

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2010022011901**

TO: Department of Enforcement
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 (hereinafter, “Merrill Lynch,” “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

Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch”) has been a FINRA member firm since 1937. It is a full-service broker-dealer with its principal offices located in New York, New York. It employs over 31,000 registered individuals and maintains over 1,200 branch offices.¹

RELEVANT DISCIPLINARY HISTORY

In May 2009, Merrill Lynch submitted an AWC consenting to the entry of findings by FINRA that, between March 2003 and August 2006, the Firm violated NASD Conduct Rules 3010 and 2110 by failing to maintain adequate systems and procedures to detect and prevent unsuitable short-term trading in closed-end funds purchased in initial public offerings. For this conduct, the Firm was censured and fined \$150,000 by FINRA.

¹ In January 2009, Merrill Lynch was acquired by Bank of America Corporation.

OVERVIEW

From approximately January 1, 2006 through March 1, 2009, Merrill Lynch failed to have a reasonable supervisory system that would flag for supervisors on an automated exception basis potentially unsuitable concentration levels in structured products in customer accounts, in violation of NASD Conduct Rules 3010 and 2110, for the time period from January 1, 2006 to December 14, 2008, and NASD Conduct Rule 3010 and FINRA Rule 2010, for the time period from December 15, 2008 to March 1, 2009.

FACTS AND VIOLATIVE CONDUCT

Structured Products

Structured products are securities derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance, and/or a foreign currency. There are many types of structured products, which may differ on the level of principal protection offered (if any), the interest or coupon rate paid, and the relative participation in the performance of the reference asset or market measure. A defining characteristic of all structured products is that they do not represent an ownership interest in the reference asset(s), unlike a mutual fund. Structured products are, in most cases, unsecured debt (notes) of the issuing company, and as such, the terms and performance of the product are subject to the creditworthiness of the entity issuing the notes. The inherent "issuer risk," in addition to other characteristics of structured products, underscores the importance of ensuring that customers invest only an appropriate amount of their assets in such products.

Regulatory Guidance

In September 2005, FINRA issued Notice to Members 05-59 as a result of concerns that broker-dealers were deficient in fulfilling sales practice obligations when selling structured products, particularly to retail customers. The Notice advised that some structured products present risks similar to that of options, and that firms should develop procedures to ensure that the structured products sold to investors matched those investors' appetite for risk. FINRA also reminded firms to perform a reasonable basis suitability determination on a structured product before recommending the product, as well as a customer-specific suitability determination. The Notice also stated that firms should ensure they establish, maintain, and enforce procedures to determine which customer accounts are eligible to purchase structured products.

Merrill Lynch's Structured Products Business and Supervision

Merrill Lynch offers for sale to retail customers a wide range of structured products, which may be grouped according to four general categories: enhanced return, enhanced income, market downside protection, and market access. From January 1, 2006 through March 1, 2009, Merrill Lynch customers effected approximately 650,000 structured-product purchases, of which greater than 50 percent involved structured-product offerings issued by the parent company of the Firm.

To supervise sales of securities to retail customers, Merrill Lynch relies upon automated exception-based reporting systems to flag transactions and/or accounts that meet certain pre-defined criteria. The various exception-based reporting systems employed by Merrill Lynch are utilized by dedicated review units or teams within Merrill Lynch that are charged with follow-up investigation of exceptions reported. Of the several exception-based reporting systems utilized by Merrill Lynch, none, prior to March 1, 2009, specifically monitored for potentially unsuitable concentration levels in structured products in customer accounts.

As a result of said conduct, Merrill Lynch violated NASD Conduct Rules 3010 and 2110, for the time period from January 1, 2006 to December 14, 2008, and NASD Conduct Rule 3010 and FINRA Rule 2010, for the time period from December 15, 2008 to March 1, 2009.

B. Merrill Lynch also consents to the imposition of the following sanctions:

A censure and a fine in the amount of \$450,000.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent 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 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 it;
- 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, 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.

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 Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against 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. 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 Respondent's 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. 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 Respondent, 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 Respondent 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 Respondent to submit it.

May 25, 2012
Date (mm/dd/yyyy)

Merrill Lynch, Pierce, Fenner & Smith Incorporated

Reviewed by:

Timothy P. Burke

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By: Mark L. Keene
MARK L. KEENE
ASSOCIATE GENERAL COUNSEL

Accepted by FINRA:

June 11, 2012
Date

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

Mark Fernandez
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CORRECTIVE ACTION STATEMENT

In late 2008, Merrill Lynch began development of an automated structured products concentration report that highlighted client accounts for supervisors on an exception-basis when certain pre-determined concentration levels were exceeded. That report was first implemented in March 2009, and remains in use at present.

This Corrective Action Statement is submitted by Merrill Lynch. It does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.