

III.

The Commission finds the following:

A. SUMMARY

On November 17 and 18, 2010, certain traders on the U.S. Dollar interest rate swaps and block futures trading desk (the “Swaps Desk”) of Bank of America, N.A. (“BANA”) made misleading statements to members of CME Group Inc.’s (“CME Group”) Market Regulation Department (“CME Market Regulation Staff”) in interviews conducted as part of an investigation into BANA’s and Merrill Lynch’s recordkeeping and execution practices with respect to block trades (“CME Investigation”).² Specifically, CME Market Regulation Staff asked these traders during their interviews whether traders on the Swaps Desk ever traded ahead of block trades by trading futures contracts on exchange after receiving an inquiry from a counterparty for a block trade in the same futures contract but before executing the block trade. In response, these traders failed to acknowledge engaging in this conduct and provided misleading answers.

In connection with the CME Investigation, Merrill Lynch failed to supervise its employees and agents in two respects. First, from at least January 2010 through December 2010, Merrill Lynch failed to supervise diligently its responses to the CME Investigation. Second, from at least January 2010 through October 2010, Merrill Lynch had in place inadequate procedures to ensure that records of block trades executed by the Swaps Desk, including records of block trade execution times, were prepared accurately and maintained in accordance with Regulations 1.31 and 1.35. In addition, from at least January 2010 through June 2012, Merrill Lynch failed to maintain records in accordance with Regulations 1.31 and 1.35 regarding certain block trades executed by the Swaps Desk. Merrill Lynch’s conduct contributed to its failure to detect trading ahead of block trades by traders on the Swaps Desk before certain traders had the opportunity to mislead CME Market Regulation Staff.

B. RESPONDENT

Merrill, Lynch, Pierce, Fenner & Smith Incorporated is a registered Futures Commission Merchant headquartered in New York and a member of the CME Group exchanges, including the Chicago Board of Trade (“CBOT”) and the Chicago Mercantile Exchange, Inc. (“CME Inc.”). Merrill Lynch is a subsidiary of Bank of America Corporation and an affiliate of BANA.

C. FACTS

In 2009 and 2010, CME Market Regulation Staff investigated certain block trades executed by the Swaps Desk and cleared through the Swaps Desk’s account at Merrill Lynch. On eight occasions between February 2008 and December 2010, CME Market Regulation requested trading records relating to a total of 30 block trades. As part of this investigation,

² The block trades at issue in this Order are block futures trades involving U.S. Treasury Note and Treasury Bond Futures (collectively, “Treasury Futures”), traded on the Chicago Board of Trade; Swap Futures, traded on the Chicago Board of Trade; and Eurodollar Futures, traded on the Chicago Mercantile Exchange, Inc.

CME Market Regulation Staff interviewed certain traders on the Swaps Desk responsible for executing these block trades on behalf of BANA. CME Market Regulation Staff interviewed these traders on November 17 and 18, 2010.

During these interviews, CME Market Regulation Staff presented to each trader data reflecting electronic trading by the Swaps Desk on Globex, CME Group's electronic trading platform, in the minutes before the reported execution time of block trades in the same futures contract also executed by the Swaps Desk. CME Market Regulation Staff asked each trader whether this data reflected trading ahead of the block trade.³ The traders answered that the electronic trades could have been unrelated to the block trades, or, if the trades were related, the electronic trades likely occurred after execution of the block trade and the reported execution time of the block trades was likely inaccurate.⁴ Moreover, the traders claimed that the time between receiving a customer's block trade inquiry and executing the block trade with the customer was so brief that it was impossible for the traders to trade ahead of a counterparty's block trade.

These statements were misleading. For certain block trades with certain counterparties executed before November 17, 2010, certain traders on the Swaps Desk did in fact trade futures contracts electronically on Globex after receiving a block trade inquiry from a counterparty for that same futures contract but before executing the block trade. As such, it was possible, using the Swaps Desk's electronic trading system, for traders to execute futures trades on Globex between the time the Swaps Desk learned of the counterparty's block trade inquiry and the time it executed the block trade. Furthermore, at times certain traders on the Swaps Desk lengthened the amount of time they had to trade ahead by listening in, without announcing their presence, to calls between certain counterparties and the sales staff responsible for handling the counterparty's trade inquiry.

Merrill Lynch engaged external counsel to represent it in connection with the CME interviews no later than November 4, 2010. On December 6, 2010, following these interviews and in reliance on the traders' representations, external counsel sent a letter to CME Market Regulation Staff. The letter stated, among other things, that the traders "did not have advance knowledge of a block trade such as to enable them to engage in any trading prior to the execution of the block."

³ As of November 2009, BANA and Merrill Lynch policy prohibited traders from trading a futures contract on exchange after receiving a block trade inquiry from a counterparty for that same futures contract but before executing the block trade.

⁴ CME Group's rules now require counterparties to report the details of block trades, including the execution time, to the exchange within five minutes of its execution.

1. Merrill Lynch Failed To Supervise

a. Merrill Lynch Failed to Supervise Properly the Handling of the Response to the CME Investigation

During the CME Investigation, Merrill Lynch's compliance department and legal department were responsible for responding to CME Market Regulation Staff's inquiries regarding block trades executed by the Swaps Desk. Over the course of the CME Investigation, Merrill Lynch's compliance and legal staff relied on the business operations support group (the "Support Group") at BANA to gather information for Merrill Lynch's responses to these inquiries. The Support Group was under the supervision of BANA's Global Rates and Currencies division and not the compliance or legal department of either BANA or Merrill Lynch. Its primary responsibility was to provide support for operational and technical issues affecting BANA's trading activity for various trading desks, including the Swaps Desk.

Merrill Lynch's compliance and legal staff exercised minimal oversight over the work of the Support Group in connection with the CME Investigation. For example, compliance staff asked members of the business operations support group to gather data and prepare an analysis of the Swap Desk's electronic futures trading activity in the five minutes before the reported execution time of certain block trades identified by CME Market Regulation Staff. The data analysis prepared by the Support Group showed that on a number of occasions certain Swaps Desk traders traded substantial volumes of futures contracts on Globex in the five minute window before the recorded execution time of a block trade in that same futures contract. However, the Support Group kept this analysis from Merrill Lynch's compliance and legal departments. Instead, a member of the Support Group gave Merrill Lynch compliance and legal staff an abridged version that omitted the trading analysis and only summarized the various recordkeeping problems associated with each block trade. As a result, Merrill Lynch compliance and legal staff never saw any internal evidence of possible trading ahead before responding to the CME Investigation and before the traders' November 2010 interviews.

In addition, Merrill Lynch's compliance and legal staff relied on the Support Group to communicate with the traders. Merrill Lynch's compliance and legal staff never conducted their own interviews of any traders on the Swaps Desk or any of the Merrill Lynch sales staff who were responsible for receiving block trade inquiries from potential counterparties and documenting and reporting executed block trades. The Support Group members spoke only with the Swaps Desk traders responsible for the block trades that CME Market Regulation Staff were investigating (and later interviewed) and never shared the results of these discussions with Merrill Lynch compliance and legal staff.

Merrill Lynch's reliance on the Support Group and failure to stay adequately informed regarding that group's work during the CME Investigation contributed to Merrill Lynch's failure to detect trading ahead of block trades by certain traders on the Swaps Desk before certain traders misled CME Market Regulation Staff during their interviews on November 17 and 18, 2010.

b. Merrill Lynch's Procedures for Preparing and Maintaining Records of Block Trades Were Inadequate and Inconsistently Implemented

From at least January 2010 until October 2010, Merrill Lynch had inadequate procedures for preparing records of block trades and for maintaining those records in accordance with Regulations 1.31 and 1.35. First, these procedures did not clearly specify who was responsible for preparing a record of an executed block trade and for reporting the block trade to the relevant exchange. Second, these procedures lacked clear guidelines as to how employees were to record accurately the execution time of the block trade. Third, these procedures did not specify the manner in which records of block trades, including trade execution times, should be prepared and maintained. Fourth, Merrill Lynch provided inadequate training regarding exchange reporting requirements for block trades and how records of block trades, including block trade execution times, were to be prepared and maintained.

In addition, the procedures in place before October 2010 were inconsistently implemented. For example, sales staff relied on mechanical clocks to timestamp paper trade tickets with block trade execution times. These clocks were often inaccurate or malfunctioned, resulting in trade tickets with inaccurate execution times, illegible execution times, or execution times that were missing entirely. Sales staff maintained timestamped paper trade tickets in hard copy form only, often in desk drawers, and a number of paper trade tickets could not be located during Merrill Lynch's response to the CME Investigation. In other instances, Merrill Lynch staff prepared a paper trade ticket for the block trade, but failed to record an execution time on the trade ticket.⁵

As a result of these deficiencies, Merrill Lynch could not provide CME Market Regulation Staff with records containing accurate block trade execution times during the CME Investigation. In addition, the traders interviewed by CME Market Regulation Staff pointed to these sometimes inaccurate and unreliable records of block trade execution times as the explanation for trading data that appeared to reflect trading ahead of block trades with certain counterparties.

2. Merrill Lynch Failed To Prepare And Maintain Records

From at least January 2010 until June 2012 and for certain block trades during this time period, Merrill Lynch failed to prepare and/or maintain the trade ticket and other records on which its employees were to record and save information regarding an executed block trade, including the execution time. For other block trades during this time period, the trade tickets and other records Merrill Lynch did prepare and maintain contained inaccurate, illegible, or missing or incomplete information regarding the block trade, including execution time information.

⁵ In October 2010, Merrill Lynch revised its procedures to clarify, among other things, that it was the responsibility of sales staff to prepare a record of the block trade, including the execution time, and report that trade to the relevant exchange. These revised procedures further specified that sales staff were responsible for electronically scanning all paper trade tickets for storage in a central repository. In addition, Merrill Lynch provided training to its sales staff on these revised procedures. Under these revised procedures, Merrill Lynch sales staff still relied on mechanical clocks and paper trade tickets to record block trade execution times.

IV.

LEGAL DISCUSSION

A. Regulation 166.3—Failure To Supervise

Regulation 166.3 states:

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

A violation under Regulation 166.3 is an independent violation for which no underlying violation is necessary. *See In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744 (CFTC Dec. 10, 1997).

A violation of Regulation 166.3 is demonstrated by showing either that: (1) the registrant's supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently. *In re Murlas Commodities*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485 at 43,161 (CFTC Sept. 1, 1995); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 (CFTC Aug. 11, 1992) (providing that, even if an adequate supervisory system is in place, Regulation 166.3 can still be violated if the supervisory system is not diligently administered); *Sansom Refining Co. v. Drexel Burnham Lambert, Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,596 at 36,566 (CFTC Feb. 16, 1990) (noting that, under Regulation 166.3, an FCM has a "duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents") (internal quotation omitted). Evidence of violations that "should be detected by a diligent system of supervision, either because of the nature of the violations or because the violations have occurred repeatedly" is probative of a failure to supervise. *In re Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,850 (CFTC April 1, 1992).

From January 2010 through December 2010, Merrill Lynch violated Regulation 166.3 because it failed to supervise diligently Merrill Lynch's response to the CME Investigation. Specifically, although Merrill Lynch's compliance and legal departments were responsible for Merrill Lynch's response to the CME Investigation, Merrill Lynch relied on the Support Group to gather information, analyze trading data, and communicate with the Swaps Desk traders in connection with Merrill Lynch's response to the CME Investigation. Merrill Lynch exercised minimal oversight over the Support Group over the course of the CME Investigation and failed to stay adequately informed of that group's findings. Merrill Lynch's reliance on the Support Group contributed to its failure to detect trading ahead of block trades by the traders on the Swaps Desk before the traders had the opportunity to mislead CME Market Regulation Staff in their November 2010 interviews.

Merrill Lynch also violated Regulation 166.3 with regard to its recordkeeping obligations. Specifically, from at least January 2010 until October 2010 Merrill Lynch had inadequate procedures for preparing and maintaining records for block trades executed by the Swaps Desk, including procedures for recording accurate block trade execution times. In addition, Merrill Lynch was not diligent in ensuring that its existing procedures for preparing and maintaining records for block trades were being implemented. These failures resulted in records of block trades executed by the Swaps Desk that were either incomplete or in some cases missing entirely, including records that had inaccurate, illegible, or missing recorded block trade execution times.

B. Section 4g and Regulations 1.31 and 1.35—Recordkeeping

Section 4g of the Act requires FCMs, among other registrants, to maintain books and records pertaining to certain “transactions and positions in such form and manner and for such period as may be required by the Commission.” Regulations 1.31 and 1.35 further elaborate that FCMs, among other registrants, must maintain certain required books and records (including trade tickets), for a period of five years and must

[k]eep full, complete, and systematic records . . . of all transactions relating to its business of dealing commodity interests . . . which shall include all orders (filled, unfilled, or canceled), trading cards, . . . journals, ledgers, . . . copies of confirmations . . . and all other records, which have been prepared in the course of its business of dealing in commodity interests

Regulations 1.31 and 1.35. A violation of these record-keeping regulations does not require scienter. *In re GNP Commodities*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,214 (CFTC Aug. 11, 1992); *see also In re Buckwalter*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,995 at 37,687 (CFTC Jan. 25, 1991); *In re DiPlacido*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,866 at 56,590 (CFTC Sept. 14, 2004).

Merrill Lynch violated Section 4g and Regulations 1.31 and 1.35 from, at least, January 2010 until June 2012 for certain block trades by failing to prepare and/or maintain the trade ticket or other records on which its employees were to record and save information regarding an executed block trade, including the execution time for the block trade, as well as by preparing records of block trades that contained inaccurate, illegible, or missing or incomplete information, including execution time information.

V.

FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that Merrill Lynch violated Section 4g of the Act, 7 U.S.C. § 4g (2012), and Regulations 1.31, 1.35, and 166.3, 17 C.F.R. §§ 1.31, 1.35, & 166.3 (2016).

VI.

OFFER OF SETTLEMENT

Merrill Lynch has submitted an Offer in which it, without admitting or denying the findings and conclusions herein:

- A. Acknowledges receipt of service of this Order;
- B. Admits the jurisdiction of the Commission to all the matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on a violation of or enforcement of this Order;
- C. Waives:
 - 1. the filing and service of a complaint and notice of hearing;
 - 2. a hearing;
 - 3. all post-hearing procedures;
 - 4. judicial review by any court;
 - 5. any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer;
 - 6. any and all claims that it may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2012) and 28 U.S.C. § 2412 (2012), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Regulations, 17 C.F.R. §§ 148.1-30 (2016), relating to, or arising from, this proceeding;
 - 7. any and all claims that it may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-253, 110 Stat. 847, 857-68 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and,
 - 8. any claims of Double Jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;
- D. Stipulates that the record basis on which this Order is entered shall consist solely of the findings contained in this Order to which Respondent has consented in the Offer; and,
- E. Consents, solely on the basis of the Offer, to the Commission's entry of this Order that:
 - 1. makes findings by the Commission that Merrill Lynch violated Section 4g of the Act and Regulations 1.31, 1.35, and 166.3;

2. orders Merrill Lynch to cease and desist from violating Section 4g of the Act and Regulations 1.31, 1.35, and 166.3;
3. orders Merrill Lynch to pay a civil monetary penalty in the amount of two million five hundred thousand dollars (\$2,500,000) (“CMP Obligation”), plus post-judgment interest. If the CMP Obligation is not paid in full within ten days of the date of entry of the Order, then post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of the Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of the Order pursuant to 28 U.S.C. § 1961 (2012); and,
4. orders Merrill Lynch and its successors and assigns to comply with the conditions, undertakings, and representations consented to in the Offer and set forth in Part VII of this Order.

Upon consideration, the Commission has determined to accept the Offer.

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

- A. Merrill Lynch shall cease and desist from violating Section 4g of the Act and Regulations 1.31, 1.35, and 166.3.
- B. Civil Monetary Penalty
 1. Merrill Lynch shall pay a civil monetary penalty in the amount of two million five hundred thousand dollars (\$2,500,000). If the CMP Obligation is not paid in full within ten days of the date of entry of the Order, then post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of the Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of the Order pursuant to 28 U.S.C. § 1961 (2012).
 2. Respondent shall pay the CMP Obligation by electronic funds transfer, U.S. postal money order, certified check, bank cashier’s check, or bank money order. If payment is to be made other than by electronic funds transfer, Respondent shall make the payment payable to the Commodity Futures Trading Commission, and sent to the address below:

Commodity Futures Trading Commission
Division of Enforcement
ATTN: Accounts Receivables
DOT/FAA/MMAC/AMZ-341
CFTC/CPSC/SEC
6500 S. MacArthur Blvd.

Oklahoma City, OK 73169
(405) 954-7262 office
(405) 954-1620 fax
nikki.gibson@faa.gov

If payment is to be made by electronic transfer, Respondent shall contact Nikki Gibson or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent shall accompany payment of the CMP Obligation with a cover letter that identifies Respondent and the name and docket number of this proceeding. Respondent shall simultaneously transmit copies of the cover letter and the form of payment to the Chief Financial Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

- C. Merrill Lynch shall comply with the following conditions and undertakings set forth in the Offer:
1. Public Statements: Merrill Lynch agrees that neither it nor any of its successors, assigns, agents or employees under its authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order, or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect Respondent's (i) testimonial obligations or (ii) right to take legal positions in other proceedings to which the Commission is not a party.
 2. Procedures and Controls Regarding Block Futures Trades:
 - a. Within ninety (90) days of the entry of this Order, Merrill Lynch shall develop procedures and controls sufficient to ensure that its employees responsible for reporting and preparing records for block futures trades executed by any trading desk within the Global Rates, Currencies, and Futures division record an accurate execution time for each block trade. These procedures and controls shall, at a minimum:
 - i. Clearly specify that Merrill Lynch sales personnel are responsible for recording the block trade execution time and reporting the block trade to the relevant exchange;
 - ii. Ensure that the technology used to record block trade execution time (1) is synchronized for all persons responsible for recording block trade execution times and (2) derives the time used to record the block trade execution time from a common source;
 - iii. Provide for regular, periodic checks of the technology used to record block trade execution time;

- iv. Ensure that the records of block trade executions are maintained in electronic format and unambiguously and legibly indicate the actual execution time of the block trade; and,
 - v. Be accessible and available to all persons with responsibility under these procedures and controls for recording block trade execution times and reporting block trades to the relevant exchanges.
 - b. For a period of two years following the date of the entry of this Order, Merrill Lynch shall have an audit conducted every three months (beginning three months following the date of the entry of this Order) (1) to ensure that the execution times of block trades are being recorded accurately and maintained in accordance with the procedures and controls developed pursuant to this order, and (2) to ensure that block trades are being reported in accordance with exchange rules. Following this two-year period, Merrill Lynch shall have this audit conducted every six months for an additional three years.
3. Cooperation with the Commission: Merrill Lynch shall cooperate fully and expeditiously with the Commission, and any other governmental agency in this action, including the Commission's Division of Enforcement in this action and in any investigation, civil litigation, or administrative matter related to the subject matter of this action or any current or future Commission investigation related thereto.
4. Partial Satisfaction: Respondent understands and agrees that any acceptance by the Commission of any partial payment of Respondent's CMP Obligation shall not be deemed a waiver of its obligation to make further payments pursuant to this Order, or a waiver of the Commission's right to seek to compel payment of any remaining balance.

The provisions of this Order shall be effective on this date.

By the Commission



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: September 22, 2017