FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014041808101

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

RE: Merrill Lynch, Pierce, Fenner & Smith Inc., Respondent
(CRD No. 7691)

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill" 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 the Firm 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 has been a FINRA member since 1937 and is headquartered in New York, New York. The Firm operates over 3,200 branch offices and employs approximately 33,000 registered representatives. Merrill is a full-service brokerage firm, providing sales and trading, research, and underwriting services to institutional and retail clients. Since January 2009, the Firm has been a broker-dealer subsidiary of Bank of America Corporation. The Firm's current minimum net capital requirement is approximately $1.7 billion.

OVERVIEW

From at least April 2013 through mid-2015 (the "Relevant Period"), Merrill failed to identify and evaluate certain trades with extended settlement dates ("ES Trades") across its product lines and business units for margin and net capital purposes. As a result, the Firm for these trades failed to collect the requisite margin in violation of FINRA Rules 4210 and 2010; take the appropriate net capital deduction in violation of SEA Rule 15c3-1(c) and FINRA Rule 2010; prevent extension of credit in cash accounts in violation of FINRA Rule 2010 by violating Regulation T of the Board of Governors of the Federal Reserve System ("Reg T"); maintain accurate schedules to the general ledger in violation of SEA Rule 17a-3 and FINRA Rules 4511 and 2010; and file accurate FOCUS Reports in violation of SEA Rule 17a-5 and FINRA Rule 2010.

According to Firm estimates, for the period March through June 2012, it extended excess margin of at least $475 million and failed to take required net capital deductions of approximately $362 million. In those instances where the Firm improperly permitted extensions of credit in violation of Reg T, the Firm estimated that it should have collected between $16 and $32 million in margin from certain customers' cash accounts.

During the Relevant Period, the Firm also failed to establish, maintain and enforce a reasonable supervisory system, including written supervisory procedures ("WSPs"), designed to achieve compliance with applicable federal securities laws and regulations with respect to margin, net capital, books and records, and Financial and Operational Combined Uniform Single ("FOCUS") Reports in violation of FINRA Rule 3110, and its predecessor rule, NASD Rule 3010. The Firm's supervisory system and written procedures failed to identify and consider ES Trades across its product lines and business units. Although the Firm was made aware of these supervisory deficiencies in April 2013 through findings made during a FINRA's Department of Member Regulation ("Member Regulation") examination, Merrill nonetheless failed to implement any remedial measures until mid-2014, and failed to implement a reasonable Firm-wide supervisory system to identify and consider ES Trades until mid-2015.

FACTS AND VIOLATIVE CONDUCT

ES Trades at the Firm

ES Trades are characterized by a longer time between trade and settlement than the standard post-trade settlement period of one to three business days. During the Relevant Period, Merrill retail and institutional customers engaged in ES Trades across numerous Firm product lines, including mortgage-backed securities, government and agency debt, corporate debt, as well as municipal and equity securities.

ES Trades comprised a significant number of trades across different product lines and business units of Merrill's business during the Relevant Period. As of June 30, 2013, the Firm reported in its FOCUS Report $326 billion in total ES Trades. However, the actual number of ES Trades far exceeded this amount by hundreds of millions of dollars.

Notwithstanding the volume and size of its ES Trade business, Merrill failed to identify and evaluate certain retail ES Trades to determine compliance with applicable net capital and margin rules. Similarly, Merrill failed to identify and evaluate institutional ES Trades for margin rule and net capital compliance, other than certain institutional customer transactions for net capital purposes. Consequently, during the Relevant Period, Merrill's computation of margin requirements and net capital deductions for tens of thousands of ES Trades was inaccurate, resulting in margin rule and net capital violations, as well as inaccurate books and records and FOCUS Report filings.

Failure to Collect Required Margin

FINRA Rule 4210 establishes various equity levels, known as "margin," that must be maintained on a security position held or carried in an account. Pursuant to FINRA Rule 4210(a)(13)(B)(ii)(e), certain categories of customer accounts and securities are classified as "exempt" from these margin requirements, but are instead subject to specified net capital deductions.

FINRA Rule 2010 requires broker-dealers to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. A violation of FINRA Rule 4210 constitutes a violation of FINRA Rule 2010.

Given that ES Trades involve extensions of credit beyond the typical settlement date when the Firm either receives payment or the security, Merrill was required to collect margin from the customer or counterparty or take a net capital charge depending on the customer's classification as "exempt" or "non-exempt" pursuant to FINRA Rule 4210.

During the Relevant Period, the Firm failed to track margin positions and determine the appropriate net capital charges for exempt and non-exempt customers and securities with respect to tens of thousands of ES Trades, resulting in hundreds of millions of dollars in uncollected margin. For example, between March through June 2012, the Firm failed to collect an average of approximately $119 million as of the last day of each month in additional required margin from its customers.

By failing to collect the appropriate margin on ES Trades, the Firm violated FINRA Rules 4210 and 2010.

Failure to Make Required Net Capital Deductions

Section 15(c) of the SEA and Rule 15c3-1 thereunder requires FINRA members to maintain minimum net capital in order to conduct a securities business and to compute net capital in accordance with specified provisions. In particular, SEA Rules 15c3-1(c)(2)(iv)(B), 15c3-1(c)(2)(viii) and 15c3-1(c)(2)(xii) specify the need to take net capital deductions in "Assets Not Readily Convertible to Cash" (specifically, "Certain Unsecured and Partly Secured Receivables," and "Open Contractual Commitments"), and "Deduction from Net Worth for Certain Undermargined Accounts." These required capital deductions apply to ES Trades.

Violations of the net capital rule constitute violations of FINRA Rule 2010.

During the Relevant Period, Merrill failed to identify tens of thousands of ES Trades and therefore did not take the required net capital deduction in lieu of collecting margin for these ES Trades. As a result, the Firm failed to take hundreds of millions of dollars of required net capital deductions during the Relevant Period. This failure had a material impact on the Firm's calculation and reporting of net capital. The Firm estimated that during a representative sample four-month period of March through June 2012, it should have deducted an average of $90 million as of the last day of each month from its net capital, but failed to do so. The Firm had sufficient net capital throughout the Relevant Period.

By failing to take required net capital deductions, the Firm violated Section 15(c) of the SEA and Rule 15c3-1(c) thereunder, and FINRA Rule 2010.

Extension of Margin in Violation of Reg T

Section 7(c) of the SEA makes it unlawful for a broker-dealer to extend or maintain credit or arrange for the extension or maintenance of credit to a customer on a security except in accordance with the rules and regulations prescribed by the Federal Reserve Board under Reg T. Violations of any of these rules and regulations constitute violations of FINRA Rule 2010.

Section 220.8 of Reg T states that a broker-dealer must obtain payment from a customer or cancel or liquidate the trade within five business days after the trade date. A creditor, such as a broker-dealer, is required to promptly cancel or liquidate a transaction or any part of a transaction for which the customer has not made full cash payment within the required time. If a payment cannot be made within the requisite five business days, the creditor may request an extension of time of the due dates from FINRA, as the Firm's examining authority. If no extension is requested, pursuant to Section 220.8 of Reg T, the Firm must cancel or liquidate the transaction. Otherwise, a transaction that settles beyond the five business day period is an extension of credit, which is prohibited to cash-account customers pursuant to Reg T.

During the Relevant Period, the Firm improperly extended credit in hundreds of its retail customers' cash accounts, in violation of Reg T. These transactions should not have been permitted in customer cash accounts, but instead should have occurred only in margin accounts where the Firm should have collected the legally required margin. This resulted in the Firm extending hundreds of millions of dollars in margin to cash-account customers during the Relevant Period. The Firm estimated that during March through June 2012, it should have collected an average of approximately $24 million, as of the last day of each month in additional margin interest from its retail customers' cash accounts.

By improperly extending margin credit in retail customers' cash accounts, the Firm violated FINRA Rule 2010 by violating Section 220.8(a)(1)-(2) of Reg T.

Inaccurate Books and Records

SEC Rule 17a-3(a)(3), promulgated under Section 17(a) of the SEA, requires that a broker-dealer keep accurate books and records, including, among others, asset and liability ledgers, customer account ledgers, and monthly balances of all ledger accounts in the form of trial balances for net capital purposes. Implicit in the requirement to make records is the requirement that the records be accurate.

FINRA Rule 4511(a) requires FINRA member firms to make and preserve accurate books, accounts, and records as required under FINRA Rules, the Exchange Act and the applicable SEA rules. The failure to maintain accurate books and records is also a violation of FINRA Rule 2010.

During the Relevant Period, by failing to identify and evaluate ES Trades for margin and net capital purposes, the Firm created and maintained inaccurate books and records, including inaccurate schedules to its General Ledger for computing net capital deduction and margin. During the period from March through June 2012, the Firm's books and records did not reflect at least $475 million in excess margin that should have been collected and overstated the Firm's net capital by approximately $362 million.

Accordingly, the Firm violated Section 17(a) of the Exchange Act, SEA Rule 17a-3(a) thereunder, and FINRA Rules 4511(a) and 2010.

Inaccurate FOCUS Reports

SEA Rule 17a-5(a), promulgated under Section 17(a) of the SEA, requires broker-dealers to report certain financial information to FINRA through a FOCUS Report. The filing of an inaccurate FOCUS Report is a violation of SEA Rule 17a-5 and also a violation of FINRA Rule 2010.

Because the Firm failed to identify and evaluate ES Trades for margin and net capital purposes, the Firm provided inaccurate net capital computations in approximately 30 monthly FOCUS Reports filed during the Relevant Period in violation of SEA Rule 17a-5 and FINRA Rule 2010.

Unreasonable Supervisory System

NASD Rule 3010(a), before December 1, 2014, and FINRA Rule 3110(a), on or after December 1, 2014, require FINRA registered broker-dealers to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. A broker-dealer's supervisory system must be tailored to the specific nature of the business engaged in by the firm, and must set out mechanisms for ensuring compliance and for detecting violations of securities laws and regulations, and not merely establish what conduct is prohibited.

NASD Rule 3010(b) and FINRA Rule 3110(b) require member firms to establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD and FINRA.

Violations of these rules also constitute violations of FINRA Rule 2010.

During the Relevant Period, the Firm's business involved ES Trades with notional values of hundreds of millions of dollars impacting the provision of hundreds of millions of dollars in margin credit, in both institutional and retail customer accounts. Due to the pervasiveness of these transactions, the Firm's supervisory systems, including written procedures, should have identified and considered all ES Trades in order to reasonably comply with margin and net capital requirements across its business lines.

During this time, however, the Firm's supervisory systems, including WSPs, did not provide for the identification and consideration of ES Trades for margin or net capital purposes, other than certain institutional customer transactions for net capital purposes.

The Firm's WSPs also failed during the Relevant Period to delegate any supervisory responsibility or specific tasks to supervisors, or provide guidance, direction or delegation of responsibility to any individual, to ensure that ES Trades and counterparties were properly classified as "exempt" or "non-exempt," and that ES Trades were properly considered for net capital and/or margin purposes, and reflected in the Firm's books and records.

Given the wide scope of the ES Trades at the Firm and their significant impact on the Firm's margin and net capital, the failure of the Firm's systems and WSPs to provide for the identification and consideration of these trades was unreasonable.[1]

Additionally, Merrill failed to reasonably respond to the deficiencies identified by Member Regulation during its December 2012 examination of the Firm. Member Regulation informed the Firm in April 2013 that it was required to apply net capital rules and margin limits to ES Trades. The Firm, however, failed to implement any remedial measures in response to the deficiencies noted by Member Regulation. In May 2014, Merrill finally revised its WSPs to ensure that net capital rules applied to institutional ES Trades; however, the Firm continued to fail to apply margin rule limitations to these transactions. Merrill also failed to institute any remedial measures for its retail business until mid-2015, when it finally established a Firm-wide supervisory system and procedures to address all ES Trades.

The Firm's failure to promptly address the deficiencies identified by Member Regulation unreasonably delayed the Firm's compliance with Sections 7(c) and 17(a) of the SEA, as well as Reg T, SEA Rules 17c3-1 and 17a-5, and FINRA Rules 4210, 4511 and 2010, in connection with hundreds of millions of dollars' worth of transactions.

As a result of the foregoing, Merrill violated FINRA Rule 3110 (a) and (b) (for conduct occurring on or after December 1, 2014), and its predecessor rule, NASD Rule 3010 (a) and (b) (for conduct occurring before December 1, 2014), and FINRA Rule 2010.

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

1. A censure; and

2. A fine in the total amount of $1,400,000.

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.

[1] The Firm, however, had sufficient net capital throughout the Relevant Period.

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 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, 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 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 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 Respondent'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. Respondent understands that Respondent 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 the Firm 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.

December 5, 2017
Date

Merrill Lynch, Pierce Fenner & Smith Inc.
Merrill Lynch, Pierce, Fenner & Smith Inc.,
Respondent

By: T. Daniel Montgomery
Associate General Counsel

Reviewed by:

Gerald Russello
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Sidley Austin LLP
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Accepted by FINRA:

12/19/17
Date

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

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