

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2020068535401**

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, Respondent Merrill Lynch, Pierce, Fenner & Smith Incorporated 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 in this AWC.

I.

ACCEPTANCE AND CONSENT

A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

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 31,000 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.

On June 6, 2014, pursuant to AWC No. 2011029999301, the firm agreed to a censure, an \$8 million fine and paid approximately \$24.2 million in restitution for supervision and suitability violations relating to the sale of mutual fund shares to certain retirement plans and charitable organizations. Between 2006 and 2011, the firm sold Class A shares with sales charges to more than 30,000 accounts that were eligible to purchase the shares without an initial sales charge.

On June 4, 2020, pursuant to AWC No. 2017053494401, the firm agreed to a censure and paid approximately \$7.2 million in restitution for its failure to have a supervisory system and written procedures reasonably designed to determine customers' eligibility for reduced sales charges through mutual fund rights of reinstatement. Between April 2011 and April 2017, the firm failed to provide over 13,000 accounts with mutual fund sales

charge waivers and fee rebates to which the customers were entitled through rights of reinstatement offered by mutual fund companies.¹

OVERVIEW

From January 2015 to January 2021, Merrill Lynch failed to establish and maintain a supervisory system reasonably designed to supervise sales of mutual fund Class C shares. In particular, the firm failed to correctly identify and implement applicable limits on customers' Class C share purchases, which resulted in customers purchasing Class C shares when Class A shares were available, typically at a lower cost. As a result, customers paid approximately \$13.4 million in excess fees and expenses.

Therefore, Merrill Lynch violated FINRA Rules 3110 and 2010.

As more fully described below, FINRA credits Merrill Lynch for its extraordinary cooperation. Accordingly, this AWC includes an undertaking to pay restitution of approximately \$15.2 million (\$13.4 million, plus interest), and a censure, but no fine.

FACTS AND VIOLATIVE CONDUCT

This matter originated from the firm's Rule 4530(b) disclosure.

Background—Mutual Fund Share Classes and Volume Discounts

Mutual fund issuers offer different classes of mutual fund shares, including Class A and Class C shares. The features of each share class are laid out in each fund's prospectus. As a general matter, however, Class A shares are subject to a front-end sales charge, while Class C shares typically do not carry a front-end sales charge but have significantly higher fees and are often subject to a contingent deferred sales charge (CDSC) higher than that applicable to a Class A alternative. Many mutual fund issuers allow customers to purchase Class A shares with a discounted front-end sales charge, or with no front-end sales charge (i.e., at net asset value or NAV), if the purchase exceeds certain volume thresholds.

If a customer qualifies to purchase Class A shares at NAV, there would be no reason for the customer to purchase Class C shares with higher annual expenses and which normally carry a higher CDSC. To prevent this possibility, many mutual fund issuers limit the amount of Class C shares a customer can purchase either in any single transaction, or in total aggregate purchases, thereafter offering Class A shares to that customer at NAV or subject to a discounted front-end load. Other issuers do not explicitly limit Class C purchases but still offer Class A shares at NAV, or with a discounted front-end load, if a customer's aggregate holdings in a particular fund family exceed certain thresholds. Mutual fund issuers may apply these purchase limits and thresholds based on a single

¹ For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

transaction, a customer's holdings in a single fund, or to a customer's aggregated holdings within a fund family or fund family sub-type (e.g., fixed income).

Merrill Lynch Failed to Reasonably Supervise the Application of Class C Share Purchase Limits and Class A Share Discounts.

FINRA Rule 3110(a) requires FINRA members to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. A violation of Rule 3110 also constitutes a violation of FINRA Rule 2010, which requires that a member, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

During the relevant period, Merrill Lynch maintained an automated system that was designed to prevent Class C share purchases when Class A shares were available to purchase at NAV or at a discount. Although the firm's automated system correctly calculated customer purchases and fund holdings, in certain instances the system mistakenly applied a purchase limit on Class C shares that was (1) inconsistent with a fund's Class C share purchase limit, or (2) inconsistent with a fund's threshold for when Class A shares were available at NAV.² As a result, thousands of Merrill Lynch customers purchased Class C shares, incurring fees and charges, when Class A shares were available at a substantially lower cost.

For example, in November 2019, a firm customer purchased \$200,000 of Class C shares of a high yield municipal bond mutual fund (the "Fund"). At that time, the customer already held over \$500,000 of Class C shares in the Fund and, therefore, was eligible under the terms of the Fund's prospectus to purchase Class A shares at NAV. Merrill's automated system, however, mistakenly applied a cap to Class C share purchases in the Fund that was higher than the threshold set by the Fund. As a result, at the time of the purchase Merrill Lynch did not direct the customer to Class A shares at NAV. Ultimately, the customer purchased higher-cost Class C shares with annualized expenses of approximately 1.76% when Class A shares were available with lower annualized expenses of approximately 0.96%.

As a result of the firm's supervisory deficiencies, Merrill Lynch customers paid approximately \$13.4 million in excess sales charges and fees.

Therefore, Respondent violated FINRA Rules 3110(a) and 2010.

CREDIT FOR EXTRAORDINARY COOPERATION

In resolving this matter without a monetary fine, Enforcement recognizes Merrill Lynch's extraordinary cooperation for: (1) initiating, after discovery of the issue, an extensive review of the firm's systems relating to Class C mutual fund sales; (2) engaging an outside consultant at considerable expense to identify affected customers; (3) promptly

² Effective in January 2021, the firm corrected these issues.

establishing a plan to provide remediation by notifying the affected customers, working with fund sponsors to convert certain customers' Class C shares to Class A shares, and agreeing to pay restitution to affected customers; and (4) providing substantial assistance to FINRA in its investigation.

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

1. a censure and
2. an undertaking to:
 - a) Within 90 days of the Notice of Acceptance of this AWC, Respondent shall pay full restitution to affected customers totaling approximately \$13.4 million, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2)), from the date of the affected transactions until the applicable restitution payment date (approximately \$1.8 million). These payments shall be made to the customers as specified in the written plan of remediation previously provided to FINRA by Merrill Lynch.
 - b) Restitution payments to customers described in Paragraph I.B.2(a) above shall be preceded or accompanied by a letter, not unacceptable to FINRA, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.
 - c) Within 60 days of completion of the payments described in Paragraph I.B.2(a) above, or such additional period agreed to in writing by the FINRA, a registered principal on behalf of the Respondent shall submit satisfactory proof of payment of restitution and prejudgment interest (separately specifying the date and amount of each paid to each customer) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Respondent. The email must identify Respondent and the case number.
 - d) If for any reason Respondent cannot locate any customer entitled to restitution after reasonable and documented efforts after the date of the payment specified in the written plan of remediation described in Paragraph I.B.2(a) above, or such additional period agreed to by FINRA in writing, Respondent shall administer all such payments pursuant to the abandoned property laws of the state of each recipient's last known residency. Respondent 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 authorities.

The imposition of a restitution order or any other monetary sanction in this AWC, 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 in this AWC shall be effective on a date set by FINRA.

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 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 its acceptance or rejection.

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 action 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 its subject matter 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. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.

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.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's 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 the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

May 23, 2022

Mark Keene

Date

Merrill Lynch, Pierce, Fenner & Smith Incorporated
Respondent

Print Name: Mark Keene

Title: Associate General Counsel

Reviewed by:

Thomas J. Hennessey

Thomas J. Hennessey
Counsel for Respondent
Morgan, Lewis & Bockius LLP
One Federal Street, Boston, MA 02110
Accepted by FINRA:

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

June 1, 2022

Tom Kuczajda

Date

Thomas Kuczajda, Director
FINRA
Department of Enforcement
15200 Omega Drive, Suite 300
Rockville, MD 20850