

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 20080144512**

TO: Department of Enforcement (“Enforcement”)  
Financial Industry Regulatory Authority (“FINRA”)

RE: Credit Suisse Securities (USA) LLC, Respondent  
CRD No. 816

Pursuant to FINRA Rule 9216 of FINRA’s Code of Procedure, the Respondent submits this Letter of Acceptance, Waiver and Consent (“AWC”) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the Respondent alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. The Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

**BACKGROUND**

Credit Suisse Securities (USA) LLC (“Credit Suisse” or the “Firm”), member New York Stock Exchange (“NYSE”) and FINRA, is a registered broker-dealer with its principal office in New York, New York, and offers a wide range of investment products and functions across asset classes, for various investment styles, including private equity hedge funds, real assets, fixed income and equities.

**OVERVIEW**

On July 28, 2004, the Securities and Exchange Commission (the “SEC”) adopted 17 CFR Part 242 (“Reg SHO”) under the Securities Exchange Act of 1934 (“Exchange Act”), effective September 7, 2004, with a compliance date of January 3, 2005. Reg SHO was, among other things, established to address potentially abusive naked short selling and other problems associated with failures to deliver while protecting and enhancing the operation, integrity and stability of the markets. As such, Reg SHO: (i) established a uniform “locate” requirement to reduce the number of potential failures to deliver; (ii) created uniform order marking requirements for sales of equity securities; and (iii) limited the time in which a broker-dealer can permit a failure to deliver to persist for

securities on the various self-regulatory organization ("SRO") threshold security lists ("threshold securities").<sup>1</sup>

As set forth below, the Firm failed to fully comply with the locate and order marking requirements of Reg SHO, as well as FINRA Rules, NASD Rules and federal securities laws during the period covering, in whole or in part, June 1, 2006 through at least December 2010 (the "Relevant Period").

Credit Suisse's failure to comply with Reg SHO's locate and order marking requirements extended across multiple Firm aggregation units and trading systems, as well as the Firm's technology and supervisory systems and procedures. The Firm's Reg SHO violations occurred due to, among other things: (1) the failure to decrease available locate shares to account for short sale orders entered but unexecuted; (2) programming errors that resulted in trading systems failing to recognize the rejection of locate requests and/or using prior days' locate approvals; (3) misapplication of the bona-fide market maker exception to the locate requirement; (4) trading systems and traders mismarking sale orders; and (5) the failure to adequately supervise locates and order marking.

As a result of these failures, the Firm improperly entered proprietary short sale orders over at least a four and one-half-year period, without having reasonable grounds to believe that the securities being sold would be available for delivery. A number of these improper short sale orders were in hard-to-borrow and threshold securities. The Firm also mismarked sale orders, including short sales mismarked as long sales, resulting in additional violations of Reg SHO's locate requirement.

As a result of the mismarked sale orders, Credit Suisse also had reporting and recordkeeping violations. Credit Suisse's mismarked sale orders flowed through to the Firm's blue sheet submissions, causing it to make inaccurate submissions of trading data to FINRA. Moreover, these same mismarked sale orders caused the Firm to inaccurately report such orders to the Automated Confirmation Transaction Service ("ACT") and the Order Audit Trail System ("OATS"). Credit Suisse also failed to create and maintain an accurate record of its mismarked sale orders.

Credit Suisse's Reg SHO supervisory system was deficient and resulted in supervisory failures of multiple aggregation units and trading desks which executed both proprietary and customer orders. These supervisory deficiencies included, among other areas, (1) the failure to detect or prevent the entry of short sales without locates, (2) the failure to detect and prevent mismarked orders, and (3) the failure to prevent and detect trading system programming issues that contributed to the locate and order marking violations.

Credit Suisse's supervisory and compliance monitoring flaws included a failure to establish and maintain: (1) reasonable and adequate supervisory procedures for

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<sup>1</sup> Threshold securities are equity securities 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 ("NSCC")]; (ii) totaling 10,000 shares or more; and (iii) equal to at least 0.5% of the issuer's total shares outstanding.

compliance with the locate and order marking requirements of Reg SHO; (2) adequate Information Technology control procedures relating to Reg SHO; and (3) an adequate Reg SHO compliance program.

Due to the Firm's supervisory and compliance deficiencies with regard to Reg SHO, certain of the Firm's aforementioned violations were not detected or corrected until after Enforcement's investigation caused Credit Suisse to conduct a substantive review of its systems for Reg SHO compliance in April 2009. In addition, Enforcement continued to identify Reg SHO violations occurring as the result of the deficiencies in the Firm's trading systems even after the Firm had completed its Reg SHO compliance review. As problems were self-identified by the Firm or identified by FINRA to the Firm, the Firm implemented changes to its systems and procedures that were designed to prevent a recurrence of these violations.

### **RELEVANT DISCIPLINARY HISTORY**

#### **Matter No. 2006005067802 (April 30, 2010)**

In April 2010, Credit Suisse was fined \$5,000 for violation of NASDAQ Rule 4755 in that the Firm entered orders into the NASDAQ Market Center that failed to correctly indicate whether the orders were buy, short sale, or long sale.

#### **Matter No. 20050024896-01 (July 18, 2008)**

In July 2008, Credit Suisse was fined \$92,500 for violations of, among other things, SEC Rules 203(a)(1) and 203(b)(3) of Regulation SHO in that the Firm knew or had reasonable grounds to believe that the sale of an equity security was or would be effected pursuant to an order marked long and failed to deliver the security on the date delivery was due. The Firm had fail-to-deliver positions at a registered clearing agency in threshold securities for 13 consecutive settlement days and failed to immediately thereafter close out the fail-to-deliver positions by purchasing securities of like kind and quantity.

#### **NYSE Hearing Board Decision 06-112 (June 28, 2006)**

In June 2006, the Firm was fined \$250,000 for violations of Rule 203(b)(1) of Regulation SHO for accepting short sale orders and effecting those orders without having borrowed securities or entered into bona-fide arrangements to borrow them or without having reasonable grounds to believe securities could be borrowed so that they could be delivered on dates delivery was due, and Rule 203(a) by effecting sales marked long when it did not know or have reasonable grounds to believe that it would be able to deliver securities on dates when the delivery was due or that customers were not representing short sales as long sales.

NYSE Hearing Board Decision 06-14 (Jan. 24, 2006)

In January 2006, Credit Suisse (then known as Credit Suisse First Boston LLC) consented to findings that it violated NYSE Rule 410A, NYSE Rule 401, and NYSE Rule 342 in connection with its failure to submit accurate EBS data. In particular, a malfunction in the Firm's blue sheet system caused short sale transactions in broker DVP/RVP accounts to be erroneously identified as long sales. The problem persisted over 11 months and effected numerous submissions made to NYSE Regulation, Inc. and other regulators. The Firm was censured, fined \$150,000, and required to conduct validation of all required blue sheet data elements. This validation was the same as the validation that all of the major firms completed under the Blue Sheet Street-Wide Initiative.

**FACTS AND VIOLATIVE CONDUCT**

**I. Credit Suisse's Locate Violations**

*Reg SHO's Locate Requirement*

Rule 203(b)(1) of Reg SHO states that, subject to certain exceptions, a "broker or dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has: (i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) Reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) Documented compliance with this paragraph (b)(1)."

Reg SHO requires a broker-dealer to have reasonable grounds to believe the security can be borrowed so that it can be delivered in time for settlement before effecting a short sale in that security. Identifying a source from which to borrow such security is generally referred to as obtaining a "locate." Reg SHO requires that this "locate" must be made and documented prior to effecting the short sale.

*The Firm's Locate and Documentation Systems and Procedures*

The Exchange Traded Funds ("ETF") Desk of the Equity Derivatives Trading Desk Aggregation Unit, also known as the Derivatives aggregation unit<sup>2</sup>, the Arbitrage Strategies Aggregation Unit ("Arb Strat")<sup>3</sup>, Electronic Adaptive Trading Aggregation

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<sup>2</sup> During June 2006, the Equity Derivatives Trading Desk Aggregation Unit, also known as the Derivatives aggregation unit, consisted of 6 trading desks including the ETF Desk which consisted of four traders. The ETF Desk executed trades for Credit Suisse clients and provided liquidity not always available on the exchanges.

<sup>3</sup> During June 2006, Arb Strat consisted of approximately 12 traders who executed proprietary trading programs that coordinated the purchase and sale of baskets of equities, thereby replicating an equity index and the simultaneous trading of future contracts.

Unit ("EAT")<sup>4</sup>, Quantitative Trading Aggregation Unit ("Quant")<sup>5</sup> and Electronic Market Making Aggregation Unit utilized an approval list process to obtain locates for short sales. Prior to the commencement of trading each trading day, each of these aggregation units submitted to Stock Loan a list of stocks together with a request for a locate of a specific number of shares of each stock. Stock Loan populated the list with the number of shares of each stock for which a locate was granted. In the event a locate request was rejected, Stock Loan noted "0" as the number of shares for which a locate was approved. The completed list (the "Approval List") was then made available for the aggregation unit to reference during the trading day. In addition to the Approval List, during the trading day these aggregation units could and did contact Stock Loan to request locates, including but not limited to, locates in stocks for which locates had earlier been granted or rejected through the Approval List process.

The Program Trading and Advanced Execution Services Aggregation Unit ("Program Trading")<sup>6</sup> entered hedge short sale orders daily for the Prime Services Swap Desk ("Prime Services"). Prime Services was supposed to obtain the locates for these short sales orders from Credit Suisse Europe Stock Loan. For short sales other than those associated with the Prime Services hedge short sales the Program Trading desk was supposed to obtain locates directly from Credit Suisse's Stock Loan department.

Locates granted by Stock Loan were documented in the Firm's stock loan system, SSSLocate, which recorded the details of the locate including the date and time the locate was granted and the number of shares for which the locate was granted.

#### *Overview of Firm's Locate Violations*

During the Relevant Period, the order entry systems used by traders who entered proprietary and customer orders permitted short sales to be entered without locates due to multiple causes. One significant cause of locate violations was the Firm's programming of order entry systems used by five aggregation units so that the entry of a short sale order did not reduce the remaining shares available from the locate that had been obtained until the order was executed. In addition, a programming error permitted traders in four aggregation units (including one aggregation unit that entered customer orders as well as proprietary trades) to enter short sale orders even though a locate request had been rejected entirely. Moreover, several of the order entry systems that the Firm

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<sup>4</sup> During June 2006, the EAT aggregation unit consisted of only one trader who engaged in statistical arbitrage strategies using internally developed algorithms to select stock baskets based on correlations between securities across different sectors or industry groups and their relationships to various market forces.

<sup>5</sup> During June 2006, Quant consisted of approximately 19 traders on two desks who engaged mainly in statistical arbitrage strategies using internally developed algorithms to select stock baskets based on correlations between securities across different sectors or industry groups and their relationships to various market forces.

<sup>6</sup> During June 2006, Program Trading consisted of approximately 13 traders on two desks who covered Program Trading clients and executed both agency and principal trades. Program Trading also engaged in proprietary trading strategies.

permitted traders to use allowed traders to enter a short sale order without providing any locate information.

Due to the volume of trading data generated by affected aggregation units Enforcement reviewed short sales entered by five aggregation units on one sample trading day, June 30, 2006, for quantification (the "Sample Period"). Quantified violations from the Sample Period were extrapolated over the entire relevant period for each causation issue.

The Firm's failure to comply with the locate requirement also extended to other aggregation units and trading desks due to programming errors and the mismarking of short sale orders as "long" sales.

**A. The Firm Programmed Trading Systems Not to Reduce Available Locate Shares Upon Short Sale Order Entry**

During the period of at least June 2006 to August 2010, the Firm improperly programmed the trading systems used by Arb Strat, ETF, EAT, Quant and Program trading so that short sale orders could be entered for a number of shares in excess of the locate granted and so that located shares available were not decreased to account for short sale orders live in the market but unexecuted. Instead, these trading systems decreased the located shares available only by the number of shares executed as the result of short sale orders. The result of this programming was that each of these aggregation units entered and had open in the market short sale orders that, singularly or jointly, exceeded available located shares. As a result, short sales were executed without a valid locate. Only after Enforcement identified numerous unexplained short sale violations did the Firm correct this violative use of locates in August 2010.

On June 30, 2006, Arb Strat, EFT, EAT, Quant and Program trading entered a total of approximately 9,130 short sale orders without valid locates as the result of failure to decrease available locates. Extrapolation over the more than four year period when these aggregation units were improperly programmed not to decrease available locates upon entry of a short sale order reveals that approximately 9.7 million short sale orders were entered without valid locates.

**B. The Firm Entered Proprietary Short Sale Orders Without Locates Based on Rejected Locate Requests**

During the period of at least June 2006 through August 2007, the trading systems used by Arb Strat, ETF, EAT and Quant failed to recognize when a locate request had been rejected. Instead, these systems treated a rejected locate request as if a locate had been granted for the full number of shares requested because the system misread the entry in the approval field. As a result, Arb Strat, ETF, EAT and Quant had the ability to enter, and in numerous instances did enter, short sales based on a locate request that had been rejected.

On June 30, 2006, these aggregation units entered approximately six short sale orders without locates in three stocks as the result of the trading systems failure to recognize a locate request as rejected. Extrapolation over the approximately two and one-half year period when the trading systems used by Arb Strat, EFT, EAT and Quant failed to recognize a locate request as rejected reveals that more than 3,780 short sale orders were entered without locates.

**C. The Firm's Arbitrage Strategies Aggregation Unit Entered Proprietary Short Sale Orders Without Locates Based On Prior Day's Locate Approvals**

Due to a delay in the availability of Arb Strat's Approval List for the current trading day, during the period of at least June 2006 through February 2007 on 16 trading days Arb Strat improperly used the prior day's Approval List as the basis for short sale locates. As a result, on each day when Arb Strat utilized the prior day's Approval List it possibly entered short sales without locates in stocks that appeared on the prior but not the current day's Approval List, or for which a greater number of locate shares were approved in a particular stock on the prior trading day.

A comparison of the Arb Strat locate approval lists for June 29, 2006 and June 30, 2006 revealed 90 stocks that appeared on the June 29, 2006 approval list but not on the June 30, 2006 approval list. On June 30, 2006, Arb Strat entered 1,749 short sale orders in 70 of these 90 stocks, including 195 short sale orders in eight threshold stocks without locates.<sup>7</sup>

Arb Strat used the prior trading day's Approval List on 16 trading days, including June 30, 2006, during the period June through August 2006. Extrapolation over the nine month period for which this problem existed, reveals that the prior day's approval list was used on 48 trade dates; and that Arb Strat entered approximately 83,952 short sale orders, including short sales orders in threshold securities, without locates due to use of the prior days' locate Approval Lists.

**D. The Firm's Trading Systems Did Not Have the Functionality to Prevent Short Sales Without Valid Locates and the Firm Failed to Have an Effective Post-Trade Locate Review System**

During the Relevant Period, order entry systems utilized by Arb Strat, ETF, EAT, Quant and Program trading did not have the functionality to automatically "block" or "stop" a short sale order from being released for execution in the event that a valid locate did not exist at the time of order entry.

In addition to the locate violations described above, on June 30, 2006, Arb Strat, ETF, Quant and Program trading entered a total of approximately 82 short sale

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<sup>7</sup> The same comparison revealed 86 stocks that appeared on the approval list for both dates, however, the number of shares for which a locate was granted was greater on June 29, 2006 than on June 30, 2006.

orders without locates in 73 stocks for which a locate had not even been requested. Extrapolation over the Relevant Period reveals that these aggregation units entered approximately 94,700 short sale orders without locates in stocks for which a locate had not even been requested.

Additional aggregation units and trading desks also utilized trading systems that permitted the entry of short sale orders without locates. During the period June 2009 through August 2009, the Firm permitted the Equity Cash Trading Aggregation Unit<sup>8</sup>, ETF and Convertibles desks, and one trader on the options desk in the Derivatives aggregation unit to enter orders through a third-party trading system ("System 1"), which did not require the entry of locate information in connection with short sale orders. As the result of the use of this functionality, the Cash/Block and ETF desks entered approximately 376 short sales without locates. The Firm was aware at the time the trading system was installed that it included a functionality that permitted the entry of short sales without locates yet took no action to determine whether locates were obtained in connection with short sales entered through this system until September 2009.

While an automated "block" or "stop" function to prevent the release for execution of short sales without locates through a firm's order entry systems is not a requirement, the absence of such an automated function requires that a firm must have in place an effective post-trade review of short sales entered through its order entry systems to ensure that the required locates were in place prior to the release of such orders through the order entry systems. Credit Suisse failed to do either. Despite being aware that the order entry systems used by certain aggregation units were programmed in such a way as to permit the entry of short sales in excess of the number of shares for which a locate had been granted, for years after Reg SHO's effective date, the Firm failed to develop functional post-trade reports or any other review system for all of its customer and proprietary trading to identify short sales entered into its order entry systems without locates.

During the Relevant Period, the Firm failed to put in place reasonable and effective post-trade exception reports to review short sale orders entered by multiple aggregation units, trading desks and traders to determine whether a valid locate had been obtained. During the relevant period, the Firm had either 13 or 14 aggregation units, as few as five and as many as eight of which used the locate list process as their primary means of obtaining locates and/or their trading systems were intentionally programmed by the Firm not to reduce available locate shares to reflect short sale orders entered. Nonetheless, the Firm did not perform any review of short sales entered by these aggregation units until July 2008. The reviews initiated in July 2008 and that continued through the remainder of the

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During June 2006, the Equity Cash Trading Aggregation Unit, also known as the Cash/Block Desk, consisted of approximately 45 traders who executed orders on behalf of the Firm's institutional client base, acting as agent and/or principal, using the Firm's capital to provide liquidity for its clients. The Cash/Block Desk also executed transactions in announced M&A arbitrage opportunities, and acquired proprietary positions to hedge or create additional liquidity for the Firm's clients.



Relevant Period were inadequate to prevent and detect short sales from being accepted and/or entered without locates. As a result of the foregoing, the Firm lacked the reasonable grounds necessary to enter short sales through at least eight of its aggregation units.

**E. The Firm Misused the Bona-Fide Market Maker Exception**

Reg SHO allows for certain categories of short sale orders to be treated as exceptions to the locate requirement<sup>9</sup>. The Firm misapplied an exception to the locate requirement by improperly treating short sales in certain securities as exceptions to the locate requirement.

During the period May 2009 through October 2009, the Firm incorrectly designated in its systems that it was a market maker in 98 securities, when it was not a market-maker in those securities. As a result, the Firm improperly treated proprietary orders in these 98 securities as exceptions to the locate requirements. During this six-month period, the Cash/Block desk entered approximately 199 short sale orders in one ETF without locates based on this misuse of the market maker exception.

**F. The Firm Failed to Adequately Document Locates**

The Program Trading Unit/Desk entered short sale hedge orders for the Firm's Prime Services Client Desk without documentation of the number of shares for which a locate had been obtained or the time when the locate had been obtained. For example, on June 30, 2006, Program Trading entered 35 short sale hedge orders in 35 stocks without documented locates, including one threshold security.

Extrapolation over the Relevant Period reveals that Program Trading failed to adequately document locates for approximately 40,400 short sale orders.

**G. Summary of Rule 203(b)(1) Violations**

Pursuant to Reg SHO, the Firm was required to reasonably ensure that its trading, including the function and review of its trading systems and its post-trade review systems and procedures, was in compliance with the "locate" requirement of Rule 203(b)(1). However, as noted above, the Firm violated the locate requirement on an ongoing basis across many of its trading systems, aggregation units and desks for an extended period of time.

Based upon the foregoing, the Firm violated Rule 203(b)(1) of Reg SHO by entering more than ten million short sale orders without locates during the

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<sup>9</sup> Short sales for which the SEC provided an exception to the locate requirement include broker-dealer to broker-dealer introduced short sales transactions, bona-fide market making activities, and certain short sales that are the result of a convertible security, option or warrant being tendered for conversion or exchange but the underlying security is not reasonably expected to be received in time for settlement.

Relevant Period. This further constituted a violation of NASD Rule 2110 and FINRA Rule 2010, which require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.<sup>10</sup>

## **II. Credit Suisse's Order Marking Violations**

As effected, Rule 200(g) of Reg SHO required that a broker or dealer mark all sell orders of any equity security as "long," "short" or "short exempt." The accurate marking of sell orders is essential for locate, stock borrow, reporting, record-keeping and execution purposes.

### *Overview of Order Marking Violations*

During the Relevant Period, short sale orders entered by Firm traders through both proprietary and third-party order entry system were mismarked for multiple reasons. First, the proprietary trading systems utilized by Firm traders automatically marked sale orders as long or short based on reference to position servers. However, these systems allowed traders to override the automatic marking, and in some cases, referenced the incorrect position server and therefore incorrectly marked sale orders. Second, with one notable exception, the third-party order entry systems that the Firm provided to traders could not access the Firm's position servers, so marking of those orders was entirely reliant on traders to mark sale orders in a compliant and accurate manner. Third, in connection with at least one third-party order entry system the trader's failure to mark sale orders as long or short resulted in the default entry of all sale orders entered through this order entry system as long sales. Fourth, the one third-party order entry system that was configured to access the Firm's position server for one aggregation unit failed to function properly, resulting in mismarked orders for at least seven proprietary traders. Accordingly, the Firm's failure to comply with the order marking requirements extended across multiple aggregation units, trading desks and strategies.

### **A. The Firm Mismarked Sell Orders Due to Numerous Programming Errors**

#### *Failure of Automatic Order Marking Through System 2 - Cash/Block*

During the period of at least June 2006 to February 2009, the Firm permitted traders on the Cash/Block desk to use a third-party order entry system, System 2, to enter proprietary sale orders. The Firm relied on System 2 to access the appropriate Firm position servers to automatically mark sale orders entered by the Cash/Block desk.

The Firm's 2007 TMMS revealed 145 sale orders that were mismarked as "long" in seven stocks on two exam trading days, entered by Cash/Block desk traders. In

<sup>10</sup> See FINRA Regulatory Notice 08-57, which describes certain changes to FINRA's rules including the change of NASD Rule 2110 to FINRA Rule 2010, effective December 15, 2008.

determining the cause of these mismarked orders, the Firm learned that from at least June 2006 through January 2009, seven of the 45 traders on the Cash/Block desk had not been properly configured for automatic order marking through this order entry system. As a result, sale orders entered during this period by these seven traders using System 2 were all marked "long" regardless of the Cash/Block desks position in the stock.

From at least June 2006 until approximately January 2009, Credit Suisse was also unaware of two features of this order entry system that affected order marking and resulted in additional but unquantified mismarked sale orders on the Cash/Block desk.

Extrapolation over the more than two and one-half years when the programming error and the two order marking features existed in this order entry system reveals that more than 48,700 Cash/Block desk sale orders were mismarked as "long" through this order entry system.<sup>11</sup>

#### *Failure to Properly Mark Increased Sale Orders – Cash Block*

On May 29, 2009, the Firm implemented use of System 1, on its Cash/Block, ETF and Convertibles desks. This order entry system mismarked sell orders in that it failed to check the aggregation unit's position to determine the appropriate order marking when a trader cancelled and replaced the original order to increase its size.

As a result, during the period of at least June 2009 to mid-October 2009, the Cash/Block desk mismarked 26 short sales as long sales and four long sales as short sales.

#### *Failure to Properly Mark Sell Orders Due to Failure to Access Position Server - ETF*

In October 2009, the Firm learned that a trading system used by the ETF desk mismarked sale orders as "short" in certain circumstances. The trading system was supposed to mark the sale orders based on the desk's aggregation unit position as reflected in the Firm's position servers. When the trading system could not obtain the position data from the position server it automatically marked sell orders entered by certain users as short sale orders causing those orders which should have been marked long to be inaccurately marked.

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<sup>11</sup> The Cash/Block desk performed market-making functions therefore its bona-fide market making transactions were subject to an exception to the locate requirements. However any hedge transactions entered into by the Cash/Block desk would not qualify for an exception to the locate requirement. Therefore, any hedge short sale orders mismarked as long would also have resulted in locate violations.

### *Failure to Properly Mark Pair-Trade ETF Sale Orders - QuantHF*

Due to a programming error, during the period February 2010 to May 2010, the order entry system used by two traders in the Firm's QuantHF (High Frequency) Trading Desk Aggregation Unit<sup>12</sup> ("System 4") marked all sale orders in ETFs as "long" sale orders. The order entry system was used in conjunction with a strategy involving the paired buying and selling of ETFs and corresponding leveraged ETFs. As a result of the programming error, despite recognizing certain orders as "short" and checking for available locates in the ETFs to be shorted, this order entry system entered all the ETF sale orders as "long" sales. The Firm was unable to quantify the number of short sale orders mismarked as "long" as the result of this pairs-trading related programming error.

### *Arb Strat Aggregation Unit*

During the one-week period of May 29 through June 5, 2009, an unanticipated result to a programming change caused 141 proprietary short sale orders of ETFs entered by Arb Strat to be mismarked as long sales. Arb Strat failed to obtain locates in connection with 62 of these mismarked short sale orders.

### *Derivatives Aggregation Unit*

The Derivatives aggregation unit also used System 2, which required traders to manually sale mark orders as "long" or "short." Reviews initiated by the Firm in the third quarter of 2009 revealed that four of nine traders on the ETF desk, and one trader on each of the Derivatives and Convertibles desks, had marked a disproportionately small number of sale orders as short. It appears that these traders mismarked short sales as long sales. In addition, while conducting this review, Credit Suisse learned that some traders and supervisors in the Derivatives aggregation unit had also mismarked as short sales orders those that should have been marked long. Any short sales mismarked as long sales also resulted in locate violations.

### *Cash/Block and Derivatives Aggregation Units*

During the period of at least June 2006 through December 2008, the Firm permitted traders in the Cash/Block and Derivatives aggregation units to use a third-party order entry system, System 3, designed primarily for trading in Pink Sheet stocks. This order entry system required traders to manually enter a code designating a short sale order as such otherwise the system defaulted to a long sale. Nonetheless, five traders using this system failed to enter the short sale order designation. Therefore, all sale orders entered through this system defaulted

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The QuantHF (High Frequency) Trading Desk Aggregation Unit ("QuantHF") is a proprietary trading desk which consisted of two traders. QuantHF executes algorithm-based trading strategies using internally developed algorithms to select stock baskets based on correlations between securities across different sectors or industry groups and their relationships to various market forces to obtain a diversified portfolio.

to entry as long sales. The Firm was unable to identify and/or quantify the short sale orders mismarked as long sales entered through this order entry system. Sale orders mismarked as long may also have resulted in required locates not being obtained and additional unquantified locate violations.

**B. Summary of Rule 200(g) Violations**

Based upon the foregoing, the Firm violated Rule 200(g) during the time periods described above in that it mismarked at least 48,700 sale orders plus an unquantified number of sale orders mismarked due to various causes. Most of these mismarked orders consisted of actual short sales that were mismarked as "long" and also violated Reg SHO's locate requirement. This misconduct also constituted a violation of NASD Rule 2110, and FINRA Rule 2010.

**III. Credit Suisse's Reporting Violations**

As noted earlier, during the Relevant Period, the Firm mismarked short sale orders as "long" and long sale orders as "short" due to its order marking issues.

Pursuant to its reporting obligations, the Firm was required to accurately report sell orders through its automated submissions of trading data ("blue sheets") for regulatory purposes. Further, the Firm was required to accurately report sell orders for public dissemination and regulatory purposes to a number of trade reporting, quotation display and collection facilities, including ACT and OATS, by indicating, among other things, whether each sell order was "long," "short," or "short exempt." As the result of the Firm's aforementioned order marking violations and the misuse of a reporting indicator for a limited type of order flow, the Firm inaccurately reported sell orders in violation of its reporting requirements.

*Blue Sheets*

NASD Rules 8211 and 8213 (and later FINRA Rules 8211 and 8213)<sup>13</sup> require that a firm submit transaction data in an automated format to regulators with certain designated information, including the indication of whether a transaction was a purchase, sale, or short sale. These "blue sheet" submissions are generated by firms at the request of regulators in connection with investigations of questionable trading. It is the responsibility of firms to reasonably ensure that the information submitted to regulators via blue sheets is accurate, and a firm's reliance on a third party vendor to assist with the preparation of the firm's blue sheets does not alter the firm's duty to comply.

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<sup>13</sup> See FINRA Regulatory Notice 08-57, which describes certain changes to FINRA's rules, effective December 15, 2008, including the change of NASD Rules 8211 and 8213 to FINRA Rules 8211 and 8213, respectively.

The Firm mismarked sell orders that flowed through to the Firm's blue sheet submissions and caused to Firm to make inaccurate blue sheet submissions of trading data to FINRA.

Based upon the foregoing, the Firm violated NASD Rules 8211 and 8213 and FINRA Rules 8211 and 8213 in that it failed to accurately report at least 48,700 sell orders plus an unquantified number of mismarked sell orders due to various causes in its blue sheets. This misconduct also constituted a violation of NASD Rule 2110 and FINRA Rule 2010.

#### *Trade Reporting Rules Generally*

The NASD 4000, 5000, 6000, and 7000 Rule Series (and later FINRA 6000 and 7000 Rule Series)<sup>14</sup> require that firms report certain over-the-counter ("OTC") transactions in equity securities to transaction reporting, quotation display and collection facilities for public dissemination and regulatory purposes. Transactions must be reported to a FINRA Facility such as a Trade Reporting Facility ("TRF"), the Alternative Display Facility ("ADF"), or the OTC Reporting Facility ("ORF").<sup>15</sup> Firms are required to accurately report these transactions by indicating, among other things, whether a transaction was a "buy", "sell", or "sell short."

#### *ACT Reporting*

NASD Rule 6130 (and later FINRA Rules 7230A and 7330)<sup>16</sup> requires that firms report transactions to ACT for a number of regulatory purposes, including but not limited to indicating whether a transaction was a "buy", "sell", or "sell short."

As described above, the Firm mismarked short sale orders as long sales and long sale orders as short sales. These mismarkings were passed through to the data systems from which the Firm created its ACT reports, causing the inaccurate reporting of such sell orders.

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<sup>14</sup> See FINRA Regulatory Notice 08-57, which describes certain changes to FINRA's rules, effective December 15, 2008, including the transfer of the NASD Marketplace Rules (the NASD Rule 4000 through 7000 Series) to the consolidated FINRA rulebook as the FINRA Rule 6000 through 7000 Series. See also FINRA Trade Reporting Frequently Asked Questions (FAQ), available at: <http://www.finra.org/Industry/Regulation/Guidance/p038942>.

<sup>15</sup> The TRFs are facilities through which firms report transactions in National Market System stocks, as defined in SEC Rule 600(b)(47) of Regulation NMS, effected otherwise than on an exchange. FINRA has established the following TRFs (each in conjunction with the pertinent Exchange): the FINRA/NASDAQ TRF and the FINRA/NYSE TRF. The ADF is both a trade reporting and quotation display and collection facility for purposes of transactions in NMS stocks effected otherwise than on an exchange. The ORF is the facility through which members report OTC transactions in OTC Equity Securities and Restricted Equity Securities, as those terms are defined in FINRA Rule 6420.

<sup>16</sup> See FINRA Regulatory Notice 08-57, which describes certain changes to FINRA's rules, including the change of NASD Rule 6130 to FINRA Rules 7230A and 7330, effective December 15, 2008.

Based upon the foregoing, the Firm violated NASD Rule 6130 and FINRA Rules 7230A and 7330 in that it failed to accurately report at least 48,700 sell orders plus an unquantified number of mismarked sell orders due to various causes to ACT. This misconduct also constituted a violation of NASD Rule 2110, and FINRA Rule 2010.

#### *OATS Reporting*

During the Relevant Period, the Firm was a "Reporting Member" within the definition set forth in NASD Rule 6951(n) (and later FINRA Rule 7410(n)). Pursuant to NASD Rule 6955(a) (and later FINRA Rule 7450(a)), the Firm was required to transmit to OATS the order information specified in NASD Rule 6954 (and later FINRA Rule 7440), including, among other things, the designation of an order as a "short sale order."<sup>17</sup>

As described above, the Firm mismarked short sale orders as long sales and long sale orders as short sales. These mismarkings were passed through to the data systems from which the Firm created its OATS reports, causing the inaccurate reporting of such sell orders.

Based upon the foregoing, the Firm violated NASD Rules 6951(n), 6954 and 6955(a) and FINRA Rules 7410(n), 7440 and 7450(a) in that it failed to accurately record and transmit at least 48,700 sell orders plus an unquantified number of mismarked sell orders due to various causes to OATS. This misconduct also constituted a violation of NASD Rule 2110 and FINRA Rule 2010.

#### **IV. The Firm Failed to Create and Maintain Certain Accurate Books and Records**

Under Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, firms are required to make and keep current and accurate books and records relating to its business, including, but not limited to, daily records of all sales of securities, and a memorandum of each purchase and sale for every customer and account of the firm. NASD Rule 3110(a) requires that firms make and preserve books, accounts, records, memoranda, and correspondence in conformity with applicable laws, rules, regulations, and statements of policy promulgated thereunder, and with the Rules of the NASD, and as prescribed by Exchange Act Rule 17a-3.

As previously described, the Firm failed to maintain accurately marked sale orders from at least June 2006 to December 2009. In addition, due to a programming error, during the period August 2007 to January 2009, customer sale orders executed through riskless principal transactions were mismarked in the Firm's internal records. Rather than recording the customer sale as "long" or "short" based on the customer's designation of the order and/or position at the time of order entry, the Firm's internal records recorded

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<sup>17</sup> See FINRA Regulatory Notice 08-57, which describes certain changes to FINRA's rules, effective December 15, 2008, including the change of NASD Rules 6951(n), 6954 and 6955(a) to FINRA Rules 7410(n), 7440 and 7450(a), respectively.

the order marking based on the position of the aggregation unit entering the riskless principal order.

Based upon the foregoing, the Firm violated Section 17(a) of Exchange Act and Rule 17a-3 thereunder and NASD Rule 3110(a) in that it failed to maintain accurately marked sale orders. This also constituted a violation of NASD Rule 2110 and FINRA Rule 2010.

V. **Systemic Supervisory Violations: The Firm's Reg SHO Supervision and Compliance Monitoring Program was Deficient**

NASD Rule 3010 requires that firms establish and maintain a supervisory system, including written supervisory procedures, related to their business that is reasonably designed to achieve compliance with the applicable securities laws, regulations and SRO rules.

*Overview of Supervisory Violations*

The Firm's written supervisory procedures ("WSPs") relating to Reg SHO were deficient in that, among other things, they failed to set forth adequate procedures to determine that: (i) locates were obtained for short sales, (ii) sale orders were properly marked, and (iii) that the trading systems were Reg SHO compliant. In addition to having inadequate WSPs, Credit Suisse failed to reasonably supervise its compliance with Reg SHO. Among other things, the Firm failed to: (i) prevent short sales from being entered without locates and perform adequate post-trade monitoring of short sales; (ii) prevent the mismarking of orders; and (iii) maintain Information Technology ("IT") protocols to supervise changes and additions to its trading systems and strategies.

A. **The Firm Failed to Supervise to Prevent Short Sales from Being Entered Without Locates and Failed to Perform Adequate Post-trade Reviews**

During the Relevant Period, the Firm failed to reasonably supervise its compliance with Reg SHO's locate requirement. As described, the Firm utilized multiple proprietary and third-party order entry systems to enter client and proprietary short sales. Several of these order entry systems allowed short sale orders to be entered without locates. The Firm failed to develop an adequate system for the post-trade review of short sales to identify short sales entered without locates. As a result, the Firm failed to detect that short sales were entered through its order entry systems without locates.

As described above, during the relevant period, the Firm had either 13 or 14 aggregation units, as few as five and as many as eight of which used the Approval List process as their primary means of obtaining locates and/or their trading systems were intentionally programmed by the Firm not to reduce available locate



shares to reflect short sale orders entered. Nonetheless, the Firm did not perform any review of short sales entered by these aggregation units until July 2008.

The reviews initiated in July 2008, which continued through August 2010, were inadequate to prevent and detect short sales from being accepted and/or entered without locates. For example, the post-trade reviews performed by the Firm did not reveal that four aggregation units had for at least four and one-half years entered short sale orders which, singularly or jointly, totaled a number of shares in excess of the available located shares. The Firm's review also failed to detect that each of these aggregation units entered short sales without locates as the result of this intentional programming. During the Relevant Period, the Firm had not implemented post-trade reviews adequate to detect the entry of short sales without locates through third-party trading systems it provides to its traders.

**B. The Firm Failed to Supervise the Marking of Sale Orders**

During the Relevant Period, the Firm failed to have adequate supervisory policies and procedures and otherwise failed to reasonably supervise the marking of sale orders. As earlier described, the Firm mismarked a significant number of sale orders, including short sales mismarked as "long" that also violated Reg SHO's locate requirement.

The Firm's policies and procedures to supervise the marking of short sales were deficient. The quarterly review of short sales entered through proprietary trading systems, by only two trading units, and consisted of the review of trading in only two stocks on one randomly selected calendar day. This review was inadequate to detect and prevent the numerous order marking violations described above. For example, the Firm only became aware of that Cash/Block traders were not properly configured by one order entry system for order marking as the result of the 2007 TMMS exam which identified mismarked sale orders despite that aggregation unit having been reviewed multiple times.

Although Firm traders entered trades in Pink Sheet stocks using an order entry system that required the manual designation of short sale orders, the Firm's policies and procedures for supervision of order marking did not include supervision of order marking in Pink Sheet stocks and the Firm never conducted a review of order marking for Pink Sheet stocks during Relevant Period. Until August 2008, Credit Suisse did not have any policy or procedure to supervise and did not supervise the marking of sale orders entered through third-party order entry systems it permitted its traders to use.

In August and September 2008, the Firm created two supervisory/monitoring reports that reviewed order mark "trends" entered through third-party order entry systems (the "Reports") to identify aggregation units or trading desks with a statistically low percentage of short sale orders. These reviews enabled the Firm

to discover order marking discrepancies on multiple trading desks in multiple aggregation units. Despite these reviews the Firm did not become aware that another order entry system was mismarking ETF orders until late October 2009.

**C. The Firm Failed to Supervise its Systems and Lacked Adequate IT Implementation and Change Protocols Affecting Reg SHO Compliance**

The Firm failed to have adequate policies and procedures to supervise and failed to adequately supervise its trading systems for Reg SHO compliance.

During the Relevant Period, the Firm failed to reasonably supervise the trading systems, both proprietary and third-party, which it made available to its traders, for compliance with Reg SHO. The Firm was not aware of the locate and order entry functions of certain third-party order entry systems that permitted the entry of short sale orders without locates and resulted in the mismarking of sale orders.

The Firm was also unaware of changes made to trading systems that negatively affected its compliance with the locate and order marking requirements of Reg SHO. In addition, the Firm failed to adequately anticipate and assess the potential regulatory impact of changes to its trading systems, including changes that impacted the Firm's compliance with the locate and order marking requirements of Reg SHO.

**D. The Firm Failed to Supervise its Books and Records and Trade Data Submissions**

During the Relevant Period, as described above, the Firm failed to reasonably supervise to maintain and failed to maintain accurate books and records and submit accurate trade data on its blue sheets, ACT and OATS reports.

**E. Summary of Supervisory Violations**

Based upon the foregoing, the Firm violated NASD Rule 3010 in that it failed to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with the applicable securities laws, regulations and SRO rules. This misconduct also constituted a violation of NASD Rule 2110 and FINRA Rule 2010.

**B. The Respondent also consents to the imposition of the following sanctions:**

Censure; and

Fine in the amount of \$1,750,000.

The Respondent agrees to pay the monetary sanction(s) upon notice that this AWC has

been accepted and that such payment(s) are due and payable. The Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

The Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

## **II.**

### **WAIVER OF PROCEDURAL RIGHTS**

The Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Respondent;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

### III.

#### OTHER MATTERS

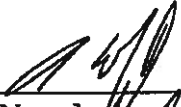
The Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Respondent; and
- C. If accepted:
  - 1. This AWC will become part of the Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Respondent;
  - 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent's disciplinary record;
  - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
  - 4. The Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that he/she has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

12/13/11  
Date

\_\_\_\_\_  
Credit Suisse Securities (USA) LLC

By:   
\_\_\_\_\_  
[Name] *Alan Kubaly*  
[Title] *Head of Technology*

By: \_\_\_\_\_  
[Name]  
[Title]

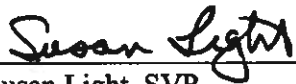
Reviewed by:

*Harry J. Weiss*  
Harry J. Weiss, Esq.  
Wilmer Cutler Pickering Hale and Dorr LLP  
1875 Pennsylvania Avenue, NW  
Washington, DC 20006  
Tel: (202) 663-6993  
Fax: (202) 663-6363  
Harry.weiss@wilmerhale.com

Accepted by FINRA:

12/27/11  
Date

Signed on behalf of the  
Director of ODA, by delegated authority

  
\_\_\_\_\_  
Susan Light, SVP  
Chief Counsel  
FINRA Department of Enforcement  
One World Financial Center  
200 Liberty Street, 11<sup>th</sup> Floor  
New York, New York 10281  
Tel: (646) 315-7333  
Fax: (202) 689-3411  
Susan.light@finra.org