

DENISE VOIGT CRAWFORD  
SECURITIES COMMISSIONER



BETH ANN BLACKWOOD  
CHAIR

BRYAN K. BROWN  
MEMBER

EDWARD ESCUDERO  
MEMBER

DERRICK MITCHELL  
MEMBER

E. WALLY KINNEY  
MEMBER

JOHN R. MORGAN  
DEPUTY SECURITIES COMMISSIONER

Mail: P.O. BOX 13167  
AUSTIN, TEXAS 78711-3167

## Texas State Securities Board

208 E. 10th Street, 5th Floor  
Austin, Texas 78701-2407  
www.ssb.state.tx.us

Phone: (512) 305-8300  
Facsimile: (512) 305-8310

IN THE MATTER OF  
THE DEALER REGISTRATION OF  
MERRILL LYNCH, PIERCE, FENNER &  
SMITH INCORPORATED

§  
§  
§  
§

**Order No. IC09-CAF-20**

TO: J. David Montague, First Vice President - Legal  
Merrill Lynch, Pierce, Fenner & Smith Incorporated (CRD No. 7691)  
222 Broadway, 16th Floor  
New York, NY 10038

### CONSENT ORDER

WHEREAS, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a dealer registered in the state of Texas, with a Central Registration Depository ("CRD") number of 7691; and

State securities regulators from multiple jurisdictions have conducted coordinated investigations into the registration of Merrill Lynch Client Associates ("CAs") and Merrill Lynch's supervisory system with respect to the registrations of CAs; and

Merrill Lynch has cooperated with regulators conducting the investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the investigations; and

Merrill Lynch has advised regulators of its agreement to resolve the investigations pursuant to the terms specified in this Consent Order (the "Order"); and

Merrill Lynch agrees to make certain changes in its supervisory system with respect to the registration of CAs, and to make certain payments in accordance with the terms of this Order; and

Merrill Lynch elects to waive permanently any right to a hearing and appeal under The Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-1 et seq. (Vernon 1964 & Supp. 2008)("Texas Securities Act"), and the Administrative Procedure Act, TEX. GOV'T CODE ANN. § 2001.001 et seq. (Vernon 2008)("Administrative Procedure Act") with respect to this Order; and

Solely for the purpose of terminating the multi-state investigations, including the investigation by the staff of the Texas State Securities Board ("Staff"), and in settlement of the issues contained in this Order, Merrill Lynch, without admitting or denying the findings of fact or conclusions of law contained in this Order, consents to the entry of this Order.

NOW, THEREFORE, the Securities Commissioner of Texas ("Securities Commissioner"), as administrator of the Texas Securities Act, hereby enters this Order:

**I.**

**FINDINGS OF FACTS**

1. Merrill Lynch admits the jurisdiction of the Texas State Securities Board in this matter.

Background on Client Associates

2. The CAs function as sales assistants and typically provide administrative and sales support to one or more of Merrill Lynch's Financial Advisors ("FAs"). There are different titles within the CA position, including Registered Client Associate and Registered Senior Client Associate.

3. The responsibilities of a CA specifically include:

- a. Handling client requests;
- b. Resolving client inquiries and complaints;
- c. Determining if client issues require escalation to the FA or the branch management team; and
- d. Processing of operational documents such as letters of authorization and client check requests.

4. In addition to the responsibilities described above, and of particular significance to this Order, some CAs are permitted to accept unsolicited orders from clients. As discussed below, Merrill Lynch's written policies and procedures require that any CAs accepting client orders first obtain the necessary licenses and registrations.

5. Notably, FAs might have a "primary CA" and a "secondary CA". As suggested by the designation, the customary practice is that the primary CA would handle the FA's administrative matters and client orders. However, if the primary CA was unavailable, the secondary CA would handle the FA's administrative matters and client orders.

6. During the period from 2002 to the present, Merrill Lynch employed approximately 6,200 CAs (average) per year.

#### Registration Required

7. Section 12.A of the Texas Securities Act specifies that an agent cannot sell, offer for sale, or make sale of any securities on behalf of a dealer within Texas unless he or she is registered as an agent for that particular dealer.

8. Pursuant to the general prohibition under Section 12.A of the Texas Securities Act, a person cannot accept unsolicited orders in Texas without being registered as an agent of the relevant dealer.

9. Pursuant to Section 14.A(5)(a) of the Texas Securities Act, a dealer may be reprimanded, suspended, or revoked for selling securities in Texas through an agent other than a registered agent.

#### Merrill Lynch Requires Registration of Client Associates

10. In order for a CA to accept client orders, Merrill Lynch generally required each CA to pass the series 7 and 63 qualification exams and to register in the appropriate jurisdictions.

11. At all times relevant to this Order, Merrill Lynch's policies and procedures specified that each CA maintain registrations in the same jurisdictions as his or her FA, or broadly required that each CA maintain registrations in all necessary jurisdictions.

## Regulatory Investigations and Findings

12. In May 2008, the Staff received a tip alleging that Merrill Lynch was failing to ensure its CAs were in compliance with jurisdictional registration requirements and its own procedures. The tip alleged that Merrill Lynch CAs were registered in two jurisdictions – the CA's home state and one neighboring state – because Merrill Lynch only paid for registrations in two jurisdictions.

13. After the Staff's initial review supported the allegations in the tip, the Staff opened an investigation into Merrill Lynch's practices in connection with CA registrations.

14. During the summer of 2008, Merrill Lynch also received inquiries regarding CA registrations from a number of other state securities regulators.

15. Because Merrill Lynch's relevant trade records were maintained in hard copy and only at branch offices across the country, the Staff's investigation focused on systemic issues with Merrill Lynch CA registrations and related supervisory structure instead of attempting to identify each incidence of unregistered activity. Specifically:

- a. After accepting a client order, CAs accessed the electronic trading system to enter the order;
- b. The CAs did not have to identify themselves during the order entry process. Therefore, there is no electronic record that identifies which orders were accepted by CAs;
- c. Instead, Merrill Lynch maintained a daily report that recorded the identity of the person who accepted and/or entered each order. However, this report was not maintained electronically, and was only maintained at the branch office where the order was entered. Merrill Lynch represented that this daily report was the only record that could identify who accepted a client order.
- d. Merrill Lynch's trading system checked the registration of the FA, but did not check the registration status of the person accepting the order to ensure that the person was registered in the appropriate jurisdiction.

16. The Staff's investigation found that many CAs supported FAs registered in Texas when the CAs were not registered in Texas as agents of Merrill Lynch. This difference in registration status increased the possibility that CAs would engage in unregistered activity.

17. The Staff's investigation found that certain Merrill Lynch CAs engaged in the sale of securities in Texas at times when the CAs were not appropriately registered in Texas.

#### Merrill Lynch's Remedial Measures and Cooperation

18. As a result of the inquiries by the Staff and other state regulators, Merrill Lynch conducted a review of its CA registration practices.

19. Merrill Lynch's review found that as of June 30, 2008, the firm had 3,780 registered CAs. Approximately 2,200, almost 60%, of those registered CAs were only registered in their home state or their home state and one additional state.

20. Consistent with the fact that many Merrill Lynch CAs were only registered in one or two jurisdictions, Merrill Lynch's review found incidences of trading by CAs not properly state registered.

21. In October 2008, Merrill Lynch amended its registration policy to require that each CA mirror the state registrations for the FAs that they support.<sup>1</sup> Merrill Lynch's Registration Compliance personnel participated in calls with branch management to advise the field about this requirement.

22. As Merrill Lynch worked on a more permanent solution, it also developed a temporary report intended to identify instances where a CA's registration did not match the FA or FAs the CA supported.

23. Between October 1, 2008 and January 28, 2009, 664 CAs registered with the Securities Commissioner as agents of Merrill Lynch. Yet, data as of February 28, 2009 indicated that significant gaps remained between the registrations of CAs and their FAs.

---

<sup>1</sup> It should be noted that Merrill Lynch's policy required CA/FA registration mirroring prior to 2006. In 2006, it amended the relevant policies and procedures to more broadly require that CAs maintain appropriate registrations.

24. However, Merrill Lynch, as a compliance enhancement, also developed an electronic system that will prevent any person from entering client orders from a jurisdiction in which the person accepting the order is not registered. Merrill Lynch has represented to the Staff that the firm began implementing this new system in June 2009 and expects it to be fully implemented by December 31, 2009.

25. Merrill Lynch provided timely responses and substantial cooperation in connection with the regulatory investigations into this issue. Furthermore, as displayed by the corrective actions described above, Merrill Lynch has acknowledged the problems associated with its CA registrations and supervisory system.

## II.

### CONCLUSIONS OF LAW

1. The Texas State Securities Board has jurisdiction over this matter pursuant to Sections 14, 23, 23-1, and 28 of the Texas Securities Act.

2. Merrill Lynch's failure to establish an adequate system to monitor the registration status of persons accepting client orders constitutes a failure to establish a supervisory system reasonably designed to achieve compliance with the Texas Securities Act and Rules and Regulations of the Texas State Securities Board ("Board Rules"). This is a violation of §115.10(a) of the Board Rules.

3. Merrill Lynch's failure to require its CAs to be registered in the appropriate jurisdictions constitutes a failure to enforce its established written procedures, and is a violation of §115.10(b)(1) of the Board Rules.

4. Pursuant to Section 14.A(5)(a) of the Texas Securities Act, Merrill Lynch's sales of securities in Texas through unregistered agents constitute bases for the issuance of an Order reprimanding Merrill Lynch.

5. Pursuant to Section 23 of the Texas Securities Act, Merrill Lynch's sales of securities in Texas through agents not registered in Texas constitute bases to order

Merrill Lynch to cease and desist engaging in the sale of securities in Texas through unregistered agents.

6. Pursuant to Section 23-1 of the Texas Securities Act, the violations of the Board Rules described above constitute bases for the assessment of an administrative fine against Merrill Lynch.

### **III.**

#### **UNDERTAKINGS**

1. Merrill Lynch hereby undertakes and agrees to immediately establish and maintain a trade monitoring system that prevents any person from entering client orders that originate from jurisdictions where the person accepting the order is not appropriately registered.

2. Merrill Lynch further undertakes and agrees to file with the Texas State Securities Board, within sixty days of the date of this Order, a report describing Merrill Lynch's improvements in its ability to monitor the identity and registration status of each person who accepts a client order entered on Merrill Lynch's trading system.

3. For the period from the date of this Order through December 31, 2010, Merrill Lynch further undertakes and agrees to notify the Texas State Securities Board if it finds that any person associated with Merrill Lynch accepted a client order in Texas without being registered, or exempt from registration, with the Securities Commissioner as an agent of Merrill Lynch.

### **IV.**

#### **ORDER**

On the basis of the Findings of Facts, Conclusions of Law, and Merrill Lynch's consent to the entry of this Order,

**IT IS HEREBY ORDERED:**

1. This Order concludes the investigation by the Texas State Securities Board

and any other action that the Texas State Securities Board could commence against Merrill Lynch under applicable Texas law on behalf of Texas as it relates to unregistered activity in Texas by Merrill Lynch's CAs and Merrill Lynch's supervision of CA registrations during the period from January 1, 2004 through the date of this Order.

2. This Order is entered into solely for the purpose of resolving the referenced multi-state investigation, and is not intended to be used for any other purpose. For any person or entity not a party to the Order, this Order does not limit or create any private rights or remedies against Merrill Lynch including, limit or create liability of Merrill Lynch, or limit or create defenses of Merrill Lynch, to any claims.

3. Merrill Lynch is hereby reprimanded.

4. Merrill Lynch is hereby ordered to cease and desist from engaging in the sale of securities in the Texas through persons not registered with the Securities Commissioner as agents of Merrill Lynch.

5. Merrill Lynch is hereby ordered to pay the sum of One million, five hundred sixty eight thousand, nine hundred eighty five dollars and no cents (\$1,568,985.00) to the general fund of the State of Texas within ten days of the date of this Order.

6. Merrill Lynch shall pay up to a total of Twenty six million, five hundred sixty three thousand, ninety four dollars and fifty cents (\$26,563,094.50) in fines, penalties and any other monetary sanctions among the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands pursuant to the calculations discussed with the multi-state working group.

7. However, if any state securities regulator determines not to accept Merrill Lynch's settlement offer, the total amount of the payment to the State of Texas shall not be affected, and shall remain at One million, five hundred sixty eight thousand, nine hundred eighty five dollars and no cents (\$1,568,985.00).

8. Merrill Lynch is hereby ordered to comply with the Undertakings contained herein.



9. Within ten days of the date of this Order, Merrill Lynch shall pay Twenty-Five Thousand Dollars (\$25,000.00) to the North American Securities Administrators Association ("NASAA") as consideration for financial assistance provided by NASAA in connection with the multi-state investigation.

10. This Order is not intended by the Texas State Securities Board to subject any Covered Person to any disqualifications under the laws of the United States, any state, the District of Columbia, Puerto Rico, or the U.S. Virgin Islands including, without limitation, any disqualification from relying upon the state or federal registration exemptions or safe harbor provisions. "Covered Person," means Merrill Lynch or any of its affiliates and their current or former officers, directors, employees, or other persons that would otherwise be disqualified as a result of the Orders (as defined below).

11. This Order and the order of any other State in related proceedings against Merrill Lynch (collectively, the "Orders") shall not disqualify any Covered Person from any business that they otherwise are qualified, licensed or permitted to perform under applicable securities laws of the State of Texas and any disqualifications from relying upon this state's registration exemptions or safe harbor provisions that arise from the Orders are hereby waived.

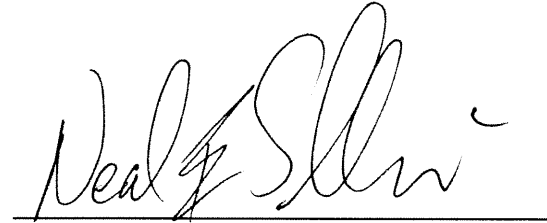
12. This Order shall be binding upon Merrill Lynch and its successors and assigns as well as to successors and assigns of relevant affiliates with respect to all conduct subject to the provisions above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events, and conditions.

SIGNED AND ENTERED BY THE SECURITIES COMMISSIONER this 8<sup>th</sup>  
day of September, 2009.

  
DENISE VOIGT CRAWFORD  
Securities Commissioner

Approved as to Form:

  
Benette L. Zivley  
Director  
Inspections and Compliance Division

  
Neal E. Sullivan, Esq.  
Bingham McCutchen  
Attorney for Merrill Lynch, Pierce,  
Fenner & Smith Incorporated

  
Ronak V. Patel  
Attorney  
Inspections and Compliance Division

**CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY MERRILL LYNCH**

Merrill Lynch hereby acknowledges that it has been served with a copy of this Consent Order ("Order"), has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

Merrill Lynch admits the jurisdiction of the Texas State Securities Board, neither admits nor denies the Findings of Facts and Conclusions of Law contained in this Order, and consents to entry of this Order by the Securities Commissioner as settlement of the issues contained in this Order.

Merrill Lynch agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any state, federal or local tax for any administrative monetary penalty that Merrill Lynch shall pay pursuant to this Order.

Merrill Lynch states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Teresa M. Brenner represents that she is Associate General Counsel of Merrill Lynch and that, as such, has been authorized by Merrill Lynch to enter into this Order for and on behalf of Merrill Lynch.

Dated this 4th day of September, 2009.

MERRILL LYNCH, PIERCE, FENNER &  
SMITH INCORPORATED

By: 

Teresa M. Brenner

Title: Associate General Counsel

SUBSCRIBED AND SWORN TO before me this 4<sup>th</sup> day of September, 2009.

  
EARLEEN M. MOBLEY

Notary Public in and for the  
State of North Carolina

My Commission expires: *Mar. 21, 2011*