FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
No. 2011030683501

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

FROM: Merrill Lynch, Pierce, Fenner & Smith Incorporated
CRD No. 7691

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch" or the "Firm") submits 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, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. The Firm hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA 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 FINRA:

BACKGROUND

Merrill Lynch has been a FINRA member since 1937 and is headquartered in New York, New York. The Firm is a global investment banking and multi-service brokerage firm with more than 2,400 branch offices and more than 32,000 registered individuals. Among other things, it provides equity research, sales and trading services, and underwriting services.

RELEVANT DISCIPLINARY HISTORY

In 2003, NASD censured Merrill Lynch and other firms as part of the Global Research Settlement and ordered the Firm to pay a total of $200,000,000 for violating NASD Rules 2110, 2210(d)(1), 2210(d)(2), and 3010, by (1) engaging in acts and practices that created and/or maintained inappropriate influence by investment banking over research analysts, and therefore imposed conflicts of interest on its research analysts, which it failed to manage appropriately; (2) issuing research reports on issuers that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about these issuers, and/or contained opinions for which there was no

reasonable basis; and (3) failing to establish and maintain adequate procedures reasonably designed to protect research analysts from conflicts of interest.[1]

In 2013, FINRA censured Merrill Lynch and ordered it to pay a total of $325,000 for violating NASD Rules 2711(h) and (i), and 2110 and FINRA Rule 2010 in connection with the Firm's issuance of equity research reports between September 2008 and March 2011. Specifically, the Firm failed to provide required disclosures related to potential conflicts of interest with the companies that were the subject of the research report. Some of the reports also included a distorted price chart. The Firm's supervisory systems were also insufficient to detect and remedy these deficiencies in a timely manner.

OVERVIEW

In April 2010, Toys R Us ("TRU") and its private equity owners ("Sponsors") invited Merrill Lynch and other broker-dealers to compete for a role in TRU's planned initial public offering (the "TRU IPO"). To win this investment banking business from TRU, Merrill Lynch's equity research analyst participated in the Firm's solicitation efforts and Merrill Lynch offered favorable research coverage to TRU. Therefore, in the context of the TRU IPO, the Firm violated two separate provisions of NASD Rule 2711, the research analyst conflict of interest rule: 2711(c)(4), which prohibits research analysts from participating in efforts to solicit investment banking business; and 2711(e), which prohibits firms from directly or indirectly offering favorable research to obtain investment banking business.

Merrill Lynch allowed its research analyst to participate in the Firm's solicitation efforts by making a presentation to TRU and its Sponsors during the "solicitation period" – *i.e.*, the period after a company has made known that it intends to proceed with a prospective investment banking services transaction, such as an IPO, and before the company has made a bona fide award of a mandate for the transaction. Before TRU awarded the TRU IPO business, it asked the equity research analysts from the firms competing for the business to make presentations to TRU's management and Sponsors. TRU provided specific topics for the analysts to address and put the firms on notice that, as part of the underwriter-selection process, it would consider each analyst's views of the company and whether the analyst's valuation was consistent with the firm's investment bankers' valuation. As described below, Merrill Lynch's equity research analyst presented to TRU and its Sponsors on May 5, 2010, during the solicitation period, thereby participating in the Firm's efforts to solicit investment banking business from TRU.

Merrill Lynch also offered favorable research to induce TRU to award the Firm its investment banking business. Following the analyst's presentation, TRU asked Merrill Lynch to complete a template showing an "Equity Commitment Committee approv[ed]" valuation of TRU, which would include the analyst's views on TRU's valuation. TRU and its Sponsors asked the firms to complete the template and provide a Firm-wide valuation that the Firm, including its analyst,

[1] In conjunction with Letter of Acceptance, Waiver and Consent No. CAF 030028 (Apr. 24, 2003), Merrill Lynch entered into a Final Judgment with the Securities and Exchange Commission ("SEC") that included, among other things, undertakings with regard to research independence and publication. $100,000,000 of the fine was deemed satisfied by a penalty paid in a prior settlement of research analyst conflicts of interest with state securities regulators.

would be expected to support after TRU awarded the TRU IPO business, absent unexpected developments. Indeed, TRU told some firms that the purpose of the template was to prevent TRU from being "burned" by an analyst's decision to adopt a negative view of TRU after the company had awarded its investment banking business to the analyst's firm. Merrill Lynch provided the valuation information that TRU requested.

TRU and the Sponsors selected Merrill Lynch as an active bookrunner for the TRU IPO. TRU, however, eventually decided not to proceed with the offering.

FACTS AND VIOLATIVE CONDUCT

I. Merrill Lynch Violated NASD Rule 2711(c)(4) by Allowing Its Research Analyst to Participate in the Solicitation of Investment Banking Business.

NASD Rule 2711, the research analyst conflict of interest rule, is designed to insulate research analysts from a myriad of conflicts that could impair their impartiality. Taken together, the various provisions of the rule play a critical role in protecting analysts from improper influences and promoting their independent role providing research and analysis to investors. NASD Rule 2711(c)(4) is a key component of the rule that is designed to preclude analysts from participating in efforts to obtain investment banking business from issuers given that analysts typically initiate coverage of issuers when their firms play a role in bringing the issuer public.

NASD Rule 2711(c)(4) states, at the outset, that "[n]o research analyst may participate in efforts to solicit investment banking business." The rule clarifies this broad prohibition by stating further that "no research analyst may, among other things, participate in any 'pitches' for investment banking business to prospective investment banking clients or have other communications with companies for the purpose of soliciting investment banking business." Thus, the rule prohibits a research analyst from being part of the deal team seeking to win investment banking business.

Under NASD Rule 2711(c)(4), an analyst may communicate with an issuer during the solicitation period as part of the analyst's due diligence efforts to gather information about the company, but may not communicate with the issuer in furtherance of soliciting a role for his investment bank in the underwriting. In the context of a meeting requested by an issuer during the solicitation period for the purpose of obtaining an analyst's views as part of the underwriter selection process, as occurred in the TRU IPO, an analyst from a soliciting investment bank may not communicate to the issuer his views about the issuer or the issuer's industry, such as his views about valuation or comparable companies.

In April 2010, TRU and the Sponsors notified several investment banking firms of their interest in bringing the company public through an initial public offering. On April 23, 2010, TRU telephoned several firms and invited them to bid for a role in the TRU IPO and scheduled a "bakeoff" with each firm's investment bankers for April 30, 2010. TRU also notified the firms that, as part of the process of selecting underwriters, it wanted to hear the views of each firm's analyst who would cover the company following the TRU IPO. Each firm understood that TRU would consider the firm's analyst's views in determining whether the firm would receive an underwriting role in the TRU IPO. TRU gave the firms a list of topics it wished the analysts to

cover, including the retail industry outlook, valuation, and comparables. TRU scheduled meetings with the analysts for May 4 and May 5, 2010.

On May 4, 2010, TRU and the Sponsors met with the equity research analysts from the firms competing for the TRU IPO business and provided background and financial information on the company for purposes of the analysts' due diligence.

On May 5, 2010, each firm's analyst made a separate presentation to TRU and the Sponsors. Under the circumstances, the analysts' presentations on May 5 constituted part of each firm's pitch for the TRU IPO, and therefore violated NASD Rule 2711(c)(4). The presentations occurred during the solicitation period for the TRU IPO. TRU made clear to each firm that its analyst's presentation would be a factor in TRU's determination of whether the firm would be awarded a role in the IPO. Each analyst presentation was structured so that the analyst spoke and TRU management and Sponsors asked questions. These meetings were not designed to provide information to the analyst that the analyst could use to "vet" the proposed transaction.

From the outset, Merrill Lynch was told that its analyst's views could influence what underwriting role, if any, it received in the TRU IPO. Shortly after being invited to pitch to TRU management and Sponsors, the Merrill Lynch analyst sent an email to his supervisor in Research Management stating that he had been asked to "participate in two meetings" with TRU management, one of which was "a pitch from me to the financial sponsors as well as the management team of Toys R Us." Merrill Lynch's investment bankers, Legal, and Compliance were also made aware of this inappropriate request. Merrill Lynch informed TRU's management and Sponsors that Merrill Lynch's analyst would participate in the meeting, but would not be permitted to provide information about TRU specifically.

After the Firm's investment bankers made their pitch to TRU management and Sponsors on April 30, 2010, the Firm's investment bankers realized that their pitch had not gone as well as they had hoped, particularly because their valuation had been based on a different metric than that used by other firms. Merrill Lynch investment bankers had a chaperoned call with the Merrill Lynch research analyst. Following that discussion, an email between two Merrill Lynch bankers stated that the Firm's "views on valuation evolved since [the pitch], as the analyst did more thinking about the framework for a Toys valuation." An updated and improved valuation was presented by investment banking to TRU management and Sponsors by phone the evening of May 4, 2010.

On May 5, 2010, the Merrill Lynch analyst met separately with TRU and the Sponsors. Consistent with guidance from Merrill Lynch Research Management, Legal, and Compliance, the Merrill Lynch analyst did not distribute or use a written presentation and did not address TRU specifically. Shortly after the Merrill Lynch analyst's presentation, the analyst emailed a TRU executive, thanking him for the meeting. The analyst wrote, "I am sorry that I was not permitted to speak about many specifics today." In an effort to offset his refusal to answer certain questions at the meeting, he then added, "but, I hope that my enthusiasm surrounding the Toys R Us story was evident." The analyst also emailed his supervisor that his "time with the sponsors went well today, I think."

Additionally, Merrill Lynch complied with TRU's request for a valuation that included the analyst's views.

As a result of the foregoing, Merrill Lynch violated NASD Rule 2711(c)(4) and FINRA Rule 2010.

II. Merrill Lynch Violated NASD Rule 2711(e) by Offering Favorable Research Coverage to Induce Receipt of TRU's Investment Banking Business.

NASD Rule 2711 recognizes that a firm can create a conflict for an analyst and compromise the analyst's independence if it promises favorable research coverage in an effort to win investment banking business. Therefore, NASD Rule 2711 contains a broad prohibition against directly or indirectly offering favorable research: "No member may directly or indirectly offer favorable research, a specific rating, or a specific price target . . . to a company as consideration or inducement for the receipt of business or compensation." Accordingly, in the context of a solicitation period where the issuer has stated that it will consider an analyst's views as part of the underwriter selection process, a firm cannot indicate to a prospective investment banking client its analyst's positive views of the company or the company's prospects, even if honestly held, or the positive prospective valuation the analyst may give the company.

Under the circumstances of the TRU IPO, Merrill Lynch offered favorable research coverage to induce receipt of investment banking business by submitting to TRU, during the solicitation period, information related to a valuation template requested by TRU and the Sponsors.

On May 6, 2010, TRU notified the firms that it would be sending a template to each firm to complete as part of the underwriter-selection process. TRU explained that, in order to be selected as an underwriter, each firm had to provide the requested valuation. TRU and the Sponsors wanted to ensure that, if a firm was selected as an underwriter, its analyst's views would be consistent with the valuation provided by its investment bankers.

Later that day, TRU sent the template to each of the firms along with a cover email. The template asked each firm to provide projected EBITDA and net income for 2010 and 2011, the corresponding valuation multiple for 2010 and 2011, and identify up to five comparable companies used for valuation. In the cover email accompanying the template, TRU wrote that, before selecting underwriters, it wanted each firm to provide (1) "Equity Commitment Committee approval of a definitive equity valuation range," and (2) "what company or companies you would choose for the purpose of determining comparative values, and why." TRU stated that if a firm was selected as an underwriter, the firm, including its analyst, would be expected to stand behind the valuation provided in the template. If the valuation changed, the firm would be expected to show that the change was "directly traceable to unexpected findings during due diligence or unexpected changes in exogenous factors." The templates were due on May 10, 2010.

Merrill Lynch understood that TRU and the Sponsors wanted a final valuation that the entire Firm, including its analyst, would support if selected as an underwriter.

After speaking with TRU about the template, a Merrill Lynch investment banker emailed his banking colleagues summarizing the conversation. He characterized the purpose of TRU's request as TRU wanting "to be sure the firms have aligned their analyst and IB views... some didn't; others it wasn't clear because analysts were not giving views."

On May 7, 2010, the day after TRU requested firms complete the template, Merrill Lynch investment bankers participated in a compliance-chaperoned call with equity research. Approximately two hours later, Merrill Lynch investment bankers responded to the TRU information request by sending a PowerPoint presentation that provided an "updated (and reaffirmed) institutional view of the valuation range for the Toys "R" Us IPO." Although Merrill Lynch did not complete the actual template provided to the firms by TRU, it provided the valuation information TRU had requested. The cover email noted that the valuation range presented "reflects the views across our platform, [and] provides absolute clarity on our Firm's perspective on value." The following day, a Merrill Lynch investment banker forwarded Merrill Lynch's response to one of the Sponsors, noting that "[t]his reflects a fully vetted Firm view on valuation for TRU."

The investment bankers also understood that TRU management and Sponsors were looking at the analysts and their view of the potential transaction for purposes of distinguishing the firms. One investment banker sent an email to his banking colleagues stating that he had spoken with one of the Sponsors, who told him that "we need to give them some clarity. Their day with analysts confused them further and frankly helped confirm our position that this is a tough one to value." Another investment banker sent an email to his banking colleagues stating that he had spoken with one of the Sponsors, who said the Sponsor "pushed again on comp set, asking what 2-3 specific comps we/[the analyst] thought were best." He noted that TRU management and Sponsors "may push again on this point as relates to [the analyst]. [Sponsor] said key is they are trying to 'avoid surprises' on the research front. I think one question we may get on Tues [a May 11 meeting] is whether [the analyst's] view evolved in any way after the mtg w mgmt last week."

In response to these concerns, a Merrill Lynch investment banker reached out to the TRU CEO asking to "review with you some thoughts on us and our 'alignment' internally around views on Toys." The same investment banker also sent an email to individuals within Merrill Lynch investment banking, reporting that he had spoken with one of the Sponsors. The investment banker confirmed that the call was "focused on reasons to be comfortable with [Merrill Lynch's] alignment internally" because the Sponsor was "[w]orried about a disconnect on that." The investment banker wrote that he provided the sponsor with "my list of five reasons to be comfortable that we are aligned."

By providing TRU the unified valuation it sought, Merrill Lynch indicated to TRU that post-IPO research coverage would be positive and aligned with investment banking.

Shortly thereafter, TRU and the Sponsors selected Merrill Lynch as an active bookrunner for the TRU IPO.

As a result of the foregoing, Merrill Lynch violated NASD Rule 2711(e) and FINRA Rule 2010.

B. The Firm also consents to the imposition of the following sanctions:

- a censure; and
- a fine in the amount of $4,000,000.

Merrill Lynch agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Merrill Lynch has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Merrill Lynch specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Merrill Lynch specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a Complaint issued specifying the allegations against it;

B. To be notified of the Complaint 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 National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Merrill Lynch specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, 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 acceptance or rejection of this AWC.

Merrill Lynch further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, 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

Merrill Lynch understands 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 NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against it; and

C. If accepted:

1. this AWC will become part of Merrill Lynch's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. Merrill Lynch 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. Merrill Lynch may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. Merrill Lynch may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it 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 FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; has agreed to its 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 Complaint, has been made to induce the Firm to submit it.

Date: 12/5/2014

Merrill Lynch, Pierce, Fenner & Smith Incorporated

By: _____
J. David Montague
Associate General Counsel and Senior Vice President

Reviewed by:

_____
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Accepted by FINRA:

Date: 12/10/14

Signed on behalf of the Director of ODA, by delegated authority

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