

**STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT**

In the matter of)
MERRILL LYNCH, PIERCE, FENNER)
& SMITH INCORPORATED,) **Case Number: 11-00004**
)
Respondent.)
_____)

NOTICE OF HEARING

TO THE RESPONDENT:

Merrill Lynch, Pierce, Fenner & Smith Inc.
One Bryant Park
New York, NY US 10036

c/o Christine A. Bruenn, Esq.
Bingham McCutchen LLP
85 Exchange Street, Third Floor
Portland, ME 04101

You are hereby notified that, pursuant to Section 11.F of the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act") and 14 Ill. Adm. Code 130, Subpart K (the "Rules"), a public hearing will be held at 69 West Washington Street, Suite 1220, Chicago, Illinois 60602, on the 9th day of June, 2011, at the hour of 10:00 a.m., or as soon thereafter as counsel may be heard, before James L. Kopecky, or another duly designated Hearing Officer of the Secretary of State.

This hearing will be held to determine whether an Order shall be entered against the Respondent in the State of Illinois and/or grant such other relief as may be authorized under the Act including but not limited to imposition of a monetary fine in the maximum amount pursuant to Section 11.E(4) of the Act, payable within ten (10) business days of the entry of the Order.

The grounds for such proposed action are as follows:

FINDINGS OF FACTS

1. Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a broker-dealer registered in the state of Illinois, with a Central Registration Depository ("CRD")

number of 7691.

2. 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.

3. Merrill Lynch has cooperated with regulators conducting the investigations by responding to inquiries, providing regulators with access to facts relating to the investigations, providing documentary evidence and other materials.

4. Merrill Lynch admits to the jurisdiction of the Department in this matter.

Background on Client Associates

5. 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.

6. 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.

7. 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.

8. 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.

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

Registration Required

10. Section 8 of the Act deals with the registration of dealers, salespersons and investment advisers. Except as otherwise provided in Section 8 of the Act, every dealer, limited Canadian dealer, salesperson, investment adviser, and investment adviser representative shall be registered as such with the Secretary of State.

11. Pursuant to the general prohibition under Section 8 of the Act, a person cannot accept unsolicited orders in Illinois without being registered.

12. Pursuant to Section 12 of the Act, a broker-dealer may be fined for selling securities in Illinois through agents other than registered agents.

Merrill Lynch Requires Registration of Client Associates

13. 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.

14. 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

15. In May 2008, the Department 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.

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

17. 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.

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

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

Merrill Lynch's Remedial Measures and Cooperation

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

21. 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.

22. 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.

23. 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.

24. 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.

25. Between October 1, 2008 and January 28, 2009, six hundred and forty seven

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.

(647) CAs registered with the Department 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.

26. 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. This system, which enhanced Merrill's primary trading systems for bond and equities trading, was fully implemented by December 31, 2009. Further, the firm has engaged in an ongoing assessment of firm processes to determine where additional changes, related to the merger with Bank of America or otherwise, may enhance the firm's registration compliance program.²

27. 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.

ALLEGATIONS OF LAW

1. The Illinois Securities Department has jurisdiction over this matter pursuant to the Act.

2. Merrill Lynch's failure to establish an adequate system to monitor the registration status of persons accepting client orders constitutes a failure to supervise under Section 8.E.(1)(e)(iv) of the Illinois Securities Law of 1953 (the "Act").

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.

² 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 was not completed until the third quarter of 2010. BAIS, whose policies have required sales assistants' state registration status to mirror the FAs they serve, continued to use its own order entry system for its existing clients until the integration was completed.

4. Pursuant to the Act, Merrill Lynch's sales of securities in Illinois through unregistered CAs subjects Merrill Lynch to sanctions under Section 8.E.(1)(e)(ii) of the Act, and is a violation of Section 12.A of the Act

5. Pursuant to Section 11 of the Act, Merrill Lynch's sales of securities in Illinois through CAs not registered in Illinois constitute bases to order Merrill Lynch to cease and desist engaging in the sale of securities in Illinois through unregistered CAs.

6. Pursuant to Section 11 of the Act, the violations described above constitute bases for the assessment of an administrative fine against Merrill Lynch.

You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130)(the "Rules"), to file an answer, special appearance, or other responsive pleadings to the allegations above within thirty (30) days of the receipt of this Notice. A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing.

Furthermore, you may be represented by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to appear shall constitute a default by you.

A copy of the Rules and Regulations promulgated under the Illinois Securities Law and pertaining to hearings held by the Office of the Secretary of State, Illinois Securities Department, are available at [http://www.ilga.gov/commission/jcar/admincode/014/01400 I 30sections.html](http://www.ilga.gov/commission/jcar/admincode/014/01400%20I%2030sections.html), or upon request.

Delivery of Notice to the designated representative of the Respondent constitutes service upon such Respondent.

Dated: This 4th day of March, 2011.

A handwritten signature in black ink that reads "Jesse White" with a stylized flourish at the end.

Jesse White
Secretary of State
State of Illinois

Attorney for the Secretary of State:

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