

1 THE PEOPLE OF THE STATE OF CALIFORNIA
2 BY AND THROUGH THE COMMISSIONER OF CORPORATIONS

3 In the matter of)
4 MERRILL LYNCH, PIERCE, FENNER) **FINDINGS OF FACT**
& SMITH INCORPORATED,) **CONCLUSIONS OF LAW**
5) **ADMINISTRATIVE CONSENT ORDER**
6 Respondent.)
7)
8)

9 WHEREAS, Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch”) is a
10 broker-dealer registered in the State of California, with a Central Registration Depository (“CRD”)
11 number of 7691; and

12 State securities regulators from multiple jurisdictions have conducted coordinated
13 investigations into the registration of Merrill Lynch Client Associates (“CAs”) and Merrill Lynch’s
14 supervisory system with respect to the registrations of CAs; and

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

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

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

22 Merrill Lynch elects to waive permanently any right to a hearing and appeal under California
23 Corporations Code sections 25532(d) and 25609 with respect to this Order; and

24 Solely for the purpose of terminating the multi-state investigations, and in settlement of the
25 issues contained in this Order, Merrill Lynch, without admitting or denying the Findings of Fact or
26 Conclusions of Law contained in this Order, consents to the entry of this Order.

27 NOW, THEREFORE, the Commissioner of the California Department of Corporations, as
28 administrator of the California Securities Law, hereby enters this Order:

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I.
FINDINGS OF FACT

1. Merrill Lynch admits the jurisdiction of the California Department of Corporations 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.

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1 Registration Required

2 7. Title 10, Ch. 3, section 260.210 of the California Code of Regulations provides that
3 upon the employment of any individual as an agent of a licensed broker-dealer, the broker-dealer
4 shall comply with the specified registration and qualification requirements and conduct a background
5 investigation and maintain records as evidence of compliance with those requirements in addition to
6 paying registration fees to the commissioner for such agents. Failure of a broker-dealer to comply
7 with this section of the regulations is a violation of Corporations Code section 25210(b) which
8 prohibits any agent of a broker-dealer from inducing or attempting to induce the purchase and sale of
9 securities in California on behalf of the broker-dealer without having first complied with the rules
10 adopted by the Commissioner of the California Department of Corporations for the registration and
11 employment of such agents.

12 8. Pursuant to the general prohibition under California Corporations Code section 25210,
13 a person cannot accept unsolicited orders in California as an agent of a broker-dealer without first
14 complying with the registration requirements of Title 10, Ch. 3, section 260.210 of the California
15 Code of Regulations.

16 9. Pursuant to California Corporations Code section 25252(b) a broker-dealer may be
17 subject to administrative penalties in the form of fines for selling securities in California other than
18 through registered agents.

19 Merrill Lynch Requires Registration of Client Associates

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

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

25 Regulatory Investigations and Findings

26 12. In May 2008, state regulators received a tip alleging that Merrill Lynch was failing to
27 ensure its CAs were in compliance with jurisdictional registration requirements and its own
28 procedures. The tip alleged that Merrill Lynch CAs were registered in two jurisdictions –

1 the CA's home state and one neighboring state – because Merrill Lynch only paid for registrations in
2 two jurisdictions.

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

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

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

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

26 16. The multi-state investigation found that certain Merrill Lynch CAs engaged in the sale
27 of securities in California at times when the CAs were not appropriately registered in California.
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1 Merrill Lynch's Remedial Measures and Cooperation

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

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

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

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

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

17 22. Between October 1, 2008 and January 28, 2009, 742 CAs registered with the
18 California Department of Corporations as agents of Merrill Lynch. Yet, data as of February 28, 2009
19 indicated that significant gaps remained between the registrations of CAs and their FAs.

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

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

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

5 **II.**
6 **CONCLUSIONS OF LAW**

7 1. The California Department of Corporations has jurisdiction over this matter pursuant
8 to the California Securities Law.

9 2. Merrill Lynch’s failure to establish an adequate system to monitor the registration
10 status of persons accepting client orders constitutes a violation of Corporations Code section 25210,
11 and Title 10, Ch. 3, sections 260.210 and 260.218.4 of the California Code of Regulations.

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 Corporations Code section 25210 and Title 10, Ch. 3, sections 260.210 and 260.218.4 of the
15 California Code of Regulations.

16 4. Pursuant to the California Corporations Code section 25212, the violations described
17 above constitute grounds to issue an order censuring Merrill Lynch.

18 5. Pursuant to the California Corporations Code section 25532, the violations described
19 above constitute grounds to issue an order requiring Merrill Lynch to desist and refrain from
20 engaging in the sale of securities in California through unregistered agents.

21 6. Pursuant to California Corporations Code section 25252, the violations described
22 above constitute a basis for the assessment of an administrative penalty against Merrill Lynch.

23 7. The California Department of Corporations finds the following relief appropriate and
24 in the public interest.

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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 California Department of Corporations, 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 California Department of Corporations if it finds that any person associated with Merrill Lynch accepted a client order in California without being registered, or exempt from registration, with the California Department of Corporations as an agent of Merrill Lynch.

IV.
ORDER

On the basis of the Findings of Fact, 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 California Department of Corporations and any other action that the California Department of Corporations could commence against Merrill Lynch under applicable California law on behalf of California as it relates to unregistered activity in California 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

1 Merrill Lynch or create defenses of Merrill Lynch, to any claims.

2 3. Merrill Lynch is hereby censured.

3 4. Merrill Lynch is hereby ordered to desist and refrain from engaging in the sale of
4 securities in the State of California through persons not registered with the California Department of
5 Corporations as agents of Merrill Lynch.

6 5. Merrill Lynch is hereby ordered to pay administrative penalties in the sum of Two
7 Hundred Eight Thousand, Five Hundred and Twenty Five Dollars (\$208,525.00) to the California
8 Department of Corporations within ten days of the date of this Order.

9 6. Merrill Lynch shall pay up to a total of Twenty Six Million, Five Hundred Sixty Three
10 Thousand, Ninety Four Dollars and Fifty Cents (\$26,563,094.50) in fines, penalties and any other
11 monetary sanctions among the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin
12 Islands pursuant to the calculations discussed with the multi-state working group.

13 7. However, if any state securities regulator determines not to accept Merrill Lynch's
14 settlement offer, the total amount of the payment to the State of California shall not be affected, and
15 shall remain at Two Hundred Eight Thousand, Five Hundred and Twenty Five Dollars (\$208,525.00).

16 8. Merrill Lynch is hereby ordered to comply with the undertakings contained
17 herein.

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

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

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

7 Dated this 1st day of December, 2009.

8 PRESTON DuFAUCHARD
9 California Corporations Commissioner

10 By _____
11 ALAN S. WEINGER
12 Deputy Commissioner
13 Enforcement Division
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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 California Department of Corporations, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order, and consents to entry of this Order by the California Department of Corporations 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 25th day of November, 2009.

MERRILL LYNCH, PIERCE, FENNER & SMITH
INCORPORATED

By: _____
Abby Meiselman
Title: Deputy General Counsel

SUBSCRIBED AND SWORN TO before me this _____ day of _____, 2009.

[Affix seal]

Notary Public in and for the
State of North Carolina

My Commission expires:
