

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Continued Membership
of
Charles Schwab & Co., Inc.
with
FINRA

Notice Pursuant to
Rule 19h-1
Securities Exchange Act
of 1934

SD-2218

April 20, 2021

I. Introduction

On September 12, 2018, Charles Schwab & Co., Inc. (“Schwab” or the “Firm”), submitted to FINRA a Membership Continuance Application (“MC-400A” or “the Application”). The Application seeks to permit the Firm, a FINRA member subject to a statutory disqualification, to continue its membership with FINRA. A hearing was not held in this matter. Rather, pursuant to FINRA Rule 9523(a), FINRA’s Department of Member Supervision (“Member Supervision”) recommended that the Chairperson of the Statutory Disqualification Committee, acting on behalf of the National Adjudicatory Council, approve the Firm’s continued membership with FINRA pursuant to the terms and conditions set forth below.

For the reasons explained below, we approve the Application.

II. The Statutorily Disqualifying Event

The Firm is subject to a statutory disqualification because of a final judgment entered against it on July 2, 2018, by the United States District Court for the Northern District of California (the “Final Judgment”). The Final Judgment permanently enjoined the Firm from violating Section 17(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Exchange Act Rule 17a-8.¹ Pursuant to the Final Judgment, the Firm was ordered to pay a \$2.8 million civil penalty. The Firm paid the penalty in full.

The Final Judgment was based on a complaint filed by the SEC, which alleged that, in 2012 and 2013, the Firm failed to file Suspicious Activity Reports (“SARs”) in

¹ Exchange Act Section 3(a)(39)(F), which incorporates by reference Exchange Act Section 15(b)(4)(C), provides that a member firm is subject to statutory disqualification if it is enjoined from, among other things, engaging in any conduct or practice as a broker-dealer or investment adviser, or in connection with the purchase or sale of any security.

connection with suspicious transactions by independent investment advisers (“Advisers”) terminated from the Firm’s custodial platform. The SEC alleged that at least 47 of the 83 terminated Advisers engaged in transactions of at least \$5,000 that were conducted at, by, or through the Firm, and that the Firm knew, suspected, or had reason to suspect these transactions were suspicious under the Bank Secrecy Act and the rules promulgated thereunder. The Firm, however, filed SARs relating to the suspicious transactions of only 10 of the terminated Advisers, and three of those SARs were filed after the SEC had already brought an enforcement action against the Advisers. The Firm failed to file SARs relating to the suspicious transactions of the remaining 37 terminated Advisers. The SEC also alleged that Schwab’s failure to file the SARs at issue resulted from its inconsistent implementation of policies and procedures for identifying and reporting suspicious transactions.

III. Background Information

A. The Firm

The Firm is based in San Francisco, California, and has been a FINRA member since 1970. According to FINRA’s Central Records Depository (“CRD”®), the Firm has 392 branch offices, 219 of which are Offices of Supervisory Jurisdiction. The Firm employs approximately 9,749 registered representatives, 981 of whom are also registered principals. The Firm does not employ anyone subject to statutory disqualification.

B. Recent Routine and Cause Examinations

In September 2020, FINRA issued the Firm a Cautionary Action in connection with the Firm’s compliance with FINRA Rule 2121. FINRA cited the Firm for failing to maintain and enforce a supervisory system reasonably designed to review and monitor commissions charged to customers within its fee-based investment advisory program. The Firm responded in writing to the exception noted in the Cautionary Action.

In May 2020, FINRA issued the Firm a Cautionary Action, which cited the Firm for failing to establish, document, and maintain a system of risk management controls and supervisory procedures that were reasonably designed to prevent the entry of erroneous orders and failing to preserve a written description of its risk management controls as part of its books and records. The Firm represented that it corrected the deficiencies noted in the Cautionary Action.

In March 2020, FINRA issued the Firm a Cautionary Action in connection with its 2019 routine examination. FINRA cited the Firm for sending securities confirmations containing inaccurate disclosures. The Firm responded in writing to the exception noted in the Cautionary Action.

In March 2020, FINRA issued the Firm a Cautionary Action in connection with the Firm’s compliance with FINRA Rule 6380A(a). FINRA cited the Firm for failing to timely submit to the FINRA/Nasdaq Trade Reporting Facility last sale reports and failing

to establish a supervisory system reasonably designed to ensure compliance with FINRA Rule 6380A(a). The Firm responded in writing to the exceptions noted in the Cautionary Action.

In March 2020, FINRA issued the Firm a Cautionary Action in connection with its proxy voting practices. FINRA cited the Firm for relying on a CBOE rule that had been repealed when it “mirror voted” proxies in equity and investment company securities on behalf of customers. The Firm responded in writing to the exception noted in the Cautionary Action.

In October 2019, FINRA issued the Firm a Cautionary Action in connection with the Firm’s compliance with certain MSRB rules. FINRA cited the Firm for failing to provide to customers accurate yield-to-worst disclosures and failing to disclose to customers material facts concerning municipal securities transactions. The Firm responded in writing to the exceptions noted in the Cautionary Action.

In June 2019, FINRA issued the Firm a Cautionary Action in connection with its 2018 trading and financial examination. FINRA cited the Firm for, among other things, the following exceptions: failing to report trades with accurate modifiers; submitting inaccurate reports to the Order Audit Trail System; providing inaccurate disclosures of commissions on customer confirmations; and failing to reasonably supervise in connection with these deficiencies.² The Firm responded in writing to the exceptions noted.

In April 2019, FINRA issued the Firm a Cautionary Action in connection with the Firm’s compliance with FINRA Rule 6191(a). FINRA cited the Firm for failing to establish, maintain, and enforce written policies and procedures, and failing to enforce its supervisory system, to achieve compliance with this rule. The Firm responded in writing to the exceptions noted in the Cautionary Action.

In March 2019, FINRA issued the Firm a Cautionary Action in connection with its 2018 routine examination. FINRA cited the Firm for exceptions pertaining to the Firm’s failures to fully disclose mark-ups and mark-downs in corporate and municipal debt securities and accurately report trade execution times on trade confirmations.³ The Firm responded in writing to the exceptions noted in the Cautionary Action.

² In connection with this examination, FINRA staff also referred the following deficiencies to trading and financial information staff for additional investigation: failing to execute customer orders at the best prevailing price; failing to accurately report trade information; and failing to supervise in connection with these and related deficiencies. This matter is pending.

³ In connection with this examination, FINRA staff also referred to FINRA’s Department of Enforcement potential deficiencies concerning the Firm’s systems to

In February 2019, FINRA issued the Firm a Cautionary Action in connection with the Firm's surveillance and review of order entry and trading activity related to marking-the-close and prearranged trading and wash sale activity. FINRA cited the Firm for failing to maintain a sufficient supervisory system to detect such activity. The Firm responded in writing to the exceptions noted in the Cautionary Action.

In January 2018, FINRA issued the Firm a Cautionary Action in connection with its 2017 routine examination. The Cautionary Action cited the Firm for failing to accurately report its customer reserve computation and maintaining an agreement with its clearing and custodial bank that improperly restricted the Firm's ability to transfer customer fully paid securities from its clearance account to its custodial account. The Firm responded in writing to the exceptions noted in the Cautionary Action.

C. Recent Regulatory Actions

In the past several years, the Firm has been subject to several regulatory actions.⁴

In May 2020, NYSE Arca and The Nasdaq Stock Market accepted an AWC from the Firm. Without admitting or denying the allegations, the Firm consented to findings that it failed to establish a system of risk management controls and supervisory procedures reasonably designed to manage the risks of its market access activity and to prevent the entry of erroneous orders, and also failed to preserve a written description of its risk management controls. The Firm was censured, fined \$50,000, and required to implement risk management controls and procedures reasonably designed to achieve compliance with applicable rules and regulations and to revise its written supervisory procedures. The Firm represents that it complied with these required undertakings.

In July 2018, the Business Conduct Committee of Cboe Exchange, Inc. accepted from the Firm a Letter of Consent. The Letter of Consent provided that, from January 2010 through August 2015, the Firm inadequately reported Large Options Position

detect and report suspicious transactions, which were identified as inadequate by the SEC in a 2014 examination report. Specifically, FINRA staff referred this matter to Enforcement to investigate whether the Firm, between February 2017 and January 2018, failed to implement corrective measures and modify existing parameters and thresholds in the Firm's anti-money laundering ("AML") Transaction Monitoring System, that were previously deemed inadequate by the SEC in a February 2014 exam report. This matter was closed in October 2020 with no further action taken.

⁴ For the Application, we agree with Member Supervision's focus on the Firm's regulatory actions that occurred in the past several years and discuss these matters herein. Although we limit our discussion to recent regulatory actions, the Firm represents that it complied with required undertakings in connection with a regulatory action by the State of New York in 2015 and a 2013 FINRA Letter of Acceptance, Waiver and Consent ("AWC").

Reports (“LOPR”) records. It also stated that the Firm failed to report LOPR records and failed to establish adequate supervisory systems reasonably designed to ensure proper LOPR reporting. The Firm was censured and fined \$300,000.

In October 2017, FINRA accepted an AWC from the Firm for violations of Exchange Act Section 17, Exchange Act Rule 17a-3, and FINRA Rules 6730, 4511, and 2110. Without admitting or denying the allegations, the Firm consented to findings that it failed to timely report to FINRA’s Trade Reporting and Compliance Engine (“TRACE”) transactions in TRACE-eligible securitized products, failed to accurately report to TRACE the correct time of trade executions, and failed to accurately show the time of execution on brokerage order memoranda. FINRA censured the Firm and fined it \$50,000.

IV. The Firm’s Proposed Continued Membership with FINRA and Proposed Supervisory Plan

The Firm seeks to continue its membership with FINRA notwithstanding the Final Judgment, which renders the Firm statutorily disqualified. In support, the Firm represents that it has taken numerous remedial steps to prevent from occurring again misconduct similar to the misconduct underlying the Final Judgment. For instance, the Firm represents that it made structural changes to streamline the SARs filing decision-making process when it terminates Advisers, and that it has nearly doubled the number of employees dedicated to AML and fraud prevention since the events underlying the Final Judgment. Further, the Firm represents that it has increased the quantity and quality of training for its Adviser Services Surveillance and Investigations (“ASSI”) group, which investigates Advisers for possible termination and determines whether or not to file SARs related to Adviser misconduct.

Moreover, the Firm has agreed to the following plan of supervision (“Supervision Plan”) as a condition of its continued membership with FINRA:

1. The Firm shall comply with the Final Judgment;
2. Schwab shall assess whether the ASSI group’s SARs investigatory and reporting procedures are appropriately tailored and being consistently applied at least every two years for a period of five years from the date of this Exchange Act Rule 19h-1 notice. Following the completion of this assessment, Schwab’s chief compliance officer shall document the results of the assessment, noting any recommended procedural enhancements. Schwab shall maintain copies of the relevant procedures, amendments thereto, and documents related to this assessment, including the results of the assessment and any related recommendation(s) in a segregated file for ease of review during any statutory disqualification examination. At the conclusion of the five-year review period, the Firm will review the ASSI group’s SARs investigatory and reporting procedures on an as-needed basis;

3. Schwab, or third parties contracted by Schwab, shall conduct an annual training for the ASSI group that covers Schwab's obligations under the Bank Secrecy Act and the rules promulgated thereunder, the Firm's SARs filing procedures, and suspicious activity risk factors particular to Advisers for a period of five years from the date of this Exchange Act Rule 19h-1 notice. After five years, the Firm will review the effectiveness of this training to determine the ongoing frequency of such training. The Firm shall maintain copies of training resources and presentations in a segregated file for ease of review during any statutory disqualification examination;
4. For a period of five years from the date of this Exchange Act 19h-1 notice, Schwab must obtain written approval from Member Supervision prior to changing any provision of the Supervision Plan;⁵ and
5. The Firm will submit any proposed changes or other information requested under this Plan to FINRA's Statutory Disqualification Program @ SDMailbox@FINRA.org.

Following approval of the Firm's continued membership in FINRA, Member Supervision represents that FINRA intends to utilize its examination and surveillance processes to assess the Firm's continued compliance with the standards prescribed by Exchange Act Rule 19h-1 and FINRA Rule 9523.

V. Discussion

Member Supervision recommends approving the Firm's request to continue its membership in FINRA. After carefully reviewing the entire record in this matter, we approve the Application.

In evaluating an application like this, we assess whether the statutorily disqualified firm seeking to continue its membership in FINRA has demonstrated that its continued membership is consistent with the public interest and does not create an unreasonable risk of harm to the market or investors. *See* FINRA By-Laws, Art. III, Sec. (3)(d); *cf. Frank Kufrovich*, 55 S.E.C. 616, 624 (2002) (holding that FINRA "may deny an application by a firm for association with a statutorily-disqualified individual if it determines that employment under the proposed plan would not be consistent with the public interest and the protection of investors"). Factors that bear on our assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, and whether there has been any intervening misconduct.

⁵ We have amended this provision to make it consistent with the other terms of the plan.

We recognize that the Final Judgment involved serious violations of the Bank Secrecy Act and the Firm's obligations to file SARs under federal rules and regulations. We note, however, that the violative conduct occurred in 2012 and 2013, more than seven years ago. We further note that the Firm represents that it has taken numerous steps to prevent similar misconduct from occurring again, such as providing additional training of its personnel and hiring additional staff tasked with AML compliance and fraud prevention. Further, the Final Judgment did not expel or suspend the Firm, and the record does not show that the SEC followed up the Final Judgment with further administrative action against the Firm.⁶ The record also does not indicate that there has been any similar misconduct by the Firm since the Final Judgment, and the Firm has consented to a Supervision Plan that will help ensure that such misconduct does not reoccur.

We further find that although the Firm has recent regulatory history, the record shows that it has taken corrective actions to address the noted deficiencies. We have also considered that the Firm has complied with undertakings imposed by regulators in 2020, 2015, and 2013. We agree with Member Supervision that the Firm's history should not prevent it from continuing as a FINRA member, and conclude that, notwithstanding its regulatory history, the continued membership of the Firm is in the public interest and does not present an unreasonable risk of harm to the market or investors.

At this time, we are satisfied, based in part upon the Firm's representations, Member Supervision's representations concerning, among other things, FINRA's future monitoring of the Firm, and the record currently before us, that the Firm's continued membership in FINRA is consistent with the public interest and does not create an unreasonable risk of harm to the market or investors. Accordingly, we approve the Firm's Application to continue its membership in FINRA as set forth herein.⁷ In conformity with the provisions of Exchange Act Rule 19h-1, the continued membership

⁶ We further note that, in connection with the Final Judgment, the SEC, among other things, found good cause to grant the Firm a waiver from the disqualification provision pursuant to Rule 506(d)(2)(ii) of Regulation D under the Securities Act of 1933 and granted the Firm an exemption from the disqualification provisions set forth in Section 9(a) of the Investment Company Act of 1940.

⁷ FINRA certifies that the Firm meets all qualification requirements and is registered with the Municipal Securities Rulemaking Board, as well as the following self-regulatory organizations and exchanges that concur with the Firm's proposed continued membership: Cboe EDGX Exchange; MEMX LLC; The Nasdaq Stock Market, LLC; and DTCC, NSCC, and FICC.

of the Firm will become effective within 30 days of the receipt of this notice by the SEC, unless otherwise notified by the SEC.

On Behalf of the National Adjudicatory Council,

Jennifer Piorko Mitchell

Jennifer Mitchell Piorko
Vice President and Deputy Corporate Secretary



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Associate General Counsel

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April 20, 2021

VIA EMAIL

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Room 10915
Washington, DC 20549
apfilings@sec.gov

RE: SD-2218: In the Matter of the Continued Membership of Charles Schwab & Co., Inc.

Dear Ms. Countryman:

Enclosed please find notice pursuant to Rule 19h-1 of the Securities Exchange Act of 1934 in the matter of the continued membership of Charles Schwab & Co., Inc.

Very truly yours,

/s/ Andrew Love

Andrew Love

Enclosure

cc: Elizabeth A. Marino, Esq.
Paula Jackson
Deon McNeil-Lambkin



Andrew J. Love
Associate General Counsel

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April 20, 2021

VIA EMAIL

Elizabeth A. Marino, Esq.
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Boston, MA 02109
emarino@sidley.com

RE: SD-2218: In the Matter of the Continued Membership of Charles Schwab & Co., Inc.

Dear Ms. Marino:

Enclosed please find notice pursuant to Rule 19h-1 of the Securities Exchange Act of 1934. Subject to FINRA Rule 9524(b)(3), the notice approves Charles Schwab & Co., Inc.'s application to continue its membership with FINRA as described therein.

Please note that pursuant to FINRA Rule 9524(b)(3), the notice shall be effective only after the Securities and Exchange Commission issues an acknowledgement letter. You will receive separate notification of any subsequent acknowledgement letter.

Very truly yours,

/s/ Andrew Love

Andrew Love

Enclosure

cc: Paula Jackson
Deon McNeil-Lambkin