

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 82382 / December 21, 2017

INVESTMENT ADVISERS ACT OF 1940
Release No. 4831 / December 21, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-18318

In the Matter of

**Merrill Lynch, Pierce, Fenner
& Smith Incorporated**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934 AND SECTION 203(e) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b), and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”) against Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. SUMMARY

A registered broker-dealer is required to file a suspicious activity report ("SAR") on a transaction (or a pattern of transactions of which the transaction is a part) conducted or attempted by, at, or through the broker-dealer involving or aggregating to at least \$5,000 that the broker dealer knows, suspects, or has reason to suspect: (1) involves funds derived from illegal activity or is conducted to disguise funds derived from illegal activities; (2) is designed to evade any requirement of the BSA; (3) has no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts; or (4) involves use of the broker-dealer to facilitate criminal activity. This matter concerns Merrill Lynch's violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder, in connection with its failure to file SARs in compliance with these reporting requirements. Merrill Lynch, in addition to offering its customers the ability to buy and sell securities, offered its customers other services in brokerage accounts, such as ATM cash deposits, wires, journal-entry transfers, check writing, ATM withdrawals, cash advances, and ACH transfers. By offering these additional services, Merrill Lynch was susceptible to risks of money laundering and other illicit financial activity associated with these services.

From at least 2011 to 2015 (the "relevant period"), Merrill Lynch had anti-money laundering ("AML") policies and procedures that were not reasonably designed to account for the additional risk associated with the additional services offered by certain of its retail brokerage accounts. Because of the deficiencies in its AML policies and procedures detailed below, Merrill Lynch failed to adequately monitor for, detect, and report certain suspicious activity related to transactions or patterns of transactions in its customers' accounts. By failing to file SARs as required, Merrill Lynch violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

B. RESPONDENT

1. Merrill Lynch, headquartered in New York, New York, is dually registered with the Commission as a broker-dealer and an investment adviser. It is a subsidiary of Bank of America Corporation ("BofA").

C. MERRILL LYNCH FAILED TO IMPLEMENT REASONABLE AML POLICIES AND PROCEDURES

2. During the relevant period, Merrill Lynch through its retail brokerage accounts offered traditional investment services such as buying and selling securities. In certain types of retail brokerage accounts, Merrill Lynch also offered other products and services such as wire transfers, checking, ATM currency deposits and withdrawals, and ACH transfers. During the relevant period, over \$2 trillion in transactions not including the purchase or sale of securities moved through Merrill Lynch brokerage accounts via cash deposits, wires, journal-entry transfers, check writing, ATM withdrawals, cash advances, and ACH transfers. These transactions presented

money laundering risks, including, but not limited to, structuring currency deposits and withdrawals to avoid cash transaction reporting obligations and other risks associated with cash-intensive activities, such as laundering the proceeds of illegal activity.

3. During the relevant period, Merrill Lynch's AML monitoring, investigations, and reporting were done as an enterprise-wide function at BofA. As a result, AML monitoring of a customer's Merrill Lynch brokerage account could have led to an investigation of that customer's transactions across the enterprise (including at BofA's consumer bank); similarly, AML monitoring of a customer's bank account could have led to an investigation of related brokerage accounts. Because this Order relates only to monitoring, investigating, and reporting of retail brokerage-account activity, this Order refers to Merrill Lynch.

4. As part of its AML program during the relevant period, Merrill Lynch attached a document entitled "Potential Money Laundering Indicators" to its AML policies and procedures to inform Merrill Lynch employees of indicators of possible money laundering. The "Potential Money Laundering Indicators" document stated: "The following potential money laundering indicators, when encountered, may warrant additional scrutiny. The mere presence of one of these indicators is not by itself evidence of criminal activity. Closer scrutiny should help to determine whether the activity is suspicious." The Potential Money Laundering Indicators document identified potential indicators for money laundering that included, but were not limited to:

- Unusual transfers of funds occurring among related accounts or among accounts that involved the same or related principals;
- Many funds transfers sent in large, round dollar amounts;
- Funds transfer activity that was unexplained, repetitive, or showed unusual patterns;
- A customer engaging in excessive journal-entry transfers between unrelated accounts without any apparent business purpose;
- Wires originating from jurisdictions which had been flagged in relation to black market peso exchange activities;
- A large number of incoming or outgoing funds transfers taking place through a business account, where there appeared to be no logical business or other economic purpose to the transfers, particularly when this activity involved high-risk locations;
- A person customarily using the automated teller machine to make several bank deposits below a specified threshold; and
- The customer engaging in transactions involving cash or cash equivalents or other monetary instruments that appeared to be structured.

5. During the relevant period, Merrill Lynch primarily used a system called "Mantas" for the automated monitoring of retail brokerage accounts to detect potential money laundering activity related to money movements. Mantas was a vendor-provided transaction monitoring system used by many financial institutions that Merrill Lynch customized to meet its specific needs. Mantas alerted on transactions that fit within the parameters of specific scenarios selected by Merrill Lynch, such as rapid movement of funds or internal journal-entry transfers between unrelated accounts. Merrill Lynch had other methods of detecting suspicious movements of funds in accounts, but those methods were primarily manual, or only alerted on certain types of activity,

such as ATM transactions or wire transfers that were routed through BofA's consumer bank before being debited or credited to the customer's Merrill Lynch account. Merrill Lynch also used a separate automated surveillance system to conduct trade surveillance. Merrill Lynch referred to the alerts produced by its AML detection channels as "events."

6. Since approximately October 2010, Merrill Lynch also used a system called "Event Processor," or "EP," which grouped Mantas events and events produced by other Merrill Lynch detection channels and assigned points to the event groups. Merrill Lynch opened a case for further investigation if an event group met a risk-based threshold "score." Additionally, an investigator could manually open a case on particular accounts, customers, or transactions, but often Merrill Lynch did not investigate Mantas events unless their event group met the risk-based threshold for opening a case as a result of additional events, whether from Mantas or other detection channels.

1. Merrill Lynch Did Not Use Mantas to Monitor Certain Accounts

7. From approximately 2006 through approximately May 2015, Merrill Lynch did not apply its Mantas automated monitoring to certain accounts. These accounts included:

- Retirement Accounts—about 4.2 million SEP, 403b, IRA, IRA Rollover, Roth IRA, and other retirement accounts as of February 2015;
- Managed Accounts—about 228,000¹ retail brokerage accounts held at Merrill Lynch as of February 2015 under the discretionary management of a Merrill Lynch registered representative or Merrill Lynch-approved outside investment adviser; and
- Securities-Based Loan Accounts—about 421,000 active retail brokerage accounts as of February 2015 that held securities-based loans, and brokerage accounts pledged as security for those loans.

8. These accounts engaged in a significant number of transactions, moving substantial amounts of funds to and from accounts at Merrill Lynch. From 2011 through 2013, managed accounts, securities-based loan accounts, and the accounts pledged to them engaged in approximately 12 million transactions moving approximately \$105 billion to and from accounts at Merrill Lynch, via checks, ATM withdrawals, cash deposits, wires, and ACH transactions during that time period. The number and dollar amount of these transactions increased each year and accounted for approximately 6% of all movements of un-invested funds at Merrill Lynch.

9. In 2006 and again in 2009, Merrill Lynch determined to not use Mantas to monitor these accounts. Other applicable AML detection channels and automated trade surveillance systems were applied to those accounts, however, these other detection channels were not sufficient for the volume of transactions occurring in certain accounts, as they were primarily manual or only alerted on certain types of activity, such as ATM transactions or wire transfers that were routed through BofA's consumer bank before being debited or credited to the customer's

¹ Some accounts were both a Managed Account and a Retirement Account; therefore, some accounts may be double counted.

Merrill Lynch account. In January 2012, during an internal review of its AML policies and procedures by new AML management and personnel, they discovered that Mantas had not been applied to these accounts since the inception of Mantas at Merrill Lynch in 2006. Although this issue was discussed with certain supervisors within the AML department, Merrill Lynch did not make arrangements for Mantas to monitor these accounts at that time. Around the end of 2014, Merrill Lynch determined that certain of the accounts should be monitored by Mantas. This change was completed by the end of May 2015.

2. Mantas Scoring Was Deficient

10. During the relevant period, Merrill Lynch excluded multiple occurrences of the same type of event from its scoring of Mantas events for two high risk detection scenarios. Therefore, an account with a single occurrence of a potentially suspicious transaction within the parameters of either detection scenario had the same scoring as an account in which the same type of transaction occurred repeatedly. In making this scoring decision, Merrill Lynch's analysis insufficiently evaluated and inadequately documented the increased money laundering risk of this repetitive behavior.

3. Merrill Lynch Did Not Investigate and Report on Certain Mantas Events

11. From about September 19, 2011 through January 2012, Merrill Lynch did not investigate Mantas events that were not grouped with an event from one of the other detection channels, such as an employee referral, a government subpoena, or an event related to a wire transfer or ATM transaction that had been routed through BofA's consumer bank before being debited or credited to a Merrill Lynch customer's retail brokerage account. Specifically, in a stated effort to reduce the number of what Merrill Lynch determined to be "false positive" cases arising solely from Mantas events, on September 12, 2011, Merrill Lynch decided that it would make various changes to the way Mantas events were generated and scored. On that date, Merrill Lynch also decided that while those changes were being implemented: (1) EP would not open a case that was generated by Mantas events only (i.e., EP opened a case only if an event group contained at least one event from a detection channel other than Mantas and reached the risk-based case threshold discussed above, including the scores of the Mantas and non-Mantas events); and (2) suspended the 646 pending cases opened since about May 2011 that were based only on Mantas events. At the time of these decisions, the most senior AML risk governance committee at Merrill Lynch expected that impacted Mantas events would be reprocessed into EP (and rescored) after the completion of the relevant changes to the way Mantas events were generated and scored.

12. On December 5, 2011, a junior Merrill Lynch AML governance committee approved the changes to how Mantas events would be generated and scored, which changes were implemented on February 1, 2012. The junior Merrill Lynch governance committee, however, also decided to retire all prior Mantas events, effectively contravening the approach adopted by the senior AML risk governance committee without reengaging with that committee. Merrill Lynch did not re-process or rescore these Mantas-only events or cases into the newly changed Mantas system. As a result, Merrill Lynch did not investigate many Mantas-only events generated from May 2011 through August 2011 and did not investigate any Mantas-only events generated from

approximately September 2011 through January 31, 2012 for possible money laundering. Merrill Lynch eventually re-processed and rescored those Mantas-only events and cases in late 2014.

4. Merrill Lynch Did Not Effectively Link Related Accounts in EP

13. During the relevant period, EP used a number of systems and techniques to group events arising from related retail brokerage accounts. However, EP inadvertently did not link related accounts that involved customers who had both U.S. dollar-denominated and foreign currency-denominated accounts. Merrill Lynch customers were able to maintain accounts in different currencies, and could move different currencies to and from these accounts. However, until mid-2015, if AML detection channels produced events on a customer's U.S. dollar-denominated and foreign currency-denominated accounts, EP did not always group those events into the same event group. As a result, a customer could have had two different event groups, neither of which reached the risk-based threshold to create a case—but which could have exceeded that threshold had the two event groups been combined. Accordingly, certain event groups did not meet the risk-based threshold and become an investigation for further review as rapidly as they otherwise would have, if at all.

5. Merrill Lynch Did Not Adequately Monitor Continuing Suspicious Activity

14. During the relevant period, Merrill Lynch did not have adequate policies and procedures for filing what were commonly known as “continuing activity” or “ongoing activity” SARs. When suspicious customer activity is continuing or ongoing, financial institutions are permitted to file SARs on the continuation of the originally reported activity after a 90-day review, rather than file within 30 days after the initial detection of facts that may constitute the basis for filing a SAR.²

15. During the relevant period, under Merrill Lynch's AML policies and procedures, once a SAR for suspicious activity in an account was filed, the AML staff generally had discretion (except where otherwise specifically required) to elect whether or not that account would be investigated again 90 days later. Specifically, until 2013, investigators were only required to investigate an account again where the continuing suspicious activity that was reported in the SAR had been investigated as a result of an external source (such as a government subpoena); investigators otherwise had discretion whether to elect that the account be investigated again if the SAR had been investigated as a result of a detection channel internal to Merrill Lynch. In 2013, the policy was expanded to require that investigators investigate an account if the continuing suspicious activity reported in the SAR had been investigated as a result of any non-systematic source—that is, any source, whether internal or external, other than an automated transaction monitoring system. In August 2014, Merrill Lynch implemented a “Continuous Suspicious Activity Event” risk factor to adequately monitor for continuing suspicious activity. This risk factor created a case whenever any AML event occurred on the same party and of the same type as contributed to a SAR filed within the preceding 90 days.

² Broker-dealers have 60 days to file if no suspect is identified on the date of initial detection. 31 C.F.R. §1023.320(b)(3).

6. Merrill Lynch Did Not Adequately Investigate AML Events

16. Once an AML case was opened, the platform used by Merrill Lynch's AML investigators during part of the relevant period did not provide sufficient visibility into transactions occurring in an account, causing the investigators sometimes unduly to limit their review to the specific events that triggered the event and not to review the account more broadly to determine whether the risk associated with that event warranted additional investigation or reporting. The investigators also did not have a tool to conduct extensive external records searches, in addition to broad, open source internet searches, on transaction counterparties. At times, the abbreviated investigation review and limited external search capabilities did not allow investigators to conduct a reasonable review of patterns of activity in the context of the Potential Money Laundering Indicators document. In addition, Merrill Lynch's training sessions for AML investigators did not always adequately address certain potential money laundering schemes.

D. MERRILL LYNCH DID NOT FILE CERTAIN SUSPICIOUS ACTIVITY REPORTS

17. As a result of the deficiencies in its AML policies and procedures identified above, Merrill Lynch failed to file SARs on suspicious movements of funds through its accounts. For example, from January 1, 2009 to July 1, 2015, in just one Merrill Lynch branch office in San Diego, California, which principally served non-U.S. resident customers, Merrill Lynch failed to file SARs on numerous suspicious money movements. In addition, Merrill Lynch also failed to timely file seven SARs firm-wide on approximately \$57,000,000 in transactions in roughly 20 accounts, due to the decision not to reprocess, rescore, and investigate Mantas events after scoring changes were completed at the end of January 2012.

18. The transactions on which Merrill Lynch failed to file SARs were part of a pattern of suspicious customer activity, occurring often through numerous commonly owned or controlled accounts, over many months and sometimes years, and matched numerous potential money laundering indicators identified in the Potential Money Laundering Indicators document. For example, accounts at the San Diego, California, branch that served non-resident customers engaged in suspicious transactions that included:

- (1) patterns of large currency deposits through ATMs to fund off-shore company accounts where there was no apparent indicia of business operations and the due diligence documents for the customer, which Merrill Lynch obtained during the account opening process to determine the expected activity in the account, did not identify currency as a potential source of funds;
- (2) accounts that engaged in complicated movements of large, even-dollar-denominated funds, through patterns of internal journal-entry transfers and deposits and withdrawals to and from accounts at third-party institutions in high risk jurisdictions, with no explanation as to the reason for the transactions being processed through multiple Merrill Lynch accounts before being sent to another financial institution; and

- (3) customers withdrawing currency via debit card cash advances and ATM withdrawals in long-term patterns with indicia of attempts to evade currency transaction report filings.

Merrill Lynch either failed to file SARs on many of these suspicious transactions or, if it did file a SAR, failed to review the accounts for continuing activity.

E. MERRILL LYNCH'S REMEDIAL EFFORTS

19. The Commission considered the remedial acts undertaken by Respondent. Merrill Lynch has remediated the issues described above as follows:

- (1) Monitoring of Certain Accounts—As described above, beginning in approximately May 2015, Merrill Lynch began monitoring accounts with Mantas.
- (2) Reprocessing of Mantas Events—In approximately 2014 and 2015, Merrill Lynch reprocessed and rescored all the Mantas events whose scores had been affected by the Fall 2011 scoring decisions, and investigated all the Mantas-event-only cases that had been closed at that time. This resulted in approximately 1,015 investigations. In 2015, Merrill Lynch subsequently filed seven SARs on approximately \$57,000,000 in transactions in roughly 20 accounts.
- (3) Scoring—In June 2015, Merrill Lynch changed the scoring for two high risk transaction scenarios so that events for transactions fitting these scenarios would score for each such transaction and not just once. In addition, in 2015, Merrill Lynch began using a separate BofA automated system to also monitor all movement of funds in Merrill Lynch retail brokerage accounts for potentially suspicious activity.
- (4) Account Linkages—In August 2015, Merrill Lynch modified EP to be able to link accounts and group events appropriately arising out of a customers' U.S. dollar-denominated and foreign currency-denominated accounts.
- (5) Continuing Suspicious Activity Monitoring—In August 2014, Merrill Lynch implemented a "Continuous Suspicious Activity Event" risk factor, which created a case whenever any AML event occurs on the same party and of the same type as contributed to a SAR filed within the preceding 90 days. This was in addition to the ability of AML investigators to elect a 90-day review in appropriate circumstances.
- (6) Investigations—Merrill Lynch made enhancements to the workstation used by investigators in order to provide more visibility into transactions occurring in an account. Merrill Lynch also enhanced research tools for AML investigators, added procedures for investigators relating to potential red flags for money laundering, provided multiple training sessions to investigators regarding various money

laundering schemes, and established additional training programs for future AML investigators.

F. VIOLATIONS

20. The BSA, and implementing regulations promulgated by the Financial Crimes Enforcement Network (“FinCEN”), require that broker-dealers file SARs with FinCEN to report a transaction (or a pattern of transactions of which the transaction is a part) conducted or attempted by, at, or through the broker-dealer involving or aggregating to at least \$5,000 that the broker dealer knows, suspects, or has reason to suspect: (1) involves funds derived from illegal activity or is conducted to disguise funds derived from illegal activities; (2) is designed to evade any requirement of the BSA; (3) has no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts; or (4) involves use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 1023.320(a)(2) (“SAR Rule”).

21. Exchange Act Rule 17a-8 requires broker-dealers to comply with the reporting, record-keeping, and record retention requirements of the BSA. The failure to file a SAR as required by the SAR Rule is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

22. By failing to file SARs with FinCEN as required by the BSA with respect to certain of its customers’ activity as described above, Merrill Lynch willfully³ violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Merrill Lynch cease and desist from committing or causing any violations and any future violations of Exchange Act Section 17(a) or Rule 17a-8 promulgated thereunder.

B. Respondent Merrill Lynch be, and hereby is censured;

³ A willful violation of the securities laws means merely ““that the person charged with the duty knows what he is doing.”” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor ““also be aware that he is violating one of the Rules or Acts.”” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

C. Respondent Merrill Lynch shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of \$13,000,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Merrill Lynch as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Alka Patel, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 444 S. Flower Street, 9th Floor, Los Angeles, CA 90071.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based

on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary