UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76899 / January 14, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17053

In the Matter of

Goldman, Sachs & Co.,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Goldman, Sachs & Co.("Goldman" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") 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 to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Exchange Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

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[1] The findings herein are made pursuant to Goldman's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. These proceedings arise out of practices engaged in by Goldman's Securities Lending Demand Team (the "Demand Team"), between November 2008 and mid-2013, in providing and documenting "locates" to enable its customers to execute short sales.

2. Regulation SHO Rule 203(b)(1) ("Reg SHO") prohibits broker-dealers from accepting short sale orders in equity securities or effecting short sales in equity securities for its own account unless the broker or dealer has borrowed the security, entered into a bona fide arrangement to borrow the security, or has "reasonable grounds" to believe the security can be borrowed so that it can be delivered on the delivery date. This is generally referred to as the "locate" requirement. Reg SHO also requires the broker-dealer to document its compliance with the "locate" requirement. To document compliance with the obligations under Reg SHO, broker-dealers typically create and maintain a "locate log" that documents the basis for each locate provided.

3. Between November 2008 and mid-2013, to comply with Reg SHO, Goldman employed a system where the vast majority of customer short sale locate requests were handled by an automated model that would either grant, in whole or in part (or "fill"), deny, or route (or "pend") the requests for further review to the Demand Team, a group of ten to twelve individuals who worked on Goldman's securities lending desk. The automated model would review and fill locate requests based on certain available inventory reported to Goldman by certain lending banks and brokerages that fed into Goldman's automated model at the start of each day after being reduced by Goldman based on their experience with various lenders (the "start-of-day inventory"). As the automated model processed locate requests, it reduced that start-of-day inventory on a 1:1 basis for all shares that were used to grant locate requests (regardless of whether the client actually used the locate). When the start-of-day inventory was depleted in that manner, the automated model would pend subsequent locate requests to the Demand Team for further review and processing.

4. Over the course of the relevant period, the number of locate requests that pended to the Demand Team grew significantly, reaching more than 20,000 locate requests per day at its peak. The volume of locate requests became far more than the Demand Team could manually handle on a request-by-request basis. Thus, instead of manually identifying an alternative source of securities to satisfy these pended requests, the Demand Team processed approximately 98 percent of the pended requests by relying on a function of Goldman's order management system referred to as "fill from autolocate," which was activated by the "F3" key. This function enabled the Demand Team to cause Goldman's automated model to fill locate requests based on the amount of inventory that existed at the start of the day (i.e., the start-of-day inventory level before any locates were granted), even though Goldman's automated model had already treated the start-of-day inventory as depleted.

5. In processing locate requests using the "F3" function, the Demand Team typically did not check alternative sources of securities or perform a meaningful further review. Instead, they relied on their general belief that Goldman's automated model was conservative and that the provision of additional locates would not result in failures to deliver the securities if and when due for settlement. The Demand Team did not document the basis for this general belief.

6. Additionally, Goldman's documentation of its compliance with Reg SHO in its locate log was inaccurate in that Goldman failed to sufficiently differentiate between locates that were filled by its automated model and locates that were filled by the Demand Team using the "F3" function. In both cases, the locate log simply contained the term "autolocate" to refer to the start-of-day inventory utilized by Goldman's automated model as the source of securities supporting the locate.

Respondent

7. Goldman, headquartered in New York, New York, is dually-registered with the Commission as a broker-dealer and investment adviser. Goldman is a wholly-owned subsidiary of The Goldman Sachs Group, Inc., whose securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act. The activity that is the subject of this Order pertains to the securities lending desk within the broker-dealer side of Goldman's business.

Background

Goldman's System for Complying with Reg SHO

8. Between November 2008 and mid-2013, to comply with its Reg SHO locate requirements, Goldman employed a system where the vast majority of customer short sale locate requests were handled by an automated model. The automated model was designed to grant, in whole or in part, or deny locate requests that met certain criteria, and route to the Demand Team the remaining requests for further review and processing. The Demand Team also received and processed a small number of locate requests that were submitted directly to the Demand Team by clients via telephone or instant messaging that generally bypassed the automated model.

9. Goldman used certain control lists and an automated model to process the vast majority of locate requests it received each day. Locate requests for securities on control lists, including an "easy-to-borrow" list, and more than a dozen lists of securities in which Goldman believed there could be a meaningful risk of delivery failure, were automatically filled or denied.

10. Locate requests for securities not on a control list were processed through Goldman's automated model. The automated model would determine whether to fill a locate request in whole or in part or pend it to the Demand Team for further review and processing. This determination was made based on the amount of inventory the automated model recognized as available for borrowing. The inventory available for filling locate requests through the automated model was based on the amount of inventory reported to Goldman by certain lender banks and brokerages. This inventory was reported to Goldman, and other major brokerages that fill locate requests, once each day several hours before the markets opened. Upon receiving the report of available inventory, Goldman would generally apply a "haircut" to (or reduce) each lender's reported inventory. Goldman would then aggregate the remaining inventory and use it—the start-of-day inventory—as the exclusive source for its automated model to fill locate requests.

11. As Goldman's automated model filled locate requests from the start-of-day inventory, it would simultaneously reduce that start-of-day inventory based upon the number of shares for which locates had been granted. Goldman referred to this reduction as the "utilization rate." Between November 2008 and mid-2013, Goldman applied a 100-percent utilization rate to

the start-of-day inventory used by the automated model, even though Goldman's clients' actual utilization rate was substantially lower and understood by Goldman to be a small fraction of that. This meant that for each locate request granted, Goldman decreased the start-of-day inventory by the corresponding number of shares granted.

12. Between November 2008 and mid-2013, using its control lists and the automated model, Goldman filled, in whole or in part, or denied the vast majority of the locate requests it received, which increased over time and peaked at approximately 250,000 locate requests per day.

The Demand Team Routinely Sourced Locates to Inventory Treated as Depleted

13. When Goldman's automated model treated the start-of-day inventory for a particular security as depleted (based on the provision of locates equal to that start-of-day inventory amount), it was programmed to pend further locate requests in that security to the Demand Team for further review and processing.[2] Over the course of the relevant period, the number of locate requests pended by the automated model to the Demand Team grew significantly, reaching more than 20,000 locate requests per day at its peak.[3]

14. After Goldman's automated model treated the start-of-the-day inventory as depleted (based on the 1:1 utilization rate), the Demand Team's review should have consisted of conducting a further review of the requests and attempting to identify additional sources of inventory for the pended locate requests, such as loan returns, firm long positions, and customer margin, or contacting lenders to identify additional supply of the securities Goldman's customers sought to locate. The Demand Team, however, did not conduct such further review on approximately 98 percent of locate requests pended to it by Goldman's automated model. Instead, before the markets opened, the Demand Team routinely processed thousands of pended locate requests by using the "fill from autolocate" function of Goldman's order management system, which was accessed via the "F3" key.

15. The "fill from autolocate" function enabled Demand Team members to select as many of the locate requests routed to it from Goldman's automated model as desired (for certain customers, 3,000 to 4,000 locate requests were sometimes selected at one time) and hit the "F3" key to process the selected requests with one keystroke. For example between 6:45 a.m. and 7:45 a.m. each day, on average, the Demand Team filled locate requests for several thousand unique CUSIPs. Additionally, in one instance, a Demand Team member granted over 5,486 locates in a 35-minute period.

16. After a Demand Team member selected "F3," the locate request would be filled by reference to the initial amount included in the start-of-day inventory for the security in question. Thus, each locate request filled using this function would cause the automated model to fill the selected locate requests based on inventory amounts that existed at the start of the day even though the automated model had treated that start-of-day inventory as depleted. The Demand Team used

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[2] Locate requests could pend for reasons other than the automated model treating start-of-day inventory as depleted, but such pends constituted a small minority of the daily pended locate requests.

[3] This significant increase in the number of pended locate requests was due, in part, to the increased use by Goldman's clients of bulk locate request lists that could contain many thousands of locate requests daily.

the "F3" function as a means to compensate for the large volume of locate requests pended to them by Goldman's automated model.

17. Before using the "F3" function, the Demand Team did not typically conduct additional review or identify other sources of inventory for the securities sought to be located, such as loan returns, firm long positions, or customer margin. Instead, they relied on their general belief that Goldman's automated model was conservative and that the provision of additional locates would not result in failures to deliver the securities if and when due for settlement. The Demand Team did not document the basis for this general belief. Although no rationale was documented in Goldman's locate log or in any contemporaneous documentation, the Demand Team's belief that the model was conservative was based on their familiarity with their client's low utilization rates and that Goldman's rate of failures remained low and did not substantially change between November 2008 and mid-2013.[4]

18. On numerous occasions, the start-of-day inventory supporting locate requests filled using the "F3" function had already been treated as depleted prior to the Demand Team filling the locate requests. In some cases, the Demand Team continued to provide locates for millions of shares after the start-of-day inventory for such securities had been treated as depleted. Further, in many instances, the Demand Team used the "F3" function to fill locate requests for securities that were included on a threshold securities[5] list, which signifies that such securities in which a substantial amount of fails to deliver have occurred and, as such, are considered generally hard to borrow. Specifically, using the F3 function, the Demand Team filled approximately 488 locate requests in threshold securities each day.

19. As a result, between November 2008 and mid-2013, certain short sales were executed by Goldman in reliance on locates provided by Goldman, without reasonable grounds to believe that the securities to be sold short could be borrowed to meet its delivery obligations.

Goldman's Locate Logs Were Inaccurate as to the Source Supporting Certain Locates

20. Goldman's locate logs were inaccurate with respect to the source supporting the locate requests it filled using the "F3" function. All locate requests were assigned a unique identifying number and were automatically logged in Goldman's locate log. The locate log included the details of the locate request, such as the identity of the customer making the locate request, the security, the amount requested to be located, and the date and time of the request. The locate log also included the details of the request's processing, such as who filled each locate

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[4] During that time period and subsequently, Goldman was generally able to meet its settlement obligations. Securities in which Goldman experienced fails to deliver were added to control lists, and locate requests in those securities were denied by the automated model.

[5] Threshold securities, as defined in Rule 203(c)(6) of Regulation SHO, are equity securities of an issuer that is registered pursuant to Section 12 of the Exchange Act or for which the issuer is required to file reports pursuant to Section 15(d) of the Exchange Act that have an aggregate fail to deliver position for (i) five consecutive settlement days at a registered clearing agency (e.g., National Securities Clearing Corporation); (a) totaling 10,000 shares or more; and (b) equal to at least 0.5% of the issuer's total shares outstanding and (ii) that is included on a list disseminated to its members by a self-regulatory organization. See http://www.sec.gov/investor/pubs/regsho.htm (last accessed November 23, 2015); see also Exchange Act Rel. No. 50103 (Jul. 28, 2004), 69 FR 48008, 48014 n. 62 (Aug. 6, 2004) ("Of course, securities that are 'threshold securities' pursuant to Rule 203(c) should generally not be included on 'Easy to Borrow' lists.")

request, the amount of the security located, the source, date, and time the request was filled or denied.

21. From November 2008 to mid-2013 Goldman's locate logs were inaccurate in that they failed to sufficiently differentiate between locates that were filled by its automated model versus locates that were filled as a result of the Demand Team's use of the "F3" function. In both cases, the locate log simply contained the term "autolocate" to refer to the aggregate inventory utilized by Goldman's automated model as the source of securities supporting the locate. The source of the security, however, was different for these different types of locates. When Goldman's automated model filled a locate request, the source of securities supporting the request was the start-of-day inventory. Conversely, when it was filled by the Demand Team using the "F3" function, the start-of-day inventory was treated as depleted and no alternative source of the security was identified.

Goldman Identified the Need to Change Its Automated Model in 2011

22. Although the Demand Team's use of the "F3" function continued through at least mid-2013, Goldman first identified the need to change its automated model in early 2011. Specifically, in early 2011, Goldman learned that the logic of its legacy automated model was causing substantially more locate requests to pend for Demand Team review than the Demand Team could handle on a request-by-request basis. Starting in early 2011, Goldman began planning to enhance the automated model. Over the next two and a half years, Goldman developed, tested, and implemented a new automated model. During this time, however, Goldman did not modify the Demand Team's use of the "F3" function in granting locate requests.

Goldman's Response to OCIE

23. In responding to an examination of its securities lending practices in 2013 by the Commission's Office of Compliance Inspections and Examinations ("OCIE"), Goldman provided responses to requests for information and findings made by OCIE examiners that were incomplete and unclear. In responding to a deficiency letter from OCIE, Goldman's response letter created the incorrect impression that the Demand Team conducted an individualized review for all locate requests pended to it from Goldman's automated model. Further, in the same letter, Goldman described the automated portion of its *current* system for filling locate requests in a manner that did not make clear the fact that it was Goldman's *legacy* automated model that was causing the high volume of locate requests to pend to the Demand Team.

24. OCIE's examination was adversely affected and unnecessarily prolonged as a result of Goldman's responses to OCIE's requests. In determining the appropriate resolution to this matter, the Commission considered, in addition to the underlying conduct, these deficiencies in Goldman's responses to OCIE staff.

<u>Goldman's Remedial Efforts</u>

25. In determining to accept the Offer, the Commission considered remedial acts undertaken by Goldman. By at least mid-2013, Goldman had phased out the use of its legacy automated model and implemented a new automated model with logic that substantially reduced the number of locate requests pended for Demand Team review. Additionally, Goldman implemented revised written policies and procedures governing the processing of locate requests

pended to the Demand Team. Shortly after the conclusion of the OCIE examination Goldman also discontinued the use of the autolocate functionality. Demand Team members are now required to locate a specific source of inventory for each locate request and to identify that source in the locate log.

Violations

26. As a result of the conduct described above, Goldman willfully[6] violated Rule 203(b)(1) of Regulation SHO promulgated under the Exchange Act, which provides, in relevant part, that before executing short sales, brokers or dealers must have "reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due."

27. As a result of the conduct described above, Goldman willfully violated Section 17(a) of the Exchange Act and Rule 203(b)(1)(iii) of Regulation SHO promulgated thereunder. Section 17(a) of the Exchange Act requires brokers and dealers, among others, to make, keep, and furnish to the Commission such records as the Commission prescribes by rule. Rule 203(b)(1)(iii) of Regulation SHO requires that brokers or dealers document compliance with Rule 203(b)(1) of Regulation SHO. The document fulfilling this documentation requirement is commonly referred to as a "locate log." Inherent in the recordkeeping requirements of Section 17(a) of the Exchange Act and Rule 203(b)(1)(iii) of Regulation SHO is a requirement that the records be complete and accurate.

IV.

In view of the foregoing, the Commission deems it appropriate, and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Rule 203(b)(1) of Regulation SHO promulgated under the Exchange Act, and any violations and any future violations of Section 17(a) of the Exchange Act and Rule 203(b)(1)(iii) thereunder relating to short sale locate records.

B. Respondent is censured.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $15,000,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

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[6] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" 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, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Goldman as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Charles Riely, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, New York 10281.

By the Commission.

Brent J. Fields
Secretary