FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2015044526701

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

RE: Merrill Lynch, Pierce, Fenner & Smith Incorporated, Respondent
Member Firm
CRD No. 7691

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

I.
ACCEPTANCE AND CONSENT

A. Merrill Lynch 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 has been a FINRA member since 1937 and is headquartered in New York, New York. It is a full-service brokerage firm with approximately 35,000 registered representatives. Among other things, it provides sales and trading services, research, and underwriting services. In January 2009, Merrill Lynch became an indirect, wholly-owned subsidiary of Bank of America Corporation.

RELEVANT DISCIPLINARY HISTORY

During the period June 2002 through February 2007, Merrill Lynch failed to establish and maintain a supervisory system and procedures reasonably designed to achieve compliance with suitability obligations related to the sale of Internal Revenue Code Section 529 qualified tuition plans ("529 plans"). Specifically, Merrill Lynch's written supervisory procedures did not reasonably ensure that the Firm's registered representatives were considering customer state income tax benefits during their 529 plan suitability analyses. The Firm adopted revised policies and procedures effective in March 2007. As such, prior to that date, the

Firm violated Municipal Securities Rulemaking Board ("MSRB") Rule G-27 and consented to a $500,000 fine and undertaking.[1]

OVERVIEW

During the period January 2011 through December 2015 (the "Relevant Period"), Merrill Lynch failed to establish and maintain a supervisory system and written supervisory procedures reasonably designed to supervise recommendations of particular share classes of 529 plans offered by state sponsors (referred to herein as the "State 529 Plans"). Specifically, Merrill Lynch was a distribution agent for 529 plans sponsored by: Colorado, Connecticut, Illinois, Indiana, Iowa, Maine, Michigan, Nebraska, New Mexico, New York, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, Virginia, Washington D.C., West Virginia, and Wisconsin.[2]

529 plans are qualified tax-deferred savings plans, designed to encourage saving for college and other future eligible education expenses.[3] 529 plans typically provide a number of investment options, including various mutual fund and exchange-traded fund portfolios. Like mutual funds, most 529 plans offer more than one "class" of units or shares (referred to collectively herein as "units") to investors. Many 529 plans offer Class A and Class C units. Each class has different fees and expenses. Higher fees and expenses can directly affect the value of a customer's investment over time.

During the Relevant Period, Merrill Lynch failed to maintain a reasonable system of supervision over the recommendation of unit classes in the State 529 Plans, constituting a violation of MSRB Rule G-27(a), (b), and (c).

Merrill Lynch agreed to pay restitution estimated to be at least $4 million relating to the sale of Class C units to certain State 529 Plan customers.[4] In resolving this matter without a monetary fine, the Department of Enforcement ("Enforcement") credits Merrill Lynch for its extraordinary cooperation, proposal of broad remediation to customers, and its implementation, prior to regulatory intervention, of corrective measures including establishing certain policies, procedures, and

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[1] *Merrill Lynch, Pierce, Fenner & Smith Inc.*, AWC No. 2009018907001 (November 2010).

[2] In addition to serving as a distribution agent for Maine's NextGen College Investing Plan ("NextGen Plan"), Merrill Lynch also served as Program Manager for the Finance Authority of Maine, the sponsor of the NextGen Plan. On May 25, 2018, Merrill Lynch entered into a Consent Order with the Maine Office of Securities that concerns the NextGen Plan. *In re Merrill Lynch, Pierce, Fenner & Smith Incorporated*, Consent Order No. 15-11252-CON ("Consent Order"). During the Relevant Period, the respective State 529 Plan program manager firms had custody of the accounts and assets invested in the State 529 Plans.

[3] As of January 1, 2018, new amendments to the United States tax code permit 529 plan customers to withdraw tax-free up to $10,000 per beneficiary, per year, for tuition in connection with enrollment or attendance at a public, private, or religious elementary or secondary school. This AWC addresses misconduct prior to January 2018.

[4] Merrill Lynch customers invested in the State 529 Plans sponsored by Illinois, Iowa, Michigan, Nebraska, Rhode Island, Washington D.C., and Wisconsin will not be entitled to remediation under this AWC, due to the respective fee structures and/or share class conversion features of those plans.

disclosures concerning unit class suitability with respect to 529 plans available for purchase through Merrill Lynch.

FACTS AND VIOLATIVE CONDUCT

529 Plans

529 plans generally permit an account holder (the "participant") to establish an account for the purpose of paying a designated beneficiary's future eligible education expenses.

529 plans are sponsored by states, state agencies, or educational institutions. States offer 529 plans either directly, through designated broker-dealers, or both. 529 plan units are municipal securities because the 529 plans are sponsored by state governments or agencies.

529 Plan Fees, Expenses, and Unit Classes

529 plan fees and expenses vary. Broker-sold 529 plans often use load-waived shares of mutual funds as components of their plan portfolios, and include sales charges and/or asset-based distribution fees at the 529 plan portfolio level.

529 plan Class A units are offered pursuant to a front-end sales load and an annualized asset-based fee. 529 plan Class C units typically are not subject to a front-end load, but generally include higher annualized asset-based fees than Class A units. As a result, Class A units may often be less expensive over extended holding periods than Class C units, despite being subject to an initial front-end sales load.[5] Relevant holding periods vary based on the unit class cost structure adopted by 529 plan sponsors.

Thus, the anticipated number of years until withdrawal of 529 plan funds can be a significant factor in determining the suitable unit class for a 529 plan investment.[6] Participants who establish 529 plan accounts for younger beneficiaries may have lengthy investment horizons, because college attendance usually begins at age 18 and early withdrawals for non-qualified expenses result in significant tax penalties. Because Class C units may be more expensive over extended holding periods, Class A units are frequently a more suitable option for accounts with younger beneficiaries and longer investment horizons (and/or accounts that qualify for breakpoint discounts). Class C units may be suitable for accounts with younger beneficiaries based on customers' facts and circumstances.

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[5] Additionally, certain 529 plans reduce front-end sales loads if the aggregate investment amount meets certain threshold amounts—known as breakpoint discounts.

[6] *See* MSRB Notice 2006-07, *MSRB Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans* (Mar. 31, 2006).

Merrill Lynch's Supervisory System and Procedures Regarding State 529 Plans

MSRB Rule G-27 requires each broker, dealer, and municipal securities dealer to supervise the conduct of its municipal securities activities to ensure compliance with MSRB rules and federal securities laws, and requires each firm to establish and maintain a system, including written supervisory procedures, to supervise municipal securities activities that is reasonably designed to achieve compliance with the federal securities laws and MSRB rules.

This matter involves Merrill Lynch's failure to have a reasonably designed supervisory system and written supervisory procedures regarding the sale of 529 plans, including the suitability of unit class recommendations. Prior to September 2015, the Firm's written supervisory procedures stated that, when recommending 529 plan investments, registered representatives should consider a number of factors, including whether the recommendation was suitable based on the beneficiary's age, client's investment time horizon and liquidity needs. However, the Firm's supervisory system, including written supervisory procedures, was not reasonably designed to ensure that the Firm's representatives were considering how the age of the beneficiary may factor into the unit class suitability determination in the context of 529 plan investments.

Specifically, although registered representatives obtained birthdates of the 529 plan beneficiaries as part of the account opening process, the Firm's supervisory system did not require registered representatives or supervisors to evaluate beneficiary age and the number of years until expected withdrawals, combined with the different fees and expenses of the available unit classes, to assess the reasonableness of the unit class recommendation. Merrill Lynch's supervisory system also did not include reasonable measures to require registered representatives to consider sales charge discounts and/or waivers based on aggregate customer investments when making unit class recommendations. The Firm's training materials did not provide guidance to its registered representatives on these issues and thus were also unreasonable.

By virtue of the foregoing, Merrill Lynch violated MSRB Rule G-27(a), (b), and (c).

The Firm's Revised Supervisory System and Procedures

Effective in September 2015, Merrill Lynch voluntarily adopted new policies and procedures concerning 529 plan unit class recommendations. Among other changes, the Firm generally limited its registered representatives to recommending Class A units for 529 plan customers with designated beneficiaries under a certain age or customers investing $250,000 or more. Merrill Lynch's customers remain free to direct their unit class selection. The Firm also enhanced its training to detail unit class fees and expenses and implemented several compliance reports alerting supervisors to contributions outside the Firm's unit class policies or Class C unit contributions near or exceeding potential breakpoint

discounts. Merrill Lynch also instituted an annual disclosure process through which it notifies certain 529 plan customers that they may benefit from a different unit class selection for future purchases.

OTHER FACTORS

In resolving this matter without a monetary fine, Enforcement recognizes Merrill Lynch's extraordinary cooperation. The Firm's approach to remediation in this matter reflected extraordinary efforts that warrant significant credit. The Firm engaged an outside consulting firm to conduct a complex analysis to identify potentially disadvantaged customers. Rather than engaging in a lengthy analysis to determine which customers should be excluded from the remediation plan, the Firm included in its remediation plan transactions that may not have resulted from a recommendation by a Merrill Lynch registered representative. The Firm then established a plan to provide broad remediation to customers harmed before and during the Relevant Period. In addition, the Firm: (i) initiated, prior to intervention by a regulator, an extensive review of the Firm's systems, practices, and procedures with respect to 529 plan recommendations; (ii) promptly corrected supervisory deficiencies identified by the Firm's internal review; and (iii) provided substantial assistance to FINRA in its investigation.

Additionally, Enforcement recognizes Merrill Lynch's settlement with the State of Maine Office of Securities and the approximately $19 million in restitution provided under the Consent Order.

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

1. A censure.

2. Within 365 days of Notice of Acceptance of this AWC ("Notice Date"), Merrill Lynch will exercise best efforts to cause designated State 529 Plan program managers, or their agents (the "Program Managers"), to: (i) remit restitution, including interest, through account credits funded by Merrill Lynch under the written plan of financial restitution previously submitted to, and acceptable to FINRA (the "Written Plan"); and (ii) pay restitution, including interest, to certain State 529 Plan investors pursuant to the Written Plan.

3. Specifically, as detailed in the Written Plan, Merrill Lynch consents to complete the following undertakings:

   a. Review transactions in State 529 Plan accounts that purchased Class C units from January 1, 2008 through December 31, 2015, and pay restitution, plus interest, at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2) ("Restitution Interest"), or to exercise best efforts to cause the Program Managers to make such payments (funded by Merrill Lynch) as stated in paragraph I.B.2 above, to investors identified

as eligible for restitution under the terms of the Written Plan ("Eligible Investors"). Merrill Lynch will calculate Restitution Interest for each Eligible Investor, for each in-scope transaction, through estimated payment dates, as described in the Written Plan. Conversion of Class C units held by Eligible Investors will be administered pursuant to the program terms of each respective State 529 Plan, at no cost to Eligible Investors.

b. Restitution payments to Eligible Investors shall be preceded or accompanied by a letter containing language, accepted by FINRA, describing the reason for the payments. The letter will state that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC. The letter may not request a waiver of, or otherwise limit, any rights the Eligible Investor has to pursue an action to obtain additional monetary compensation or other remedies for grievances related to the Eligible Investor's 529 plan investments.

4. To the extent that Merrill Lynch has knowledge of any failure of the Program Managers to remit restitution and/or Restitution Interest to Eligible Investors as detailed under the Written Plan, within thirty (30) days of notice of such failure, the Firm shall notify FINRA. Notice of any failure shall be submitted to Jackie A. Wells, FINRA – Department of Enforcement, Brookfield Place, 200 Liberty Street, New York, NY 10281, or by e-mail from a work-related account of a registered principal and officer of the Firm to EnforcementNotice@FINRA.org, in each instance identifying Merrill Lynch, Pierce, Fenner & Smith Incorporated and Matter No. 20150445267 ("Submission Instructions").

5. Within sixty (60) days of completion of the payments described in Paragraph I.B.2, and I.B.3 above, or such additional period agreed to in writing by FINRA staff, the Firm shall provide notice confirming that Merrill Lynch has complied with the terms of the Written Plan. The notice shall include a list of customers who received restitution, those customers' account numbers, the 529 plan names, restitution amounts, Restitution Interest amounts, and restitution payment dates. Notice shall be provided pursuant to the Submission Instructions.

6. With respect to Eligible Investors who no longer hold active accounts that can be credited the restitution and Restitution Interest, if for any reason the Firm cannot locate such Eligible Investors after reasonable and documented efforts following expiration of the 365 day payment period described above (or such additional period agreed to by a FINRA staff member in writing), or Eligible Investors do not cash checks representing restitution and Restitution Interest, Merrill Lynch shall administer all such payments pursuant to the abandoned property laws of the state of each relevant Eligible Investor's residency. After expiration of the payment

period described above, Merrill Lynch shall provide the staff with a quarterly schedule of all payments subject to this agreement that were escheated pursuant to state abandoned property laws, including the name of the Eligible Investor, state of residency/escheatment, amount of escheated payment and escheatment date.

7. Upon written request by Merrill Lynch showing good cause, FINRA staff may extend any of the procedural dates set forth above.

Merrill Lynch has specifically and voluntarily waived any right to claim an inability to pay at any time hereafter the monetary sanction imposed in this matter.

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

II.
WAIVER OF PROCEDURAL RIGHTS

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

A. To have a Complaint issued specifying the allegations against Merrill Lynch;

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, Merrill Lynch 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.

Merrill Lynch 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

Merrill Lynch 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 Merrill Lynch; and

C. If accepted:

1. this AWC will become part of Merrill Lynch's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Merrill Lynch;

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. Merrill Lynch 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. Merrill Lynch 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 Merrill Lynch'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. Merrill Lynch may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Merrill Lynch 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 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.

October 31, 2019
Date

Merrill Lynch, Pierce, Fenner & Smith Incorporated
Respondent

By: Mark L. Keene

Mark L. Keene
Print Name

Associate General Counsel
Title

Reviewed by:

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Accepted by FINRA:

11/6/2019
Date

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

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