UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 82898 / March 19, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18406

In the Matter of **ELECTRONIC TRANSACTION CLEARING, INC.** **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 Electronic Transaction Clearing, Inc. ("ETC" 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 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[1] that:

Summary

1. These proceedings arise out of ETC's violations of Sections 15(c)(2), 15(c)(3) and 17(a)(1) of the Exchange Act and Rules 15c2-1(a), 15c3-3 and 17a-5 thereunder. Rule 15c3-3, known as the "Customer Protection Rule," seeks to avoid, in the event of a broker-dealer failure, a delay in returning the customer's securities or worse, a shortfall where the customers are not made whole. It accomplishes this by requiring broker-dealers to safeguard the cash and securities of their customers, and by requiring a broker-dealer to maintain physical possession or control of its customers' fully paid and excess margin securities. Physical possession or control generally means that the broker-dealer must hold these securities in a location specified by the rule and that the securities be free of any liens or other interest that a third-party could exercise to secure an obligation of the broker-dealer. Paragraph (a)(1) of Rule 15c2-1, known as one of the hypothecation rules, generally provides that a broker-dealer may not, without prior customer consent, hypothecate or pledge as collateral a customer's securities in a way that would allow the securities to be commingled with other customers' securities. In addition, paragraph (a) of Rule 17a-5, known as the financial reporting rule, requires broker-dealers to file monthly and quarterly FOCUS Reports and annual financial reports,[2] and paragraph (d)(2)(ii) of Rule 17a-5 requires broker-dealers to file supporting schedules to its annual financial reports that include information contained in the FOCUS Reports relating to the possession and control requirements under Rule 15c3-3.

2. On several occasions in November and December 2015, ETC moved approximately $7.8 million in cash customers' fully paid securities to its omnibus margin account maintained at another clearing firm ("Clearing Firm A"), to meet the in-house margin requirements of that clearing firm. Also, on three occasions in September and November 2015, ETC delivered fully paid securities of two cash customers valued at over $17.77 million from its Depository Trust Company ("DTC") account to Clearing Firm A's DTC account in exchange for immediate funds. And in December 2015, ETC failed to properly segregate a customer's excess margin securities, causing approximately $17.7 million of the customer's excess margin securities to be loaned out by Clearing Firm A. ETC did not obtain the customers' consent before moving or pledging these securities. In doing so, ETC violated the Customer Protection Rule and the hypothecation rules.

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[1] 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.

[2] A FOCUS Report is a "Financial and Operational Combined Uniform Single Report" (Form X-17A-5) that is filed by a registered broker-dealer with the Commission or the broker-dealer's designated examining authority. *See* 17 CFR 240.17a-5(a). FOCUS Reports are the basic financial and operational reports of broker-dealers registered with the Commission, and require a broker-dealer to report its balance sheet, income statement, statement of changes in ownership equity, and net capital calculation.

ETC's failure to obtain and maintain physical possession or control of customer assets also caused it to violate the financial reporting rule, because it failed to report such possession or control failures in its monthly and quarterly FOCUS Reports and the supporting schedule to its annual financial report for 2015.

Respondent

3. **Electronic Transaction Clearing, Inc.** ("ETC") is a Delaware corporation with its principal place of business in Los Angeles, California. ETC has been registered with the Commission as a broker-dealer since June 2008 and is a member of the Financial Industry Regulatory Authority, Inc. ETC is a privately held company and a wholly-owned subsidiary of ETC Global Holdings, Inc.

Customer Protection, Hypothecation, and Financial Reporting Rules

6. Section 15(c)(3)(A) of the Exchange Act authorizes the Commission to prescribe rules relating to the "acceptance of custody and use of customers' securities and the carrying and use of customers' deposits or credit balances" and states that no broker-dealer shall induce or attempt to induce any purchase or sale of securities in contravention of these rules. Rule 15c3-3 was promulgated under this statutory provision and is designed to prevent broker-dealers from using or risking customer funds or securities in a manner inconsistent with the rule.

7. Rule 15c3-3 requires a carrying broker-dealer to promptly obtain and thereafter maintain physical possession or control over customers' fully paid and excess margin securities. 17 CFR 240.15c3-3(b). As defined in the rules, "fully paid securities" are securities that have been fully paid for and are not being pledged as collateral to other securities on margin, "margin securities" are securities that have been bought on margin, and "excess margin securities" are securities whose value exceeds 140% of the debt balance in the account. *See* 17 CFR 250.15c3-3(a)(3)-(5).

8. Physical possession or control generally means that a broker-dealer must hold customer securities in one of several "good control" locations specified in Rule 15c3-3(c). The securities must also be free and clear of liens or any other interest that could be exercised by a third-party to secure an obligation of the broker-dealer. 17 CFR 240.15c3-3(c). In addition, a broker-dealer is required to review its books and records each day in order to determine the quantity of fully paid or excess margin securities it holds for its customers, to determine if these securities are not in its possession or control and, if they are not, to initiate steps to obtain their possession or control. *See* 17 C.F.R. § 240.15c3-3(d)(1)-(4). Moreover, Rules 17a-5(a) and 17a-5(d)(2)(ii), promulgated under Exchange Act Section 17(a)(1), require broker-dealers to file FOCUS Reports and to file supporting schedules to its annual financial reports and FOCUS Reports related to the Rule 15c3-3 possession and control requirements.

9. Section 15(c)(2)(A) of the Exchange Act generally prohibits broker-dealers from inducing or attempting to induce the purchase or sale of any security by means of any fraudulent, deceptive, or manipulative act or practice. Section 15(c)(2)(D) provides that the Commission shall, by rules and regulations, "define and prescribe means reasonably designed to prevent such

acts and practices . . . ." One of those rules is Rule 15c2-1(a)(1), which specifically states that fraudulent, deceptive or manipulative acts or practices include the direct or indirect hypothecation by a broker or dealer of "any securities carried for the account of any customer" that would "permit the commingling of securities" without the customer's consent.

Facts

10. ETC is a registered broker-dealer that provides high volume execution and clearing services to customers. It is considered a carrying broker-dealer because it maintains custody of its customers' securities and cash.

11. ETC has arrangements with other clearing firms to provide clearing services for ETC and some of its large-position customers. ETC has an omnibus clearing agreement with Clearing Firm A, under which ETC carried two omnibus margin accounts for certain ETC customers ("Omnibus Margin Accounts"). The margin account customers would trade securities at ETC during the day, and ETC would then place those securities into the Omnibus Margin Accounts at Clearing Firm A at the end of day.

12. Under the arrangement with Clearing Firm A, ETC, on behalf of its customers, was required to meet Clearing Firm A's margin requirements for these Omnibus Margin Accounts. One of the terms of the arrangement was that Clearing Firm A held a first priority lien on all of the securities in the Omnibus Margin Accounts, except for any fully paid or excess margin securities that were specifically identified by ETC as securities that should be segregated from the other securities in the accounts. Toward that end, at the end of each trading day, ETC would send Clearing Firm A a list of those securities that should be segregated.

13. On several occasions in late 2015, ETC moved its cash customers' fully paid securities into an Omnibus Margin Account to meet Clearing Firm A's margin requirements or to borrow money to address liquidity needs. In each case, ETC failed to maintain possession or control over these securities and subjected them to liens by Clearing Firm A. The aggregate market value of these securities was about $25.5 million.

14. On six separate occasions from November 10, 2015 to December 31, 2015, ETC moved the fully paid securities of eight cash customers to one of the Omnibus Margin Accounts at Clearing Firm A. These fully paid securities were commingled with other customers' securities in the applicable Omnibus Margin Account. As of December 31, 2015, the securities were valued at approximately $7.8 million. At no point did ETC obtain consent from the customers before moving the securities to the Omnibus Margin Account. Moving these securities and commingling them in the Omnibus Margin Account allowed ETC to meet Clearing Firm A's margin requirements.

15. On three occasions in September and November 2015, ETC delivered fully paid securities of two cash customers from its DTC account to Clearing Firm A's DTC account in exchange for immediate funds. The market value of these securities was over $17.77 million. ETC made these transactions on a "delivery versus payment," or "DVP," basis. This means that when it moved the securities from its DTC account to Clearing Firm A's DTC account, ETC was

credited funds at DTC while Clearing Firm A was debited funds at DTC. In other words, ETC used its cash customers' securities to borrow money from Clearing Firm A. After the securities were transferred to Clearing Firm A's DTC account, they were transferred into one of the Omnibus Margin Accounts. As a result, these securities were also commingled with other customers' securities in those margin accounts. ETC did not disclose to its cash customers that it borrowed money using their fully paid securities as collateral or that a lien would be placed on their securities.

16. ETC also failed to determine if the fully paid or excess margin securities of its customers were truly in the firm's possession or control, and failed to initiate steps to obtain possession or control of those securities. ETC had generally considered any security it identified in its segregation instructions to Clearing Firm A to be under ETC's possession or control, even when the securities were moved into the Omnibus Margin Account or DTC accounts of Clearing Firm A. By doing so, ETC failed to accurately determine the quantity of fully paid securities and excess margin securities in its possession or control and the quantity of fully paid securities and excess margin securities not in its possession or control.

17. In addition, in December 2015, because of a system error, ETC did not correctly code the proper amount of a customer's excess margin securities that needed to be segregated from Clearing Firm A's margin requirements. As a result, ETC caused approximately $17.7 million of this customer's excess margin securities to be subject to Clearing Firm A's lien and loaned out by Clearing Firm A to other firms. ETC discovered the error on Friday December 11, 2015, and notified Clearing Firm A about the problem on Monday December 14, 2015. Clearing Firm A could not get all the securities returned from the stock loan until December 18, 2015.

18. In its monthly and quarterly FOCUS Reports filed at the time and in the supporting schedules filed with the firm's annual financial report for 2015, ETC did not report its failure to maintain possession or control of its customers' fully paid securities that were moved over to the Omnibus Margin Accounts or to Clearing Firm A's DTC account, or its failure to segregate a customer's excess margin securities.

Violations

19. As a result of the conduct described above, ETC willfully[3] violated Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder, which, among other things, requires a carrying broker-dealer to promptly obtain and thereafter maintain physical possession or control over customers' fully paid and excess margin securities, and to review its books and records in order to determine the quantity of fully paid or excess margin securities it holds for its customers, to

[3] 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)).

determine if these securities are not in its possession or control and, if they are not, to initiate steps to obtain their possession or control.

20. As a result of the conduct described above, ETC willfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-1(a)(1) thereunder, which generally prohibits broker-dealers from inducing or attempting to induce the purchase or sale of securities through fraud and generally prohibits the hypothecation of any securities carried for the account of a customer without the customer's consent.

21. As a result of the conduct described above, ETC also willfully violated Section 17(a)(1) of the Exchange Act and Rules 17a-5(a) and 17a-5(d)(2) thereunder, which require broker-dealers to file FOCUS Reports and supporting schedules related to the Rule 15c3-3 possession and control requirements.

ETC's Remedial Efforts

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

IV.

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

Accordingly, pursuant to Sections 15(b)(4) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent ETC cease and desist from committing or causing any violations and any future violations of Sections 15(c)(2) and (3), and 17(a)(1) of the Exchange Act, and Rules 15c-2(a)(1), 15c3-3 and 17a-5 thereunder.

B. Respondent ETC is censured.

C. Respondent ETC shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $80,000, 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:

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

(2) ETC 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) ETC 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 ETC 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 John Berry, Division of Enforcement, Securities and Exchange Commission, 444 S. Flower St., Suite 900, Los Angeles, CA 90071.

E. 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