UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of WILLIAM TIRRELL, Respondent.	ANSWER AND AFFIRMATIVE DEFENSES Administrative Proceeding File No. 3-17313

ANSWER AND AFFIRMATIVE DEFENSES OF RESPONDENT WILLIAM TIRRELL

Respondent William E. Tirrell, by his attorneys, asserts the following answers to the allegations contained in the Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP"), upon knowledge with respect to himself and his own acts and upon information and belief with respect to all other matters.

GENERAL DENIAL

Except as expressly admitted in this Answer, Mr. Tirrell denies each and every allegation contained in the OIP. To the extent that Mr. Tirrell uses terms in this Answer that the Division of Enforcement ("Division") defined in the OIP, that use is not an acknowledgement or admission of any characterization the Division may ascribe to the defined terms. Mr. Tirrell denies that the Division is entitled to any of the relief sought in the OIP. Mr. Tirrell expressly reserves the right to seek to amend and/or supplement this Answer as may be necessary.

I.

Mr. Tirrell denies having sufficient information to address what the Securities and Exchange Commission ("SEC" or "Commission") deemed "appropriate" and in the "public

interest," as set forth in Section I, except to state that the OIP was not appropriate or in the public interest.

II.

SUMMARY

Mr. Tirrell admits the following allegations set forth under the heading "Summary" (the "Summary"): (i) Rule 15c3-3 requires, among other things, broker-dealers to safeguard cash of their customers so that customer assets can be returned if the firm fails; (ii) Mr. Tirrell was the Head of the Regulatory Reporting Department for Merrill Lynch, Pierce, Fenner & Smith, Inc. ("MLPF&S") from approximately 2004 until April 20, 2016; (iii) Mr. Tirrell served as the Financial and Operations Principal ("FinOp") for MLPF&S while serving as Interim CFO of MLPF&S from August 9, 2011 until September 5, 2012, and again from April 29, 2014 until April 20, 2016; and (iv) MLPF&S's Regulatory Reporting Department, among other things, was responsible for calculating MLPF&S's customer reserve requirement on at least a weekly basis. Mr. Tirrell admits that the allegations in the Summary purport to describe Rule 15c3-3 and he respectfully refers the Court to the rule for its substance. To the extent that the allegations in the Summary contain legal conclusions, no response is required. Except as expressly admitted, Mr. Tirrell denies the allegations in the Summary.

RESPONSE TO SPECIFIC ALLEGATIONS

Incorporating the foregoing, Mr. Tirrell states as follows in response to the specific allegations set forth in the OIP:

1. William Tirrell, age 61, is a resident of Lawrenceville, NJ and an associated person of broker-dealer and investment adviser MLPF&S. From 2004 until April 2016, he was the FinOp and Head of the Regulatory Reporting Department for MLPF&S and in that role oversaw regulatory reporting for MLPF&S and MLPro. Concurrent with that role, Tirrell was the Acting CFO of MLPF&S from August 2014 to April 2016. He holds a Series 27 license.

RESPONSE TO PARAGRAPH 1: Mr. Tirrell admits that (i) he is 63 years old and a resident of Lawrenceville, New Jersey; (ii) he is an associated person of broker-dealer and investment advisor MLPF&S; (iii) he was the Head of the Regulatory Reporting Department for MLPF&S from approximately 2004 until April 20, 2016 and in that role oversaw regulatory reporting for MLPF&S and Merrill Lynch Professional Clearing Corp. ("MLPro" and, collectively with MLPF&S, "ML"); (iv) he was the FinOp for MLPF&S while serving as Interim CFO of MLPF&S from August 9, 2011 until September 5, 2012, and again from April 29, 2014 until April 20, 2016; and (v) he holds a Series 27 license. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 1.

2. Merrill Lynch, Pierce, Fenner & Smith Incorporated, headquartered in New York, New York, is dually-registered with the Commission as a broker-dealer and investment adviser. It is a wholly-owned subsidiary of Bank of America Corp.

RESPONSE TO PARAGRAPH 2: Mr. Tirrell admits the allegations in Paragraph 2.

3. Merrill Lynch Professional Clearing Corp., headquartered in New York, New York, is registered with the Commission as a broker-dealer. It is a wholly-owned subsidiary of MLPF&S.

RESPONSE TO PARAGRAPH 3: Mr. Tirrell admits the allegations in Paragraph 3.

4. SEFT Trader was a Managing Director at MLPF&S who worked on its Structured Equity Financing & Trading ("SEFT") desk from 2005 to 2012.

RESPONSE TO PARAGRAPH 4: Mr. Tirrell admits that SEFT Trader was a Managing Director at MLPF&S who worked on the Structured Equity Financing & Trading Desk ("SEFT desk"). Except as expressly admitted, Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 4, and on that basis denies them.[1]

5. Rule 15c3-3 under the Exchange Act is designed to protect broker-dealer customers in the event a broker-dealer becomes insolvent. The intent and objective of the Rule is:

[1] Trial counsel for the Division has confirmed by email the identity of "SEFT Trader" and the answers contained herein are based on that confirmation.

> the elimination of the use by broker-dealers of customer funds and securities to finance firm overhead and such firm activities as trading and underwriting through the separation of customer related activities from other broker-dealer operations.

Rule 15c3-3 Adopting Release, Exch. Rel. No. 9775, 1972 WL 125434, at *1 (Sept. 14, 1972).

RESPONSE TO PARAGRAPH 5: Mr. Tirrell admits that the allegations in Paragraph 5 purport to describe Rule 15c3-3 and he respectfully refers the Court to the rule for its substance.

Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 5.

6. Rule 15c3-3(e) requires a broker-dealer that maintains custody of customer securities and cash (a "carrying broker-dealer") to maintain a reserve of funds and/or certain qualified securities in an account at a bank ("Reserve Account") that is at least equal in value to the net cash owed to customers. 17 CFR 240.15c3-3(e).

RESPONSE TO PARAGRAPH 6: Mr. Tirrell admits that the allegations in Paragraph 6 purport to describe Rule 15c3-3 and he respectfully refers the Court to the rule for its substance.

Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 6.

7. The amount of net cash owed to customers is computed pursuant to a formula set forth in Exhibit A to Rule 15c3-3 ("Reserve Formula"), which most carrying broker-dealers calculate on a weekly basis. 17 CFR 240.15c3-3a. Under the Reserve Formula, the carrying broker-dealer adds up customer credit items that it owes its customers (*e.g.*, cash in customer securities accounts) and then subtracts from that amount customer debit items that its customers owe it (*e.g.*, margin loans). If credit items exceed debit items, that net amount must be deposited, or already be on deposit, in the Reserve Account in the form of cash and/or qualified securities. 17 CFR 240.15c3-3(e). A broker-dealer generally cannot make a withdrawal from the Reserve Account until the next computation and even then only if the computation shows that the reserve requirement has decreased. *Id.* The broker-dealer must make a deposit into the Reserve Account if the computation shows an increase in the reserve requirement.

RESPONSE TO PARAGRAPH 7: Mr. Tirrell admits that the allegations in Paragraph 7 purport to describe Rule 15c3-3 and he respectfully refers the Court to the rule for its substance.

Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 7.

8. If a broker-dealer owes more to its customers than its customers owe to it, the broker-dealer must set aside at least an amount equal to that difference so that it is readily available to repay customers.

RESPONSE TO PARAGRAPH 8: Mr. Tirrell admits that the allegations in Paragraph 8 purport to describe Rule 15c3-3 and he respectfully refers the Court to the rule for its substance. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 8.

9. FINRA's Interpretations of Financial and Operational Rules handbook includes an update first issued in 1989 which states that the Commission staff has advised that any "device, window dressing or restructuring of transactions made solely to reduce an excess of credits over debits in the Rule 15c3-3 formula computation and not otherwise a normal business transaction" may be considered a circumvention of the Rule. FINRA Interpretations of Financial and Operational Rules, Rule 15c3-3(e)(2)/02 ("Interp. 15c3-3(e)(2)/02") *formerly* N.Y.S.E. Interpretation Handbook, Vol. II, Interpretation Memo No. 89-10, Aug. 23, 1989 (Commission Staff to NYSE) (No. 89-11, 1989 WL 1169979, Oct. 9, 1989).

RESPONSE TO PARAGRAPH 9: Mr. Tirrell admits that the allegations in Paragraph 9 purport to selectively quote from the Financial Industry Regulatory Authority's ("FINRA") Interpretations of Financial and Operational Rules handbook and he respectfully refers the Court to the handbook for its substance. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 9.

10. Tirrell worked in MLPF&S's Regulatory Reporting Department from November 1980 to April 2016. The primary function of MLPF&S's Regulatory Reporting Department is to maintain ML's compliance with the Customer Protection Rule and other SEC and CFTC financial responsibility rules.

RESPONSE TO PARAGRAPH 10: Mr. Tirrell admits (i) the allegations in the second sentence of Paragraph 10; and (ii) that he began working in MLPF&S's Regulatory Reporting Department in November 1980. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 10.

11. During 2009 to 2012, which is when ML executed Leveraged Conversion Trades for the purpose of using customer money to finance firm activities, Tirrell was the Head of MLPF&S's Regulatory Reporting Department and its FinOp. In those roles, Tirrell was ultimately responsible for supervision and performance of MLPF&S's obligations under Rule 15c3-3, which included calculating the Reserve Formula each week and ensuring that there was sufficient cash and/or qualified securities in the Reserve Account to protect customers.

RESPONSE TO PARAGRAPH 11: Mr. Tirrell admits that (i) between 2009 and 2012, ML executed Leveraged Conversion Trades; (ii) Mr. Tirrell was the Head of MLPF&S's Regulatory Reporting Department during the period 2009 to 2012; (iii) Mr. Tirrell was the FinOp for MLPF&S while serving as Interim CFO of MLPF&S from August 9, 2011 until September 5, 2012; and (iv) MLPF&S's Regulatory Reporting Department was primarily responsible for ensuring that ML complied with SEC and CFTC financial responsibility rules, which, among other things, included calculating the amount that must be deposited in ML's Special Reserve Bank Accounts for the Exclusive Benefit of Customers ("Reserve Accounts") under the formula set forth in Rule 15c3-3a ("Reserve Formula") each week. To the extent that Paragraph 11 contains legal conclusions, no response is required. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 11.

12. Tirrell also was ultimately responsible for ensuring monthly FOCUS Reports filed with regulators by MLPF&S and MLPro were complete and accurate.

RESPONSE TO PARAGRAPH 12: Mr. Tirrell admits that the Regulatory Reporting Department was responsible for submitting FOCUS Reports for MLPF&S and MLPro to FINRA. To the extent that Paragraph 12 contains legal conclusions, no response is required. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 12.

13. Tirrell has many years of experience working on issues relating to Rule 15c3-3 and is extremely familiar the Rule's requirements. For example, while the Leveraged Conversion Trades were underway, Tirrell was familiar with the Commission guidance summarized in paragraph 9 concerning window dressing and alerted the traders who structured the Trades to it.

RESPONSE TO PARAGRAPH 13: Mr. Tirrell admits that (i) he has more than 35 years of experience on issues related to Rule 15c3-3 and is familiar with the rule's requirements; and (ii) while the Leveraged Conversion Trades were underway, he was aware of the Commission

guidance summarized in Paragraph 9. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 13.

14. Tirrell positioned his department to further the interests of the business units of which the Regulatory Reporting Department served as a crucial control function. In a self-evaluation submitted in the year before he worked with others to get the Leveraged Conversion Trades underway for the express purpose of reducing ML's Reserve Account balance, Tirrell touted his ability to "utilize the regulatory systems and skill sets for business purposes."

RESPONSE TO PARAGRAPH 14: Mr. Tirrell admits that the allegations in Paragraph 14 purport to selectively quote one of Mr. Tirrell's self-evaluations and he respectfully refers the Court to the self-evaluation for its substance. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 14.

15. At roughly the same time that the Leveraged Conversion Trades were conceived and introduced, on October 8, 2008, MLPro settled charges by FINRA that the firm had repeatedly failed to maintain – by hundreds of millions of dollars – the minimum required amount in the Reserve Account. This violation should have further underscored to Tirrell the importance of ensuring that the Leveraged Conversion Trades were fully compliant with the Customer Protection Rule.

RESPONSE TO PARAGRAPH 15: Mr. Tirrell admits that the allegations in Paragraph 15 purport to describe an enforcement action by FINRA and he respectfully refers the Court to the corresponding Accept, Waiver and Consent form for its substance. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 15.

16. From 2009 to 2012, ML executed a series of trades that reduced the balance of its Reserve Account by billions of dollars and then used those freed-up funds to finance firm inventory and thereby finance its business activities.

RESPONSE TO PARAGRAPH 16: Mr. Tirrell admits that from 2009 to 2012, ML executed Leveraged Conversion Trades that had the effect of reducing the amount of cash or cash equivalents that ML was required to maintain in its Reserve Accounts. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 16.

17. To efficiently manage the firm's capital, ML requires its trading desks to finance the securities they hold. ML makes capital available to its trading desks so that the desks can purchase securities, but it charges an interest rate on this capital, known as the firm's treasury rate, that typically is higher than the interest that external third parties charge. To avoid being assessed the more expensive internal financing, a trading desk finances its positions externally through a repurchase agreement, stock loan, or other means. As described below, the Leveraged Conversion Trades used interest-free funds obtained through reductions to the Reserve Account balance to finance business activities.

RESPONSE TO PARAGRAPH 17: Mr. Tirrell admits that the allegations in the first, second, and third sentences of Paragraph 17 generally describe trading operations at ML. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 17.

18. In 2008, ML sought to reduce the amount of cash it was required to deposit in the Reserve Account that it maintained for the benefit of MLPF&S's and MLPro's customers. MLPF&S's SEFT desk developed a trade designed to introduce customer debits into the Reserve Formula through making solicited margin loans to certain customers, which would decrease dollar-for-dollar the amount ML was required to maintain in the Reserve Account.

RESPONSE TO PARAGRAPH 18: Mr. Tirrell admits the allegations in the second sentence of Paragraph 18. Except as expressly admitted, Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 18, and on that basis denies them.

19. SEFT Trader conceived of the trade and was responsible for structuring it. While developing the trade, the SEFT desk consulted with Tirrell about the Trades' potential impact on the Reserve Formula to ensure the Trades would have the desired effect on the Reserve Account and would not run afoul of the Rule. To help Tirrell understand the proposed Trade, the SEFT desk shared flow charts that described the Trades and fully responded to Tirrell's questions and requests for information. Neither SEFT Trader nor other traders on the SEFT desk involved with structuring the Trades had responsibilities with respect to the Reserve Account or had expertise with Rule 15c3-3.

RESPONSE TO PARAGRAPH 19: Mr. Tirrell admits that (i) SEFT Trader conceived of the trade and was responsible for structuring it; (ii) the SEFT desk consulted with Mr. Tirrell about the Leveraged Conversion Trades' potential impact on ML's reserve requirements; and (iii) the SEFT desk shared certain materials related to the proposed trade with Mr. Tirrell. Except as

expressly admitted, Mr. Tirrell denies the allegations in Paragraph 19 to the extent that they refer to him, and to the extent that they refer to other parties, lacks knowledge or information sufficient to form a belief as to the truth of them, and on that basis denies them.

20. Beginning in mid-2008, Tirrell helped guide the proposed trade through ML's internal approval process. Tirrell advised people within ML that he did not believe that it was necessary to subject the proposal for the Trades to MLPF&S's New Product Review. The firm's Structured Finance Committee ("SFC"), however, reviewed them. Tirrell and SEFT Trader worked with the SFC during their review of the Trades.

RESPONSE TO PARAGRAPH 20: Mr. Tirrell denies the allegations in Paragraph 20 to the extent that they refer to him, and to the extent that they refer to other parties, lacks knowledge or information sufficient to form a belief as to the truth of them, and on that basis denies them.

21. As originally presented to the SFC for approval, the Leveraged Conversion Trades were conversion trades that used listed options financed by customers through margin loans extended by MLPF&S or MLPro. This margin loan introduced a customer debit into the Reserve Formula that reduced the minimum amount ML was required to maintain on deposit in ML's Reserve Account.

RESPONSE TO PARAGRAPH 21: Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 21, and on that basis denies them.

22. In this listed conversion trade, a customer would buy a put and sell a call on a stock with the same strike price and expiration date. The customer would also purchase on margin the stock to cover the call. Because the options fully hedged the customer's stock purchase, it was insulated from market risk provided that the customer could fully cover the short position created by his call option. In addition to this stock borrow risk, the trade presented other risks because it was exposed to the market, such as pin risk, dividend risk, and early exercise risk.[2]

---

[2] Pin risk arises when the market price of the underlying stock at the time of the put and call's expiration is close to the strike price. If this occurs, there is a risk that options may not be exercised and the customer is left with a large, undesired, and unhedged stock position. Dividend risk occurs when a dividend on the underlying stock is unexpectedly cancelled or lowered. Because the pricing of a conversion trade takes into account the anticipated dividend amount, any dividends paid that are less than this anticipated amount will result in a loss to the customer. Early exercise risk materializes when the owner of the call or put option exercises the option prior to its expiration date.

RESPONSE TO PARAGRAPH 22: Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 22, including footnote 2, and on that basis denies them.

23. The original version of the trade, as presented by the SEFT desk to Tirrell and to internal reviewers in a one page handout, expressly proposed that the trade be used to provide "synthetic financing" to ML through which the firm's inventory would be used in the Trades and financed through the reductions to the amount deposited into the Reserve Account caused by the extension of the margin loan to a customer. A Leveraged Conversion Trade using listed options cannot finance firm inventory in situations where other market participants on the exchange are able to step in to take the other side of the customer's put and call options. If the customer long position in that scenario is sourced from ML's inventory, ML would lose that inventory when the counterparty to the conversion trade exercised its in-the-money put or call. To avoid that, under the trade proposed by the SEFT desk, ML would ensure that it always was the counterparty to the customer's conversion trade and thereby was guaranteed to retain the inventory it used in a Leveraged Conversion Trade.

RESPONSE TO PARAGRAPH 23: Mr. Tirrell admits that the allegations in Paragraph 23 purport to describe a one-page diagram presented to Mr. Tirrell by the SEFT desk, which does not contain the phrase "synthetic financing," and he respectfully refers the Court to the diagram for its substance. Except as expressly admitted, Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 23, and on that basis denies them.

24. Through this proposed trade, the SEFT desk was proposing to finance a customer – through the extension of a margin loan – so that the customer could then use the loan it received to provide that same financing back to ML – through the customer's purchase of ML firm inventory used to cover the short. While this reciprocal financing cancels itself out, the margin loan extended to the customer would reduce the Reserve Account and those funds could be used – on an interest-free basis – to finance the firm inventory used in the Trade.

RESPONSE TO PARAGRAPH 24: Mr. Tirrell admits that the allegations in Paragraph 24 purport to describe a one-page diagram prepared by the SEFT desk and he respectfully refers the Court to the diagram for its substance. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 24.

25. As stated above, one of the primary objectives of the Reserve Account requirement in Rule 15c3-3 is to prevent broker-dealers from using customer assets to finance firm activities. In August 2008, the SFC rejected the SEFT desk's proposal but agreed to a modified one in which firm inventory could be financed incidentally through a customer-driven trade, but could not be the impetus for the conversion trade or the terms or securities used in a trade. As reflected in a revised handout also shared with Tirrell, (i) the Trades would be exposed to the market, (ii) ML could take the other side of the Trades, but floor traders could also step in and take all or part of the Trades, and (iii) the customer's long position used to cover the short would be sourced as all customer shorts typically were sourced by the firm, through either a borrow from an external lender, firm inventory, or some combination of the two. The following is the handout revised to reflect limitations imposed by internal reviewers:

[*Diagram intentionally omitted*]

RESPONSE TO PARAGRAPH 25: Mr. Tirrell admits that the allegations in Paragraph 25 purport to describe Rule 15c3-3 and he respectfully refers the Court to the rule for its substance. Mr. Tirrell admits that the allegations in Paragraph 25 purport to describe a one-page diagram prepared by the SEFT desk and he respectfully refers the Court to the diagram for its substance. Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in the second sentence of Paragraph 25, and on that basis denies them. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 25.

26. After executing Leveraged Conversion Trades according to the limitations imposed by the SFC, the SEFT desk in early 2009 renewed their request to use the Trades to finance firm inventory. The SEFT desk also requested to scale the Trades up so that they could reduce the minimum amount required to be maintained in the Reserve Account by a greater amount.

RESPONSE TO PARAGRAPH 26: Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 26, and on that basis denies them.

27. Tirrell and others within ML, which by that time had recently been acquired by Bank of America Corp., sought to discuss the Leveraged Conversion Trades with staff from FINRA and the Commission's Division of Trading and Markets ("T&M").

RESPONSE TO PARAGRAPH 27: Mr. Tirrell admits that (i) ML and its affiliates were acquired by Bank of America Corp. ("Bank of America") in January 2009; and (ii) Mr. Tirrell,

along with other professionals acting on behalf of Bank of America, met with representatives of FINRA and the Commission's Division of Trading and Markets ("T&M") on August 14, 2009 to discuss the Leveraged Conversion Trades. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 27.

28. Tirrell and SEFT Trader presented the Leveraged Conversion Trades at a meeting with FINRA and T&M in August 2009. SEFT Trader answered a few technical questions about the Trade, and Tirrell presented the overview, discussed the regulatory implications, and fielded most of the questions from regulators.

RESPONSE TO PARAGRAPH 28: Mr. Tirrell admits that he, along with other professionals acting on behalf of Bank of America, met with representatives of FINRA and T&M on August 14, 2009 to discuss the Leveraged Conversion Trades. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 28.

29. Tirrell did not describe the intended purpose and effect of the Trades to regulators. Rather, Tirrell presented them, consistent with the diagram above, as standard conversion trades that, while solicited by the firm, were executed to meet the investment objectives of ML customers. Tirrell, using the revised handout shown above, described the Trades to regulators. In addition to explaining the bullets on the slide concerning market exposure and the use of only actively traded large cap stocks, Tirrell told regulators that ML's customers took on real risk, which in Tirrell's view made the Leveraged Conversion Trades like any other conversion trade.

RESPONSE TO PARAGRAPH 29: Mr. Tirrell denies the allegations in Paragraph 29.

30. Tirrell did not inform FINRA or T&M, either at the August 2009 meeting or subsequently, that the primary purpose of the Leveraged Conversion Trades was to finance firm inventory.

RESPONSE TO PARAGRAPH 30: Mr. Tirrell denies the allegations in Paragraph 30.

31. Had Tirrell disclosed the true purpose of the Trades, the FINRA and T&M staff who attended this meeting never would have allowed ML to execute them.

RESPONSE TO PARAGRAPH 31: Mr. Tirrell denies the allegations in Paragraph 31.

32. Based on, among other considerations, the revised handout shown to regulators and representations at the meeting concerning (i) the supposed presence of real risk and economic substance, and (ii) the characterization of the Trades as standard conversion trades driven by customers' investment objectives, the regulators did not object to the version of the

Leveraged Conversion Trades that was presented. The trade components Tirrell and SEFT Trader presented at the meeting were important to the regulators. While they did not object to the Trade as presented, the regulators limited them by advising ML that the Trades collectively could not exceed a notional value of $3 billion for any given calculation period.

RESPONSE TO PARAGRAPH 32: Mr. Tirrell admits that ML initially agreed to limit the notional value of the Leveraged Conversion Trades to $3 billion. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 32.

33. Over the next year, the Leveraged Conversion Trades would lose each of the key attributes that had been presented to regulators by Tirrell.

RESPONSE TO PARAGRAPH 33: Mr. Tirrell denies the allegations in Paragraph 33.

34. Shortly after ML met with regulators, it began using the Leveraged Conversion Trades to finance firm inventory in a manner inconsistent with Tirrell's presentation to regulators. ML chose stocks that it had in inventory and that it otherwise would seek to finance through a more costly repurchase agreement or other means. ML then advised floor traders that it intended to take the other side of the trade and that they need not locate counterparties on the exchange. The margin loan extended to customers in each trade created a debit that reduced the required amount to be deposited into the Reserve Account by hundreds of millions and, collectively, billions of dollars. The cash freed from ML's Reserve Account through this debit was used to finance the security sold to the Leveraged Conversion Trade customer as part of the trades.

RESPONSE TO PARAGRAPH 34: Mr. Tirrell admits that the margin loan that MLPro extended to customers in the Leveraged Conversion Trades had the effect of reducing the amount of cash or cash equivalents that ML needed to maintain in its Reserve Accounts by, collectively, billions of dollars. Mr. Tirrell lacks knowledge or information sufficient to form a belief as to whether the allegations in the second, third, and fifth sentences of Paragraph 34 are true, and on that basis denies them. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 34.

35. By using this interest-free cash to finance its own inventory, ML profited from the Trades.

RESPONSE TO PARAGRAPH 35: Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 35, and on that basis denies them.

36. Once ML began using the Leveraged Conversion Trades to finance firm inventory, ML's financing needs, and not the investment decisions of customers, dictated the terms of the Trades. As a result, the customer debits created by the Trades became purely firm driven. A significant portion of the Leveraged Conversion Trades were done with limited liability companies ("LLCs") that were set up at ML's behest by customers who were told they would receive fixed profits and had no meaningful input into the Trades. The customers received risk-free returns from ML, returns that ML paid the customers from the profits it obtained from reducing its Reserve Account balance. This was contrary to how Tirrell described the Trades to regulators in August 2009, and was never subsequently disclosed to regulators.

RESPONSE TO PARAGRAPH 36: Mr. Tirrell denies the allegations in Paragraph 36 to the extent that they refer to him, and to the extent that they refer to other parties, lacks knowledge or information sufficient to form a belief as to the truth of them, and on that basis denies them.

37. SEFT Trader sought to modify the Leveraged Conversion Trades so that the SEFT desk had total control over each leg of each trade. As summarized below, the Trades became, with Tirrell's knowledge and approval, instantaneous roundtrips with delayed settlements that kept the customer debit in the formula for months after the Trade was completed.

RESPONSE TO PARAGRAPH 37: Mr. Tirrell denies the allegations in Paragraph 37 to the extent that they refer to him, and to the extent that they refer to other parties, lacks knowledge or information sufficient to form a belief as to the truth of them, and on that basis denies them.

38. The SEFT desk sought to use unlisted, over-the-counter ("OTC") options. OTC options, which are bilateral contracts directly between the LLC and ML, would eliminate exposure to the listed option market and the risks that come with it.

RESPONSE TO PARAGRAPH 38: Mr. Tirrell admits that the SEFT desk sought to use unlisted, over-the-counter ("OTC") options in the Leveraged Conversion Trades. Except as expressly admitted, Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 38, and on that basis denies them.

39. Before the SEFT desk took any steps toward this change, it consulted with and requested permission from Tirrell.

RESPONSE TO PARAGRAPH 39: Mr. Tirrell denies the allegations in Paragraph 39 to the extent that they refer to him, and to the extent that they refer to other parties, lacks knowledge or information sufficient to form a belief as to the truth of them, and on that basis denies them.

40. In December 2009, Tirrell emailed FINRA staff to advise them that the SEFT desk "would like to [] use unlisted options as it provides greater flexibility" and that these proposed Trades "would still be written on large Cap stocks." "I don't see this as a material change to the current arraingement [sic]," Tirrell stated in the email, "but wanted to ensure you are in agreement." Tirrell attached to his email the outdated transaction diagram that had previously been presented to regulators.

RESPONSE TO PARAGRAPH 40: Mr. Tirrell admits that the allegations in Paragraph 40 purport to selectively quote the email that Mr. Tirrell sent to FINRA on December 14, 2009 and he respectfully refers the Court to the email for its substance. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 40.

41. FINRA staff responded to Tirrell by email on January 11, 2010 by asking him for "clarifications in writing to the SEC and FINRA" regarding "the difference in transactions as compared to [ML's] last proposal"; "regulatory impacts, if any, aside from the margin requirements," and the rationale for why this version of the Leveraged Conversion Trades should be allowed to have a similar impact on the Reserve Formula.

RESPONSE TO PARAGRAPH 41: Mr. Tirrell admits that the allegations in Paragraph 41 purport to selectively quote the email that FINRA sent to Mr. Tirrell on January 11, 2010 and he respectfully refers the Court to the email for its substance. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 41.

42. Tirrell did not provide the requested information. The SEFT desk obtained internal approval from Tirrell and others for Leveraged Conversion Trades using OTC options. Within ML, only Tirrell knew at the time about FINRA staff's questions posed in the January 2010 email.

RESPONSE TO PARAGRAPH 42: Mr. Tirrell denies the allegations in Paragraph 42.

43. With the OTC version of the Leveraged Conversion Trades, ML had the ability to make structural changes that could not have been achieved with the version of the Trades using listed options.

RESPONSE TO PARAGRAPH 43: Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 43, and on that basis denies them.

44. During the structuring and testing of the OTC version of the Leveraged Conversion Trades, which took place from January 2010 to when they began to be executed in September 2010, the SEFT desk sent Tirrell presentations detailing the proposed transaction structure and the economics of the proposed OTC Trade and requested to meet with him to walk him through those presentations.

RESPONSE TO PARAGRAPH 44: Mr. Tirrell admits that (i) the SEFT desk provided Mr. Tirrell with certain information about the use of OTC options in the Leveraged Conversion Trades; (ii) the SEFT desk executed test trades incorporating OTC options into the Leveraged Conversion Trades; and (iii) the SEFT desk executed Leveraged Conversion Trades using OTC options. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 44.

45. After an insufficient examination of the proposed differences in the transaction structure, Tirrell did not disclose them to the FINRA staff who specifically requested that he explain such differences. These failures to disclose important changes to the Trades prevented regulators from receiving information that would have instantly prompted them to prohibit ML from moving forward.

RESPONSE TO PARAGRAPH 45: Mr. Tirrell denies the allegations in Paragraph 45.

46. A significant difference in the transaction structure of the OTC version was the use of delayed settlements. Under this new structure, the Trades involved the sale and instantaneous repurchase of securities and a put and a call that expired on the trade date. ML also delayed the settlement of the return sale of the securities for weeks and, in some cases, months. ML used this delayed settlement as a justification for keeping the purported customer debit in the Reserve Formula for the entire period until securities settled.

RESPONSE TO PARAGRAPH 46: Mr. Tirrell denies the allegations in Paragraph 46.

47. A MLPro senior executive became concerned about the use of a delayed settlement in this proposal and escalated his concerns to Tirrell and others. Tirrell gave ultimate approval to the use of this feature.

RESPONSE TO PARAGRAPH 47: Mr. Tirrell denies the allegations in Paragraph 47 to the extent that they refer to him, and to the extent that they refer to other parties, lacks knowledge or information sufficient to form a belief as to the truth of them, and on that basis denies them.

48. As with the use of OTC options and other departures from his earlier presentation to regulators, Tirrell did not inform FINRA of ML's use of delayed settlements. The FINRA and T&M staff who were present at the August 2009 meeting view this change as extremely important. In their view, under this undisclosed revised structure, the customer is flat on day one, and the margin loan is not financing any customer activity and therefore the customer debit created by that margin loan is not legitimate.

RESPONSE TO PARAGRAPH 48: Mr. Tirrell denies the allegations in Paragraph 48.

49. Tirrell also knew ML was further delaying already substantially delayed settlements if it suited firm needs. In other words, the delayed settlement date was repeatedly further delayed so long as ML desired. Still, Tirrell did not disclose this difference in the transaction structure to FINRA and T&M, who were both under the mistaken impression that customer, not firm, objectives drove the Trades.

RESPONSE TO PARAGRAPH 49: Mr. Tirrell denies the allegations in Paragraph 49.

50. Another difference with this version of the Trade relates to the prices used. Because the prices used for OTC options are not reported and are not exposed to the market, ML could depart from the prevailing market price of the securities and reverse engineer prices, often at off-market levels, to achieve a precise amount of compensation for the counterparty participating in the Trades. Again, Tirrell did not disclose this change to FINRA despite the focus on market exposure at the August 2009 meeting.

RESPONSE TO PARAGRAPH 50: Mr. Tirrell denies the allegations in Paragraph 50.

51. Tirrell also learned that the SEFT desk sought to depart from ML's assurance that it would only use large cap stocks. By moving to OTC options, which can be written on any security, ML could diverge from Tirrell's representation to regulators made in August 2009 and reiterated in his December 2009 email that ML would use only actively traded large cap stocks. As discussed below, using OTC options allowed ML to use customer money to finance certain of its less liquid positions like convertible bonds. During this period, the convertible bond market was especially illiquid. Liquidating these securities would have taken a period of time during which customers would not have been able to access their accounts. Also, a liquidation of a large amount of convertible bonds into an already illiquid market would likely be achieved only by selling them at a significant discount. Consequently, this modification to the Trades exposed ML customers to substantial market risk in the event ML failed. Tirrell once again failed to disclose this modification to regulators.

RESPONSE TO PARAGRAPH 51: Mr. Tirrell denies the allegations in Paragraph 51.

52. Tirrell had access to the SEFT desk and to information about the Trades, even as they evolved over time. In seeking Tirrell's approval of changes made to the Trades, SEFT Trader and others on the SEFT desk timely provided Tirrell with information about the Trades and responded to questions he asked and requests he made.

RESPONSE TO PARAGRAPH 52: Mr. Tirrell denies the allegations in Paragraph 52.

53. In the OTC iteration of the Trades, which lasted from approximately September 2010 to April 2012, ML reduced the minimum amount required in its Reserve Account by up to $5 billion per week through Leveraged Conversion Trades.

RESPONSE TO PARAGRAPH 53: Mr. Tirrell admits that regulators agreed that ML could execute the Leveraged Conversion Trades with a notional value up to $5 billion. Except as expressly admitted, Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 53, and on that basis denies them

54. While failing to provide the requested differences in transaction structure to FINRA staff, Tirrell was diligent in obtaining regulatory approval to expand the monetary limits applicable to the Trades. After repeated follow-up by Tirrell, the regulators granted ML's request to expand the size of the Leveraged Conversion Trades, as they understood them based on the August 2009 meeting, from $3 billion to $5 billion.

RESPONSE TO PARAGRAPH 54: Mr. Tirrell admits that regulators agreed that ML could increase the notional value of the Leveraged Conversion Trades from $3 billion to $5 billion. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 54.

55. From August 2009 to April 2012, Tirrell and those under his supervision improperly included purported customer debits in ML's Reserve Formula. During this period, ML's Reserve Account balance ranged from approximately $7.6 to $12.8 billion; therefore, ML was able to reduce the customer money it deposited into its Reserve Account by approximately 28% to 40%. Including the improper debits arising from the Trades in the Reserve Formula caused MLPF&S and MLPro to misreport the aggregate amount of customer debits in monthly FOCUS Reports throughout the life of the Trades.

RESPONSE TO PARAGRAPH 55: Mr. Tirrell denies the allegations in Paragraph 55.

56. At the August 2009 meeting with FINRA and T&M, and in a subsequent email confirming the takeaways from that meeting, Tirrell agreed to provide details on executed Leveraged Conversion Trades in its FOCUS Reports that MLPF&S and MLPro each submit to FINRA and the Commission monthly.

RESPONSE TO PARAGRAPH 56: Mr. Tirrell admits that at the August 2009 meeting with FINRA and T&M and in a subsequent email confirming the takeaways from that meeting, Mr. Tirrell stated that Bank of America would provide details about the executed Leveraged

Conversion Trades in the memo field of ML's FOCUS Reports. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 56.

57. MLPF&S did not, however, provide details relating to its Leveraged Conversion Trade activity in any monthly FOCUS Reports filed in 2009, 2010, or 2011. And, aside from one FOCUS Report filed in September 2009, MLPro similarly failed to provide this information from 2009 to 2012. During this period, FINRA's monitoring of information pertaining to ML's Reserve Account led it to conclude that Leveraged Conversion Trades were being executed. FINRA staff raised this suspicion to Tirrell, who confirmed it and assured FINRA staff that FOCUS Reports would contain information on Leveraged Conversion Trades going forward. Despite Tirrell's assurance, ML continued to fail to provide this information for years.

RESPONSE TO PARAGRAPH 57: Mr. Tirrell admits that the Regulatory Reporting Department included details about the Leveraged Conversion Trades in the memo field of MLPro's September 2009 FOCUS Report, but inadvertently did not include details about the Leveraged Conversion Trades in the memo fields of some other FOCUS Reports during the pendency of the Leveraged Conversion Trades. Except as expressly admitted, Mr. Tirrell denies the allegations in Paragraph 57.

58. Monthly FOCUS Reports as well as MLPF&S annual reports signed by Tirrell filed while Leveraged Conversion Trades were being executed were inaccurate because they contained information on the computation of the Reserve Account that took into account billions of dollars in improper customer debits generated from the Trades.

RESPONSE TO PARAGRAPH 58: To the extent that Paragraph 58 contains legal conclusions, no response is required. Mr. Tirrell otherwise denies the allegations in Paragraph 58.

59. In early 2012, a new co-head of the business unit that included the SEFT desk learned of the Leveraged Conversion Trades and became concerned about whether they complied with the Customer Protection Rule. Around the same time, a member of the SFC who initially reviewed the Trades learned about the OTC version and similarly became concerned. After the co-head discussed the OTC version of the Trades with the SEFT desk, this SFC member, and others within ML, the firm retained external counsel to review the Leveraged Conversion Trades.

RESPONSE TO PARAGRAPH 59: Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 59, and on that basis denies them.

60. ML thereafter changed two practices associated with the Trades. First, ML had the LLCs sign OTC contracts for all of their OTC Leveraged Conversion Trades that attempted to retroactively create the OTC options that had expired many months ago and that were used in Trades that had already been fully executed. Second, after years of failing to report Leveraged Conversion Trades in FOCUS Reports, both MLPF&S and MLPro began submitting the required information in their respective FOCUS Reports for the months January 2012 through April 2012.

RESPONSE TO PARAGRAPH 60: Mr. Tirrell admits that ML inadvertently did not include details about the Leveraged Conversion Trades in the memo fields of some FOCUS Reports during the pendency of the Leveraged Conversion Trades, but included details about the Leveraged Conversion Trades in other FOCUS Reports. Except as expressly admitted, Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 60, and on that basis denies them.

61. In April 2012, ML prohibited the SEFT desk from executing any new Leveraged Conversion Trades. Tirrell was aware of the review of the Trades and aware that ML changed its practices associated with the trades, but neither Tirrell, nor anyone else at ML, provided any information relating to the circumstances of the discontinuation of the Leveraged Conversion Trades in 2012 to the regulators.

RESPONSE TO PARAGRAPH 61: Mr. Tirrell admits that (i) ML and its advisors reviewed the Leveraged Conversion Trades; and (ii) ML eventually stopped executing the Leveraged Conversion Trades. Except as expressly admitted, Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 61, and on that basis denies them.

62. ML conceived of and executed the Leveraged Conversion Trades during an extremely precarious period of time in the financial markets. By using up to $5 billion in customer money to finance proprietary trading activity, ML failed to maintain the required minimum amount in its Reserve Account during this period.

RESPONSE TO PARAGRAPH 62: Mr. Tirrell denies the allegations in Paragraph 62.

63. By using customer cash to finance firm inventory, ML made approximately $50 million in profits through the Leveraged Conversion Trades, which represents the amount the firm saved by using interest-free customer money to finance its inventory rather than doing so through other means such as repurchase agreements.

RESPONSE TO PARAGRAPH 63: Mr. Tirrell lacks knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 63, and on that basis denies them.

* * *

As to Sections IV, V, and VI of the OIP, no response is required. To the extent that a response is required, Mr. Tirrell denies the allegations in Sections IV, V, and VI of the OIP, denies that he violated any securities laws or regulations, and denies that any action should be taken against him.[3]

AFFIRMATIVE DEFENSES

Further answering the OIP, Mr. Tirrell sets forth the following defenses. By asserting these affirmative defenses, Mr. Tirrell does not admit that he bears the burden of proof on any issue, and does not accept any burden he would not otherwise bear. Mr. Tirrell reserves the right to amend this Answer with additional defenses of which he may become aware through review of the investigative file or other investigation.

First Affirmative Defense

1. The claims alleged in the OIP are barred, in whole or in part, because the Commission lacks jurisdiction over this proceeding.

Second Affirmative Defense

2. The claims alleged in the OIP are barred, in whole or in part, because this administrative proceeding is the product of an impermissible delegation of legislative authority in contravention of Article I of the United States Constitution.

---

[3] The OIP omits Section III.

Third Affirmative Defense

3. The claims alleged in the OIP are barred, in whole or in part, because this administrative proceeding violates Article II of the United States Constitution because it impermissibly shields an inferior office from removal by the President.

Fourth Affirmative Defense

4. The claims alleged in the OIP are barred, in whole or in part, because this administrative proceeding violates the doctrine of separation of powers.

Fifth Affirmative Defense

5. The claims alleged in the OIP are barred, in whole or in part, because this administrative proceeding violates Mr. Tirrell's right to procedural due process under the United States Constitution.

Sixth Affirmative Defense

6. The claims alleged in the OIP are barred, in whole or in part, because this administrative proceeding violates Mr. Tirrell's right to equal protection of the laws under the United States Constitution.

Seventh Affirmative Defense

7. The claims alleged in the OIP are barred, in whole or in part, because this administrative proceeding violates Mr. Tirrell's right to a jury trial under the Seventh Amendment of the United States Constitution.

Eighth Affirmative Defense

8. The claims alleged in the OIP are barred, in whole or in part, by the applicable statutes of limitation, statutes of repose and/or the doctrine of laches.

Ninth Affirmative Defense

9. The claims alleged in the OIP are barred, in whole or in part, because the OIP fails to state a claim upon which relief can be granted.

Tenth Affirmative Defense

10. The claims alleged in the OIP are barred, in whole or in part, because the OIP fails to state a claim upon which the Commission can take any remedial action.

Eleventh Affirmative Defense

11. The claims alleged in the OIP are barred, in whole or in part, because Mr. Tirrell did not participate in any unlawful conduct, and the conduct of parties other than Mr. Tirrell proximately caused the alleged harm complained of in the OIP. The violations alleged were the result of negligent, willful, and/or intentional acts or omissions of, or failures by, persons other than Mr. Tirrell. The acts of such third parties constitute intervening and superseding causes of any alleged violations of the securities laws.

Twelfth Affirmative Defense

12. The claims alleged in the OIP are barred, in whole or in part, because Mr. Tirrell performed his responsibilities in accordance with the scope of his authority and did so in a reasonable and diligent manner.

Thirteenth Affirmative Defense

13. The claims alleged in the OIP are barred, in whole or in part, because Mr. Tirrell, ML, and Bank of America had established procedures that would reasonably be expected to prevent and detect, insofar as practicable, any violation and otherwise to comply with any applicable rules.

Fourteenth Affirmative Defense

14. The claims alleged in the OIP are barred, in whole or in part, because Mr. Tirrell acted in good faith and reasonably discharged his duties without reasonable cause to believe that such procedures were not being complied with.

Fifteenth Affirmative Defense

15. The claims alleged in the OIP are barred, in whole or in part, because Mr. Tirrell relied in good faith upon the judgment of professionals, including ML's and Bank of America's in-house counsel, outside counsel, compliance and accounting professionals, and legal consultants as to matters that he reasonably believed were within such persons' professional or expert competence.

Sixteenth Affirmative Defense

16. The claims alleged in the OIP are barred, in whole or in part, to the extent that ML and Bank of America had in place a reasonable and proper system of compliance, and Mr. Tirrell reasonably and in good faith relief on such institutional processes to ensure adequate and appropriate legal review and compliance.

Seventeenth Affirmative Defense

17. The claims alleged in the OIP are barred, in whole or in part, because the alleged actions of Mr. Tirrell were not conducted intentionally, willfully, recklessly, or negligently.

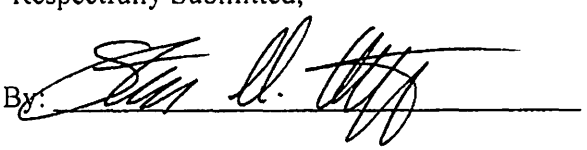
Eighteenth Affirmative Defense

18. The claims alleged in the OIP are barred, in whole or in part, because the imposition of a penalty against Mr. Tirrell is not in the public interest and is not consistent with the requirements of justice.

WHEREFORE, having fully answered, Mr. Tirrell requests that the relief described in the OIP be denied and the proceedings herein be dismissed.

Dated: September 30, 2016
New York, New York

Respectfully Submitted,

By: 

FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP
Steven M. Witzel
Lawrence Gerschwer
Joshua D. Roth
Kira M. Whitacre
Leigh G. Rome
One New York Plaza
New York, NY 10004
(212) 859-8000

Attorneys for William E. Tirrell