

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

**NO. 20110288421-01**

**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, Respondent Merrill Lynch, Pierce, Fenner & Smith Incorporated ("BOFA" "MLMA" or the "firm") 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 AND RELEVANT DISCIPLINARY HISTORY**

The firm has been a member of FINRA since January 26, 1937, and its registration remains in effect. The firm has the following relevant disciplinary history:

- On August 21, 2012, an AWC became final in which the firm was censured and fined for, among other things, violations of NASD Rule 4632(a). For these violations, the firm was fined \$10,000.
- On December 12, 2012, an AWC became final in which the firm was censured and fined for, among other things, violations of NASD Rule 6130 and FINRA Rules 6182 and 7230A. For these violations, the firm was fined \$240,000.
- On April 1, 2013, an AWC became final in which the firm was censured and fined for, among other things, violations of SEC Rule 10b-10 and NASD Rule 2230. For these violations, the firm was fined \$65,000.

- On April 2, 2013, an AWC became final in which the firm was censured and fined for, among other things, violations of NASD Rule 2320. For these violations, the firm was fined \$650,000.
- On January 7, 2014, an AWC became final in which the firm was censured and fined \$45,000 for violations of SEC Rule 17a-3 and NASD Rule 3110.

## **BACKGROUND**

In 20110288421, the staff in the Customer Issues Section of FINRA's Department of Market Regulation (the "staff") and the Legal Section conducted an investigation concerning the handling of customer orders in non-convertible preferred securities ("NCPS") by the firm's Global Banking & Markets Credit Trading Desk (the "Credit Desk"), which was a fixed-income trading desk located in New York, from July 1, 2010 through December 31, 2012 (the "NCPS review period").

In 20130359458, the staff conducted an investigation concerning the handling of customer orders in over the counter convertible preferred securities ("OTC CPS") by the firm's Global Wealth and Retirement Solutions Block Trading Desk (the "Block Desk"), from January 1, 2011 through September 30, 2014 (the "OTC CPS review period").

Based upon the investigations, FINRA determined that the firm violated the rules set forth below.

## **FACTS AND VIOLATIVE CONDUCT**

### **20110288421**

During the NCPS review period, Financial Advisers ("FA") in the firm's Global Wealth & Investment Management ("GWIM") division had two options for executing customer orders in NCPS – either route the order electronically to an exchange via the firm's Private Client Order Entry ("PCOE") system, or route the order to the Credit Desk for manual execution. During the NCPS review period, the firm executed the majority of its NCPS transactions electronically and the remainder was handled manually by the Credit Desk.

The manual execution of NCPS transactions was initiated by a GWIM FA, facilitated through one of three service desks<sup>1</sup> and executed by the Credit Desk. The customer incurred an additional charge, in the form of a mark-up or mark-down of from \$.04 to \$.12 per share, when a NCPS transaction was manually executed by the Credit Desk (orders handled on an automated basis through PCOE did not have this mark-up or mark-down). The additional charge by the Credit Desk led directly to the customer receiving an inferior price when compared to the displayed quotes on automated markets. For instance, on July 2, 2012, the Credit Desk sold 600 shares of a NCPS issued by J.P. Morgan Chase & Co. at \$24.12 to a customer when 600 shares were offered on an automated trading center at \$24.08.

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<sup>1</sup> The service desks were located in New York, NY, Hopewell, NJ and Charlotte, NC.

In 1,508 executions by the Credit Desk, 100% of the trade quantity or greater was electronically displayed in the market at better or equal prices than what the customer received. Because there was 100% displayed liquidity at better or equal prices on automated markets (which could have been accessed through PCOE) for each of the 1,508 transactions, these orders executed by the Credit Desk were handled in a manner inconsistent with the firm's best execution obligations.

Other violative conduct was also identified during the investigation. The Credit Desk trader who handled the majority of transactions in this matter manually inputted the trade details into the firm's order management system and she had no ability to record a time of execution other than the time the trade was inputted into the firm's system. Because the trader was frequently handling multiple tasks simultaneously, and there was a time delay between when the terms of the trade were agreed upon and when the trade details were inputted, the firm's trade reports submitted to the FINRA/Nasdaq Trade Reporting Facility ("TRF") and its books and records reflected inaccurate order execution times.

The staff sampled internal communications, trade reports and the firm's books and records related to 19 customer transactions executed by the Credit Desk. It was determined after this review that the firm, in the 19 instances: 1) recorded an inaccurate order execution time on its books and records; 2) submitted to the TRF a trade report that contained an inaccurate execution time; and 3) submitted to the TRF a trade report that reflected the Credit Desk's mark-up or mark-down in the reported unit price. Separately, it was also determined that in 1,337 instances, the firm recorded an order receipt time that was inaccurate because it reflected a later time than the execution time reported to the TRF.

The firm also issued inaccurate customer confirmations to its customers. In 5,410 instances, the firm failed to disclose the difference between the price reported to the TRF and the price to the customer, which represented compensation to the firm, on trade confirmations sent to customers. Also, in 7,925 instances, the customer trade confirmations stated that "for reported securities, unless otherwise indicated "price" is the reported price." The price disclosed to the customer, however, did not match the price reported to the TRF but instead included a mark-up or mark-down.

Finally, it was determined that during the NCPS review period the firm lacked written supervisory procedures ("WSPs") for the following areas on the firm's Credit Desk: 1) equity trade reporting; 2) the accuracy of customer confirmations; and 3) the accuracy of books and records.<sup>2</sup>

As a result of the above-described conduct, it was determined that the firm violated: 1) NASD Rule 2320,<sup>3</sup> 2) Section 10 of the Securities Exchange Act of 1934 ("Exchange

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<sup>2</sup> A supervisory deficiency related to the firm's fair pricing and best execution obligations for transactions executed on the Credit Desk was also identified in the investigation. This deficiency, however, was resolved in a separate matter (STAR No. 20100226911)(December 16, 2014), which resulted in a separate fine and an undertaking to revise the firm's WSPs.

<sup>3</sup> Or FINRA Rule 5310 on or after May 31, 2012.

Act”) and SEC Rule 10b-10 thereunder and NASD Rule 2230;<sup>4</sup> 3) Section 17 of the Exchange Act and SEC Rule 17a-3 thereunder and NASD Rule 3110;<sup>5</sup> 4) FINRA Rules 7230A and 2010; and 5) NASD Rule 3010.

More specifically, it was determined that:

1. During the NCPS review period, in 1,508 transactions for or with a customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. The conduct described in this paragraph constitutes separate and distinct violations of NASD Rule 2320 (or FINRA Rule 5310 on or after May 31, 2012) and FINRA Rule 2010.
2. During the NCPS review period, in 19 instances, the firm submitted to the TRF a last sale report of a transaction in a reportable security that included: 1) an inaccurate time of execution; and 2) a mark-up or mark-down in the unit price. The conduct described in this paragraph constitutes separate and distinct violations of FINRA Rule 7230A.
3. During the NCPS review period, the firm failed to record the correct time of order entry on the memorandum of 1,337 brokerage orders. The firm also failed to record the correct time of execution on the memorandum of 19 brokerage orders. The conduct described in this paragraph constitutes separate and distinct violations of Section 17 of the Exchange Act and SEC Rule 17a-3 thereunder, NASD Rule 3110 (or FINRA Rule 4511 on or after December 5, 2011) and FINRA Rule 2010.
4. From January 8, 2009 through May 20, 2014, in 5,410 instances, the firm failed to disclose on customer confirmations in connection with a transaction in an NMS stock the difference between the price reported to the TRF and the price to the customer, which represented compensation to the firm. Also, in 7,925 instances, the customer trade confirmation stated that “for reported securities, unless otherwise indicated ‘price’ is the reported price.” The price disclosed to the customer, however, did not match the price reported to the TRF but instead included a mark-up or mark-down. The conduct described in this paragraph constitutes separate and distinct violations of Section 10 of the Exchange Act and SEC Rule 10b-10 thereunder, NASD Rule 2230 (or FINRA Rule 2232 on or after June 17, 2011) and FINRA Rule 2010.
5. During the NCPS review period, the firm's supervisory system did not provide *for supervision reasonably designed to achieve compliance with respect to* certain applicable securities laws and regulations, and/or the Rules of FINRA.

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<sup>4</sup> Or FINRA Rule 2232 on or after June 17, 2011.

<sup>5</sup> Or FINRA Rule 4511 on or after December 5, 2011.

At a minimum, adequate WSPs addressing quality of markets topics should describe the following:

- a. specific identification of the individual(s) responsible for supervision;
- b. the supervisory steps and reviews to be taken by the appropriate supervisor;
- c. the frequency of such reviews; and
- d. how such reviews shall be documented.

The firm's WSPs failed to provide for the four above-cited minimum requirements for adequate WSPs, for transactions executed on the Credit Desk, in the following subject areas: Equity Trade Reporting; Accuracy of Books & Records; and Accuracy of Customer Confirmations. This resulted in the firm's supervisory system to be inadequate in monitoring activity in the above areas. The conduct described in this paragraph constitutes a violation of NASD Rule 3010 and FINRA Rule 2010.

20130359458

During the OTC CPS review period, the firm's Block Desk manually executed customer orders in OTC CPS. The Block Desk handled these orders during the OTC CPS review period on an agency basis and obtained quotations from third party broker-dealers. But in so doing, the Block Desk failed to access displayed quotations in these securities on automated markets.

The staff reviewed all customer orders in OTC CPS executed by the Block Desk and compared each execution price to the respective inside market at the time of execution. The staff determined that, in 551 instances, customers received an inferior price when: 1) there was sufficient displayed liquidity to execute the order in full at the better price; and 2) the better price was displayed during the entire life cycle of the order. The staff calculated restitution to be approximately \$53,000 in connection with these 551 orders and the firm has evidenced that restitution was made.

Additionally, in connection with 1,380 separate market orders in OTC CPS, the Block Desk failed to obtain executions for these orders despite the fact that, at the time of order receipt, the OTC marketplace displayed two-sided quotations within the National Best Bid or Offer that could have at least partially satisfied the order. The Block Desk failed to review automated quotations by market makers in OTC CPS securities when it handled customer order flow in these securities.

The customer orders in OTC CPS routed to the Block Desk were also automatically converted from Held orders to Not Held orders. The firm acknowledged that the customer orders in OTC CPS securities routed to the Block Desk were not initially placed with any specific instructions or expectations to be handled as Held or Not Held. Because these were customer orders being handled on an agency basis that could have been executed on an automated market, the orders should have been marked as Held, absent instructions to the contrary.

Finally, the Block Desk's WSPs during the OTC CPS review period were deficient. Specifically, there were no supervisory reviews to ensure that marketable customer orders are executed fully and promptly on the Block Desk (as required by FINRA Rule 5310.01). The firm was also unable to produce evidence that it performed best execution reviews for OTC CPS during the OTC CPS review period.

Accordingly, in 20130359458, it was determined that the firm violated: 1) NASD Rule 2320;<sup>6</sup> 2) NASD Rule 2111(a);<sup>7</sup> 3) Section 17 of the Exchange Act and SEC Rule 17a-3 thereunder and NASD Rule 3110;<sup>8</sup> 4) NASD Rule 3010; and FINRA Rule 2010. More specifically, it was determined that:

6. During the OTC CPS review period, in 551 transactions for or with a customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. The conduct described in this paragraph constitutes separate and distinct violations of NASD Rule 2320 (or FINRA Rule 5310 on or after May 31, 2012) and FINRA Rule 2010.<sup>9</sup>
7. During the OTC CPS review period, in 1,380 instances, the firm failed to execute an order. The conduct described in this paragraph constitutes separate and distinct violations of NASD Rule 2111(a) (or FINRA Rule 5310.01 for conduct on or after May 31, 2012) and FINRA Rule 2010.
8. During the OTC CPS review period, in 7,609 instances, the firm incorrectly marked a "Held" market order as "Not Held." The conduct described in this paragraph constitutes separate and distinct violations of Section 17 of the Exchange Act and SEC Rule 17a-3 thereunder, NASD Rule 3110 (or FINRA Rule 4511 on or after December 5, 2011) and FINRA Rule 2010.
9. During the OTC CPS review period, the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to certain applicable securities laws and regulations, and/or the Rules of FINRA. At a minimum, adequate WSPs addressing quality of markets topics should describe the following:
  - a. specific identification of the individual(s) responsible for supervision;
  - b. the supervisory steps and reviews to be taken by the appropriate supervisor;
  - c. the frequency of such reviews; and
  - d. how such reviews shall be documented.

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<sup>6</sup> Or FINRA Rule 5310 on or after May 31, 2012.

<sup>7</sup> Or FINRA Rule 5310.01 on or after May 31, 2012.

<sup>8</sup> Or FINRA Rule 4511 on or after December 5, 2011.

<sup>9</sup> As referenced earlier, restitution by the firm in connection with the 551 customer transactions has been made in full.

The firm's WSPs failed to provide for the four above-cited minimum requirements for adequate WSPs, for the timely handling of market orders in OTC CPS handled by the Block Desk. The conduct described in this paragraph constitutes a violation of NASD Rule 3010 and FINRA Rule 2010.

10. The firm failed to provide documentary evidence that during the OTC CPS review period it performed the supervisory reviews set forth in its WSPs concerning best execution of customer orders in OTC CPS executed on the Block Desk. The conduct described in this paragraph constitutes violations of NASD Rule 3010 and FINRA Rule 2010.

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

- A censure;
- A fine of \$650,000 (\$365,000 for the best execution violations, \$150,000 for the supervision violations, \$60,000 for the books and records violations, \$25,000 for the customer confirmation violations, \$25,000 for the trade reporting violations, and \$25,000 for the market order timeliness violations);
- Restitution is ordered to be paid to customers in the amount of \$124,128.30, in connection with the transactions referenced in paragraph I.A.1, above, plus interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from the date of the violative conduct until the date this AWC is accepted by the National Adjudicatory Council; and
- An undertaking to submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, no later than 30 days after the AWC becomes final, a signed, dated letter or e-mail from a work-related account of the registered principal to [MarketRegulationComp@finra.org](mailto:MarketRegulationComp@finra.org), acknowledging that the firm revised its written supervisory procedures to address the deficiencies described in paragraphs I.A.5 and 9, above, and the date the revised procedures were implemented.

A registered principal on behalf of the firm shall submit satisfactory proof of payment of the restitution, or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, either by letter that identifies the firm and case number, or by email from a work-related account of the registered principal of the firm to [MarketRegulationComp@finra.org](mailto:MarketRegulationComp@finra.org). This proof shall be provided to FINRA no later than 120 days after acceptance of this AWC.

If for any reason, the firm cannot locate any customer identified after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by FINRA staff in writing, the firm shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed-property or abandoned-property fund for the state in which the customer is known to have last resided. The firm shall provide satisfactory proof of such action to FINRA in the manner described above, within 14 days of forwarding the undistributed restitution and interest to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the

timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. It has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

The firm 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 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 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 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**

The firm 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 firm; 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. The firm 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 firm 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. The firm 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.

April 13, 2017  
Date

Respondent  
Merrill Lynch, Pierce, Fenner & Smith  
Incorporated

By: David Montague  
Name: David Montague  
Title: Associate General Counsel

Reviewed by:  
EBM  
Counsel for Respondent  
Elizabeth Baird  
Morgan, Lewis & Bockius LLP  
202.373.6561  
Accepted by FINRA:

5/16/17  
Date

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

Robert A. Marchman / JS  
Robert A. Marchman, Esq.  
Executive Vice President  
Department of Market Regulation