

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 82533 / January 18, 2018**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-18341**

<b>In the Matter of</b>	:	<b>ORDER INSTITUTING ADMINISTRATIVE</b>
	:	<b>AND CEASE-AND-DESIST PROCEEDINGS,</b>
	:	<b>PURSUANT TO SECTIONS 15(b) AND 21C OF</b>
<b>Industrial and Commercial</b>	:	<b>THE SECURITIES EXCHANGE ACT OF</b>
<b>Bank of China Financial</b>	:	<b>1934, MAKING FINDINGS, AND IMPOSING</b>
<b>Services LLC</b>	:	<b>REMEDIAL SANCTIONS AND A CEASE-</b>
	:	<b>AND-DESIST ORDER</b>
<b>Respondent.</b>	:	
	:	
	:	

**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”).

**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 Securities Exchange Act of 1934, 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<sup>1</sup> that:

### **Summary**

ICBCFS is a broker-dealer and participant of the Depository Trust Company, a registered clearing agency. As such, ICBCFS provides equity clearing services to a wide range of institutional clients. In providing those services, ICBCFS has obligations under Regulation SHO to close out its Continuous Net Settlement ("CNS") fails to deliver.<sup>2</sup> From April 2013 until August 2016, ICBCFS failed to close out certain CNS fails to deliver because it improperly claimed credit against its close-out obligations while not meeting the requirements of Rule 204(e). As a result, ICBCFS repeatedly violated Rule 204(a) of Regulation SHO.

### **Respondent**

1. ICBCFS, headquartered in New York, New York, is registered with the Commission as a broker-dealer. ICBCFS is a wholly owned subsidiary of the Industrial and Commercial Bank of China Limited. The activity that is the subject of this Order pertains to ICBCFS's broker-dealer activities as a participant of a registered clearing agency.

### **Background**

#### **Rule 204 of Regulation SHO**

2. Regulation SHO was adopted, in part, to address problems associated with persistent fails to deliver.<sup>3</sup> Rule 204 of Regulation SHO imposes close-out requirements for fails to deliver resulting from sales of equity securities.<sup>4</sup> Rule 204(a) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency, the participant must purchase or borrow securities of like kind and quantity to close-out the fail to

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> CNS is a method of clearing and settling securities transactions through the National Securities Clearing Corporation that results in net receives or net deliveries of securities and funds. All references to fails to deliver in this Order refer to CNS fails to deliver in equity securities.

<sup>3</sup> "The rule is designed to help ensure that buyers of equity securities receive delivery of their shares, thereby helping to discourage persistent fails to deliver, which may have a negative effect on the securities markets and investors . . ." Exchange Act Release No. 34-60388, 74 FR 38266 at 38289 (Jul. 31, 2009) ("Rule 204 Adopting Release").

<sup>4</sup> See Exchange Act Release No. 34-60388, 74 FR 38266 at n.35 (Jul. 31, 2009) ("Rule 204 Adopting Release"). The review period pre-dates the Commission's adoption of the T+2 settlement cycle for securities transactions. Therefore, during the review period, investors generally completed or settled their security transactions within three settlement days, which is known as T+3 (or "trade date plus three days").

deliver position. For short sales, the participant must do this by no later than the “beginning of regular trading hours on the settlement day following the settlement date” (i.e., T+4).<sup>5</sup>

3. In addition to the T+4 close-out requirement for short sales, the close-out requirement is T+6 for fails to deliver resulting from long sales and bona fide market making activity. Specifically, Rule 204(a)(1) provides that if the participant can demonstrate on its books and records that such fail to deliver position resulted from a long sale, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date (i.e., T+6) immediately close-out the fail to deliver position by purchasing or borrowing securities of like kind and quantity. Rule 204(a)(3) provides that if the fail to deliver position is attributable to bona fide market making activities by a registered market maker, options market maker, or other market maker obligated to quote in the over-the-counter market, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date (i.e., T+6), immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity.

4. Rule 204(e) allows a broker-dealer to claim pre-fail credit for certain purchases or borrows in advance of the applicable close-out deadline. Specifically, Rule 204(e) provides that even if a participant of a registered clearing agency has not closed-out a fail to deliver position at a registered clearing agency in accordance with Rule 204(a), or has not allocated a fail to deliver position to a broker-dealer in accordance with Rule 204(d), a broker-dealer shall not be subject to the requirements of Rule 204(a) or (b) if the broker-dealer purchases or borrows the securities, and complies with the conditions set forth in Rule 204(e)(1) through (4).<sup>6</sup> Rule 204(e)(1) through (4) requires that (1) the purchase or borrow is bona fide; (2) the purchase or borrow must be executed after trade date but by no later than the end of regular trading hours on settlement date (i.e., T+3) for the transaction (i.e., on T+1, T+2 or T+3); (3) the purchase or borrow must be of a quantity of securities sufficient to cover the entire amount of that broker or dealer’s fail to deliver position at a registered clearing agency in that security; and (4) the broker or dealer that is purchasing or borrowing securities must be able to demonstrate on its books and records that it is net flat or net long in that security on the day of the purchase or borrow.

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<sup>5</sup> 17 C.F.R. 242.204(a). The close-out requirement requires that a participant take affirmative action to close out its fail to deliver position by purchasing or borrowing securities and does not permit the participant to offset the amount of its fail to deliver position with shares that the participant receives or will receive during the applicable close-out date (i.e., during T+4 or T+6, as applicable). In addition, to meet its closeout obligation a participant also must be able to demonstrate on its books and records that on the applicable close-out date, it purchased or borrowed shares in the full quantity of its fail to deliver position and, therefore, that the participant has a net flat or net long position on its books and records on the applicable close-out date (i.e., during T+4 or T+6, as applicable). Rule 204 Adopting Release, 74 FR at 38272. Where a participant subject to the close-out requirement purchases or borrow securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant’s fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement. *See id.* at 38272 n.82.

<sup>6</sup> 17 C.F.R. 242.204(e).

## **ICBCFS's Rule 204 Practices and Procedures**

5. ICBCFS's Rule 204 procedures included the creation of a list (the "Rule 204 Action Items List") that (a) identified the securities with respect to which ICBCFS had a fail to deliver position; (b) identified the correspondent broker-dealers who caused or contributed to the fail to deliver position; and (c) indicated the applicable close-out date for each fail to deliver position and whether such applicable close-out date was T+4 or T+6. ICBCFS personnel responsible for Rule 204 compliance used the Rule 204 Action Items List to track ICBCFS's Rule 204 close-out obligations.

6. In advance of the applicable close-out deadline, ICBCFS notified the correspondent broker-dealers who had caused a particular fail to deliver position that ICBCFS would attempt to borrow securities in order to cover that fail to deliver position. ICBCFS further notified the correspondent broker-dealers that, if it was unable to borrow to cover the fail to deliver position, the fail to deliver position would be closed out by the applicable deadline. The cost of those close outs then would be passed on to the correspondent broker-dealer causing the fail to deliver position.

7. In order to avoid these costs, ICBCFS's correspondent broker-dealers often asked ICBCFS to claim credit against its close-out obligation due to purchases the correspondent broker-dealers claimed to have effected prior to or on the close-out date. Based on these credit claims, ICBCFS removed the securities from its Rule 204 Action Items List and took no further close-out action relating to the fail to deliver position in that security. As a result, when the Rule 204(a) deadline arrived, ICBCFS did not take any affirmative action to close-out.

8. In more than 4,000 instances between April 2013 and August 2016, ICBCFS claimed credit against its close-out obligations even though it did not meet the requirements of Rule 204(e). Specifically, ICBCFS claimed credit based on purchases that occurred after the settlement date for the transaction when Rule 204(e) only allows credit for purchases occurring "no later than the end of regular trading hours" on the settlement date.<sup>7</sup> ICBCFS also claimed credit for purchases that only partially covered its fail to deliver positions even though Rule 204(e) requires that the purchases cover "the entire amount" of the fail to deliver position on T+1, T+2, or T+3.<sup>8</sup> Finally, ICBCFS claimed credit for purchases on days when it had a net short position on its books and records even though Rule 204(e) only allows credit if the participant can "demonstrate that it has a net flat or net long position on its books and records on the day of the purchase or borrow."<sup>9</sup>

9. Additionally, ICBCFS in certain circumstances incorrectly double-counted purchases for credit against its close-out obligations. For example, ICBCFS incurred four consecutive fails to deliver in shares of Growlife Inc. (PHOT) – with a corresponding series of

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<sup>7</sup> 17 C.F.R. 242.204(e)(2).

<sup>8</sup> 17 C.F.R. 242.204(e)(3).

<sup>9</sup> 17 C.F.R. 242.204(e)(4).

four separate Rule 204(a) close-out obligations – from January 13, 2014 through January 16, 2014. The cumulative amount of the four separate close-out obligations was 935,261 shares. ICBCFS claimed full credit against each of the four separate close-out obligations based on purchases that totaled only 264,696 shares.<sup>10</sup> The only way for those purchases to cover the full amount of ICBCFS’s four close-out obligations was to double-count (or even quadruple-count) those purchases.

10. This double-counting of purchases for credit resulted in prolonged fails to deliver:

Security	Amt. of Fail	Date of Fail	Close-Out Date	Duration of Fail
PHOT	791,335	1/13/14	1/16/14	T+34
PHOT	13,047	1/14/14	1/17/14	T+33
PHOT	97,833	1/15/14	1/21/14	T+39
PHOT	33,046	1/16/14	1/22/14	T+41

11. ICBCFS also claimed credit based on reported purchases that never occurred. In many instances, ICBCFS’s correspondent broker-dealers claimed they were going to purchase shares sufficient to cover ICBCFS’s fail to deliver position, but never did so. Based on these claimed (but never effected) purchases, ICBCFS took the securities off of its Rule 204 Action Items list and did not take the required Rule 204(a) close-out action.

12. In other instances, ICBCFS’s correspondent broker-dealers made purchases sufficient to cover ICBCFS’s close-out obligations, but then, unbeknownst to ICBCFS, immediately sold the same securities in the same amount, thus re-establishing their (and ICBCFS’s) fail to deliver position. ICBCFS incorrectly claimed credit against its Rule 204(a) close-out obligations based on the initial purchases, notwithstanding the off-setting sales.<sup>11</sup>

13. ICBCFS had institutional knowledge of its prolonged fail to deliver positions resulting from its incorrect claims of credit against its Rule 204(a) close-out obligations. ICBCFS generated an internal, daily report called the “Aged CNS Fails” report. That report documented numerous instances of prolonged fail to deliver positions caused by ICBCFS’s Rule

<sup>10</sup> ICBCFS had net purchases of PHOT in the following amounts: 24,922 shares on January 14, 2014; 195,274 shares on January 15, 2014; 32,000 shares on January 17, 2014; and 12,500 shares on January 21, 2014.

<sup>11</sup> Rule 204(e) does not permit credit in such circumstances – in order to claim credit, the participant must be able to “demonstrate that it has a net flat or net long position on its books and records on the day of the purchase or borrow.” 17 C.F.R. 242. 204(e)(4).

204(a) deficiencies. Although ICBCFS had the Aged CNS Fails report from April 2013 forward, it did not review the report to identify prolonged fail to deliver positions as part of its Rule 204(a) compliance until January 2015.

14. As a result of the conduct described above, ICBCFS willfully violated Rule 204(a) of Regulation SHO, which requires participants of registered clearing agencies to close-out CNS failures to deliver resulting from sales of equity securities by the beginning of regular trading hours on T+4 in the case of short sales, and T+6 in the case of long sales and bona fide market making activity.<sup>12</sup>

15. In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent and cooperation afforded the Commission staff.

#### **Undertakings**

16. Respondent undertakes to cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order.

#### **IV.**

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

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

A. Respondent ICBCFS cease and desist from committing or causing any violations and any future violations of Rule 204(a) of Exchange Act Regulation SHO.

B. Respondent ICBCFS is censured.

C. Respondent ICBCFS shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$1,250,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to 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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<sup>12</sup> 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 ICBCFS 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 Robert A. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington DC, 20549.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary