

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT**

**NO. 20130358229-01**

**TO: Department of Market Regulation  
Financial Industry Regulatory Authority ("FINRA")**

**RE: Merrill Lynch, Pierce, Fenner & Smith Incorporated, Respondent  
Broker-Dealer  
CRD No. 7691**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "firm" or "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 Respondent alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. 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**

The firm became a member of FINRA on January 26, 1937, and its registration remains in effect.

**RELEVANT DISCIPLINARY HISTORY**

On June 4, 2014, the firm finalized an AWC for, among other things, violations of SEC Rule 17a-4 committed during the review period of March 2006 through January 2014. The firm was censured and fined a total of \$1 million.

On January 7, 2014, the firm finalized an AWC for, among other things, violations of SEC Rule 17a-4 and NASD Rule 3110 committed during the review period of April 1, 2006 through December 31, 2010. The firm was censured and fined a total of \$45,000.

On November 18, 2013, the firm finalized an AWC for, among other things, violations of FINRA Rule 7450 committed during the trade dates of July 1, 2009 and July 2, 2009. The firm was censured and fined a total of \$35,000 of which \$10,000 was for violating FINRA Rule 7450.

On October 24, 2013, the firm finalized an AWC for, among other things, violations of FINRA Rules 7230A and 7450, and NASD Rule 3010 committed during various review periods between July 2008 and August 2011. The firm was censured and fined a total of \$85,000 of which \$22,500 was for violating FINRA Rule 7450, \$15,000 was for violating FINRA Rule 7230A, and \$10,000 was for supervision violations.

On April 8, 2013, the firm finalized an AWC for, among other things, violations of SEC Rule 10b-10 committed during the review period of March 2010 through March 2011. The firm was censured and fined a total of \$65,000.

On March 4, 2013, the firm finalized an AWC for, among other things, violations of FINRA Rules 7230A and 7450 committed during various review periods between July 2008 and May 2011. The firm was censured and fined a total of \$150,000 of which \$30,000 was for violating FINRA Rule 7230A and \$65,000 was for violating FINRA Rule 7450.

On December 12, 2012, the firm finalized an AWC for, among other things, violations of FINRA Rule 7230A committed during the review periods of April 2007 through June 2007, October 2008 through December 2008, and January 2008 through February 2010. The firm was censured and fined a total of \$265,000 of which \$245,000 was for violating FINRA Rule 7230A.

On June 21, 2012, the firm finalized an AWC for, among other things, violations of SEC Rules 17a-3, 17a-4 and 10b-10 committed during the review periods of April 2003 through December 2011, July 2006 through April 2008, 1992 through June 2011, 2007 through 2010, October 2001 through March 31, 2010, and August 2004 through June 2010. The firm was censured and fined a total of \$2.8 million.

## SUMMARY

1. In Matter Nos. 20130358229 and 20140399379, the Trading and Financial Compliance Examination (“TFCE”) Group of the Department of Market Regulation (the “TFCE staff”) reviewed the trading activity of the firm for trade dates July 16 and 17, 2013 and August 13, 2014, respectively. In the course of its examination and a subsequent investigation by the Legal Section staff of the Department of Market Regulation (“DMR”), the DMR staff identified a number of systemic issues concerning the firm’s trade reporting, Order Audit Trail System (“OATS”) reporting, books and records and supervision. These findings resulted in the violation of SEC and FINRA rules, as set forth below.

### Trade and OATS Reporting

2. FINRA uses trade reporting and OATS data as an integral part of its automated market surveillance program to detect manipulative activity and other potential violations of FINRA rules and the federal securities laws. The transmission of inaccurate or incomplete trade reports or reportable order events (“ROEs”) can hamper FINRA’s ability to detect potentially violative conduct and/or create false

positive alerts requiring the expenditure of unnecessary resources to resolve the alerts. Moreover, these failures also cause the audit trail to be inaccurate.

3. During the review periods detailed below, the firm submitted to the FINRA/Nasdaq Trade Reporting Facility (“TRF”) millions of inaccurate trades in which purchases were reported as principal sales and agency crosses. The firm also submitted millions of trades it was not required to submit.
4. During the review periods below, the firm also submitted millions of inaccurate or incomplete ROEs to OATS including the submission of New Orders with inaccurately placed cancel stamps, New Order reports for modifications of existing orders, broker-dealer orders reported as customer orders, inaccurate Good Till Time (“GTT”) Time In Force designations, and intermarket sweeps orders (“ISOs”) without the required ISO special handling code. The firm also failed to report millions of execution reports to OATS.

#### Books and Records

5. FINRA relies on the accuracy of a firm’s books and records in order to properly conduct its surveillance of brokers and dealers. These records ensure that FINRA has access to certain basic information about securities transactions to allow for the adequate policing of the securities markets. Failure to capture and maintain accurate books and records adversely and materially affects FINRA’s ability to surveil the securities markets and monitor member firms’ compliance with securities rules and regulations.
6. During the review periods detailed below, the firm failed to capture the minimum quantity (“MQT”) special handling instructions on millions of order tickets which are used for transactions that should be canceled if a specified minimum quantity cannot be executed. The firm also recorded incorrect receipt and route timestamps on millions of order tickets.

#### Supervision

7. During the review periods detailed below, the firm’s written supervisory procedures (“WSPs”) were not reasonably designed to ensure compliance with FINRA’s trade and OATS reporting rules, customer confirmation rules, and the books and records requirements in SEC Rule 17a-3.
8. The firm’s WSPs required supervision of a number of modifiers but failed to call for a supervisory review of the .RX modifier which concern transactions reported for regulatory transaction fees.
9. The firm’s OATS reporting WSPs required the review of a small number of OATS reports on a monthly basis to ensure the accuracy of such reports. Given the volume

of the firm's OATS reporting obligations, the scope of the firm's WSPs was not reasonably designed to capture and identify any reporting problems.

10. The firm's books and records, customer confirmations and OATS WSPs required the review of a small number of books and records and customer confirmations on a monthly basis to ensure the accuracy of such records. Given the volume of the firm's books and records, customer confirmations and OATS reporting obligations, the scope of the firm's WSPs was not reasonably designed to capture and identify the accuracy of such records.

### **FACTS AND VIOLATIVE CONDUCT**

11. In matters 20130358229 and 20140399379, the TFCE staff found the following systemic failures at the firm.

#### **Trade Reporting:**

12. Between May 2010 and April 2014 a system configuration error caused an implementation inconsistency between the firm's internal alternative trading system ("ATS") and its trade reporting engine which misinterpreted certain custom tags that communicated the firm's/customers' capacity. This error caused the firm to report 20,041,738 trades inaccurately to the FINRA TRF. Specifically, the firm (i) reported purchases as principal sales, (ii) reported agency crosses as principal transactions, (iii) reported purchases as principal short sales, and (iv) reported trades to the TRF that were not required to be reported. Additionally, between January 2012 and April 2014, the firm failed to correctly configure certain MPID flags causing the firm to fail to report such contra-side MPIDs on approximately 8,739,712 trade reports. The conduct described in this paragraph constitutes separate and distinct violations of FINRA Rule 7230A.

#### **OATS:**

13. Between approximately January 2011 and October 2014, the firm failed to report execution reports for trades executed by a particular desk. The staff sampled the firm's OATS reporting between October 1, 2014 and October 24, 2014. During this period, the firm failed to report approximately 67,046 execution reports. Based on this sampling, it was estimated that the firm failed to report approximately 2.4 million execution reports to OATS between January 2011 and October 2014.
14. Between approximately January 2013 and August 2015, the firm's OATS reporting vendor inaccurately appended the cancel timestamp to New Order reports, indicating a full cancellation, where such orders were residual share amount cancellations. The staff sampled the firm's OATS reporting between August 3, 2015 and August 17, 2015. During this period, the firm incorrectly appended the cancel timestamp on approximately 2.95 million ROEs. Based on this sampling, it was estimated that the

firm reported approximately 153 million inaccurate ROEs to OATS between January 2013 and August 2015.

15. Between approximately March 2011 and October 2015, a component in the firm's order management system incorrectly translated a re-opening of an order as a New Order event and caused the firm to inaccurately report New Order reports to OATS. The staff sampled the firm's OATS reporting between August 3, 2015 and August 17, 2015. During this period, the firm inaccurately reported 1,150 New Order reports to OATS. Based on this sampling, it was estimated that the firm reported approximately 119,600 inaccurate ROEs to OATS between March 2011 and October 2015.
16. Between approximately January 2013 and June 17, 2015, the firm failed to accurately configure a client profile which caused the firm to report broker-dealer orders as customer orders. The staff sampled the firm's OATS reporting between June 1, 2015 through June 16, 2015. During this period, the firm incorrectly reported 16.42 million broker-dealer orders as customer orders. Based on this sampling, it was estimated that the firm reported approximately 985.2 million inaccurate ROEs to OATS between January 2013 and June 2015.
17. Between approximately January 2, 2014 and October 16, 2014, the firm's OATS reporting vendor referenced the wrong field for OATS reporting causing inaccurate "Time In Force" tags to be reported. The staff sampled the firm's OATS reporting between October 1, 2014 and October 16, 2014. During this period, the firm reported inaccurate "Time In Force" tags on approximately 6 million ROEs. Based on this sampling, it was estimated that the firm reported approximately 102 million inaccurate ROEs to OATS between January 2, 2014 and October 16, 2014.
18. Between approximately February 11, 2014 and January 30, 2015, the firm failed to report certain trades as intermarket sweeps orders ("ISOs"). The staff sampled the firm's OATS reporting for the period of January 2015. During this period, the firm failed to report approximately 356,000 trades as ISOs to OATS. Based on this sampling, it was estimated that the firm reported approximately 8.9 million inaccurate ROEs to OATS between February 11, 2014 and January 30, 2015.
19. The conduct described in paragraphs 13 through 18 constitutes separate and distinct violations of FINRA Rule 7450.

Books and Records:

20. During the period of at least January 2013 through August 21, 2015, the firm failed to record on the firm's order records MQT special handling instructions. This error impacted approximately 120.1 million order records during the first half of August 2015. Based on this sampling, it was estimated that approximately 720 million records were affected throughout the period.
21. During the period of approximately January 2, 2013 through October 16, 2014, certain firm orders contained incorrect receipt and route timestamps between the

period of January 2, 2013 through October 16, 2014. The error impacted approximately 6 million orders during the first half of October 2014. Based on this sampling, it was estimated that approximately 102 million records were affected throughout the period.

22. The conduct described in paragraphs 20 and 21 constitutes separate and distinct violations of Section 17 of the Securities Exchange Act of 1934 (“Exchange Act”), SEC Rule 17a-3, and FINRA Rules 4511 and 2010.

Supervision:

23. Between May 2010 and October 2015, the firm’s supervisory system, including its WSPs, did not provide for supervision reasonably designed to achieve compliance with respect to certain applicable securities laws and regulations, and/or Rules of FINRA and SEC, with respect to OATS, books and records, customer confirmations and trade reporting. As described above, the scope of the firm’s review with respect to OATS, books and records and customer confirmations was not reasonably designed to ensure the accuracy of such records given the volume of the firm’s reporting and books and records obligations.
24. On July 16 and 17, 2013, as described above, the firm’s trade reporting WSPs, which failed to call for a supervisory review of .RX modifiers, were not reasonably designed to ensure the accuracy of trade reports which included .RX modifiers.
25. The conduct described in the paragraphs above constitutes separate and distinct violations of NASD Rule 3010 (for conduct that occurred before December 1, 2014), FINRA Rule 3110 (for conduct that occurred on or after December 1, 2014) and FINRA Rule 2010.

In addition to the issues described above, the staff also found the following violations:

**20130358229**

26. On trade dates July 16 and 17, 2013, the firm: (i) incorrectly reported a trade as an exercise of an over-the-counter (“OTC”) option; (ii) in 9 instances incorrectly reported a step-out transaction with a principal capacity for an agency trade; and (iii) in 1 instance incorrectly reported a trade to the TRF as a buy where the firm’s order records indicate it was a principal short sale transaction. The conduct described in this paragraph constitutes separate and distinct violations of FINRA Rule 7230A.
27. On trade dates July 16 and 17, 2013, the firm: (i) in 5 instances inaccurately submitted special handling code delivery instructions “CSH” to OATS; (ii) in 2 instances failed to submit information to OATS for a reportable event; (iii) in 2 instances submitted inaccurate special handling code information to OATS for a proprietary firm order; (iv) in 1 instance submitted an inaccurate account type code and an inaccurate order origination code to OATS; and (v) in 1 instance failed to

submit execution information to OATS. The conduct described in this paragraph constitutes separate and distinct violations of FINRA Rule 7450.

28. On trade dates July 16 and 17, 2013, in 541 instances, the firm inaccurately provided written notifications to its customers that transactions executed as a single execution were executed at an average price. The conduct described in this paragraph constitutes separate and distinct violations of Section 10 of the Exchange Act, SEC Rule 10b-10 and FINRA Rule 2232.
29. For the month of May 2013, the firm made available a report on the covered orders in national market system securities that it received for execution from any person. This report included incorrect information as to canceled shares. The conduct described in this paragraph constitutes separate and distinct violations of SEC Rule 605 of Regulation NMS ("SEC Rule 605").

**20140399379**

30. On trade date August 13, 2014: (i) in 1 instance the firm reported an incorrect cancel time to OATS; (ii) in 1 instance the firm incorrectly submitted a NW report when a CR was required and erroneously appended an IOC special handling instruction; (iii) in 1 instance the firm failed to submit a RT report to OATS; and (iv) in 1 instance the firm reported an incorrect desk share quantity to OATS. The conduct described in this paragraph constitutes separate and distinct violations of FINRA Rule 7450.
31. On trade date August 13, 2014: (i) in 1 instance the firm failed to provide data regarding certain routes to Nasdaq and desk special handling codes reported to OATS; (ii) in 1 instance the firm recorded an inaccurate order route time; (iii) in 1 instance the firm's order record did not include the PEG and DLO special handling instructions reported to OATS; (iv) in 2 instances the firm's order records did not support the usage of the MQT special handling code reported to OATS and the Order Received Times of the cancel/replace events and the final cancel event reported to OATS did not coincide with the order records; (v) in 1 instance the volume routed and the time reported for the CR and subsequent RT events did not coincide with the order records; (vi) in 2 instances the firm failed to memorialize the 'Good Til Time'; and (vii) in 5 instances, the firm failed to provide a complete and accurate trading ledger with respect to Nasdaq OMX PSX Order Entries. The conduct described in this paragraph constitutes separate and distinct violations of Section 17 of the Exchange Act, SEC Rules 17a-3, 17a-4 and FINRA Rule 4511.

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

A censure, a fine of \$2,800,000 (consisting of a \$360,000 fine for violating FINRA Rule 7230A, a \$360,000 fine for violating FINRA Rule 7450, a \$10,000 fine for violating SEC Rule 10b-10 and FINRA Rule 2232, a \$620,000 fine for the supervision violations and a \$1,450,000 fine for the SEC Rule 605 and books and records violations), and an undertaking to revise the firm's WSPs with respect to the areas described in paragraphs I.A.23 and I.A.24. Within 60 business days of

acceptance of this AWC by the National Adjudicatory Council (“NAC”), a member of senior management of the Respondent shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a signed, dated letter, or an e-mail from a work-related account of the member of senior management to MarketRegulationComp@finra.org, providing the following information: (1) a reference to this matter; (2) a representation that the firm has revised its WSPs to address the deficiencies described in this paragraph; and (3) the date the revised procedures were implemented.

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. It has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

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

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 firm;
- 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 NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, 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.

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

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 Respondent; and
- C. If accepted:
  - 1. this AWC will become part of the firm’s permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the firm;
  - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
  - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
  - 4. 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. 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 firm’s: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm 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 it has agreed to the AWC's 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.

09/30/16  
Date

Respondent  
Merrill Lynch, Pierce, Fenner & Smith  
Incorporated

By: Pankil Patel  
Name: [Signature]  
Title: MD

Reviewed by:

\_\_\_\_\_  
Attorney Name:  
Counsel for Respondent:  
Firm Name:  
Address:  
City/State/Zip:  
Phone Number:

Accepted by FINRA:

10/17/16  
Date

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

[Signature]  
Robert A. Marchman  
Executive Vice President and Counsel  
FINRA Department of Market Regulation