

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2017053494401**

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, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch" 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 Merrill Lynch alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Merrill Lynch 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 has been a FINRA member since 1937 and is headquartered in New York, New York. It is a full-service brokerage firm with approximately 31,000 registered representatives. Among other things, it provides sales and trading services, research, and underwriting services. In January 2009, Merrill Lynch became an indirect, wholly-owned subsidiary of Bank of America Corporation.

RELEVANT DISCIPLINARY HISTORY

On June 6, 2014, pursuant to Letter of Acceptance, Waiver and Consent No. 2011029999301, the Firm agreed to a censure, \$8 million fine and approximately \$24.2 million in restitution for supervision and suitability violations relating to the sales of mutual fund shares to certain retirement plans and charitable organizations. Between 2006 and 2011, the Firm sold Class A shares with sales charges to more than 30,000 accounts that were eligible to purchase the shares without an initial sales charge.

OVERVIEW

Between April 2011 and April 2017 (the “Relevant Period”), Merrill Lynch failed to provide over 13,000 accounts with mutual fund sales charge waivers and fee rebates to which the customers were entitled through rights of reinstatement offered by mutual fund companies. As a result, eligible customers paid approximately \$6 million in excess sales charges and fees during the Relevant Period. Merrill Lynch failed to establish, maintain and enforce a supervisory system and procedures reasonably designed to ensure that customers received these sales charge waivers, relying primarily on individual registered representatives to determine customer eligibility for waivers and apply the waivers manually without reasonable supervisory oversight. As a result, the Firm violated NASD Rules 3010(a) and (b) (for the period prior to December 1, 2014) and FINRA Rules 3110(a) and (b) (for the period after December 1, 2014) and 2010.

FACTS AND VIOLATIVE CONDUCT

A. Rights of Reinstatement

Mutual fund issuers generally offer various privileges to their shareholders which are set forth in a fund’s prospectus or statement of additional information (“SAI”). These privileges sometimes include a right of reinstatement (“ROR”), which allows investors to purchase shares of a fund after previously selling shares of that fund or another fund in the same fund family, without incurring a front-end sales charge (typically, but not always, involving Class A shares), or to recoup all or part of a contingent deferred sales charge fee (“CDSC”), provided the reinvestment occurs within a designated time period. During the Relevant Period, the time frame for reinstatement eligibility differed depending on the fund. Typically the period ranged from 30 days to 120 days, but in some cases was up to one year.

B. Merrill Lynch Failed to Reasonably Supervise its Rights of Reinstatement Process

FINRA Rules 3110(a) and (b) require FINRA members to establish and maintain a supervisory system and to establish, maintain and enforce supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations and FINRA rules. NASD Rules 3010(a) and (b) required substantially the same.¹

FINRA Rule 2010 provides that a member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.

This matter arose from a routine cycle exam by FINRA’s Department of Member Supervision, and the Firm subsequently investigated the matter further and filed a report pursuant to FINRA Rule 4530 relating to rights of reinstatement.

During the Relevant Period, Merrill Lynch failed to establish and maintain a supervisory system and failed to establish, maintain and enforce supervisory procedures reasonably

¹ FINRA Rule 3110 replaced NASD Rule 3010 effective December 1, 2014.

designed to ensure that all eligible mutual fund investors received sales charge waivers or CDSC rebates available through rights of reinstatement. Instead, Merrill Lynch relied on its registered representatives to manually identify and apply such waivers and rebates through rights of reinstatement. While all reinstatement requests required supervisory approval, supervisors were not required to take steps to reasonably ensure that customers eligible for reinstatements received them. The Firm's reliance on its registered representatives was not reasonably designed given the number of customers involved and the complexity of determining who should be granted sales charge waivers or CDSC rebates and how such waivers and rebates should be calculated.

In addition, the Firm did not monitor specifically for missed reinstatements, but instead relied on an alert that only identified accounts that sold a mutual fund during the preceding week, purchased a mutual fund from the same fund family within five business days and was not executed as an exchange. This alert, however, was not reasonably designed to detect missed reinstatements because many of the mutual fund companies on Merrill's platform waived sales charges or rebated CDSC charges when investors reinvested between 30 and 120 days, and in some cases up to a year, from the date of the initial sale.

Because the Firm's procedures placed the responsibility on representatives to determine if clients were eligible for reinstatement privileges and because the alert did not reasonably surveil for missed reinstatements, Merrill failed to detect that its advisors did not provide 13,328 accounts with sales charge waivers and CDSC rebates to which they were entitled pursuant to rights of reinstatement. As a result, impacted customers paid approximately \$6 million in excess sales charges and fees during the Relevant Period.

Merrill has subsequently enhanced its procedures. In particular, by April 2017, the Firm automated its reinstatement process to apply sales charge waivers and CDSC rebates automatically to shares purchased that are subject to rights of reinstatement, provided the repurchase occurs within 90 days following the redemption and the redemption and purchase occur in the same account, as specified in the relevant fund prospectus.

By virtue of the foregoing, Merrill Lynch violated FINRA Rules 3110(a), (b) and NASD Rules 3010(a) and (b) and FINRA Rule 2010.

CREDIT FOR EXTRAORDINARY COOPERATION

In resolving this matter without a monetary fine, Enforcement recognizes Merrill Lynch's extraordinary cooperation for: (1) engaging an outside consulting firm to conduct a complex analysis to identify potentially disadvantaged customers and calculate total remediation; (2) investigating the extent to which the Firm did not provide rights of reinstatement; (3) promptly establishing a plan to provide remediation, notifying the disadvantaged customers, and paying restitution to affected customers;² (4) promptly remediating supervisory deficiencies with respect to rights of reinstatement; and (5) providing substantial assistance to FINRA in its investigation.

² Merrill reviewed transactional activity through April 2018 to identify all potential CDSCs to be remediated.

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

- a Censure; and
- Restitution, plus interest, to the affected customers in the total amount of \$7,225,700.12.³

The sanctions imposed herein shall be effective on the date set by the 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.

³ In May 2019, prior to the effective date of this AWC, the Firm paid full restitution, plus statutorily calculated interest, to the affected customers and provided proof of payment and documentation of the methodology used to determine restitution to FINRA Staff.

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 Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent'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 in accordance with FINRA Rule 8313;
 - 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 Respondent's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- 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 Merrill Lynch, 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 Merrill Lynch has 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 Merrill Lynch to submit it.

6/1/2020
Date (mm/dd/yyyy)

Merrill Lynch, Pierce, Fenner & Smith
Incorporated

By: Mark L. Keene

Mark L. Keene
Print Name

Associate General Counsel
Title

Reviewed By: 

Thomas J. Hennessey
Counsel for Respondent
Morgan, Lewis & Bockius LLP
One Federal Street
Boston, MA 02110

Accepted by FINRA:

6/4/2020
Date

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



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