

**NASDAQ OMX BX, INC.**  
**NOTICE OF ACCEPTANCE OF AWC**

**Certified, Return Receipt Requested**

TO: **Merrill Lynch, Pierce, Fenner & Smith Incorporated**  
**Mr. J. David Montague**  
**Associate General Counsel & Senior Vice President**  
**One Bryant Park**  
**New York, NY 10036**

**Merrill Lynch Professional Clearing Corp.**  
**Mr. Gary E. Yetman**  
**Managing Director**  
**One Bryant Park**  
**6<sup>th</sup> Floor**  
**New York, NY 10036**

FROM: The NASDAQ OMX BX, Inc. (the "Exchange")  
c/o Financial Industry Regulatory Authority ("FINRA")  
Department of Market Regulation  
9509 Key West Avenue  
Rockville, MD 20850

DATE: June 23, 2015

RE: Notice of Acceptance of Letter of Acceptance, Waiver and Consent No. 20110277299-03

**Please be advised** that your above-referenced Letter of Acceptance, Waiver and Consent ("AWC") has been accepted on **June 23, 2015** by the Exchange Review Council's Review Subcommittee, or by the Office of Disciplinary Affairs on behalf of the Exchange Review Council, pursuant to Nasdaq OMX BX Rule 9216. A copy of the AWC is enclosed herewith.

You are again reminded of your obligation, if currently registered, immediately to update your Uniform Application for Broker-Dealer Registration ("Form BD") to reflect the conclusion of this disciplinary action. Additionally, you must also notify FINRA (or the Exchange if you are not a member of FINRA) in writing of any change of address or other changes required to be made to your Form BD.

You are reminded that Section I of the attached Letter of Acceptance, Waiver, and Consent includes an undertaking. In accordance with the terms of the AWC, a registered principal of the firm is required to notify the Compliance Assistant, Legal Section, Market Regulation Department, 9509 Key West Avenue, Rockville, MD 20850, of completion of the undertaking.

You will be notified by the Registration and Disclosure Department regarding sanctions if a suspension has been imposed and by the Nasdaq's Finance Department regarding the payment of any fine if a fine has been imposed.

Merrill Lynch, Pierce, Fenner & Smith Incorporated and  
Merrill Lynch Professional Clearing Corp.  
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If you have any questions concerning this matter, please call W. Kwame Anthony, Senior Counsel,  
at (646) 430-7030.



Robert A. Marchman  
Executive Vice President, Legal Section  
Department of Market Regulation, FINRA

Signed on behalf of Nasdaq OMX BX, Inc.

Enclosure

FINRA District 10 – New York  
Michael Solomon, Regional Director  
One World Financial Center  
200 Liberty Street  
New York, NY 10281

Elizabeth H. Baird, Esq.  
Morgan, Lewis & Bockius LLP  
2020 K Street NW  
Washington, DC 20006-1806  
Counsel for Respondent

**NASDAQ OMX BX, INC.**  
**LETTER OF ACCEPTANCE, WAIVER AND CONSENT**  
**NO. 20110277299-03**

TO: NASDAQ OMX BX, Inc.  
c/o Department of Market Regulation  
Financial Industry Regulatory Authority ("FINRA")

RE: Merrill Lynch, Pierce, Fenner & Smith Incorporated, Respondent  
Broker-Dealer  
CRD No. 7691

Merrill Lynch Professional Clearing Corp., Respondent  
Broker-Dealer  
CRD No. 16139

Pursuant to Chapter XXX of the Grandfathered Rules of NASDAQ OMX BX, Inc.<sup>1</sup> (the "Exchange") and Rule 9216 of The Exchange Code of Procedure<sup>2</sup>, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Pierce") and Merrill Lynch Professional Clearing Corp. ("Merrill Pro") (collectively, the "Firms") submit 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, the Exchange will not bring any future actions against the Firms alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. Merrill Pierce and Merrill Pro hereby accept and consent, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of the Exchange, or to which the Exchange 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 the Exchange:

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<sup>1</sup> The applicable Rules and authority for this action can be found in the By-Laws of NASDAQ OMX BX, Inc., the Rules of NASDAQ OMX BX ("The Options Rules") and the Grandfathered Rules of the Exchange.

<sup>2</sup> Additionally, this disciplinary matter is further governed by The Nasdaq Code of Procedure.

## BACKGROUND

Merrill Pierce became a member of the Exchange in 1981, and Merrill Pro became a member of the Exchange in 1988. Thereafter, both became Options Participants<sup>3</sup> of the Boston Options Exchange (“BOX”),<sup>4</sup> a facility of the Exchange, when Merrill Pierce’s and Merrill Pro’s Options Participation Agreements were accepted by the Exchange. Under the terms of that agreement, the Firms agreed, among other things, to be bound by the Rules of the Exchange, as amended, including the Grandfathered Boston Options Exchange Group LLC Rules (“BOX Trading Rules”), and to be subject to the Exchange’s jurisdiction and oversight. Trading on BOX as a facility of the Exchange ceased as of May 14, 2012.

Merrill Pierce and Merrill Pro have no prior disciplinary history with respect to the matters addressed in this AWC.

## SUMMARY

On behalf of the Exchange, the staff of FINRA’s Market Regulation Department (the “staff”) conducted a review of Merrill Pierce’s and Merrill Pro’s order entry activities in their capacity as Options Participants during the period between 2008 and 2012 (the “review period”) for compliance with Exchange rules governing the use of origin codes.

Applicable Exchange rules require that, when accepting an order, a member must obtain and record an appropriate account type or origin code in each order record and as an order detail when entering orders into the Exchange’s systems to indicate the kind of account for which the order will be executed and cleared. Each options market has its own origin codes, but at a minimum, all have codes to indicate that an order is being executed for a customer, a firm, or a market maker. Similarly, when transactions clear at The Options Clearing Corporation (“OCC”), they clear in the “Customer,” “Firm,” or “Market Maker” range (i.e., in the clearing member’s customer account, firm account, or market maker account at OCC). Origin codes are important because, among other things, they affect the accuracy of the Option Participant’s order records and the Exchange’s audit trail. In addition, origin codes must be accurate as part of ensuring that trades are reported to OCC with accurate trade details.

During the review period, Merrill Pierce and Merrill Pro violated certain BOX Trading Rules and federal securities laws when entering and executing certain orders on behalf of their broker-dealer clients. The Firms improperly marked numerous options orders with incorrect origin codes and sent those orders to the Exchange through various order entry systems employed by the Firms to send

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<sup>3</sup> An Options Participant was a firm or organization that was registered with the Exchange for the purpose of trading in options on BOX as an Order Flow Provider or Market Maker.

<sup>4</sup> BOX became a facility of NASDAQ OMX BX in August 2008.

options orders, resulting in: (i) an inaccurate audit trail and inaccurate order records; (ii) trades being reported to OCC with inaccurate trade details; and (iii) an adverse impact to the Exchange's ability to surveil for and detect potential violations of its rules and of federal securities laws. Additionally, the staff concluded that the Firms had supervisory deficiencies related to these matters, which are outlined in detail herein.

## FACTS AND VIOLATIVE CONDUCT

### **Inaccurate Origin Codes**

1. Pursuant to BOX Trading Rule Chapter V, Section 15(b)(ix), the account type (origin code) was one of the minimum information elements that was required to be included on order tickets.
2. From 2008 until May 14, 2012, when trading on BOX as a facility of the Exchange ceased, Merrill Pierce executed numerous transactions with incorrect origin codes across multiple markets, including the Exchange. Merrill Pierce's execution of orders with incorrect origin codes resulted from certain accounts having been on-boarded<sup>5</sup> with incorrect origin codes in their respective account profiles (e.g., an account that should have been coded as "Firm" was coded as "Customer," and some orders entered for that account were entered incorrectly with the "Customer" origin code), limitations in its order management system that failed to include all potential origin code designations or defaulted to an improper origin code at various points during the review period, and from errors made by Merrill Pierce employees when placing origin codes on orders at the point of order acceptance, entry, or execution.
3. From 2008 until July 2011, when Merrill Pro ceased accepting orders for execution, Merrill Pro executed numerous transactions with incorrect origin codes across multiple markets, including the Exchange. Merrill Pro used incorrect account origin codes to execute trades for certain accounts because it had placed the wrong origin code in the account profiles of those accounts at on-boarding.
4. Despite the fact that in each year from 2008 through 2010, the Firms traded millions of contracts by executing orders with incorrect origin codes, they lacked procedures for ensuring orders had been entered with correct origin codes, and for conducting reviews to detect that orders had been entered and executed with incorrect origin codes. Instead, the Firms only learned about misrepresented orders in isolation—for example, when reconciling positions on their books with positions at OCC on the day after a trade, when a client complained that an order had been executed with an incorrect origin code, or when an exercise had taken place incorrectly—and then addressed each instance in isolation and on an ad hoc basis.

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<sup>5</sup> "On-boarding" refers to the process of setting up a client's account in Merrill Pierce's or Merrill Pro's order management system.

5. In approximately 2007, an employee in Merrill Pro's Chicago office, who handled clearing for both Firms' clients, began gathering data to respond to an increasing number of regulatory inquiries where FINRA was investigating different Merrill Pro customers' use of incorrect origin codes. In 2010, this employee grew concerned that in instances when Merrill Pierce's traders had executed trades and requested origin code changes, making origin code changes at the exchanges and making post-trade adjustments at OCC could evidence regulatory violations or bring regulatory scrutiny. Despite this knowledge, neither Firm had taken measures to ensure that it executed orders with correct origin codes, or to detect instances in which it had executed orders with incorrect origin codes.
6. Although Merrill Pierce began taking steps later in 2010 to address the execution of orders with incorrect origin codes after conducting a review that led to the creation and implementation of exception reports to identify instances in which it had executed orders with incorrect origin codes, it still continued trading hundreds of thousands of contracts each year with incorrect origin codes through May 14, 2012, when trading on BOX as a facility of the Exchange ceased.
7. Merrill Pro never addressed its ongoing deficiencies relating to its inaccurate use of origin codes before it stopped transmitting and executing orders altogether in July 2011.
8. Each instance in which Merrill Pierce or Merrill Pro executed an order with an incorrect origin code could have had adverse consequences, such as creating inaccurate order records, creating an inaccurate audit trail, reporting trades to OCC with inaccurate trade details, and adversely impacting the Exchange's ability to surveil for and detect potential violations of its rules and federal securities laws.
9. By marking orders with the wrong origin code, Merrill Pro and Merrill Pierce violated the following rules:
  - a. Section 17(a)(1) of the Exchange Act and SEC Rule 17a-3(a)(6)(i) thereunder requiring Options Participants to create a memorandum of each order, and any other instruction, showing the terms and conditions of the order.
  - b. BOX Trading Rule Chapter III, Section 1, which prohibited violations of the Exchange Act and rules thereunder, BOX rules, and the rules of OCC as they relate to reporting or clearing transactions.
  - c. BOX Trading Rule Chapter III, Section 2, which required Participants to ensure that the transaction of business complied with the Exchange Act, BOX rules, and OCC rules.
  - d. BOX Trading Rule Chapter V, Section 15(b)(ix), which required the inclusion of an account type in the order ticket for each options order received from a Customer.

- e. BOX Trading Rule Chapter VIII, Section 1(a), which required Participants to make and keep records prescribed by Boston Options Exchange Regulation LLC, the Exchange Act and the rules thereunder.

## Supervision

10. BOX Trading Rule Chapter III, Section 1 required every Options Participant to supervise associated persons with respect to compliance with the Exchange Act and rules thereunder, BOX Trading Rules and OCC rules. Chapter III, Section 2 required an Options Participant to be responsible for ensuring that business conduct on BOX complied with applicable laws and rules, and subparagraph (i) required that it have adequate arrangements to ensure all staff members involved in conducting business on BOX were suitable, adequately trained, and properly supervised. The Firms violated BOX Trading Rules Chapter III, Sections 1, 2(a), and 2(a)(i) by failing to establish reasonable supervisory systems and controls, including written supervisory procedures and separate systems of follow-up and review, that were reasonably designed to achieve compliance with BOX's origin code requirements.
11. Prior to October 2010, Merrill Pierce did not have any exception reports to identify incorrect origin codes on orders and had no system whatsoever for conducting reviews to ensure that correct origin codes were placed on orders. Instead, Merrill Pierce often learned it had used incorrect origin codes only when its clients informed it that trades had been executed with an incorrect origin code, or because problems arose when trades had cleared in the wrong range at OCC (e.g., clearing in the "Customer" range when they were supposed to have cleared in the "Firm" range). These instances resulted in discrepancies between Merrill Pierce's positions on its own books and its positions on OCC's books. Merrill Pierce would then make adjustments at OCC to move positions into the proper range. After that time, whenever a certain employee within Merrill Pro became concerned that making origin code adjustments could invite regulatory scrutiny or action, the employee informed others within the organization that adjustments would only be made if certain other employees approved them. Yet, the violations continued. Additionally, despite instituting an exception report and supervisory reviews in 2010, Merrill Pierce continued entering and executing orders with incorrect origin codes through May 2012.
12. Merrill Pro never had a system for identifying incorrect origin codes on orders or conducting any reviews to ensure correct origin codes were placed on orders. Instead, as with Merrill Pierce, Merrill Pro learned that trades had been entered with incorrect origin codes as a result of discrepancies between its positions on its own books and its positions with OCC. In addition, through May 2012, Merrill Pro never had a system of supervision to ensure that the trades for which it was the clearing firm cleared with the correct origin codes at OCC.

13. In summary, during the review period, the Firms failed to have supervisory systems and controls in place, including a separate system of follow-up and review, reasonably designed to achieve compliance with the Exchange's origin code requirements in that the Firms failed to do the following: (i) reasonably address origin code requirements in the development and programming of its order entry systems; (ii) maintain written supervisory procedures reasonably designed to achieve compliance with the Exchange's rules relating to the assignment of origin codes; (iii) adequately train their employees with respect to the significance of properly marking origin codes in their order entry systems; and (iv) adequately supervise their employees with respect to the proper marking of origin codes.
  14. The conduct described in Paragraphs 11 through 13 constituted violations of Chapter III, Sections 1, 2(a), and 2(a)(i) of the BOX Trading Rules.
- B. Merrill Pierce and Merrill Pro consent to the imposition of the following sanctions:
1. A censure and a joint and several fine in the amount of \$9,000,000, of which \$315,000 shall be paid to the Exchange.<sup>6</sup>
  2. Merrill Pierce agrees to an undertaking pursuant to which at intervals of 90, 180, 270, and 360 days after acceptance of this AWC, Merrill Pierce shall make a written submission to the Exchange, in care of FINRA, regarding its compliance with the Exchange's rules and policies governing the inclusion of account origin codes in order and execution data. At a minimum, the written submission shall address and include the following:
    - a. an assessment of the degree to which Merrill Pierce has taken additional remedial steps to confirm that it is including accurate account origin codes in its order records and in electronic entries of order and transaction data in the Exchange's systems;
    - b. the adequacy of Merrill Pierce's policies, systems, procedures, and training relating to including accurate account origin codes in its order and execution audit trail data;
    - c. copies of all exception reports identifying instances in which inaccurate account origin codes were included in Merrill Pierce's order and execution audit trail data; and
    - d. an explanation of all remedial actions that Merrill Pierce had taken in response to instances appearing on the exception reports produced in response to Item B.2.c.
  3. Merrill Pro agrees to an undertaking to revise its written supervisory procedures with respect to the areas described in Paragraph I.A.12. Within 30

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<sup>6</sup> The balance of the fine will be paid to the self-regulatory organization listed after Paragraph B.3.

business days of acceptance of this AWC, a registered principal of Merrill Pro shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a signed, dated letter, or an e-mail from a work-related account of the registered principal to MarketRegulationComp@finra.org, providing the following information: (1) a reference to this matter; (2) a representation that Merrill Pro has revised its written supervisory procedures to address the deficiencies described in Paragraph I.A.12; and (3) the date the revised procedures were implemented.

Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between Merrill Pierce and Merrill Pro collectively and each of the following self-regulatory organizations: BATS Exchange Inc.; Chicago Board Options Exchange, Incorporated; International Securities Exchange LLC; NASDAQ OMX PHLX LLC; The NASDAQ Options Market LLC; and NYSE Regulation, Inc., on behalf of NYSE Arca Inc. and NYSE MKT LLC.

Merrill Pierce and Merrill Pro agree to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Merrill Pierce and Merrill Pro have submitted an Election of Payment form showing the method by which they propose to pay the fine imposed.

Merrill Pierce and Merrill Pro specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

## **II.**

### **WAIVER OF PROCEDURAL RIGHTS**

Merrill Pierce and Merrill Pro specifically and voluntarily waive the following rights granted under the Rules of the Exchange and the Exchange Code of Procedure:

- A. to have a Formal Complaint issued specifying the allegations against the Firms in writing;
- B. to be notified of the Formal 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 Exchange Review Council and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Merrill Pierce and Merrill Pro specifically and voluntarily waive any right to claim bias or prejudgment of the Chief Regulatory Officer, the Exchange Review Council, or any member of the Exchange Review Council, 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.

Merrill Pierce and Merrill Pro further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of 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

Merrill Pierce and Merrill Pro understand that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by FINRA's Department of Market Regulation and the Exchange Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs ("ODA"), pursuant to Exchange Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Merrill Pierce or Merrill Pro; and
- C. If accepted:
  - 1. This AWC will become part of Merrill Pierce's and Merrill Pro's permanent disciplinary records and may be considered in any future actions brought by the Exchange or any other regulator against the Firms;
  - 2. Nasdaq may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with Nasdaq Rule 8310 and IM-8310-3; and
  - 3. Merrill Pierce and Merrill Pro 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. The Firms may not take any position in any proceeding brought by or on behalf of the Exchange, or to which the Exchange is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Merrill Pierce's or Merrill Pro's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which the Exchange is not a party.

- D. Merrill Pierce and Merrill Pro may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Merrill Pierce and Merrill Pro understand that they 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 the Exchange, nor does it reflect the views of the Exchange or its staff.

The undersigned, on behalf of Merrill Pierce and Merrill Pro, certify that persons duly authorized to act on their behalves have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that they have agreed to the AWC's 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 Pierce or Merrill Pro to submit it.

Date

May 11, 2015

Respondent

Merrill Lynch, Pierce, Fenner & Smith Incorporated

By: J. David Montague

Name: J. David Montague

Title: Associate General Counsel & Senior VP

Date

5-11-2015

Respondent

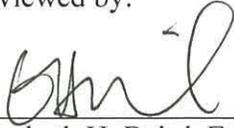
Merrill Lynch Professional Clearing Corp.

By: Gary E. Yetman

Name: Gary E. Yetman  
Managing Director

Title: \_\_\_\_\_

Reviewed by:

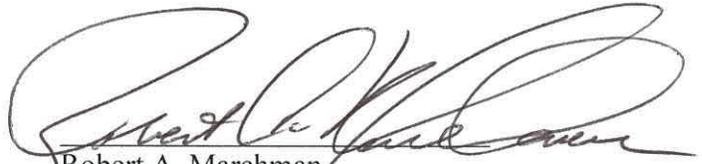


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Counsel for Merrill Lynch, Pierce, Fenner & Smith Incorporated  
and Merrill Lynch Professional Clearing Corp.

Accepted by NASDAQ OMX BX, Inc.

6/23/15  
Date



Robert A. Marchman  
Executive Vice President  
Department of Market Regulation

Signed on behalf of NASDAQ OMX BX,  
Inc., by delegated authority from the  
Director of ODA

ELECTION OF PAYMENT FORM

Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Professional Clearing Corp. intend to pay the fine proposed in the attached AWC by the following method (check one):

- A firm check or bank check for the full amount;
- Wire transfer; or
- The installment payment plan.<sup>7</sup>

Respectfully submitted,  
Respondent  
Merrill Lynch, Pierce, Fenner & Smith Incorporated

May 11, 2015  
Date

By: J. David Montague

Name: J. David Montague

Title: Associate General Counsel & Senior VP

Respectfully submitted,  
Respondent  
Merrill Lynch Professional Clearing Corp.

5-11-2015  
Date

By: Gary Eget

Name: Gary E. Yetman  
Managing Director

Title: \_\_\_\_\_

<sup>7</sup> The installment payment plan is only available for a fine of \$50,000 or more. Certain requirements apply.