

BATS EXCHANGE, INC.
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 201/0277299

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

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

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

Pursuant to Rule 8.3 of the Rules of BATS Exchange, Inc. ("BATS" or the "Exchange"), Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Pierce") and Merrill Lynch Professional Clearing Corp. ("Merrill Pro") (collectively, the "Firms") submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, BATS will not bring any future actions against the Firms alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The Firms hereby accept and consent, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of BATS, or to which BATS is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by BATS:

BACKGROUND

1. Merrill Pro and Merrill Pierce became members of BATS in August 2008 and were approved as Options Members in February 2010, when BATS commenced options trading.

SUMMARY

2. On behalf of BATS, the staff of FINRA's Market Regulation Department (the "staff") conducted a review of Merrill Pierce's and Merrill Pro's order entry activities in their capacity as Options Members during the period February 2010 through 2014 (the "review period") for compliance with BATS rules and policies governing the use of origin codes.
3. Applicable BATS rules and policies require that when accepting an order, an Options Member must obtain and record an appropriate account type or origin code in each order record and as an order detail when entering orders into the Exchange's systems to indicate the kind of account for which the order will be executed and cleared. Each options market has its own origin codes, but at a minimum, all have codes to indicate that an order is being executed for a customer, a firm, or a market maker. Similarly, when transactions clear at The Options Clearing Corporation ("OCC"), they clear in the "Customer," "Firm," or "Market Maker" range (i.e., in the clearing member's customer account, firm account, or market maker account at OCC). Origin codes are important because, among other things, they affect the accuracy of the Options Member's order records and the Exchange's audit trail. In addition, origin codes must be accurate as part of ensuring that trades are reported to OCC with accurate trade details.
4. During the review period, Merrill Pierce and Merrill Pro violated certain BATS rules and federal securities laws when entering and executing certain orders on behalf of their broker-dealer clients. The Firms improperly marked numerous options orders with incorrect origin codes and sent those orders to BATS through various order entry systems employed by the Firms to send options orders, resulting in the following: (i) an inaccurate audit trail and inaccurate order records; (ii) trades being reported to OCC with inaccurate trade details; and (iii) an adverse impact to the Exchange's ability to surveil for and detect potential violations of its rules and of federal securities laws. Additionally, the staff concluded that the Respondents had supervisory deficiencies related to these matters, which are outlined in detail herein.

RELEVANT PRIOR DISCIPLINARY HISTORY

5. Merrill Pierce and Merrill Pro have no prior relevant disciplinary history.

FACTS AND VIOLATIVE CONDUCT

6. Pursuant to BATS Rule 20.7, Audit Trail, an Options Member must submit certain order information in a form prescribed by BATS.
7. From February 2010 through 2014, Merrill Pierce executed numerous transactions with incorrect origin codes across multiple markets, including BATS. Merrill Pierce's

execution of orders with incorrect origin codes resulted from certain accounts having been on-boarded¹ with incorrect origin codes in their account profiles (e.g., an account that should have been coded as “Firm” was coded as “Customer,” and some orders entered for that account were entered incorrectly with the “Customer” origin code); limitations in its order management system that failed to include all potential origin code designations or defaulted to an improper origin code at various points during the review period; and from errors made by Merrill Pierce employees when placing origin codes on orders at the point of order acceptance, entry, or execution.

8. From February 2010 until July 2011, when Merrill Pro ceased accepting orders for execution, Merrill Pro executed numerous transactions with incorrect origin codes across multiple markets, including BATS. Merrill Pro used incorrect account origin codes to execute trades for certain accounts because it had placed the wrong origin code in the account profiles of those accounts at on-boarding.
9. Prior to trading options on BATS, the Firms lacked procedures for ensuring orders had been entered with correct origin codes, and for conducting reviews to detect that orders had been entered and executed with incorrect origin codes. As a result, they traded millions of contracts on other markets by executing orders with incorrect origin codes. The Firms only learned about misrepresented orders in isolation—for example, when reconciling positions on their books with positions at OCC on the day after a trade; when a client complained that an order had been executed with an incorrect origin code; or when an exercise had taken place incorrectly—and then addressed each instance in isolation and on an ad hoc basis. The Firms continued executing orders with incorrect origin codes once they began trading options on BATS.
10. In 2010, around the time Merrill Pierce began trading options on BATS, an employee in Merrill Pro’s Chicago office, who handled clearing for both Firms’ clients, grew concerned that in instances when Merrill Pierce had executed trades and requested origin code changes, making those changes at the exchanges and making post-trade adjustments at OCC could evidence regulatory violations or bring regulatory scrutiny. This employee had been responding to regulatory requests regarding Merrill Pro’s customers’ use of incorrect origin codes since 2007. Despite the employee’s concerns, neither Firm had taken measures to ensure that it executed orders with correct origin codes, or to detect instances in which it had executed orders with incorrect origin codes.
11. Although Merrill Pierce began taking steps in 2010 to address the execution of orders with incorrect origin codes, including conducting a review that led to the creation and implementation of exception reports to identify instances in which it had executed orders with incorrect origin codes, it still continued trading hundreds of thousands of contracts each year with incorrect origin codes through 2014.

¹ “On-boarding” refers to the process of setting up a client’s account in Merrill Pierce’s or Merrill Pro’s order management system.

12. Merrill Pro never addressed its ongoing deficiencies relating to its inaccurate use of origin codes before it stopped transmitting and executing orders altogether in July 2011.
13. Each instance in which Merrill Pierce or Merrill Pro executed an order with an incorrect origin code could have had adverse consequences, such as creating inaccurate order records, creating an inaccurate audit trail, reporting trades to OCC with inaccurate trade details, and adversely impacting the Exchange's ability to surveil for and detect potential violations of its rules and federal securities laws.
14. By marking orders with the wrong origin code, Merrill Pro and Merrill Pierce violated the following rules:
 - a. Section 17(a)(1) of the Securities Exchange Act of 1934 and SEC Rule 17a-3(a)(6)(i) thereunder requiring Options Members to create a memorandum of each order, and any other instruction, showing the terms and conditions of the order;
 - b. BATS Rule 18.1 requiring that Options Members refrain from engaging in conduct in violation of the Exchange Act and Rules thereunder, BATS Rules, and OCC Rules as they relate to reporting or clearing options transactions;
 - c. BATS Rule 18.2(a)(6) requiring an Options Member to ensure that accurate information is entered into the BATS system;
 - d. BATS Rule 20.7(b)(17) requiring that order records contain certain information; and
 - e. BATS Rule 24.1(a) requiring the creation of books and records as prescribed by BATS and by the Exchange Act and rules thereunder.

Supervision

15. BATS Rules 5.1, 18.1, and 20.1(b)(4) together require an Options Member to establish and enforce written procedures and controls, and to supervise associated persons to ensure compliance with applicable securities laws and BATS rules. Rule 5.2 and 18.2(a)(2) make an Options Member responsible for proper supervision. Rule 18.2 also requires, among other things, that an Options Member have adequate arrangements to ensure all personnel involved in its business are adequately trained and supervised.
16. Merrill Pierce and Merrill Pro each violated BATS Rules 5.1, 5.2, 18.1, 18.2(a), and 20.1(b)(4) by failing to have adequate supervisory systems and controls in place, including written supervisory procedures and separate systems of follow-up and review, that were reasonably designed to achieve compliance with BATS's origin code requirements.
17. Prior to October 2010, Merrill Pierce did not have any exception reports to identify

incorrect origin codes on orders and had no system whatsoever for conducting reviews to ensure correct origin codes were placed on orders. Instead, Merrill Pierce often learned it had used incorrect origin codes only when its clients informed it that trades had been executed with an incorrect origin code, or because problems arose when trades had cleared in the wrong range at OCC (e.g., clearing in the “Customer” range when they were supposed to have cleared in the “Firm” range). These instances resulted in discrepancies between Merrill Pierce’s positions on its own books and its positions on OCC’s books. Merrill Pierce would then make adjustments at OCC to move positions into the proper range. After that time, whenever a certain employee within Merrill Pro became concerned that making origin code adjustments could invite regulatory scrutiny or action, the employee informed others within the organization that adjustments would only be made if certain other employees approved them. Yet, the violations continued. Additionally, despite instituting an exception report and supervisory reviews in 2010, Merrill Pierce continued entering and executing orders with incorrect origin codes through 2014.

18. Merrill Pro never had a system for identifying incorrect origin codes on orders or conducting any reviews to ensure correct origin codes were placed on orders. Instead, as with Merrill Pierce, Merrill Pro learned that trades had been entered with incorrect origin codes as a result of discrepancies between its positions on its own books and its positions with OCC. In addition, through 2014, Merrill Pro never had a system of supervision to ensure that the trades for which it was the clearing firm cleared with the correct origin codes at OCC.
19. In summary, during the review period, the Firms failed to have supervisory systems and controls in place, including separate systems of follow-up and review, reasonably designed to achieve compliance with the Exchange’s origin code requirements in that the Respondents failed to do the following: (i) reasonably address origin code requirements in the development and programming of its order entry systems; (ii) maintain written supervisory procedures reasonably designed to achieve compliance with the Exchange’s rules relating to the assignment of origin codes; (iii) adequately train their employees with respect to the significance of properly marking origin codes in their order entry systems; and (iv) adequately supervise their employees with respect to the proper marking of origin codes.
20. The conduct described in Paragraphs I.A.16–19 constitutes violations of BATS Rules 5.1, 5.2, 18.1, 18.2(a), and 20.1(b)(4).

B. The Firms also consent to the imposition of the following sanctions:

1. A censure; and
2. A joint and several fine in the amount of \$9,000,000, of which \$200,000 shall be paid to BATS.²

² The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.4.

3. Merrill Pierce agrees to an undertaking pursuant to which at intervals of 90, 180, 270, and 360 days after acceptance of this AWC, Merrill Pierce shall make a written submission to BATS, in care of FINRA, regarding its compliance with BATS's rules and policies governing the inclusion of account origin codes in order and execution data. At a minimum, the written submission shall address and include the following:
 - a. an assessment of the degree to which Merrill Pierce has taken additional remedial steps to confirm that it is including accurate account origin codes in its order records and in electronic entries of order and transaction data in BATS's systems;
 - b. the adequacy of Merrill Pierce's policies, systems, procedures, and training relating to including accurate account origin codes in its order and execution audit trail data;
 - c. copies of all exception reports identifying instances in which inaccurate account origin codes were included in Merrill Pierce's order and execution audit trail data; and
 - d. an explanation of all remedial actions that Merrill Pierce had taken in response to instances appearing on the exception reports produced in response to Item B.3.c.
4. Merrill Pro agrees to an undertaking to revise its written supervisory procedures with respect to the areas described in Paragraph I.A.18. Within 30 business days of acceptance of this AWC, a registered principal of Merrill Pro shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a signed, dated letter, or an e-mail from a work-related account of the registered principal to MarketRegulationComp@finra.org, providing the following information: (1) a reference to this matter; (2) a representation that Merrill Pro has revised its written supervisory procedures to address the deficiencies described in Paragraph I.A.18; and (3) the date the revised procedures were implemented.
5. Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between Merrill Pierce and Merrill Pro collectively and individually with each of the following self-regulatory organizations: Chicago Board Options Exchange, Incorporated; International Securities Exchange, LLC; NASDAQ OMX BX, Inc.; NASDAQ OMX PHLX LLC; NASDAQ Options Market LLC; and NYSE Regulation, Inc. on behalf of NYSE Arca Inc. and NYSE MKT. The aggregate settlement amount across all markets is \$9,000,000.
6. The Firms agree to pay the monetary sanctions upon notice that this AWC has been accepted and that such payment is due and payable. They have submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

7. The Firms specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.
8. The sanctions imposed herein shall be effective on a date set by BATS.

II.

WAIVER OF PROCEDURAL RIGHTS

The Firms specifically and voluntarily waive the following rights granted under BATS Rules:

- A. to have a Statement of Charges issued specifying the allegations against the Firms;
- B. to be notified of the Statement of Charges and have the opportunity to answer the allegations in writing;
- C. to defend against the allegations in a disciplinary hearing before a Hearing Panel, to have a written record of the hearing made and to have a written decision issued; and
- D. to appeal any such decision to the Appeals Committee of BATS's Board of Directors and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firms specifically and voluntarily waive any right to claim bias or prejudgment of the Chief Regulatory Officer ("CRO"), in connection with her participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The Firms further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of BATS Rule 8.16, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

The Firms understand that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the CRO, pursuant to BATS Rule 8.3;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firms; and
- C. If accepted:
 - 1. This AWC will become part of the Firms' permanent disciplinary records and may be considered in any future actions brought by BATS or any other regulator against the Firms;
 - 2. This AWC will be published on a website maintained by BATS in accordance with BATS Rule 8.11, *Interpretations and Policies .01*. In addition, this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firms' disciplinary record; and
 - 3. The Firms may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firms may not take any position in any proceeding brought by or on behalf of BATS, or to which BATS is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firms': (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which BATS is not a party.

The Firms may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firms understand that they may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by BATS, nor does it reflect the views of BATS or its staff.

The undersigned, on behalf of the Firms, certify that persons duly authorized to act on their behalfs have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that they have agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Statement of Charges, has been made to induce the Firms to submit it.

May 11, 2015
Date

Merrill Lynch, Pierce, Fenner & Smith Incorporated
Respondent

By: J. David Montague

Name: J. David Montague

Title: Associate General Counsel + Senior VP

5-11-2015
Date

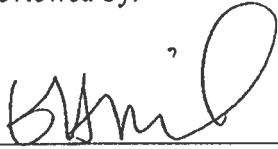
Merrill Lynch Professional Clearing Corp.
Respondent

By: Gary E. Yetman

Name: Gary E. Yetman
Managing Director

Title: _____

Reviewed by:



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

6/9/2015
Date


Tamara Schademann
Chief Regulatory Officer
BATS Exchange, Inc.

ELECTION OF PAYMENT FORM

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

- A firm check or bank check for the full amount; or
- Wire transfer.

Respectfully submitted,

May 11, 2015
Date

Respondent
Merrill Lynch, Pierce, Fenner & Smith
Incorporated

By: J. David Montague

Name: J. David Montague

Title: Associate General Counsel & Senior VP

Date

Respondent
Merrill Lynch Professional Clearing Corp.

By: Ray Eget

Name: _____

Title: _____