UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 101158 / September 25, 2024

INVESTMENT ADVISERS ACT OF 1940
Release No. 6727 / September 25, 2024

ADMINISTRATIVE PROCEEDING
File No. 3-22173

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[1] that:

INTRODUCTION

1. From March 2016 to April 2018 (the "Relevant Period"), Merrill, a registered broker-dealer and investment adviser, failed adequately to inform certain clients that a third-party investment adviser, Harvest Volatility Management LLC ("Harvest"), materially exceeded investment exposure levels specifically designated by such clients in a strategy that Harvest managed. During the Relevant Period, Merrill knew or reasonably should have known that certain clients' actual investment levels exceeded the dollar amounts designated and agreed upon between the clients and Harvest, which caused certain clients to pay higher fees, to be subject to increased market exposure and, ultimately, to incur investment losses. By failing adequately to notify certain clients of their over-exposure to an options overlay strategy relative to what those clients had contractually agreed to with Harvest, Merrill breached its fiduciary duties to those clients and willfully violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

RESPONDENT

2. **Merrill** is a Delaware company headquartered in New York, New York. Merrill has been registered with the Commission as an investment adviser since 1978 and as a broker-dealer since 1959. Since 2009, Merrill has been an indirect wholly-owned subsidiary of Bank of America Corporation.

OTHER RELEVANT PARTY

3. **Harvest** is a privately-owned investment adviser registered with the Commission since 2008, when it was founded. Harvest is a Delaware limited liability company with its principal place of business in Norwalk, Connecticut. Harvest provides advisory services to high-net worth individuals, registered investment companies, private funds, pension and profit-sharing plans, and corporations.

FACTS

4. In or about August 2011, Merrill approved Harvest's Collateral Yield Enhancement Strategy ("CYES") for investment by eligible ultra-high net worth investors. CYES was an "options overlay" strategy through which enrolled participants pledged existing cash or investment assets held in their Merrill accounts as collateral. Cash or investment assets held at Merrill (whether in brokerage accounts and/or investment advisory accounts) were eligible to be pledged as

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

collateral. In general terms, Harvest used the collateral as the basis for an options trading strategy on the S&P 500 Index ("SPX"). The stated objective of CYES was to generate incremental returns for enrolled investors from the "harvesting" of options premiums, without requiring the investors to commit new money to participate in the strategy.

5. For purposes of this Order, the relevant CYES investors introduced by Merrill are generally those who enrolled in CYES before January 1, 2017. The investors introduced by Merrill enrolled in CYES through a written investment management agreement ("IMA"). Harvest created the form of the IMA, which Merrill approved for use with investors it introduced. In the IMA, investors instructed Harvest regarding their desired level of exposure to CYES by specifying a "Notional Amount" in dollars in Schedule A of the IMA. Harvest used this Notional Amount to determine the initial number of index options to purchase for the investor's account. The IMA employed by Harvest before January 2017 ("pre-2017 IMA") also provided that, "on each successive initiating trade in the Account, the Notional Amount may temporarily exceed the Notional Capacity or initial Notional Amount as a result of changes in the index level." Investors could increase or decrease their designated Notional Amount by providing Harvest with an amended Schedule A to their IMAs.

6. "Notional Amount" indicates the amount of money represented by a position on a particular financial instrument, including options contracts. For CYES, the Notional Amount of a client's account was based on the number of options contracts multiplied by the current market value of the SPX multiplied by 100 (contracts × SPX value × 100). Thus, if a client designated a Notional Amount of $6 million and the SPX was at 2,000, Harvest would purchase 30 contracts (30 × 2,000 × 100 = 6,000,000), even though the market price of the underlying contracts was a small fraction of the Notional Amount. If the SPX moved to 2,200, then the same 30 contracts would have a Notional Amount value of $6.6 million. Because the SPX generally changes every trading day, the actual Notional Amount of clients' accounts generally also changed each trading day. Accordingly, to allow only temporary deviations to investors' Notional Amounts, Harvest would be required periodically to adjust the number of options contracts representing the strategy based on changes in the SPX.

7. Pursuant to the pre-2017 IMA, Harvest charged an annualized fee of 50 bps of clients' actual Notional Amounts—i.e., the actual notional level of the account, and not the Notional Amount specified in Schedule A to the IMA—for managing CYES. Pursuant to a written Solicitation Agreement between Harvest and Merrill, Harvest paid Merrill 30% of Harvest's management fees (i.e., 15 basis points annualized) and incentive fees in consideration for Merrill introducing Harvest to eligible investors. The IMA also required Harvest to execute options trades through Merrill, for which Merrill received the associated trading commissions. According to the terms of the IMA for investors introduced by Merrill, Harvest was the investment adviser for the strategy and Merrill was the custodian. In numerous instances during the Relevant Period, however, Merrill financial advisors discussed CYES with investors and advised investors regarding, among other things, whether to invest in CYES, the designation of Notional Amount levels for CYES relative to investors' overall Merrill portfolios and their ongoing overall exposure to CYES. Many investors who were introduced to CYES by Merrill had existing investment advisory account relationships with the firm, many of which were pledged as collateral for CYES.

8. During the Relevant Period, the SPX increased by more than 25%. As a result, for accounts in which Harvest did not reduce the number of options contracts representing the strategy in corresponding fashion, actual Notional Amounts increased by more than 25%. In many cases, Notional Amounts materially exceeded the dollar amounts that investors introduced by Merrill had specified in their pre-2017 IMAs.

9. By the end of 2016, numerous accounts for CYES investors introduced by Merrill with pre-2017 IMAs had actual Notional Amounts that exceeded contractually-designated levels. By January 2017, Merrill had actual or constructive knowledge that over 100 accounts of investors introduced by Merrill were materially over the Notional Amounts directed by those clients.

10. The SPX increased by over 21% during 2017. Because Harvest did not adjust the number of contracts for many CYES investor accounts introduced by Merrill, the actual Notional Amounts in those accounts grew by over 21%, further increasing Notional Amount overages during 2017. By the end of 2017, 186 pre-2017 CYES accounts introduced by Merrill were 30% or more above the client-specified Notional Amounts, and 74 of those accounts were 50% or more above client-specified Notional Amounts.

11. In the fourth quarter of 2017 and first quarter of 2018, the CYES had negative returns. Because certain Merrill clients were subject to actual Notional Amounts that materially exceeded their contractually-designated levels, they experienced investment losses greater than if Harvest had maintained the client-directed Notional Amounts in their pre-2017 IMAs.

12. In the second quarter of 2018, Harvest changed its trading process to regularly adjust the number of CYES options contracts to correspond with clients' designated Notional Amounts in pre-2017 IMAs. As a result of Harvest's failure to adjust contracts for certain clients introduced by Merrill during the Relevant Period, Harvest charged those clients excessive management fees, of which Harvest paid approximately $2 million to Merrill under the Solicitation Agreement. Merrill also received approximately $1 million in excess commissions to execute options transactions directed by Harvest.

13. By early 2017, Harvest had communicated to certain Merrill personnel that actual Notional Amounts in some CYES accounts were materially above client-directed amounts. For example, throughout the Relevant Period, Harvest provided Merrill sales and product personnel with monthly reports showing, for certain accounts, that Notional Amounts in accounts introduced by Merrill were increasing and that Harvest was not systematically adjusting the number of options contracts for pre-2017 IMA clients in response to changes in the SPX. Similarly, for numerous Merrill clients who also had investment advisory accounts at Merrill, Harvest communicated with designated account representatives who serviced those accounts in addition to product and sales personnel. In late 2016 and early 2017, Harvest informed certain Merrill financial advisors in writing that accounts for some clients they serviced were 20% or more above client-directed levels. In some cases, representatives worked with investors to reduce Notional Amount exposure or execute new Schedule As to their IMAs. In other cases, investors remained subject to continuing Notional Amount deviations.

14. Through those communications, Merrill knew or should reasonably have known that Harvest was not systematically managing CYES for Merrill clients who enrolled under pre-2017 IMAs so that their Notional Amounts would only exceed contractually-designated levels "temporarily." As a result of that actual or constructive notice and the firm's relationship with affected clients, Merrill was subject to a fiduciary duty to reasonably and adequately notify them that Harvest was not managing Notional Amounts in a manner consistent with pre-2017 IMA terms. While some Merrill financial advisors did so, the firm did not adequately and uniformly notify all affected pre-2017 IMA clients of the Notional Amount deviations caused by Harvest, along with the resulting impact on fees and transactional costs.

15. Merrill failed to adopt and implement policies and procedures reasonably designed to ensure that it communicated to clients the material information it received from Harvest regarding potential mismanagement and trading beyond contractual limits. During the Relevant Period, Merrill personnel became aware that Harvest was not systematically adjusting the number of options contracts that Harvest purchased in numerous accounts with pre-2017 IMAs, but Merrill failed to communicate such information to clients with whom it had a fiduciary relationship.

VIOLATIONS

16. Section 206(2) of the Advisers Act makes it unlawful for an investment adviser, directly or indirectly, to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. As a result of the conduct described above, Merrill willfully violated Section 206(2).[2]

17. Section 206(4) of the Advisers Act prohibits any investment adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and authorizes the Commission to prescribe rules designed to prevent such conduct. Rule 206(4)-7 under the Advisers Act requires, among other things, a registered investment adviser to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder. As a result of the conduct described above, Merrill willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

DISGORGEMENT AND CIVIL PENALTIES

18. The disgorgement and prejudgment interest ordered in Section IV is consistent with equitable principles and does not exceed Respondent's net profits from its violations, and will be

[2] "Willfully," for purposes of imposing relief under Section 15(b) of the Exchange Act and Section 203(e) of the Advisers Act, "'means no more than 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." *Tager v. SEC,* 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC,* which construed the term "willfully" for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of Section 207 of the Advisers Act).

distributed to harmed investors to the extent feasible. The Commission will hold funds paid pursuant to Section IV in an account at the United States Treasury pending distribution. Upon approval of the distribution final accounting by the Commission, any amounts remaining that are infeasible to return to investors, and any amounts returned to the Commission in the future that are infeasible to return to investors, may be transferred to the general fund of the U.S. Treasury, subject to Section 21F(g)(3) of the Exchange Act. In connection with this distribution, Respondent will produce, without service of subpoena, all documents and other information reasonably requested by the Commission staff.

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 shall 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 Merrill is censured.

C. Respondent Merrill shall, within 14 days of the entry of this Order, pay disgorgement of $2,000,000, and prejudgment interest of $800,000, to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Respondent Merrill shall also, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $1,000,000, to the Securities and Exchange Commission. 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 the 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 D. Mark Cave, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, prejudgment interest, and penalty referenced in Section IV.C. above. The Fair Fund may be added to or combined with any other fund established in any related action arising out of the same facts that are the subject of this Order. 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.

Vanessa A. Countryman
Secretary