FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20130392118-01

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

RE: RBC Capital Markets, LLC, Respondent
Broker-Dealer
CRD No. 31194

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, RBC Capital Markets, LLC ("DAIN," 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 the firm 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

RBC Capital Markets, LLC has been a FINRA member since March 19, 1993, and its registration remains in effect. The firm has more than 250 branch offices, including its headquarters in New York, NY, with approximately 2,500 registered representatives in the U.S.

RELEVANT DISCIPLINARY HISTORY

On April 24, 2013, FINRA accepted an AWC in which the firm was censured and fined a total of $97,500, including $7,500 for violations of Securities and Exchange Commission ("SEC") Rule 203(b)(1) of Regulation SHO for trade date September 8, 2011.

SUMMARY

FINRA's review of the firm's compliance with Rule 204 of SEC Regulation SHO determined that during the period January 1, 2014 through April 5, 2016, the firm's supervisory system was not reasonably designed to account for the Multi-day Approach, which it utilized to calculate credit toward the firm's close-out and delivery obligations. The firm's deficient supervisory system allowed numerous violations of Rule 204 to go undetected.

In additional reviews, FINRA found that the firm failed to close out fail-to-deliver positions in accordance with Rule 204 of Regulation SHO during the periods June 1, 2013 through September 30, 2013, October 1, 2014 through December 31, 2014, and January 1, 2016 through June 2, 2016.

Based on the foregoing reviews, the Department of Enforcement found that the firm violated NASD Rule 3010 (for conduct prior to December 1, 2014), FINRA Rule 3110 (for conduct on or after December 1, 2014), Rule 204(a) of Regulation SHO of the Exchange Act, and FINRA Rule 2010.

RELEVANT RULES AND REGULATORY GUIDANCE

NASD Rule 3010 (effective until December 1, 2014) and FINRA Rule 3110 (effective as of December 1, 2014) requires member firms to establish and maintain a system, including the establishment and maintenance of written supervisory procedures ("WSPs"), to supervise its activities that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA Rules.

FINRA Rule 2010 requires that a member, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

In general, during the relevant periods, transactions in equity securities settled within three settlement days of the transaction date ("T+3"). Settlement means that on T+3, the buyer in a securities transaction is required to pay for the securities, while the seller is required to deliver the securities. This exchange of securities for payment typically takes place at a registered clearing agency, such as National Securities Clearing Corporation ("NSCC"). Fails-to-deliver ("fails") happen when a seller does not make delivery within the T+3 time frame.

Rule 204 of Regulation SHO was adopted on a permanent basis on July 31, 2009.[1] The purpose of the rule, in part, was to reduce the number of outstanding fails and the length of time these fails remained open. To achieve this purpose, Rule 204 strengthened close-out requirements for fails resulting from sales of any equity security. Specifically, Rule 204(a) requires that fails resulting from short sales of an equity security be "closed-out"

[1] Exchange Act Release No. 34-60388, 74 Fed. Reg. 38,266 (July 27, 2009), available at https://www.sec.gov/rules/final/2009/34-60388.pdf ("Rule 204 Adopting Release").

by purchasing or borrowing securities of like kind and quantity by no later than the beginning of trading on the settlement day following the settlement date (*i.e.*, T+4). In certain circumstances, exemptions in Rule 204(a)(2) and (a)(3) provide additional time during which fails may be closed-out (*i.e.*, the required close-out period is extended past the beginning of trading on T+4).

Rule 204(a)(2) requires a fail position in an equity security at a registered clearing agency resulting from a sale of a security that the seller is "deemed to own" ("DTO") to be closed out by purchasing securities of like kind and quantity by no later than the beginning of regular trading hours on T+35.[2]

Rule 204(a)(3) requires a fail position in an equity security at a registered clearing agency resulting from bona fide market making activity to be closed out by borrowing or purchasing securities of like kind and quantity by no later than the beginning of regular trading hours on T+6.

Rule 204(d) allows a participant of a registered clearing agency, if it is able to identify the broker-dealers from which the participant receives trades for clearance and settlement whose trading activities have caused a fail, to reasonably allocate a portion of a fail to a broker-dealer, based on that broker-dealer's short position ("allocation").

Rule 204(e) allows a participant of a registered clearing agency to count purchase or borrow activity done after the trade date, but prior to the settlement date (*i.e.*, on T+1, T+2, or T+3), as credit toward closing out a fail, provided that certain conditions are met ("pre-fail credit"). One such condition of Rule 204(e) as written was that the purchase or borrow activity used to claim pre-fail credit take place on a single date that was either T+1, T+2, or T+3.

Footnote 81 of the Rule 204 Adopting Release stated: "In determining its close-out obligation, a participant may rely on its net delivery obligation as reflected in its notification from NSCC regarding its securities delivery and payment obligations, provided such notification is received prior to the beginning of regular trading hours on the applicable close-out date."[3]

As discussed below, subsequent regulatory guidance published by the SEC in the form of a No Action Letter modified the strict requirement contained in Rule 204(e) that limited broker-dealers to claiming pre-fail credit for activity all on a single date prior to the settlement date.[4] Subject to certain conditions, the guidance contained in the No Action Letter allows firms to calculate pre-fail credit by aggregating net purchase activity done across multiple days from T+1 through T+3; and in addition, in the case of fails resulting

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[2] Generally, DTO (defined in Rule 200(b)) securities are sold pursuant to SEC Rule 144.

[3] Rule 204 Adopting Release, 74 Fed. Reg. at 38,272.

[4] FINRA, CBOE, C2, SEC No Action Letter, (Sept. 6, 2013), available at https://www.sec.gov/divisions/marketreg/mr-noaction/2013/finra-cboe-c2-090613-201.pdf ("SEC No Action Letter").

from bona fide market making activity, allows firms to aggregate net purchase activity done across multiple days from T+1 through T+5 as credit towards closing out such a fail position ("post-fail credit") (together with pre-fail credit, "Credit").

OVERVIEW

1. RBC's Supervisory System Related to the Multi-day Approach Was Not Reasonably Designed

In general, the firm had a process in place for tracking and closing-out fails. Specifically, the DAIN Settlements Group ("SG") and Stock Loan Desk ("SLD") monitored and tracked fails and, if the tracking process identified fails for which the firm was responsible, took action to close out fails by borrowing or purchasing shares in compliance with Reg. SHO. Each morning SG and SLD reviewed the Short and Long Account Report ("Fail Report"), which identified all securities where the firm had a fail obligation. DAIN's SG utilized data from the Fail Report, stock records and the Sold Not Long Report ("SNL Report") to identify accounts with short positions that contributed to the firm's fail obligations. The SG then checked the Fail Report against any positions that may have settled in the overnight cycle. For any positions that did not settle overnight, DAIN would seek to borrow the securities to satisfy all or part of the fail obligation. If shares were unavailable to borrow, the firm would initiate a buy-in by market open on the identified close-out date and notify the relevant customer of the buy-in, if applicable. DAIN's WSPs stated that it utilized the "Multi-day Approach" to calculate Credit towards its close-out obligations.

For fails arising from activity by its correspondent broker-dealers, the firm generally allocated the fails as appropriate to the correspondents by issuing an allocation notice pursuant to Rule 204(d) of Reg. SHO. In the case of allocations to an affiliated correspondent broker-dealer ("BD1") following market-making-related fails, DAIN's SG and SLD continued to monitor BD1's fails and executed buy-ins on behalf of BD1 if necessary. The firm's supervisory personnel, in accordance with its WSPs, also relied on these reports to conduct supervisory reviews of the firm's compliance with Rule 204.

Despite these procedures, FINRA found that the firm's supervisory system with respect to its use of the Multi-day Approach for monitoring and closing out BD1's fails was not reasonably designed to comply with the requirements of Rule 204 of Regulation SHO.

a. The Multi-day Approach

In a No Action Letter dated September 6, 2013, the SEC's Division of Trading and Markets staff published regulatory guidance enabling broker-dealers to calculate their delivery obligation by aggregating net purchases done across multiple days (on which the broker-dealer could demonstrate on its books and records that it had net purchases for the day) leading up to the applicable close-out date, and claim Credit towards a close-out

obligation for such purchases.[5] The SEC's No Action Letter called this method of calculating Credit the "Multi-day Approach," which it approved so long as certain conditions were met. Most importantly in this case, one of those conditions is that a firm not count shares twice when calculating and claiming Credit toward a close-out obligation; *i.e.*, not apply purchased shares to close-out a fail obligation and also apply that same purchase to claim a reduction in its net delivery obligation at NSCC.[6] Specifically, the SEC No Action Letter stated that the Multi-day Approach was acceptable if it is "applied in a manner that avoids double-counting net purchases, or purchases for compliance with a close-out date (*i.e.*, T+4 or T+6) requirement."[7] Furthermore, the No Action Letter stated that the Multi-day Approach could be used only if, "[r]eliance on the NSCC net delivery obligation under footnote 81 of the Rule 204 Adopting Release would be applied in a manner that avoids double-counting of multi-day activity claimed for Credit."[8]

b. Improper Application of Multi-day Approach

DAIN misapplied the Multi-day Approach, and therefore the firm failed to implement a supervisory system reasonably designed to track, allocate, and close-out fails that resulted from bona fide market making activity by BD1 in accordance with Rule 204 of Regulation SHO. Specifically, prior to market open on T+6, the firm claimed Credit for what it called "overnight reductions" in its calculations of the amounts it allocated to BD1 on T+1 through T+5, even though those reduction amounts matched exactly to the size of net purchases for which DAIN, on behalf of BD1, had already identified as meeting a prior close-out date requirement. Pursuant to Rule 204(d), DAIN produced and distributed to BD1 an automated allocation notice report listing BD1's close-out and delivery obligations (DAIN executed buy-ins on BD1's behalf if necessary). DAIN's allocation notice report was designed to include the "overnight reductions" in its calculation of BD1's fail obligation even though DAIN had already claimed Credit for these shares on BD1's behalf, resulting in double-counting. DAIN's double-counting of shares for Credit was contrary to the guidance provided in the SEC's No Action Letter.

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[5] *Id.*

[6] Specifically, Paragraph 8 of the incoming Request Letter to the SEC stated: *In the event of an Allocation to an Allocated Broker-Dealer, the Participant would establish a consistent methodology that would similarly apply footnote 81 of the Rule 204 Adopting Release in a manner that avoids double-counting of multi-day activity claimed for Credit. Specifically, the Participant would apply a methodology to reduce the potential for re-applying a reduction in a Participant's fail to deliver at NSCC that may have resulted from purchases or borrows for compliance with an Allocated Broker-Dealer's close-out requirement and, thus, already have been applied to the amount of the Allocated Broker-Dealer's close out requirement*. FINRA, CBOE, C2 Request for No Action ("incoming request letter") at 11.

[7] SEC No Action Letter at 4.

[8] *Id.*

The following example illustrates DAIN's use of purchased shares to both meet a close-out date requirement *and* subsequently reduce allocations to its correspondent BD 1 in a sample symbol between March 14 and March 21, 2014. The firm stated that the fails in the symbol were a result of BD1's bona fide market making activity (requiring T+6 close-out), and that the fails were allocated entirely to BD1 pursuant to Rule 204(d).[9] DAIN indicated that the initial fail position of 13,172 shares that developed on March 14, 2014, and was set to reach T+6 on March 19, 2014, was closed out by a net purchase of 14,792 shares on March 18, 2014. The net purchase of 14,792 shares settled on March 21, 2014. In addition to using the 14,792-share net purchase on March 18, 2014 to claim Credit to close-out the 13,172-share fail, DAIN also reduced the amount it allocated (via the allocation notice report) to BD1 by 14,792 shares prior to the start of trading on March 21, 2014, the date on which the purchase settled. Thus, DAIN double-counted this purchase activity when allocating the fail positions to BD1. The firm's method of double-counting resulted in the 14,792-share fail reaching T+6 on March 25, 2014 without being closed out, in violation of Rule 204(a)(3). DAIN's method of using the same purchase activity both for meeting a close-out date requirement and for subsequently reducing the size of its allocation amount to BD1, resulting in fails extending beyond T+6, existed in seven other sample exceptions reviewed by the staff as well, in violation of Rule 204(a)(3).

The firm's reliance on a system to track its close out obligation by double-counting shares for Credit was contrary to the regulatory guidance provided in the SEC No Action Letter and caused prolonged fails. Therefore, the firm's supervisory system was not reasonably designed to comply with Rule 204 of Regulation SHO.

The firm indicated that it discontinued its use of this method of double-counting shares to reduce BD1's close-out obligation as of April 5, 2016.

2. RBC Failed to Close-Out Market Making Fails within T+6

The fails in these matters developed from bona fide market making activity by one of DAIN's correspondent broker-dealers, an unaffiliated firm ("MM1"). MM1 was a registered market maker in the subject securities, which were penny stocks. MM1 received orders to sell large amounts of shares of the penny stocks from two of its broker-dealer customers. The shares were restricted and met the definition of DTO shares. To facilitate the orders to sell, MM1 engaged in market making activity in the securities, and sold stock short with the street throughout the trading day until it was short the desired net amount of shares to fulfill the original customer orders to sell. MM1 fulfilled the customer orders to sell, at the same time attempting to cover the short position that developed from its street-side market making activity, by purchasing shares at a net price from the two broker-dealers in amounts that fulfilled the initial DTO customer sell orders. MM1's purchases never settled, however, because the broker-dealer customers did not deliver the shares to MM1 due to delays associated with sales of DTO shares. As a result

[9] Despite the allocation to BD1, DAIN stated that it continued to track and close-out fails on BD1's behalf.

of not receiving shares from its broker-dealer customers, MM1 did not deliver the corresponding shares to the street-side purchasers within the time frame required by T+6, causing prolonged fails to deliver.

DAIN did not allocate the fails that resulted from MM1's bona fide market making activity to MM1, and therefore was responsible for closing out the fails within T+6, as required by Rule 204(a)(3). On or around T+4, DAIN's Buy-In Department directly contacted the two broker-dealers that entered the initial orders with MM1 to sell DTO securities, asking those firms about the status of the delivery of the shares to MM1. In response, MM1's broker-dealer customers generally provided DAIN's Buy-In Department with restricted stock certificates that more or less matched the quantity of the outstanding fail positions. After DAIN received the restricted stock certificates from the two broker-dealers, it did not do anything else, and took no steps to close-out the fails resulting from MM1's market making activity by purchasing or borrowing shares of like kind and quantity. The original street-side market making fails remained open for extended periods of time past T+6, and were eventually closed out when the restrictions were removed from the stock certificates and the two broker-dealer firms delivered the certificates to DAIN. DAIN was required to close-out MM1's market making sales within T+6 by borrowing or purchase shares of like kind and quantity, however.

In at least 14 instances during the period October 31, 2014 to December 31, 2014 and at least 15 instances during the period January 1, 2016 through June 2, 2016, DAIN failed to close-out market-making-related fails within T+6, in violation of Rule 204(a)(3).

3. RBC Failed to Close-Out Fails within Required Time Frames

In 20 instances during the third quarter of 2013, the firm did not close-out fails within the time required by SEC Rule 204(a). Specifically, 18 of the 20 instances arose when customer accounts at one of the firm's correspondent broker-dealers participated in an initial public offering ("IPO") in a threshold security. The firm did not allocate the fails to its correspondents, and therefore was responsible for closing-out the fails within the required time frame, which in this case was T+6 because the initial sales were long sales [Rule 204(a)(1)]. The firm did not do so because a large number of shares were "locked" at Depository Trust & Clearing ("DTC") for 45-days after the IPO due to an option agreement entered into by the lead underwriter, which was a separate entity. The underwriter's voluntary restriction on the shares was not a restriction on delivery, and did not prevent the firm from either requesting the underwriter or DTC to release the shares or taking affirmative actions to allow it to close-out the fails by purchasing or borrowing securities. The firm did not do so, and instead waited for the lock-up agreement to expire, by which time the 18 separate fails were outstanding past the required close-out date for a total of 214 days (an average of 12 days past the required close-out date).

In one of the 20 instances, the firm failed to close-out a fail within the required time frame that resulted from market making activity by one of the firm's correspondents in a second security. DAIN did not allocate the relevant portion of the fail to its correspondent, and was therefore responsible for closing it out within T+6 [Rule

204(a)(3)]. The firm assumed that the correspondent's separate purchase activity on the trade date would close out the fail, but the purchase activity failed to settle within T+3 as expected. The firm did not take any subsequent affirmative action to close-out the fail within the required time frame, but rather waited for the purchase activity to settle, by which time the fail was outstanding past the required close-out date for approximately 19 days.

In another instance, a customer of an investment advisor for which the firm provided brokerage, back-office, and related services sold restricted shares. The fail occurred after the firm attempted to cover the short position by submitting restricted stock certificates to the transfer agent for removal of the restricted legend. The transfer agent rejected the restricted certificates because the issuer's prospectus was no longer valid. The firm continued to apply a T+35 time frame to close out the fails even after the certificates were rejected. As soon as the certificates were rejected, the T+35 time frame no longer applied, and the firm should have taken immediate steps to close out the fail by purchasing or borrowing securities of like kind and quantity.

FACTS AND VIOLATIVE CONDUCT

Matter No. 20140417111

1. From January 1, 2014 through April 5, 2016, the firm misapplied the SEC's regulatory guidance regarding the Multi-day Approach to calculating Credit toward a close-out obligation when allocating and subsequently tracking fails on behalf of its affiliated correspondent broker-dealer firm, BD1. This resulted in fails extending beyond the time frame required for bona fide market making activity by Rule 204(a)(3) of Regulation SHO. The firm's failure to implement and enforce a supervisory system reasonably designed to achieve compliance with the applicable securities laws and regulations, including SEC and FINRA Rules, regarding the close-out of fail-to-deliver positions as required by Rule 204(a) of Regulation SHO constitutes a violation of NASD Rule 3010 (for conduct prior to December 1, 2014), FINRA Rule 3110 (for conduct on or after December 1, 2014), and FINRA Rule 2010.

2. Beginning on January 1, 2014 through April 5, 2016, in at least seven instances, the firm had a fail-to-deliver position at a registered clearing agency in an equity security that was attributable to market making activities, and did not close out the fail-to-deliver positions by purchasing or borrowing securities of like kind and quantity within the time prescribed by SEC Rule 204(a)(3). The conduct described in this paragraph constitutes separate and distinct violations of SEC Rule 204(a)(3) and FINRA Rule 2010.

Matter Nos. 20150449464 and 20160510455

3. Beginning on October 1, 2014 through December 31, 2014, in at least 14 instances, the firm had a fail-to-deliver position at a registered clearing agency in an equity security that was attributable to market making activities, and did not close out the fail-to-deliver positions by purchasing or borrowing securities of like kind and quantity within the time prescribed by SEC Rule 204(a)(3). The conduct described in this paragraph constitutes separate and distinct violations of SEC Rule 204(a)(3) and FINRA Rule 2010.

4. Beginning on January 1, 2016 through June 2, 2016, in at least 15 instances, the firm had a fail-to-deliver position at a registered clearing agency in an equity security that was attributable to market making activities, and did not close out the fail-to-deliver positions by purchasing or borrowing securities of like kind and quantity within the time prescribed by SEC Rule 204(a)(3). The conduct described in this paragraph constitutes separate and distinct violations of SEC Rule 204(a)(3) and FINRA Rule 2010.

Matter No. 20130392118

5. Beginning on June 5, 2013 and continuing through August 30, 2013, in 20 instances, the firm had a fail-to-deliver position at a registered clearing agency in an equity security and did not close out the fail-to-deliver positions by purchasing or borrowing securities of like kind and quantity within the time prescribed by SEC Rule 204(a). The conduct described in this paragraph constitutes separate and distinct violations of SEC Rule 204(a) and FINRA Rule 2010.

B. The firm also consents to the imposition of the following sanctions:

- A censure; and
- A fine of $215,000.

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. The firm 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.

11.6.18
Date

Respondent
RBC Capital Markets, LLC

By: _____

Name: Andrew Small

Title: Chief Compliance Officer - Wealth Management

Reviewed by:

_____
Attorney Name
Counsel for Respondent

Accepted by FINRA:

11/8/18
Date

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

_____
Gerald J. O'Hara, Esq.
Counsel
Department of Enforcement