

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2009020383001**

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, Respondent 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 it alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent 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, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") has been a FINRA member firm since 1937. It is a full-service broker-dealer with its principal offices located in New York, New York. It employs over 31,000 registered individuals and maintains over 1,200 branch offices.¹

RELEVANT DISCIPLINARY HISTORY

Although Merrill Lynch has a disciplinary history within the last five years, none of it relates to its anti-money laundering compliance program.

¹ In January 2009, subsequent to the violations set forth herein, Merrill Lynch was acquired by Bank of America Corporation.

OVERVIEW

Merrill Lynch failed to enforce its anti-money laundering compliance program ("AMLCP") and written procedures by accepting third-party checks for deposit into a customer's account that, contrary to the procedures, did not identify that customer by name. As a result, one of its customers, a registered representative at another member firm, was able to move over \$9 million of misappropriated funds through his Merrill Lynch cash management brokerage account. By failing to enforce its written procedures and to develop and implement a reasonably-designed AMLCP, Merrill Lynch violated NASD Conduct Rules 3011(a), 3011(b) and 2110.

FACTS AND VIOLATIVE CONDUCT

AMLCP Requirements

In July 2002, the Department of Treasury ("Treasury") issued regulations requiring suspicious transaction reporting for broker-dealers.² Consequently, since 2002, broker-dealers have been required by FINRA to, among other things:

(a) establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder; and

(b) establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder.³

A firm's AMLCP must address a number of areas including monitoring transactions to report suspicious activity where appropriate. For example, when potentially suspicious activity that warrants investigation is identified, a firm must initiate a review of that activity promptly and complete its review within a reasonable period of time.⁴ Firms are required to file a Form SAR-SF with Treasury's Financial Crimes Enforcement Network reporting "any suspicious transaction relevant to a possible violation of law or regulation."⁵

² 31 C.F.R. §103.19(a)(1) (2002).

³ NASD Conduct Rule 3011.

⁴ See The SAR Activity Review, Issue 10 (May 2006).

⁵ 67 Fed. Reg. 44048 (July 1, 2002). See also, 31 C.F.R. §103.19(a)(1) (2002).

To be required to file a SAR, it is not necessary for a broker-dealer to prove that a customer has engaged in illegal activity or to have actual knowledge of illicit or unlawful trading by a customer; rather, it is sufficient that the broker-dealer have reason to suspect that a transaction or series of transactions involve unlawful activity or lack an apparent lawful purpose. The Treasury also has advised broker-dealers to determine whether activity raises suspicions by monitoring for various "red flags." FINRA *Notice to Members* ("NtM") 02-21 and NtM 02-47 emphasize members' duties to detect "red flags" and, if detected, to perform additional due diligence before proceeding with a suspicious transaction.

Additionally, broker-dealers should tailor their AMLCP to fit their business. In developing an appropriate AMLCP, a broker-dealer should consider factors such as its size, location, business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.⁶

Broker Smith Moved Over \$9 Million of Misappropriated Funds through his Merrill Lynch Account

From 1992 to at least March 2009, Maxwell Baldwin Smith ("Smith"), who during that period was employed as a registered representative at several other FINRA member firms, held a cash management brokerage account at Merrill Lynch as a customer. From 1992 through at least June 2008, Smith convinced seven individuals, at least four of whom were elderly, to invest over \$9 million in a private placement of an investment called a Health Care Financial Partnership Direct loan ("HCF"). Most, if not all, of the seven individuals were customers of Smith at one or more of the other broker-dealer firms that employed him. One of the customers, who is now 95 years old, accounted for at least \$8.6 million of the funds invested.

In documentation provided by Smith to the customers, Health Care Financial was described as a company "formed for the purpose of obtaining a high level of interest income through investment in a diversified portfolio of High Yielding income projects which have been sold to finance or refinance health care facilities, such as nursing homes and continuing care retirement centers for the elderly." Smith recommended the purchase of the loans as "an attractive investment for purchasers of nursing home bonds." Depending on the loan purchased, Smith promised the customers annual interest ranging from 7.5% to 9%. The terms of the loans ranged from 2 to 30 years. Smith told the customers that Merrill Lynch was an underwriter or general partner in HCF. Moreover, the customers believed that the fact that the checks were payable to Merrill Lynch meant that the investments were safe and authentic.

⁶ NtM 02-21, at 4.

After Smith convinced them to invest in HCF, the customers withdrew funds from their brokerage and other accounts, and used personal checks to purchase the shares. In accordance with Smith's instructions, the customers made their HCF investment purchase checks payable to Merrill Lynch. In most instances, Smith also instructed the customers to write a Merrill Lynch account number on those checks, which were for large dollar amounts in the low to mid-six figures. Smith, however, did not reveal to the customers that that was the account number for his personal Merrill Lynch account.

Smith did not invest the above-referenced funds on the customers' behalf. Unbeknownst to the customers, Health Care Financial was a sham entity and HCF was a fictitious investment. Instead of investing the funds as promised, Smith misappropriated the customers' money by depositing their checks into his Merrill Lynch account, which, from 1992 through at least June 2008, was not used to effect any securities transactions. He then transferred those funds to a personal bank account by writing large dollar checks payable to himself and to cash. Smith used those funds to make purported "interest payments" to the unsuspecting customers or to purchase real estate, antiques and vacations for himself. By misappropriating customer funds, Smith violated NASD Conduct Rules 2330 and 2110 and IM-2310-2.⁷

Merrill Lynch Failed to Implement its Procedures

From at least April 2002 through June 2008 ("relevant time period"), Merrill Lynch had deposit acceptance procedures that were part of its AMLCP. Those procedures classified checks payable to a third party, such as the ones Smith deposited, as described above, as "non-personal checks," which its procedures defined as those drawn on any account other than the depositing client's own bank account. For "non-personal checks" made payable to Merrill Lynch, the procedures stated that such checks were acceptable for deposit only if the payee line read: "Pay to the order of Merrill Lynch Pierce Fenner & Smith, Inc., for the account of (client's name and account number)." Merrill Lynch's procedures also warned employees to look out for potential evidence of money laundering, such as a client: 1) exhibiting patterns of depositing checks and later requesting a partial or complete withdrawal without market investment; 2) seeking to deposit the funds of a third party with whom there is no family or fiduciary relationship; and 3) receiving or disbursing funds not corresponding to the client's known business activities and financial situation (e.g., large deposits, receipts, or

⁷ On February 2, 2010, FINRA barred Smith for this misconduct. In November 2009, Smith pleaded guilty to criminal charges, which included first-degree money laundering and mail fraud, arising from the scheme described herein. He is currently awaiting sentencing.

disbursements of funds from or to entities that seem to have no logical connection with the client's business).

During the relevant time period, Smith deposited his customers' HCF investment checks into his personal account at Merrill Lynch. The HCF investor checks were non-personal checks made payable to Merrill Lynch and, in most instances, Smith's account number had been written on the check by the customer. The absence of Smith's name on the checks gave no indication to those outside of Merrill Lynch, including Smith's investors, that the money was going to Smith's personal account. In accepting these deposits, the firm failed to follow its written procedures because these "non-personal checks" were accepted for deposit without containing the name of the Merrill Lynch client (Smith in this case) who owned the account. Had Merrill Lynch enforced its procedures, Smith would not have been able to move the proceeds of his misappropriation scheme through Merrill Lynch.

Moreover, Merrill Lynch disregarded certain indications of Smith's misconduct, such as the fact that he was: 1) depositing large amounts of money into, and then moving large amounts of funds out of, an account that had no market investment activity through the use of large dollar checks payable to himself or to cash; and 2) depositing the funds of third parties with whom he had no apparent family or fiduciary relationship.

During the relevant time period, Merrill Lynch did not have internal controls in place to ensure compliance with its deposit acceptance procedures regarding non-personal checks. For example, there were no procedures or a system for a post-deposit review and rejection of such checks. Moreover, Merrill Lynch did not have an adequate system to monitor deposit activity in accounts such as Smith's which lacked securities activity and displayed the indications of misconduct discussed above.

By failing to enforce its written procedures and to develop and implement a reasonably-designed AMLCP, Merrill Lynch violated NASD Conduct Rules 3011(a), 3011(b) and 2110.

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

- a censure; and
- a fine in the amount of \$400,000.

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

Respondent 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

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 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.

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 it;
- 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 it;
 - 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. 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 the firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party; and
- 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 or its staff.

The undersigned, on behalf of Respondent, 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 we have 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.

Merrill Lynch, Pierce, Fenner & Smith Incorporated

June 8, 2011

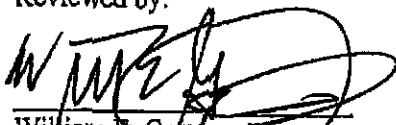
Date (mm/dd/yyyy)

By: Mark L. Keene

Name: **MARK L. KEENE**

Title: **ASSISTANT GENERAL COUNSEL**

Reviewed by:



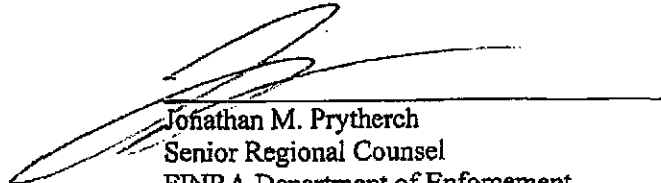
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Accepted by FINRA:

July 26, 2011

Date

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



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