

# Alabama Securities Commission

In the matter of

MERRILL LYNCH, PIERCE, FENNER  
& SMITH INCORPORATED,

Respondent.

**ADMINISTRATIVE CONSENT ORDER**  
**CO-2009-0039**

WHEREAS, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a broker-dealer registered in the state of Alabama, 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 Alabama Securities Act and related rules with respect to this Order; and

Solely for the purpose of terminating the multi-state investigations, 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 Director of the Alabama Securities Commission ("ASC"), hereby enters this Order:

I.

**FINDINGS OF FACTS**

1. Merrill Lynch admits the jurisdiction of the Alabama Securities Commission 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.

1  
2 Registration Required

3 7. Pursuant to *Code of Alabama 1975, § 8-6-3(a)*, it is unlawful for any person to  
4 transact securities business in the State of Alabama as a dealer or agent for securities unless  
5 properly registered under this Article. Merrill Lynch effected securities transactions without  
6 benefit of agent registration in the State of Alabama in violation of *Code of Alabama 1975, § 8-6-*  
7 *3(a), et seq.*

8 8. Pursuant to the general prohibition under the Alabama Securities Act, a person  
9 cannot accept unsolicited orders in Alabama without being registered pursuant to *Code of Alabama*  
10 *1975, § 8-6-3(a) et seq.*

11 9. Pursuant to Section 8-6-19(i) *et seq.* of the Alabama State Securities Act, a broker-  
12 dealer may be fined for selling securities in Alabama through agents other than registered agents.

13 Merrill Lynch Requires Registration of Client Associates

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

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

19 Regulatory Investigations and Findings

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

25 13. The multi-state initial review by state regulators supported the allegations in the  
26 tip and the ASC opened an investigation into Merrill Lynch's practices in connection with CA  
registrations.

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

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

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

20           16.       The multi-state investigation found that many CAs supported FAs registered in  
21 Alabama when the CAs were not registered in Alabama as agents of Merrill Lynch. This  
22 difference in registration status increased the possibility that CAs would engage in unregistered  
23 activity.

24           17.       The multi-state investigation found that certain Merrill Lynch CAs engaged in the  
25 sale of securities in Alabama at times when the CAs were not appropriately registered in Alabama.

26           Merrill Lynch's Remedial Measures and Cooperation

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

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

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

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

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

16           23.       Between October 1, 2008 and January 28, 2009, 352CAs registered with the ASC  
17 as agents of Merrill Lynch. Yet, data as of February 28, 2009 indicated that significant gaps  
18 remained between the registrations of CAs and their FAs.

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

24           25.       Merrill Lynch provided timely responses and substantial cooperation in  
25 connection with the regulatory investigations into this issue. Furthermore, as displayed by the

26           <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.

1 corrective actions described above, Merrill Lynch has acknowledged the problems associated with  
2 its CA registrations and supervisory system.

## 3 4 II.

### 5 CONCLUSIONS OF LAW

6 1. The ASC has jurisdiction over this matter pursuant to *Code of Alabama 1975, § 8-6-*  
7 *I, et seq.* (The Alabama Securities Act).

8 2. Merrill Lynch's failure to establish an adequate system to monitor the registration  
9 status of persons accepting client orders constitutes a failure to establish a reasonably designed  
10 supervisory system and/or failure to establish, maintain and enforce reasonably designed  
11 procedures.

12 3. Merrill Lynch's failure to require its CAs to be registered in the appropriate  
13 jurisdictions constitutes a failure to enforce its established written procedures, and is a violation of  
14 *Code of Alabama 1975, § 8-6-3(a)*.

15 4. Merrill Lynch's sales of securities in Alabama through unregistered CAs constitute  
16 the employment of unregistered agents/sales representatives.

17 5. Merrill Lynch's sales of securities in Alabama through agents and/or sales  
18 representatives not registered in Alabama constitute basis to order Merrill Lynch to cease and  
19 desist engaging in the sale of securities in Alabama through unregistered agents and sales  
20 representatives.

21 6. Pursuant to *Code of Alabama 1975, § 8-6-19, et seq.*, the violations described above  
22 constitute bases for the assessment of an administrative fine against Merrill Lynch.

23 7. The ASC finds the following relief appropriate and in the public interest.  
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3 **III.**

4 **UNDERTAKINGS**

5 1. Merrill Lynch hereby undertakes and agrees to immediately establish and maintain a  
6 trade monitoring system that prevents any person from entering client orders that originate from  
7 jurisdictions where the person accepting the order is not appropriately registered.  
8

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

13 3. For the period from the date of this Order through December 31, 2010, Merrill  
14 Lynch further undertakes and agrees to notify the ASC if it finds that any person associated with  
15 Merrill Lynch accepted a client order in Alabama without being registered, or being exempt from  
16 registration.  
17

18 **IV.**

19 **ORDER**

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

22 **IT IS HEREBY ORDERED:**

23 1. This Order concludes the investigation by the ASC and any other action that the ASC  
24 could commence against Merrill Lynch under applicable Alabama law on behalf of Alabama as it  
25 relates to unregistered activity in Alabama by Merrill Lynch's CAs and Merrill Lynch's supervision of  
26 CA registrations during the period from January 1, 2004 through the date of this Order.

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

6           3.       Merrill Lynch is hereby ordered to cease and desist from engaging in the sale of  
7 securities in Alabama through persons not registered with the ASC as agents of Merrill Lynch.  
8 Merrill Lynch is hereby ordered to pay the sum of Three Hundred Twenty-Five Thousand Two  
9 Hundred Dollars (\$325,200.00) for costs incurred during the investigation of this matter, and/or for  
10 securities and investor education, and/or for other securities and investor protection purposes, at the  
11 sole discretion of the ASC within ten days of the date of this Order, payable as follows: Alabama  
12 Securities Commission Three Hundred Thousand Dollars (\$300,000.00), Investor Protection Trust  
13 Fifteen Thousand Dollars (\$15,000.00), and North American Securities Administrators Association  
14 Ten Thousand Two Hundred Dollars (\$10,200.00).

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

19           5.       However, if any state securities regulator determines not to accept Merrill Lynch's  
20 settlement offer, the total amount of the payment to the State of Alabama shall not be affected, and  
21 shall remain at Three Hundred Twenty-Five Thousand Two Hundred Dollars (\$325,200.00).

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

23           7.       This order is not intended by the ASC to subject any Covered Person to any  
24 disqualifications under the laws of the United States, any state, the District of Columbia, Puerto  
25 Rico, or the U.S. Virgin Islands including, without limitation, any disqualification from relying  
26 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 or former officers,

1 directors, employees, or other persons that would otherwise be disqualified as a result of the Orders  
2 (as defined below).

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

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

12 Dated this 1<sup>st</sup> day of December, 2009.



Alabama Securities Commission  
401 Adams Avenue, Suite 280  
Montgomery, AL 36130  
334 242-2984

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By: 

Joseph P. Borg  
Director

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

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

10 Merrill Lynch admits the jurisdiction of the Alabama Securities Commission neither admits  
11 nor denies the Findings of Facts and Conclusions of Law contained in this Order, and consents to  
12 entry of this Order by the Alabama Securities Commission as settlement of the issues contained in this  
13 Order.

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

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

19 Abby Meiselman represents that she is Deputy General Counsel and Manager of the Litigation  
20 Department of the ultimate parent of Merrill Lynch and that, as such, has been authorized to enter into  
21 this Order for and on behalf of Merrill Lynch.

22 Dated this 25th day of November, 2009.

23 MERRILL LYNCH, PIERCE, FENNER & SMITH  
24 INCORPORATED

25 By: 

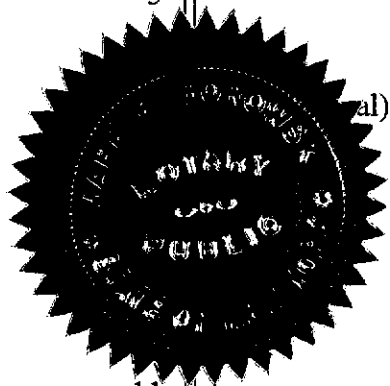
26 Abby Meiselman

Title: Deputy General Counsel

1 STATE OF NEW YORK  
2 COUNTY OF NEW YORK

3 I certify that Abby Meiselman personally known to me, appeared before me this day and  
4 acknowledged the due execution of the foregoing instrument.

5 Witness my hand and official seal, this the 25<sup>th</sup> day of November, 2009.



*Mark F. Borowski*  
\_\_\_\_\_, Notary Public  
My Commission Expires: \_\_\_\_\_

MARK F. BOROWSKI  
Notary Public, State of New York  
No. 41-4905960  
Qualified in Queens County  
Certificate Filed in New York County  
Commission Expires Sept. 21, 2013