

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Continued Membership
of
RBS Securities Inc.
with
FINRA

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

SD-2026

Date: June 17, 2016

I. Introduction

On February 5, 2014, RBS Securities Inc. (“RBS” or the “Firm”) submitted a Membership Continuance Application (“MC-400A” or the “Application”) to FINRA’s Department of Registration and Disclosure. 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 Regulation (“Member Regulation”) recommends that the Chair 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

RBS is subject to a statutory disqualification as a result of a Final Judgment entered on November 25, 2013 by the United States District Court for the District of Connecticut (the “Final Judgment”) that permanently enjoined the Firm from violating Sections 17(a)(2) and (3) of the Securities Act of 1933 (the “Securities Act”) in the offer or sale of any security.¹

The Final Judgment resulted from a complaint (the “Complaint”) filed by the SEC on November 7, 2013, alleging that RBS made misstatements and omissions in its

¹ Section 3(a)(39)(F) of the Securities Exchange Act of 1934 (“Exchange Act”), incorporating 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 in connection with the purchase or sale of any security.

offering documents for a 2007 offering of a subprime residential mortgage-backed security (“RMBS”). The SEC alleged that RBS misled investors about the quality and safety of subprime loans that comprised the RMBS. Specifically, the Complaint stated that RBS hired a third party to conduct due diligence on a small sample of subprime mortgages that RBS purchased to later securitize and offer to investors. The due diligence revealed that a large number of the sampled loans did not meet the mortgage lender’s underwriting guidelines. Although RBS excluded from the offering those loans identified in the sample as materially failing to meet guidelines, the SEC alleged that the Firm knew or should have known that it was likely that a substantial number of additional loans underlying the offering materially deviated from the mortgage lender’s underwriting guidelines. RBS included a representation in its prospectus supplement that the subprime loans included in the offering were “generally” in compliance with the mortgage lender’s underwriting guidelines. The SEC alleged that this representation was false or misleading because the Firm’s due diligence showed that almost 30 percent of the underlying loans deviated so much from the underwriting guidelines that they should have been excluded from the offering. Ultimately, the RMBS performed poorly, and the SEC alleged that investors lost at least \$80 million as of the date the Complaint was filed. By engaging in the conduct described above, the SEC charged RBS with violating Securities Act Sections 17(a)(2) and 17(a)(3).

On November 25, 2013, without admitting or denying the allegations in the Complaint, RBS consented to the entry of the Final Judgment. In addition to enjoining RBS, the Final Judgment ordered RBS to disgorge \$80,352,639, together with prejudgment interest of \$25,190,552, and pay a civil penalty of \$48,211,583. The SEC did not follow up with further administrative action, nor did it require RBS to engage in any undertakings with respect to its business.

III. Background Information about RBS

RBS has been a member of FINRA since 1983. According to FINRA’s Central Registration Depository (“CRD”®), it has three branch offices, two of which are Offices of Supervisory Jurisdiction (“OSJs”), and it employs approximately 350 registered individuals and 2,005 non-registered individuals.

A. Recent Routine Examinations

Over the past four years, FINRA has conducted four cycle Sales Practice and Financial and Operational (“FinOp”) examinations of RBS. The most recent examination began in June 2015 and concluded in January 2016. That examination resulted in a referral to FINRA’s Department of Enforcement (“Enforcement”) for exceptions relating to the Firm’s failure to maintain a policy that ensured that all electronic communications are stored in accordance with Exchange Act Rule 17a-4(f). The 2015 examination also resulted in a Cautionary Action against the Firm with respect to exceptions relating to the Firm’s failure to comply with Regulation T, FINRA’s margin requirements, and applying improper haircuts when calculating net capital.

The Firm's 2014 examination commenced in July 2014 and concluded in January 2015. Three exceptions were noted during this examination, which resulted in a Cautionary Action against the Firm. The exceptions related to the Firm's anti-money laundering ("AML") program, which FINRA found to be deficient for failing to conduct periodic reviews of its correspondent accounts for foreign financial institutions; the Firm's failure to establish a process to assess and monitor credit risk exposure to the Firm's affiliated entities; and the Firm's application of improper haircuts, which resulted in a books and records deficiency.

The Firm's 2013 FinOp examination commenced in June 2013 and concluded in June 2014. FINRA noted three exceptions from this examination, all relating to the SEC's financial responsibility rules (including Exchange Act Rules 15c3-1, 15c3-3, and 15c3-5). The examination resulted in a Cautionary Action against the Firm.

The Firm's 2012 examination commenced in March 2012 and concluded in November 2012. From that examination, six exceptions were noted. The Firm was cautioned for four out of six exceptions: violations of Exchange Act Rule 15c3-3(b)(3) relating to the physical possession or control of securities; failing to provide disclosure information on its Uniform Application for Broker-Dealer Registration relating to litigation in which the Firm was involved; failing to maintain Qualified Institutional Buyer certifications for Rule 144A transactions; and failing to comply with AML rules² by approving customer accounts prior to completing a customer due diligence program.

B. Recent Regulatory Actions

In the last four years, RBS has consented to a total of eight AWCs with FINRA. None of these actions involve findings similar to the misconduct that rendered the Firm statutorily disqualified. Collectively, the FINRA AWCs addressed misconduct relating to: reporting violations in connection with FINRA's Trade Reporting and Compliance Engine ("TRACE"); failure to review email communications; failure to notify FINRA of pending complaints; failure to amend Uniform Applications for Securities Industry Registration or Transfer; failure to comply with the Customer Protection Rule, Net Capital Rule, Regulation SHO, and failure to keep records of excess margin; and submitting inaccurate data through the Order Audit Trail System. RBS was censured in connection with each AWC, and ordered to pay fines ranging from \$5,000 to \$475,000. The Firm has paid all fines in connection with the AWCs.

The Firm has also entered into a number of settlements with other self-regulatory organizations for violations unrelated to this Application. Since December 2012 and as recently as September 2015, RBS settled regulatory actions with the Chicago Board of Trade, Chicago Mercantile Exchange, Chicago Board Options Exchange, CBOE Futures Exchange LLC, Commodity Exchange, and Board of Governors of the Federal Reserve System. The settlements related to allegations involving failure to report block trades for

² The Firm resolved the two remaining two exceptions via a Letter of Acceptance, Waiver and Consent ("AWC"). See *infra* Part III.B.

customers within the applicable time frames; inaccurate trade data; failing to have at least two proprietary trading principals; overstating open interest in futures contracts; and exceeding data entry error levels. RBS was ordered to pay fines ranging from \$2,500 to \$85,000, all of which the Firm paid.

The Firm and its parent company, The Royal Bank of Scotland Group PLC, are also presently engaged in civil litigation with a number of plaintiffs, including state and federal regulators as well as private plaintiffs. Several of those actions involve allegations against RBS relating to its RMBS business. RBS has also recently resolved a number of ongoing matters with federal banking regulators that are unrelated to this Application.

IV. The Firm's Proposed Continued Membership with FINRA

RBS seeks to continue its membership with FINRA notwithstanding the Final Judgment that rendered it statutory disqualified. As noted above, the SEC did not require RBS to comply with any undertakings or undergo any changes to its business. Nonetheless, RBS represents that it has taken steps to address the misconduct alleged by the SEC in the Complaint and prevent its reoccurrence.

Primarily, the Firm no longer engages in the line of business that led to its statutory disqualification. The Firm no longer purchases and securitizes any whole loan pools consisting of residential mortgages, including “newly originated” subprime residential mortgage loans.³ The Firm has stated that it currently has no intention of resuming this business; however, it has agreed that, in the event it does seek to reengage in this line of business in the future, it will first file an application with FINRA, as provided for in NASD Rule 1017, to obtain FINRA’s prior approval to do so. As part of any such application, the Firm will submit to FINRA its amended policies and procedures relating to due diligence and disclosure practices associated with RMBS offerings for approval as part of a required application under NASD Rule 1017.

Following the approval of the Firm’s continued membership in FINRA, FINRA intends to utilize its examination and surveillance processes to monitor the Firm’s continued compliance with the standards prescribed by FINRA Rule 9523. FINRA will examine the Firm during either the first year following the filing of the Rule 19h-1 Notice or, alternatively, during the Firm’s regularly scheduled cycle examination. After the initial examination, the determination of how often to examine the Firm will be driven by FINRA’s overall risk-based assessment of the Firm.

³ The term “newly originated” refers to loans that have been originated fewer than 180 days from the date of the purchase by RBS. Newly originated subprime residential mortgage loans were the subject of the Complaint, which resulted in the Final Judgment and the Firm’s statutory disqualification.

V. Discussion

Member Regulation 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.

We recognize that the Final Judgment involved serious violations of securities rules and regulations. We note, however, that the violative conduct occurred in 2007, close to nine years ago, and related to a single offering of RMBS that consisted of newly originated residential mortgages. Further, the Final Judgment did not impose an expulsion or suspension of the Firm, did not require any undertakings or remedial measures, and did not place any limitations on RBS's securities activities, functions, or operations.⁴ Following the Final Judgment, the Firm represents that it undertook steps to reasonably prevent any future violations of Securities Act Sections 17(a)(2) and (3) by making a number of modifications and enhancements to its due diligence practices relating to RMBS. Since that time, RBS has ceased the business that led to its statutory disqualification and has agreed to file an application with FINRA should it seek to resume that business. In such a case, FINRA will have the opportunity to review and approve RBS's amended procedures and suggest modifications to help ensure compliance with applicable laws, rules, and regulations.

We further find that although the Firm has recent disciplinary history, the record shows that it has taken corrective actions to address noted deficiencies. We agree with Member Regulation that the Firm's disciplinary 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.

⁴ We have also considered that the SEC, in connection with the Final Judgment, has granted the Firm a waiver of the disqualification provisions of the Securities Act (specifically, Securities Act Rules 602(b)(4) and 602(c)(2)).

At this time, we are satisfied, based in part upon the Firm's representations, Member Regulation's representations concerning 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.⁵ Accordingly, we approve the Firm's Application to continue its membership in FINRA as set forth herein. In conformity with the provisions of Exchange Act Rule 19h-1, the continued membership of the Firm will become effective within 30 days of the receipt of this notice by the Commission, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith
Senior Vice President and Corporate Secretary

⁵ FINRA certifies that the Firm meets all qualification requirements and represents that it is registered with NQX, DTC, NSCC, and FICC, which concur with the Firm's proposed continued membership.