UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 83886 / August 20, 2018

INVESTMENT ADVISERS ACT OF 1940
Release No. 4989 / August 20, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18651

In the Matter of **Merrill Lynch, Pierce, Fenner & Smith Incorporated,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e) AND 203(k) 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 Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill" 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 it 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 Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) 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

1. Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill"), a registered investment adviser, failed to disclose that the portfolio manager evaluation process employed in connection with a January 2013 termination recommendation for over fifteen hundred of its retail advisory accounts was exposed to a conflict of interest involving other business interests.

2. In representations to its advisory clients, Merrill described an investment-merits due diligence process for the products it offered and recommended on its investment advisory platforms. In December 2012, Due Diligence, a unit of Global Wealth & Retirement Solutions ("GWRS"), recommended terminating from those platforms certain products ("Products") that Merrill's retail advisory clients had invested approximately $575 million dollars in and that was managed by a U.S. investment advisory subsidiary of a foreign multinational banking and financial services corporation (the "U.S. Subsidiary"). Consistent with Merrill's standard process for evaluating such termination proposals, the recommendation was presented to an internal governance committee ("Governance Committee") in January 2013. Before the Governance Committee met to consider the recommendation, the U.S. Subsidiary learned of the proposed termination from a Merrill employee due to operational and timing issues concerning removing the Products. As a direct result of the premature disclosure, the U.S. Subsidiary proceeded to contact senior management within GWRS ("Senior Management") to make a direct pitch to Merrill to retain the Products. The pitch from an officer of the U.S. Subsidiary ("Officer A") to a Merrill Senior Executive ("Senior Executive") addressed the merits of the recommendation and the adequacy of Due Diligence's review, but also included an appeal to the broader business relationship between the companies. The Senior Executive informed the officer of the U.S. Subsidiary on the same day as the pitch, six days prior to the Governance Committee meeting, that the Products would not be terminated and the U.S. Subsidiary would have additional time to make its case to Due Diligence. After additional communications between and among the U.S. Subsidiary and Senior Management, the Governance Committee deferred the proposed termination. At no time were the full Governance Committee or Merrill's clients informed of the communications between the U.S. Subsidiary and Senior Management.

3. This undisclosed conflict of interest in Merrill's decision-making process violated Section 206(2) of the Advisers Act. Merrill also violated 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

Respondent

4. **Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill") (CRD # 7691),** a wholly owned indirect subsidiary of Bank of America Corporation ("BoA"), is a Delaware company headquartered in New York, NY. Merrill has been registered with the Commission as an investment adviser since 1978 and as a broker-dealer since 1959.

Related Entities

5. **Global Wealth & Retirement Solutions ("GWRS")** is a business unit within Merrill that provides investment solutions across all product platforms, including equity, debt and structured products, alternative investments, and delivery of due diligence and investment management solutions for client portfolios. In addition, GWRS provides personal and institutional retirement solutions which include administration, recordkeeping, consulting and execution services to businesses and their employees' workplace-based benefit plans.

6. **Investment Management & Guidance ("Due Diligence")** is a business unit within GWRS comprised of due diligence professionals focused on providing investment advisory clients and financial advisors with investment advice.

7. **Global Banking & Markets ("GBAM")** is a business unit within BoA that includes Business Banking, Global Commercial Banking, Global Corporate & Investment Banking, Global Markets and Wholesale Credit. The Global Corporate & Investment Banking unit of GBAM provides advisory expertise concerning mergers and acquisitions, corporate banking, treasury, debt and equity underwriting.

B. Facts

Relevant Platforms

8. From 2012 through 2013, clients on Merrill platforms ("Platforms") who were invested in the Products paid a fee to Merrill, which was responsible for, among other things, identification of third-party investment managers available for client selection, performance reporting, and advice and guidance. Clients on the Platforms could only select from the investments available on the Platforms.

Merrill's Disclosures Concerning Portfolio Manager Selection and Evaluation

9. According to the brochures provided to clients and as part of the Form ADV filed with the Commission (the "Brochures") regarding selection and evaluation of third-party managed investments: "[Due Diligence] uses a multi-factor process for identifying and selecting Style [investment] Managers and Funds, that incorporates quantitative, qualitative, [and] objective and subjective components," and "[f]actors for evaluation include, but are not limited to: Organizational structure and growth; Adherence to investment style; Evaluation of risk and volatility; Investment professional and strategy resources; Investment philosophy and process; Portfolio construction; and Performance." Clients relied on Merrill to use these disclosed investment quality factors in determining which investments are available on the platforms and did not expect that Merrill would evaluate investments based on other business interests.

10. The marketing materials available to clients also highlighted the experience of

the Due Diligence analysts and process. A brochure available to clients titled "Merrill Lynch Investment Manager Research, Evaluation and Selection" (the "Evaluation Brochure") stated that "[a]fter the due diligence team identifies and evaluates potential managers, the recommendations are presented to our investment committees, which review and approve all investment manager strategies to which we guide your Financial Advisor." The Evaluation Brochure also stated: "Our investment committees consider these and other factors: A forward-looking assessment of the manager's performance potential; Expectations and objectives; Investment style; Risk/return profile; Time horizon." The Evaluation Brochure touts the "robust due diligence and governance process [that] results in a roster of investment managers that we believe has the ability to support your investment objectives." These factors are largely duplicative of the investment quality-focused factors (e.g., performance) identified in the Brochures with the addition of specific factors that address the potential investment concerns and objectives of individual clients (e.g., time horizon).

The Portfolio Manager Selection and Evaluation Process

11. In general, during the time period 2012 through early 2013, a material change in any product on the Platforms—such as replacing the product's portfolio manager—would result in Due Diligence conducting an in-depth review of the product. If, through the due diligence process, Due Diligence analysts concluded that the product should be terminated from the Platforms and clients invested in the product should be offered alternatives, the analysts would prepare a termination recommendation and supporting documentation, including analysis underpinning the recommendation and proposed alternatives, for approval through a Due Diligence governance process. If the committees in that process approved of the termination recommendation, it would move forward to the Governance Committee, which was comprised of executives from several areas of Merrill, including Due Diligence. The Governance Committee was ultimately responsible for deciding whether the Products should be terminated from the Platforms and whether clients invested in the Products should be offered alternatives. Generally, a Merrill employee would notify the third party manager after the termination decision had been made by the Governance Committee. However, no written policy or procedure governed this process.

12. The Governance Committee Charter in effect in January 2013 stated that the Governance Committee "is responsible for the evaluation, review, approval, supervision and oversight of all Products, platforms and/or services managed or maintained by [the investment advisory business], including the Third party and FA-Directed programs… offered to Merrill Lynch [] or other clients." But the only guidance the Governance Committee Charter provides to the Committee "[i]n addressing its purpose" is that it "shall take into account credit, market, compliance, operational, fiduciary and reputational risks, if applicable." No other Governance Committee policy or procedure advised the Governance Committee to consider the evaluation factors disclosed to clients in the Brochure or Evaluation Brochure.

The Due Diligence Process for the Products

13. In the spring of 2012, the U.S. Subsidiary notified Due Diligence that it was replacing the long-time portfolio manager for the Products and moving portfolio management responsibilities from a single manager to a team based in a different location along with its other

related operations (the "New Team"), and that the transition to the New Team would take place over the course of several months to a year. This impending material change to the Products' management led Due Diligence to place the Products on "hold," meaning no new accounts could invest in the Products though current accounts could continue to do so. As was customary with a portfolio management change, Due Diligence also undertook an in-depth evaluation of the Products and the New Team's ability to manage them. This review commenced in or about May 2012 and included three meetings with various representatives from the U.S. Subsidiary: an in-person meeting in May 2012 in the location of the outgoing portfolio manager attended by the outgoing portfolio manager; an in-person meeting in July 2012 in the same location attended by the outgoing portfolio manager and the New Team; and a conference call with the New Team in October 2012. Prior to making its termination recommendation, Due Diligence did not conduct an on-site visit to the New Team's location.

14. In December 2012, the Due Diligence analysts concluded that the Products should be terminated and replaced by other products on the platform. The analysts prepared supporting documentation and provided it to the Due Diligence governance committees. Key considerations in this recommendation were that the long-standing portfolio manager was leaving and the New Team lacked comparable experience in selecting bonds for similarly concentrated portfolios. In this regard, the New Team had previously been responsible for institutional accounts with a minimum of $100 million invested in diversified portfolios of approximately 150 bonds whereas the Products were historically held in retail accounts with a minimum of $100,000 invested in portfolios of 20-25 bonds specifically selected by the prior portfolio manager.

15. The Due Diligence committees approved the termination recommendation in late December 2012. The recommendation was scheduled to be heard at the next meeting of the Governance Committee on January 16, 2013. Prior to this time, the Governance Committee had voted on and approved all termination recommendations presented to it by Due Diligence. By early January 2013, financial advisors were raising issues about an increase in the number of terminations in the past year as compared with prior years and this was known to members of the Governance Committee and other senior executives.

16. After this recommendation was scheduled on the Governance Committee's agenda, an employee responsible for operational aspects of the Platforms ("Employee A") notified the U.S. Subsidiary about the termination recommendation. Employee A did so because Employee A assumed the Governance Committee would approve the termination recommendation and there were operational and timing issues related to removing the Products from a third-party managed diversified portfolio on Merrill's platform a few days after the Governance Committee meeting. Merrill typically did not notify managers of Due Diligence recommendations regarding their products in advance of Governance Committee decisions.

<u>The U.S. Subsidiary's "Plan of Action" and the Governance Committee's Meeting</u>

17. Upon learning of the termination recommendation, the U.S. Subsidiary immediately put into place a so-called "plan of action" to prevent the termination by, among other measures, having executives at various levels at the U.S. Subsidiary contact Merrill. Accordingly, U.S. Subsidiary Officer A scheduled a call with the Senior Executive. A Senior

Relationship Manager at GBAM ("GBAM Relationship Manager"), responsible for being the point of contact to the U.S. Subsidiary for all of its business relationships with BoA, learned of the scheduled call and emailed the Senior Executive to speak beforehand.

18. The Senior Executive was aware that the U.S. Subsidiary and various of its affiliates were large clients of BoA. Within the preceding six months, the Senior Executive had participated in a relationship-building meeting with a senior officer of the U.S. Subsidiary, who was Officer A's boss, and the Head of BoA's Global Financial Institutions Group, who was one of the "deal captains" for the GBAM team seeking an active bookrunner role in a registered offering associated with the U.S. Subsidiary (the "Offering").

19. On the morning of January 10, U.S. Subsidiary Officer A had a telephone conversation with the Senior Executive. According to an internal U.S. Subsidiary email from Officer A regarding the call, Officer A "stress[ed] the size and importance of the relationship, the thoughtful near year transition plan, the quality of the [New Team] and extensive resourcing which drove [the transition] decision, and [their] commitment to the space." Officer A also discussed their respect for "the importance and autonomy" of due diligence teams but said that they were "disappointed" that they had not had the opportunity "for a more thorough vetting and onsite [due diligence] and so were surprised to hear that [they] were going to be terminated." According to Officer A, the Senior Executive "was very attentive, stressed the importance of the partnership and committed to look into the issue" and committed to making sure that two of the Senior Executive's reports, members of the Governance Committee, were personally involved: ("Senior Manager A" and "Senior Manager B").

20. Shortly after the call, the Senior Executive spoke by phone to Senior Manager B, who was also a senior member of Due Diligence. According to Senior Manager B, the Senior Executive expressed concern that there had been a rush to judgment on the part of Due Diligence, a lack of on-site due diligence with the New Team, and that Due Diligence's efforts did not show the firm in good light with regard to other commercial opportunities.

21. After their call, Senior Manager B emailed the Senior Executive, with a copy to Senior Manager A, of what Senior Manager B understood to be the reasons for the termination recommendation and asserted that it would be the Governance Committee's decision whether to keep the Products on hold.

22. Later, during the evening of January 10, the Senior Executive left a voicemail for U.S. Subsidiary Officer A. According to an internal U.S. Subsidiary email from Officer A describing the message, the Senior Executive "indicated that a series of conversations took place internally at [Merrill] and [Merrill] decided that they will keep [the Products] 'on hold' for a period of time to give [the U.S. Subsidiary] an opportunity for additional dialogue and to fully make the case for what [the U.S. Subsidiary was] doing strategically" and Officer A would hear back from Senior Managers A and B on next steps.

23. On January 14, 2013, after asking the GBAM Relationship Manager to facilitate an in-person meeting with Due Diligence, another officer at the U.S. Subsidiary ("Officer B") spoke by phone with a Due Diligence employee who was also a member of the Governance Committee ("Due Diligence Employee"). Unaware that the U.S. Subsidiary had been told by the

Senior Executive that the Products would remain on hold, the Due Diligence Employee informed Officer B that Merrill was proceeding, as planned, to terminate the Products because of the "'highly uncertain' transitions of accounts at [the U.S. Subsidiary]" and "the concern[] that the transition to the broader platform put the clients at risk," to which Officer B "expressed disappointment with [the Due Diligence's] decision but understood [their] position" and said that the U.S. Subsidiary "wished [Due Diligence] would have done an on [site] due diligence, that [the U.S. Subsidiary] had put a thoughtful transition in place, [and] had dedicated [portfolio manager] resources for [the Products] but were leveraging the benefit of broad resources". The Due Diligence Employee agreed to continue tracking the Products and left the door open for a future meeting where the U.S. Subsidiary could "win them back."

24. The next day, January 15, 2013, U.S. Subsidiary Officer A reached out to the Senior Executive by voicemail and email about "recent developments." The Senior Executive then emailed Senior Managers A and B, informing them that Officer A had just reached out, and asking if there been "new developments on this front, subsequent to last week's decision to defer [the Governance Committee's] consideration of the termination." Senior Manager B responded: "The analyst team remains in ongoing dialogue with all major managers and could certainly spend more time observing the new process if the [Governance Committee] decides to keep the strategy 'on hold.'" That afternoon, according to an internal U.S. Subsidiary email from Officer A, Senior Manager B called Officer A and stated that there would be additional due diligence on the Products, *i.e.*, the Products would not be terminated, despite the fact that the Governance Committee had not rendered a decision. Later that day, an executive at the U.S. Subsidiary sent an email to Employee A, who managed the Governance Committee agenda, that said, "It was recently communicated to us that the proposal to terminate will not be part of tomorrow's Governance Committee agenda and [the U.S. Subsidiary] will be afforded an extension of time to further and fully demonstrate our commitment and capabilities in the SMA space…. As it stands now, this news is so new that it may be filtering through your organization, down to the key players in Due Diligence [and other areas, including the product group] but I wanted to inform you directly."

25. The Due Diligence Employee received this email on the morning of January 16 and forwarded the email to another Merrill executive, stating, "Here is a first. An external manager telling an internal product staffer what can go on an internal governance agenda" to which the recipient responded, "[A]stonishing."

26. Employee A asked if Senior Manager A was "aware of any agreement to delay discussing [the termination recommendation] at today's [Governance Committee]." Senior Manager A stated, "[Senior Executive] and [Senior Manager B] spoke to [U.S. Subsidiary Officer A] and that was communicated and I am in support…." However, after first considering removing the matter from the agenda of the Governance Committee meeting, an internal email stated that the termination recommendation would remain on the agenda to "capture our decision to postpone."

27. On January 16, 2013, at the Governance Committee meeting—in a break from ordinary practices—the Due Diligence analyst's presentation was cut short. In yet a further deviation from practices, no vote was taken. The full Governance Committee was not informed of the communications with the U.S. Subsidiary. According to the meeting minutes, the

Governance Committee "discussed the proposed terminations, and elected to defer the proposed terminations, pending further reviews by [Due Diligence] of the [New Team's] performance, including the implementation (if appropriate) in the near term of certain analytical 'quant screens.'"

Post Meeting Events and Product Fees

28. In late February 2013, GBAM learned that it was awarded a non-active bookrunner role in the Offering. GBAM had pitched to be an active bookrunner. The active bookrunners received a significantly greater allocation than the non-active bookrunners.

29. On March 5, 2013, two days prior to a previously scheduled meeting, U.S. Subsidiary Officer A spoke to the Senior Executive by phone. According to an internal U.S. Subsidiary email from Officer A, the two discussed the agenda for the meeting. Officer A also mentioned the decision on the Offering and told the Senior Executive that it was not what the U.S. Subsidiary had hoped for and the U.S. Subsidiary had "advocated strongly" for Merrill to get the active bookrunner role, but it was not the U.S. Subsidiary's decision. Officer A reminded the Senior Executive of Merrill's role in their other offerings and as a trading partner, and said that the U.S. Subsidiary "would advocate for [them] strongly" on follow on offerings that the U.S. Subsidiary "hoped [to] have more ability to influence." Officer A noted that the Senior Executive "was not aware of this yet but took it in stride." Officer A also thanked the Senior Executive "for the on-site [due diligence] opportunity."

30. Due Diligence conducted the requested on-site due diligence and in-person visit to the New Team's office later that month. The visit did not cause Due Diligence to change the "hold" status on the Products.

31. The Products were kept on hold until December 2013. By that time, the New Team had demonstrated to the satisfaction of Due Diligence that it had successfully managed the Products. During 2013, the Products performed similar to, and in some cases, better than the replacement products that Due Diligence had proposed. On December 13, 2013, Due Diligence recommended removing the Products from hold.

32. On December 17, 2013, the Governance Committee approved removing the Products from hold and reinstated the Products to the Platforms as open to new accounts. From January 2013 through December 2013, Merrill earned approximately $4.03 million in fees from the Platforms' investment advisory clients based on the value of their investments in the Products.

C. <u>Remedial Actions</u>

33. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

D. Violations

34. As a result of the conduct described above, Merrill willfully[1] violated Section 206(2) of the Advisers Act which prohibits an investment adviser from, directly or indirectly, engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

35. As a result of the conduct described above, Merrill willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder.

IV.

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

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

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall, within 14 days of the entry of this Order, pay disgorgement of $4,032,871.89 and prejudgment interest of $806,981.03 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). Respondent shall within 14 days of the entry of this Order, pay a civil money penalty in the amount of $4,032,871.89 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 SEC Rule of Practice 600 and/or 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

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[1] 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)).

(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, Pierce, Fenner & Smith Incorporated 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 Steven G. Rawlings, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281.

By the Commission.

Brent J. Fields
Secretary