

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20080145847-01**

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

RE: Merrill Lynch, Pierce, Fenner & Smith Incorporated, Respondent
Broker-Dealer
CRD No. 7691

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLCO" 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. The firm 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

The firm became a member of FINRA on January 26, 1937, and its registration remains in effect. The firm has the following relevant disciplinary history:

On or about September 24, 2008, an AWC became final in which the firm was censured and fined for, among other things, violations of NASD Rule 2320 for its failure to comply with its best execution obligations in 54 transactions in equity securities. The firm paid a fine of \$47,500 for the violations of NASD Rule 2320.

SUMMARY

This matter involves an investigation by the Customer Issues staff of FINRA's Department of Market Regulation (the "staff") regarding the firm's compliance with its best execution obligations in connection with retail transactions in exchange listed non-convertible preferred securities executed off exchange on the firm's proprietary ML

BondMarket order execution system ("ML BondMarket") during the period from April 1, 2006 through December 31, 2010 (the "review period").

ML BondMarket was one of the options available at the firm for executing customer transactions in non-convertible preferred securities and was programmed to provide automated executions in transactions in non-convertible preferred securities of 5,000 shares or less based upon published quotations. In the instances described below, however, the firm failed to execute transactions of non-convertible securities on ML BondMarket within the National Best Bid and Offer ("NBBO").

FACTS AND VIOLATIVE CONDUCT

1. During the review period, ML BondMarket had a flawed pricing logic that only incorporated the quotations from the two primary exchanges where the non-convertible securities were listed. As a result, in instances when there was a better price on a market other than the primary listing exchange, the firm systematically executed transactions in non-convertible preferred securities with its customers on ML BondMarket at prices that were inferior to the NBBO. Specifically, in 12,259 transactions for or with a customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. The conduct described in this paragraph constitutes separate and distinct violations of NASD Rules 2320 and 2110 or FINRA Rule 2010.¹
2. During the review period, the firm failed to establish and maintain a supervisory system, including written supervisory procedures ("WSPs"), that were reasonably designed to ensure compliance with the firm's best execution obligations for transactions in non-convertible preferred securities executed on ML BondMarket. The firm's supervisory system relating to ML BondMarket was deficient in a number of respects. The firm failed to perform any post-execution review of non-convertible preferred transactions executed on ML BondMarket to ensure compliance with the firm's best execution obligations despite the fact that it received several inquiry letters from the staff during the review period regarding the relevant conduct. Although the firm took some remedial measures that were intended to address issues raised by the staff, the firm failed to identify the flawed pricing logic until December 2010. Moreover, approximately 2,200 transactions contained in this AWC were identified on FINRA's best execution report cards that were available to the firm from February 2008 through June 2011. Despite these "red flags" the firm failed to perform any meaningful supervisory review for best execution of non-convertible preferred transactions executed on ML BondMarket.

¹ NASD Rule 2110 became FINRA Rule 2010 on December 15, 2008.

3. The firm's WSPs were not adequate. From at least April 1, 2006 through January 1, 2009, the WSPs did not describe the supervisory steps to be taken by the person responsible for a best execution supervisory review of non-convertible preferred transactions executed on ML BondMarket. From January 1, 2009 through December 31, 2010, the firm's WSPs related to the best execution of non-convertible preferred securities on ML BondMarket did not provide for: (1) the person or persons responsible for ensuring compliance with the applicable rules; (2) a statement of the supervisory steps to be taken by the person responsible for supervision; (3) a statement as to how often such persons should take such steps; and (4) a statement as to how the completion of supervisory reviews should be documented.
4. The conduct described in paragraphs two and three, above, constitutes a violation of NASD Rule 3010, NASD Rule 2110 (for conduct prior to December 15, 2008), and FINRA Rule 2010 (for conduct on and after December 15, 2008).

B. The firm also consents to the imposition of the following sanctions:

- A censure;
- A fine of \$1,050,000 (\$650,000 for the best execution violations and \$400,000 for supervision violations).
- An undertaking to revise the firm's WSPs with respect to the areas described above. Within 30 business days of acceptance of this AWC by the National Adjudicatory Council ("NAC"), a registered principal of the firm shall submit to the **COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850**, a signed, dated letter, or an e-mail from a work-related account of the registered principal to MarketRegulationComp@finra.org, providing the following information: (1) a reference to this matter; (2) a representation that the firm has revised its written supervisory procedures to address the deficiencies described above; and (3) the date the revised procedures were implemented.
- Restitution in connection with the 12,259 transactions in the total amount of \$323,950.04, plus interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from the date of the violative conduct until the date this AWC is accepted by the NAC. A registered principal of the firm shall submit satisfactory proof of payment of the restitution, or of reasonable and documented efforts undertaken to effect restitution, to the **COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850** or in an e-mail from a work-related account of the registered principal to MarketRegulationComp@finra.org, no later than 120 days after acceptance of this AWC. If for any reason, Respondent cannot locate any customer after reasonable and documented efforts within such period, or such additional period agreed to by the staff, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed-property or abandoned-property fund for the state in which the customer is known to have last resided.

The firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. It has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

The firm 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.

II.

WAIVER OF PROCEDURAL RIGHTS

The firm 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 firm;
- 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 NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the firm specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

The firm 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

The firm 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 the firm;
- C. If accepted:
 - 1. this AWC will become part of the firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. The firm 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. The firm 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 the firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm 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 it 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 herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the firm to submit it.

February 27, 2013
Date

Respondent
Merrill Lynch, Pierce, Fenner & Smith
Incorporated

By: J. David Montague
Name: J. David Montague
Title: Associate General Counsel

Reviewed by:

David H. Baird
Attorney Name DAVID H. BAIRD
Counsel for Respondent
Firm Name BOWEN HAMM MCDONALD LLP
Address 2020 K ST, NW
City/State/Zip WASHINGTON, D.C. 20006
Phone Number 202-373-6561

Accepted by FINRA:

4/2/13
Date

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

Thomas R. Gira
Thomas R. Gira
Executive Vice President
Department of Market Regulation