

COMMONWEALTH OF KENTUCKY
PUBLIC PROTECTION CABINET
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF SECURITIES
AGENCY CASE NO. 2009-AH- 98

In the matter of)
MERRILL LYNCH, PIERCE, FENNER)
& SMITH INCORPORATED,) **ADMINISTRATIVE CONSENT ORDER**
Respondent.)

WHEREAS, Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch”) is a broker-dealer registered in the Commonwealth of Kentucky, 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 KRS 292.470 and KRS 292.490 with respect to this Order; and

Solely for the purpose of terminating the multi-state investigations, including the investigation by the staff of the Department of Financial Institutions (“DFI”), Division of Securities, 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 Commissioner of the DFI, as administrator of the Kentucky Securities Act (KRS Chapter 292), hereby enters this Order:

I.

FINDINGS OF FACTS

1. Merrill Lynch admits the jurisdiction of the DFI 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. Pursuant to KRS 292.330(1), it is unlawful for any person to transact business in Kentucky as a broker-dealer or agent unless that person is registered, and it is unlawful for any broker-dealer or issuer to employ an agent unless the agent is registered.

8. Pursuant to the general prohibition under KRS 292.330(1) cited in paragraph 7 above, a person cannot accept unsolicited orders in Kentucky without being registered as a broker-dealer or broker-dealer agent in accordance with KRS 292.330.

9. Pursuant to KRS 292.500(14), the Commissioner may assess civil fines against any person who violates any provision of the Securities Act or any rule or order entered thereunder. In addition to any fines levied, the Commissioner may also assess the costs of any investigation, including attorney's fees incurred as a result of bringing an enforcement action, pursuant to KRS 292.500(15). Further, pursuant to KRS 292.470, whenever it appears to the Commissioner that any person has engaged in or is about to engage in any act or practice constituting a violation of any provision of KRS Chapter 292, he may issue a final order containing findings of fact and conclusions of law, directing any person found to have engaged in activity that constitutes a violation of KRS Chapter 292 to cease and desist from the activity, pay fines assessed under KRS 292.500(14) and costs assessed under KRS 292.500(15), or perform any other mandate reasonably calculated to carry out the provisions of the Kentucky Securities Act.

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

14. Because Merrill Lynch's relevant trade records were maintained in hard copy and only at branch offices across the country, the multi-state 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.

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

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

Merrill Lynch's Remedial Measures and Cooperation

17. As a result of the inquiries by state securities regulators, Merrill Lynch conducted a review of its CA registration practices.

18. 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.

19. 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.

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

21. 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.

¹ 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.

22. Between October 1, 2008 and January 28, 2009, 373 CAs registered with the DFI's Division of Securities 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.

23. However, Merrill Lynch, as a compliance enhancement, also developed an electronic system that will prevent a person from entering client orders from a state 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.

24. 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 DFI has jurisdiction over this matter pursuant to KRS 292.500(1).
2. Merrill Lynch's failure to establish an adequate system to monitor the registration status of persons accepting client orders constitutes a violation of KRS 292.330(13)(a)9a for a failure to establish a reasonably designed supervision system.
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 KRS 292.330(13)(a)9a.
4. Pursuant to KRS 292.330(1), Merrill Lynch's sales of securities in Kentucky through unregistered CAs constitute violations of KRS 292.330(1) for use/employment of unregistered agents/sales representatives and constitute the basis for entry of an Order

reprimanding and/or assessing a fine against Merrill Lynch.

5. Pursuant to 292.330 and KRS 292.470, Merrill Lynch's sales of securities in Kentucky through unregistered agents not registered in Kentucky constitute bases to order Merrill Lynch to cease and desist engaging in the sale of securities in Kentucky through unregistered agents.

6. Pursuant to KRS 292.330 and KRS 292.500(14), the violations described above constitute bases for the assessment of an administrative fine against Merrill Lynch.

7. The DFI finds the following relief appropriate and in the public interest.

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 DFI, 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 DFI if it finds that any person associated with Merrill Lynch accepted a client order in Kentucky without being registered, or exempt from registration, with the 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 DFI and any other action that the DFI could commence against Merrill Lynch under applicable Kentucky law on behalf of the Commonwealth of Kentucky as it relates to unregistered activity in Kentucky 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 Kentucky through persons not registered with the DFI as agents of Merrill Lynch.
5. Merrill Lynch is hereby ordered to pay the sum of Four Hundred Thirty Three Thousand Eight Hundred and Fifty Dollars (\$433,850) to the DFI, with the check to be made payable to the Kentucky State Treasurer, and delivered to Department of Financial Institutions, Attn: William Owsley, Legal Counsel, 1025 Capital Center Drive, Suite 200, Frankfort, Kentucky 40601. The monies received by the DFI pursuant to this paragraph may be used in accordance with Kentucky law, including but not limited to KRS 286.1-485, to reimburse the DFI for costs incurred during the investigation of this matter, for securities and investor education, and/or for other securities and investor protection purposes, at the sole discretion of the Commissioner. Payment shall be made by Merrill Lynch 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 Commonwealth of Kentucky shall not be affected, and shall remain at Four Hundred Thirty Three Thousand Eight Hundred and Fifty Dollars (\$433,850).

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

9. This order is not intended by the DFI 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 or former officers, directors, employees, or other persons that would otherwise be disqualified as a result of the Orders (as defined below).

10. 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 Commonwealth of Kentucky and any disqualifications from relying upon this state's registration exemptions or safe harbor provisions that arise from the Orders are hereby waived.

11. 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.

Dated this 3rd day of December, 2009.

BY ORDER OF THE COMMISSIONER



Charles A. Vice

