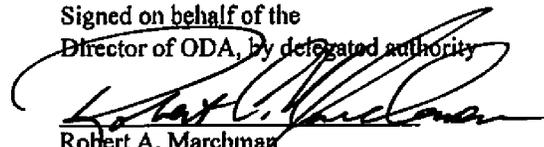
June 20, 2017  
Date

Respondent  
Wells Fargo Securities, LLC

By:   
Name: Jonathan G Webers  
Title: President

Reviewed by:   
Michael J. Diver, Esq.  
Michael J. Lohnes, Esq.  
Counsel for Respondent  
Katten Muchin Rosenman LLP  
525 W. Monroe Street  
Chicago, IL 60661-3693  
(312) 902-5601 / (312) 902-5341  
[michael.diver@kattenlaw.com](mailto:michael.diver@kattenlaw.com)  
[michael.lohnes@kattenlaw.com](mailto:michael.lohnes@kattenlaw.com)

Accepted by FINRA:  
6/21/17  
Date

Signed on behalf of the  
Director of ODA, by delegated authority  
  
Robert A. Marchman  
Executive Vice President  
FINRA Department of Market Regulation