

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58250 / July 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13106

In the Matter of

E*Trade Clearing LLC and
E*Trade Securities LLC

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS, PENALTIES AND
A CEASE-AND-DESIST ORDER PURSUANT
TO SECTIONS 15(b)(4), 21B AND 21C OF
THE SECURITIES EXCHANGE ACT OF
1934**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against E*Trade Clearing LLC and E*Trade Securities LLC (“Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (“Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained herein, except as to the Commission’s jurisdiction over Respondents and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, Penalties and a Cease-and-Desist Order Pursuant to Sections 15(b)(4), 21B and 21C of the Securities Exchange Act of 1934 (“Order”), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

Respondents

1. E*Trade Clearing LLC and E*Trade Securities LLC (collectively, hereinafter through section III, "E*Trade") are wholly owned indirect subsidiaries of E*Trade Financial Corporation, a Delaware corporation headquartered in New York. E*Trade Clearing LLC and E*Trade Securities LLC are broker-dealers registered with the Commission pursuant to Section 15(b) of the Exchange Act and are members of the Financial Industry Regulatory Authority ("FINRA").

Summary

2. These proceedings arise out of E*Trade's violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder, which require a broker-dealer to comply with the reporting, recordkeeping and record retention requirements in regulations implemented under the Bank Secrecy Act ("BSA"),¹ including the requirements in the customer identification program ("CIP") rule applicable to broker-dealers.² The CIP rule generally requires a broker-dealer to establish, document, and maintain procedures for identifying customers and verifying their identities. E*Trade established, documented and maintained a CIP that specified it would verify all accountholders in a joint account; however, from October 2003 to June 2005, E*Trade failed to verify the identities of 65,442 secondary accountholders in joint accounts. Consequently, E*Trade's documented procedures differed materially from its actual procedures.

3. By failing to document accurately its customer verification procedures, E*trade willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

Findings

4. For the 20-month period between October 2003 and June 2005, E*Trade's CIP procedures stated that the firm would verify customer identities by using, primarily, a method of comparing customer information with a third-party vendor. E*Trade's CIP procedures further required the firm to keep records that include a description of identifying information relied upon to verify the customer's identity.

5. During the relevant period, E*Trade failed to follow the verification procedures set forth in its CIP. Specifically, E*Trade did not verify the identities of secondary accountholders in newly opened joint accounts. E*Trade's 20-month failure to accurately document its CIP was systemic, resulting from the lack of a cohesive organizational structure, the lack of adequate

¹ Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the Bank Secrecy Act), 12 U.S.C. § 1829b, 12 U.S.C. §§ 1951-1959, and 31 U.S.C. § 5311-5330.

² 31 CFR § 103.122.

management oversight, and miscommunications between personnel in several E*Trade business groups.

6. For example, prior to the effective date of the CIP rule, E*Trade expanded its contractual agreement with a third-party vendor to include vetting new customer information for CIP purposes.³ E*Trade's CIP procedures included submitting the names of new customers to the vendor at the end of each day via a computerized "batch file." However, E*Trade's systems did not submit the names of secondary accountholders in newly opened joint accounts. At this time, E*Trade's written CIP procedures required the firm to confirm the identities of customers in joint accounts, yet E*Trade failed to modify its batch file process to be in compliance with its own procedures and failed to document accurately its CIP.

7. For example, in June and July 2004, nine months after the CIP compliance deadline, the risk operations group noticed that secondary accountholder information was still not being properly vetted and reported the non-compliance to E*Trade's three top compliance officers and other members of senior management, yet E*Trade failed to fix the problem.

8. For example, thirteen months after the CIP compliance deadline, in November 2004, the problem resurfaced again when E*Trade hired a new risk operations manager who assumed CIP responsibilities. No one briefed the new risk operations manager on the firm's ongoing failure to revise its systems to vet secondary accountholder information in joint accounts or to accurately document its CIP and these CIP failures continued for six more months.

9. Finally, in June 2005, seven months after assuming the position, the risk operations manager noticed E*Trade's CIP failure, identified a total of 65,442 active joint accounts that were opened after the CIP compliance date, and manually submitted the secondary accountholder information for verification. According to E*Trade, the verification process did not identify any joint accounts that should not have been opened.

10. As a result of the conduct described above, Respondents willfully⁴ violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder by failing to document accurately its CIP.

Legal Discussion

11. Section 17(a) of the Exchange Act and Rule 17a-8 thereunder require a broker-dealer to comply with certain reporting, recordkeeping and record retention requirements in the regulations implemented under the BSA. These regulations include the CIP rule which had a compliance date of

³ The CIP rule defines "customer" as "a person that opens a new account" and individuals that open new accounts for individuals that lack legal capacity or for an entity that is not a legal person. *See* 31 CFR § 103.122(a)(4).

⁴ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *see Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

October 1, 2003.⁵ The CIP rule requires that broker-dealers establish procedures for making and maintaining records of all information obtained to comply with the rule, including records describing the methods and results of any measures undertaken to verify the identities of customers.⁶

12. E*Trade's written CIP specified that it would verify secondary accountholders. In fact, E*Trade's actual procedures did not include verifying the identities of these customers. Accordingly, E*Trade did not accurately document its CIP as required pursuant to the CIP rule.

13. E*Trade, by failing to document accurately its CIP, did not comply with the recordkeeping and record retention requirements under the CIP rule and therefore willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

Undertakings

14. E*Trade has undertaken to do the following actions:

a. E*Trade will retain, within thirty (30) days of the issuance of this Order, at E*Trade's expense, a qualified independent compliance consultant ("Consultant"), not unacceptable to the Commission staff, to conduct a comprehensive regulatory review of E*Trade's CIP, including a review and test of the firm's CIP technology and customer verification procedures related to Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. E*Trade will provide a copy of the engagement letter detailing the Consultant's responsibilities to Merritt A. Gardiner, Senior Counsel, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5631B ("Enforcement Staff").

b. E*Trade will require the Consultant, within sixty (60) days of the Consultant's engagement, to develop a written plan of sufficient scope and detail to achieve the regulatory review objectives set forth in paragraph 14.d below. E*Trade will require the Consultant and other qualified persons hired by the Consultant ("Qualified Persons") to have adequate knowledge and understanding of E*Trade's CIP compliance policies and procedures. E*Trade will require the Consultant and the Qualified Persons to exercise due professional care and independence in performing the regulatory review. E*Trade will require the Consultant to formulate conclusions concerning its assessment, as described in Paragraph 14.d below, based on sufficient evidence that is obtained through, among other things; (i) inspection of documents, including written procedures, rules, and staff files; and (ii) interviews of appropriate personnel of E*Trade.

⁵ The BSA, as amended by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (Pub. L. 107-56), directed the Department of Treasury and the Commission to jointly issue regulations requiring, among other things, broker-dealers to implement reasonable procedures to verify the identity of any person seeking to open an account (to the extent reasonable and practicable) and to maintain records of the information used to verify the person's identity. See Customer Identification Programs for Broker-Dealers, Release No. 34-47752 (April 29, 2003), 68 CFR 25113 (May 9, 2003).

⁶ 31 CFR 103.122(b)(3).

c. E*Trade will within ninety (90) days from the entry of this Order create, implement, and maintain written policies and procedures designed to ensure that at all times E*Trade is in full compliance with the CIP rule, including provisions describing in reasonable detail the processes utilized to verify the identification of E*Trade customers.

d. E*Trade will require the Consultant to assess (i) the adequacy of E*Trade's CIP policies and procedures; and (ii) whether E*Trade is in substantial compliance with its statutory CIP obligations and the policies and procedures referenced in paragraph 14 herein.

e. No later than forty-five (45) days after the Consultant's review is concluded, E*Trade will require the Consultant to (i) prepare a Report identifying the scope of the regulatory review and detailing its assessment as to (a) the adequacy of E*Trade's CIP policies and procedures; (b) whether E*Trade is in substantial compliance with the policies and procedures referenced in paragraph 14 herein, and (ii) submit the Report to E*Trade's Board of Directors, to the Commission's Enforcement Staff, to the Commission's Director of the Office of Compliance, Inspections and Examinations and to the Commission's Director of the Division of Trading and Markets. With respect to any policies, practices and procedures not in compliance with the CIP rule, E*Trade will require the Consultant to make recommendations for how E*Trade should modify or supplement its policies, practices and procedures to remedy the deficiencies identified by the Consultant in the Report.

f. One year after the Consultant's Report is submitted to the entities identified in paragraph 14.e above, E*Trade will require the Consultant to assess E*Trade's remediation of any deficiencies identified by the Consultant in its Report. No later than forty-five (45) days after the Consultant completes this follow-up review, E*Trade will require the Consultant to submit a supplemental report to the entities identified in paragraph 14.e above summarizing the Consultant's findings concerning E*Trade's remediation efforts.

g. E*Trade will cooperate fully with the Consultant and Qualified Persons, and will provide the Consultant and Qualified Persons with access to its files, books, records (excluding any privileged documents) and staff as reasonably requested for the regulatory review.

h. E*Trade may apply to the Commission's staff for an extension of the deadlines described above before their expiration, and upon a showing of good cause by E*Trade, the Commission's staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate.

i. E*Trade (i) will not terminate the Consultant without prior written approval of the Commission's staff; and (ii) will compensate the Consultant and Qualified Persons engaged to assist the Consultant for services rendered pursuant to this Order at their

reasonable and customary rates.

j. E*Trade will require the Consultant to enter into an agreement that provides that, for the period of the engagement and for a period of two years from completion of the engagement, the Consultant will not enter into any employment, consultant, attorney-client, reviewing or other professional relationship with E*Trade or any of their present or former affiliates, directors, officers, employees or agents acting in their capacity as such. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any Qualified Person engaged to assist the Consultant in the performance of his/her duties under this Order will not, without the prior written consent of the Commission's staff, enter into any employment consultant, attorney-client, reviewing or other professional relationship with E*Trade, or any of its present or former affiliates, directors, officers, employees or agents acting in its capacity as such, for the period of the engagement and for a period of two years after the engagement.

15. Notwithstanding the above, E*Trade may revise its CIP policies and procedures to reflect any subsequent changes in the applicable rules and regulations.

IV.

In determining to accept the Offers, the Commission considered remedial acts undertaken by Respondents and the cooperation afforded the Commission staff.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed upon in Respondents' Offers of Settlement.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondents shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder;

B. Respondents are censured pursuant to Section 15(b)(4) of the Exchange Act;

C. Pursuant to Section 21B of the Exchange Act, Respondents shall, within 30 days of the entry of this Order, each pay a civil money penalty of \$500,000.00 (for a total of \$1 million) to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, United States Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover of a letter that identifies E*Trade Clearing LLC and E*Trade Securities LLC as the Respondents in these

proceedings and the file number of these proceedings. A copy of the cover letter and money order or check shall be sent to Cheryl Scarboro, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-5631B; and

D. Respondents shall comply with the undertakings enumerated in section III above.

By the Commission.

Florence E. Harmon
Acting Secretary