

NYSE ARCA, INC.

NYSE REGULATION,

Complainant,

v.

MERRILL LYNCH, PIERCE, FENNER &
SMITH INCORPORATED,

Respondent.

FINRA Proceeding No. 20140411279

September 26, 2018

Merrill Lynch, Pierce, Fenner & Smith Incorporated violated NYSE Arca Rules 11.18(a), (b), and (c), and 11.1(b), by failing to adequately supervise trading activity for potential cross-product manipulation or mini-manipulation and failing to adhere to principles of good business practice in the conduct of its affairs. Consent to censure, \$15,625 fine, and undertaking.

Appearances

For the Complainant: Elyse D. Kovar, Esq., Eric S. Brown, Esq., and Andrew Beirne, Esq.,
FINRA Department of Enforcement.

For the Respondent: Emily Gordy, Esq., McGuire Woods LLP.

DECISION

Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch” or “Firm”) and NYSE Arca, Inc. (“Exchange”) entered into an Offer of Settlement and Consent for the sole purpose of settling this disciplinary proceeding, without adjudication of any issues of law or fact, and without admitting or denying any allegations or findings referred to in the offer of settlement.¹ The Hearing Officer accepts the Offer of Settlement and Consent and issues this Decision in accordance with NYSE Arca Rules.²

¹ FINRA’s Office of Hearing Officers reviewed the Offer of Settlement and Consent under the terms of a Regulatory Services Agreement (as amended) among NYSE Group, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., NYSE American LLC, and FINRA.

² The facts, allegations, and conclusions contained in this Decision were taken from the executed Offer of Settlement and Consent.

FINDINGS OF FACTS AND VIOLATIONS

Background and Jurisdiction

1. Merrill Lynch became registered as an Options Trading Permit (“OTP”) Holder with NYSE Arca, Inc. on October 27, 1958, and its registration remains in effect. The Firm has no relevant disciplinary history.
2. On behalf of the Exchange, the Department of Market Regulation’s Options Regulation staff (“Staff”) of the Financial Industry Regulatory Authority (“FINRA”) conducted a review of potentially manipulative trading by the Firm in equities and the overlying options between January and March 2014. Staff also reviewed the reasonableness of the Firm’s supervisory systems and written supervisory procedures (“WSPs”) to detect and prevent potential cross-product manipulation or mini-manipulation between January 2014 and June 2017, later expanded to December 1, 2017 (the “Review Period”).
3. In a letter dated September 12, 2017, which Merrill Lynch received, FINRA notified the Firm that it was investigating the Firm’s compliance with its supervisory obligations regarding potential mini-manipulation.

Overview

4. As a result of Staff’s reviews, FINRA’s Department of Enforcement determined that, during the Review Period, the Firm had no supervisory systems or surveillances reasonably designed to ensure compliance with Exchange rules prohibiting manipulative cross-product trading or mini-manipulative activity. In addition, from January 2014 to the present, the Firm had no WSPs with respect to the detection and prevention of potential mini-manipulation.

Violations

5. NYSE Arca Rule 11.18(a) requires an OTP Firm to supervise associated persons with respect to compliance with federal securities laws and Exchange rules. NYSE Arca Rule 11.18(b) requires an OTP Firm to establish and maintain a supervisory system reasonably designed to ensure compliance with applicable federal securities laws and regulations and Exchange rules. NYSE Arca Rule 11.18(c) requires an OTP Firm to establish, maintain, and enforce written procedures to supervise its business and associated persons, which are reasonably designed to ensure compliance with applicable federal securities laws and regulations and Exchange rules.
6. NYSE Arca Rule 11.1(b) requires OTP Firms and all associated persons thereof to adhere to principles of good business practice in the conduct of its affairs.

7. Between January and March 2014, Merrill Lynch traders, trading on behalf of the Firm, on multiple occasions and trade dates, engaged in trading whereby they effected purchases or sales of equity securities in a Firm proprietary account, immediately followed by purchases or sales of options overlying those securities. These transactions were potentially inconsistent with just and equitable principles of trade, because they could have disrupted the market for the equity securities and the overlying equity options. Depending on the economic rationale of the Firm's traders for effecting the transactions, these transactions could have constituted manipulative cross-product trading or mini-manipulation trading activity.
8. Beginning in October 2014, Staff advised Merrill Lynch that it was reviewing potential mini-manipulation activity by Firm traders. In furtherance of its reviews, Staff sent additional correspondence to the Firm seeking information and updates regarding the Firm's surveillances and procedures to monitor for potential mini-manipulation.
9. Before and during the Review Period, notices were made available to the securities industry through public settlements involving mini-manipulation, industry conferences that addressed mini-manipulation, and FINRA Priorities Letters in 2012 and 2013, which highlighted mini-manipulation as an area of FINRA's focus. Despite the foregoing and the multiple letters Staff sent to Merrill Lynch, during the Review Period the Firm had no supervisory systems or surveillances reasonably designed to ensure compliance with Exchange rules prohibiting manipulative cross-product trading or mini-manipulation activity. In addition, from January 2014 to the present, the Firm had no WSPs with respect to the detection and prevention of potential mini-manipulation.
10. Accordingly, Merrill Lynch violated NYSE Arca Rules 11.18(a), (b) and (c), and 11.1(b).

ORDER

Merrill Lynch, Pierce, Fenner & Smith Incorporated violated NYSE Arca Rules 11.18(a), (b) and (c), and 11.1(b), by failing to adequately supervise trading activity for potential cross-product manipulation or mini-manipulation and failing to adhere to principles of good business practice in the conduct of its affairs.

SANCTIONS

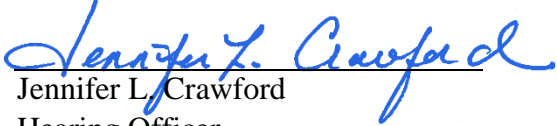
Merrill Lynch, Pierce, Fenner & Smith Incorporated is censured and fined \$15,625.³

Merrill Lynch shall undertake to revise the Firm's WSPs with respect to mini-manipulation. Within 30 business days of the date of this Decision, a registered principal of the Firm shall

³ Pursuant to separate settlement agreements, Merrill Lynch agreed to a total fine of \$125,000, of which \$15,625 shall be paid to NYSE Arca Inc, and the remaining amount paid to: (i) BOX Options Exchange LLC; (ii) The NASDAQ Options Market LLC; (iii) Nasdaq GEMX, LLC; (iv) Nasdaq PHLX LLC; (v) Miami International Securities Exchange, LLC; (vi) Nasdaq ISE LLC; and (vii) NYSE American LLC.

submit to the Compliance Assistant, Department of Enforcement, 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: (i) a reference to this matter; (ii) a representation that the Firm has revised its WSPs to address the deficiencies described in paragraph 9; and (iii) the date the revised procedures were implemented.

These sanctions are effective immediately.


Jennifer L. Crawford
Hearing Officer