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**COMMISSIONERS**  
KRISTIN K. MAYES, Chairman  
GARY PIERCE  
PAUL NEWMAN  
SANDRA D. KENNEDY  
BOB STUMP

ERNEST G. JOHNSON  
EXECUTIVE DIRECTOR



ARIZONA CORPORATION COMMISSION

ORIGINAL

MEMORANDUM

**TO:** Kristin K. Mayes, Chairman  
Gary Pierce  
Paul Newman  
Sandra D. Kennedy  
Bob Stump

Arizona Corporation Commission  
**DOCKETED**

NOV 19 2009

**FROM:** Matthew J. Neubert *[Signature]*  
Director of Securities

DOCKETED BY *[Signature]*

**DATE:** November 17, 2009

**RE:** Proposed Order re: Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc.;  
S-03497A-09-0439

**CC:** Ernest G. Johnson, Executive Director

ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL  
2009 NOV 19 PM 2:28  
RECEIVED

Attached is a proposed Order for Relief and Consent to Same ("Order"), fully executed by Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"). In the proposed Order, Merrill Lynch agrees to cease and desist from engaging in the sale of securities in Arizona through persons not registered with the Commission as agents of Merrill Lynch, to make systemic changes to monitor the registration status of persons who accept orders from Arizona clients to allow it to reasonably supervise its salesmen, and to pay \$344,400.00, as an administrative penalty.

The proposed Order is the result of a multi-state effort in which Arizona participated, addressing gaps in registration by Merrill Lynch's assistant sales representatives ("Client Associates" or "CAs") whereby many CAs were not registered in states where they might provide services based upon the registration statuses of the salesmen the CAs served. Merrill Lynch cooperated in the investigation, providing information to identify the scope of the gaps in registration.

Merrill Lynch uses CAs to provide administrative and sales support to one or more of Merrill Lynch's Financial Advisors ("FAs"). Merrill Lynch's compliance procedures always

required CAs to be registered in all states where they accepted client orders, and until 2006, Merrill Lynch's policy required registration of CAs to mirror registration of FAs. In 2006, Merrill Lynch amended its relevant policies and procedures to more broadly require that CAs maintain "appropriate registrations."

As a result of inquiries by state regulators after receiving information from a former Merrill Lynch employee, Merrill Lynch conducted a review of CA registration gaps and practices. Merrill Lynch's review found incidences of CAs not properly state registered in states where the FAs served were registered.

The final result of the investigation includes Merrill Lynch's payment of \$26,563,094.50 into the multistate fund to compensate 50 states the District of Columbia, Puerto Rico, and the U.S. Virgin Islands, for fines and administrative penalties. The total amount paid was allocated for distribution to participating states in accordance with a formula approved by the negotiating committee for the participating states.

In addition to penalties, Merrill Lynch accepted undertakings to develop and implement 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 began implementing this new system in June 2009, and expects it to be fully implemented by December 31, 2009<sup>1</sup>.

The Division supports this proposed Order as serving the public interest.

Originator: Pam Johnson

MN/ptj

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<sup>1</sup> Note that in late October, 2009, Banc of America Investment Services, Inc. ("BAIS") migrated on the Central Registration Depository to Merrill Lynch, however, the trading and order entry integration will not be completed until the third quarter of 2010. BAIS, whose policies have required sales assistants to mirror the FAs they serve, will continue to use its own order entry system until the integration is completed

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2  
3 COMMISSIONERS

4 KRISTIN K. MAYES, Chairman  
5 GARY PIERCE  
6 PAUL NEWMAN  
7 SANDRA D. KENNEDY  
8 BOB STUMP

9 IN THE MATTER OF: )  
10 MERRILL LYNCH, PIERCE, FENNER ) DOCKET NO. S-03497A-09-0439  
11 & SMITH INCORPORATED, ) DECISION NO. \_\_\_\_\_  
12 Respondent. ) **ORDER FOR RELIEF AND CONSENT TO**  
13 ) **SAME**

14 WHEREAS, Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch”) is a dealer  
15 registered in the state of Arizona, with a Central Registration Depository (“CRD”) number of 7691; and  
16 State securities regulators from multiple jurisdictions have conducted coordinated investigations  
17 into the registration of Merrill Lynch Client Associates (“CAs”) and Merrill Lynch’s supervisory system  
18 with respect to the registrations of CAs; and

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

22 Merrill Lynch has advised regulators of its agreement to resolve the investigations pursuant to  
23 the terms specified in this Order for Relief and Consent to Same (the “Order”); and

24 Merrill Lynch agrees to make certain changes in its supervisory system with respect to the  
25 registration of CAs, and to make certain payments in accordance with the terms of this Order; and  
26  
27  
28

1 Merrill Lynch elects to waive permanently any right to a hearing and appeal under Articles 11  
2 and 12 of the Securities Act of Arizona, A.R.S. § 44-1801 et seq. (“Securities Act”) with respect to this  
3 Order; and

4 Solely for the purpose of terminating the multistate investigations, and in settlement of the issues  
5 contained in this Order, Merrill Lynch, without admitting or denying the findings of fact or conclusions  
6 of law contained in this Order, consents to the entry of this Order.

7 NOW, THEREFORE, the Arizona Corporation Commission (“Commission”), as administrator  
8 of the Securities Act, hereby enters this Order:

9 **I.**

10 **FINDINGS OF FACT**

11 1. Merrill Lynch admits the jurisdiction of the Commission in this matter.

12 **A. Background on Client Associates**

13 2. The CAs function as sales assistants and typically provide administrative and sales support to  
14 one or more of Merrill Lynch’s Financial Advisors (“FAs”). There are different titles within the CA  
15 position, including Registered Client Associate and Registered Senior Client Associate.

16 3. The responsibilities of a CA specifically include:

- 17 a. Handling client requests;  
18 b. Resolving client inquiries and complaints;  
19 c. Determining if client issues require escalation to the FA or the branch management team; and  
20 d. Processing of operational documents such as letters of authorization and client check  
21 requests.

22 4. In addition to the responsibilities described above, and of particular significance to this Order,  
23 some CAs are permitted to accept unsolicited orders from clients. As discussed below, Merrill Lynch’s  
24 written policies and procedures require that any CAs accepting client orders first obtain the necessary  
25 licenses and registrations.

26 5. Notably, FAs might have a “primary CA” and a “secondary CA.” As suggested by the  
27 designation, the customary practice is that the primary CA would handle the FA’s administrative matters  
28

1 and client orders. However, if the primary CA was unavailable, the secondary CA would handle the  
2 FA's administrative matters and client orders.

3 6. During the period from 2002 to the present, Merrill Lynch employed approximately 6,200  
4 CAs (average) per year.

5 **B. Merrill Lynch Requires Registration of Client Associates**

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

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

11 **C. Regulatory Investigations and Findings**

12 9. In May 2008, state regulators received a tip alleging that Merrill Lynch was failing to ensure  
13 its CAs were in compliance with jurisdictional registration requirements and its own procedures. The tip  
14 alleged that Merrill Lynch CAs were registered in two jurisdictions – the CA's home state and one  
15 neighboring state – because Merrill Lynch only paid for registrations in two jurisdictions.

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

18 11. Because Merrill Lynch's relevant trade records were maintained in hard copy and only at  
19 branch offices across the country, the multistate investigation focused on systemic issues with Merrill  
20 Lynch CA registrations and related supervisory structure instead of attempting to identify each incidence  
21 of unregistered activity. Specifically:

22 a. After accepting a client order, CAs accessed the electronic trading system to enter the order;

23 b. The CAs did not have to identify themselves during the order entry process. Therefore, there  
24 is no electronic record that identifies which orders were accepted by CAs;

25 c. Instead, Merrill Lynch maintained a daily report that recorded the identity of the person who  
26 accepted and/or entered each order. However, this report was not maintained electronically, and was  
27 only maintained at the branch office where the order was entered. Merrill Lynch represented that this  
28 daily report was the only record that could identify who accepted a client order.

1 d. Merrill Lynch's trading system checked the registration of the FA, but did not check the  
2 registration status of the person accepting the order to ensure that the person was registered in the  
3 appropriate jurisdiction.

4 12. The multistate investigation found that many CAs supported FAs registered in Arizona when  
5 the CAs were not registered in Arizona as agents of Merrill Lynch.

6 13. The multistate investigation found that certain Merrill Lynch CAs engaged in the sale of  
7 securities in Arizona at times when the CAs were not appropriately registered in Arizona.

8 **D. Merrill Lynch's Remedial Measures and Cooperation**

9 14. As a result of the inquiries by state regulators, Merrill Lynch conducted a review of its CA  
10 registration practices.

11 15. Merrill Lynch's review found that as of June 30, 2008, the firm had 3,780 registered CAs.  
12 Approximately 2,200, almost 60 percent, of those registered CAs were only registered in their home  
13 states or their home states and one additional state.

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

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

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

22 19. Between October 1, 2008, and January 28, 2009, 617 CAs registered with the state of  
23 Arizona as agents of Merrill Lynch. Yet, data as of February 28, 2009, indicated that significant gaps  
24 remained between the registrations of CAs and their FAs.

25 20. However, Merrill Lynch, as a compliance enhancement, also developed an electronic system  
26 that will prevent a person from entering client orders from a state in which the person accepting the  
27

28 <sup>1</sup> 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.

1 order is not registered. Merrill Lynch has represented to the state regulators that the firm began  
2 implementing this new system in June 2009 and expects it to be fully implemented by December 31,  
3 2009.

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

## 8 II.

### 9 CONCLUSIONS OF LAW

10 1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona  
11 Constitution and the Securities Act.

12 2. Merrill Lynch's failure to establish an adequate system to monitor the registration status of  
13 persons accepting client orders constitutes failure to reasonably supervise its salesmen within the  
14 meaning of A.R.S. § 44-1961(A)(12).

15 3. Merrill Lynch's failure to require its CAs to be registered in the appropriate jurisdictions  
16 constitutes a failure to enforce its established written procedures, and is a basis for the issuance of an  
17 Order assessing an administrative penalty against Merrill Lynch pursuant to A.R.S. § 44-1961(B)(1).

18 4. Pursuant to A.R.S. § 44-1961, Merrill Lynch's sales of securities in Arizona through salesmen  
19 not registered in Arizona constitute bases to order Merrill Lynch to cease and desist from engaging in  
20 the sale of securities in Arizona through unregistered salesmen.

21 5. The Commission finds the following relief appropriate and in the public interest.

## 22 III.

### 23 UNDERTAKINGS

24 1. Merrill Lynch hereby undertakes and agrees to immediately establish and maintain a trade  
25 monitoring system that prevents any person from entering client orders that originate from jurisdictions  
26 where the person accepting the order is not appropriately registered.



1 5. Merrill Lynch shall pay up to a total of Twenty-six Million Five Hundred Sixty-three  
2 Thousand Ninety-four Dollars and 50/100 cents (\$26,563,094.50) in fines, penalties and any other  
3 monetary sanctions among the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin  
4 Islands pursuant to the calculations discussed with the multistate working group.

5 6. However, if any state securities regulator determines not to accept Merrill Lynch's settlement  
6 offer, the total amount of the payment to the state of Arizona shall not be affected, and shall remain at  
7 Three Hundred Forty-four Thousand Four Hundred Dollars (\$344,400.00).

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

9 8. This order is not intended by the Commission to subject any Covered Person to any  
10 disqualifications under the laws of the United States, any state, the District of Columbia, Puerto Rico, or  
11 the U. S. Virgin Islands including, without limitation, any disqualification from relying upon the state or  
12 federal registration exemptions or safe harbor provisions. "Covered Person" means Merrill Lynch or any  
13 of its affiliates and their current or former officers or former officers, directors, employees, or other  
14 persons that would otherwise be disqualified as a result of the Orders (as defined below).

15 9. This Order and the order of any other state in related proceedings against Merrill Lynch  
16 (collectively, the "Orders") shall not disqualify any Covered Person from any business that they  
17 otherwise are qualified, licensed or permitted to perform under applicable securities laws of Arizona and  
18 any disqualifications from relying upon this state's registration exemptions or safe harbor provisions that  
19 arise from the Orders are hereby waived.

20 10. This Order shall be binding upon Merrill Lynch and its successors and assigns as well as to  
21 successors and assigns of relevant affiliates with respect to all conduct subject to the provisions above

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1 and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events,  
2 and conditions.

3 IT IS FURTHER ORDERED that this Order shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

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7 CHAIRMAN

COMMISSIONER

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11 COMMISSIONER

COMMISSIONER

COMMISSIONER

12  
13 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,  
14 Executive Director of the Arizona Corporation  
15 Commission, have hereunto set my hand and caused the  
16 official seal of the Commission to be affixed at the  
17 Capitol, in the City of Phoenix, this \_\_\_\_\_ day of  
18 \_\_\_\_\_, 2009.

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21 \_\_\_\_\_  
22 ERNEST G. JOHNSON  
23 EXECUTIVE DIRECTOR

24  
25  
26 \_\_\_\_\_  
27 DISSENT

28  
\_\_\_\_\_

29 This document is available in alternative formats by contacting Shaylin A. Bernal, ADA Coordinator,  
30 voice phone number 602-542-3931, e-mail [sabernal@azcc.gov](mailto:sabernal@azcc.gov).

31 (pj)

## CONSENT TO ENTRY OF ADMINISTRATIVE ORDER

Merrill Lynch hereby acknowledges that it has been served with a copy of this Order for Relief and Consent to Same (the "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 Commission, neither admits nor denies the Findings of Facts and Conclusions of Law contained in this Order, and consents to entry of this Order by the Commission 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 14<sup>th</sup> day of October, 2009.

MERRILL LYNCH, PIERCE, FENNER &  
SMITH INCORPORATED

By: *Teresa M. Brenner*

Teresa M. Brenner

Title: Associate General Counsel

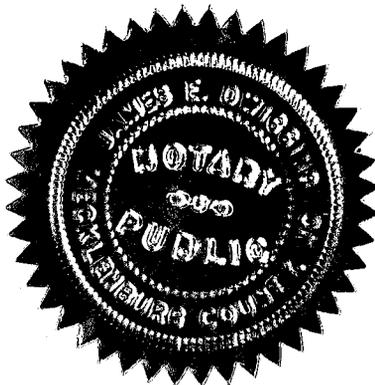
STATE OF NORTH CAROLINA

COUNTY OF MECKLENBURG

I certify that Teresa M. Brenner personally known to me, appeared before me this day and acknowledged the due execution of the foregoing instrument.

Witness my hand and official seal, this the 14th day of October, 2009.

(Official Seal)



*James E. Dwiggin*

James E. Dwiggin, Notary Public

My Commission Expires: May 2nd, 2010.

1 SERVICE LIST FOR:

2 MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED

3

4 Christine A. Bruenn, Esq.

5 Bingham McCutchen LLP

6 85 Exchange Street

7 Suite 300

8 Portland, ME 04101

9 Counsel for Merrill Lynch, Pierce, Fenner & Smith Incorporated

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