FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014043580203

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

RE: Merrill Lynch, Pierce, Fenner & Smith Inc., Respondent
Member Firm
CRD No. 7691

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Merrill Lynch, Pierce, Fenner & Smith Inc. ("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 the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. Merrill Lynch 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

Respondent Merrill Lynch has been a FINRA member since 1937. Its principal offices are in New York, New York. Merrill Lynch is a global investment banking and brokerage firm that provides, among other things, retail brokerage and wealth management services. Among its services, Merrill Lynch participates in public offerings as an underwriter and/or member of a selling group and it sells shares of those public offerings to its retail customers. The Firm employs more than 35,017 registered individuals and maintains approximately 3,541 branch offices. In January 2009, Merrill Lynch was acquired by Bank of America Corporation.

RELEVANT DISCIPLINARY HISTORY

Merrill Lynch has no relevant disciplinary history.

OVERVIEW

FINRA Rule 5130 promotes investor confidence and serves an important role in preserving the integrity of the equity initial public offering ("IPO") process by ensuring that FINRA members do not provide favorable treatment to industry

insiders at the expense of public customers. Rule 5130 prohibits members from selling IPO shares to certain "restricted persons," including associated persons of broker-dealers and immediate family members of persons associated with the selling member. By definition, IPO shares that are sold to industry insiders are not available to public customers who might otherwise have purchased them.

From 2010 through March 2018 (the "Relevant Period"), Merrill Lynch violated Rule 5130 by making at least 1,462 prohibited sales of IPO shares in 325 different offerings to 149 customer accounts in which restricted persons held a beneficial interest. All of the restricted persons who improperly received IPO allocations from Merrill Lynch were associated persons of broker-dealers and/or immediate family members of Merrill Lynch financial advisors ("FAs"). Among the IPOs improperly sold to these accounts were highly anticipated and sought after stocks such as Facebook, Inc., General Motors Co., LinkedIn Corp., and Twitter Inc. At least 120 different FAs located in 79 of the Firm's branch offices effected the prohibited IPO sales.

These transactions occurred because Merrill Lynch failed to implement supervisory systems and procedures reasonably designed to achieve compliance with Rule 5130. Merrill Lynch also failed to reasonably respond when it learned that it had repeatedly sold IPOs to immediate family members of Merrill Lynch FAs. And, Merrill Lynch failed to train any of its employees on Rule 5130 from at least January 2010 to September 2014, even though it depended on its employees to help the Firm comply with the rule's requirements. When the Firm began offering training on Rule 5130, it did not offer the training to many key employees who were integrally involved in effecting IPO transactions.

As a result of the foregoing conduct, Merrill Lynch violated FINRA Rules 5130, 3110(a) and (b) and 2010, and NASD Rule 3010(a) and (b).

FACTS AND VIOLATIVE CONDUCT

FINRA Rule 5130 "plays an important part in maintaining investor confidence in the capital raising and public offering process."[1] The rule protects the integrity of the public offering process by ensuring that: (1) FINRA members make *bona fide* public offerings of securities at the offering price; (2) members do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to members; and (3) industry insiders, including FINRA members and their associated persons, do not take advantage of their "insider" position to purchase "new issues" for their own benefit at the expense of public customers.[2]

[1] Notice to Members 03-79 (Dec. 2003) at 2 (discussing NASD Rule 2790, which preceded FINRA Rule 5130).
[2] *Id.*

Rule 5130 prohibits a FINRA-member firm from selling IPO shares to any account in which a "restricted person" has a beneficial interest, and defines "restricted person" to include an associated person or employee of any broker-dealer, and an "immediate family member" of a person employed by or associated with the broker-dealer selling the IPO to the immediate family member. Under Rule 5130(b), before selling an IPO to any account, a FINRA member "must in good faith have obtained within the twelve months prior to such sale, a representation from ... the account holder(s), or a person authorized to represent the beneficial owners of the account, that the account is eligible to purchase new issues in compliance with [Rule 5130]." However, "a member may not rely upon any representation that it believes, or has reason to believe, is inaccurate."

A. Merrill Lynch Repeatedly Sold IPOs to Restricted Persons

During the Relevant Period, Merrill Lynch served as part of the selling group for numerous IPOs. Through its involvement in these offerings, Merrill Lynch received allotments of the issuers' IPO shares to sell to its retail customer accounts. In violation of Rule 5130, over an eight-year period, Merrill Lynch made at least 1,462 sales of IPO shares in 325 different offerings to 149 customer accounts in which restricted persons held a beneficial interest. Merrill Lynch generated approximately $490,530 in revenue from the 1,462 violative transactions. The restricted buyers received "transaction profits" (the greater of actual profits or imputed profits) on these transactions.

Although Merrill Lynch required certifications from each of the customers that they were eligible to purchase new issues, the Firm's system for tracking new issue eligibility certifications did not compare customer certifications against contrary information in the Firm's possession indicating that a customer was a restricted person because he or she was (a) an associated person of a broker-dealer, and/or (b) an immediate family member of a Merrill Lynch FA. For some transactions, Merrill Lynch had more than one reason to believe that a customer was a restricted person - from the knowledge of the Firm's FAs, information provided by the customers, and/or information provided by other broker-dealers.

Merrill Lynch knew or should have known that at least:

- 91 customers were restricted persons, because the Merrill Lynch FA who sold the customer the IPO knew or should have known, at the time of the transaction, that the customer was an associated person of a broker-dealer and/or an immediate family member of the FA.

- 19 customers were restricted persons, because those customers each told Merrill Lynch that he or she was employed by a broker-dealer when the customer opened his or her account(s). The Firm recorded this information in the Client Profile maintained for each of those customers at the time of the IPO transaction.

- 18 customers were restricted persons, because another broker-dealer had told Merrill Lynch, in accordance with NYSE Rule 407, that the customer was associated with that broker-dealer, or because the Firm entered into a "blanket agreement" under which the other broker-dealer granted Merrill Lynch permission to open or maintain accounts for some or all of its associated persons. Those 407 letters and blanket agreements were associated with the Firm's files for the customers.

- 14 customers were restricted persons, because the Firm delivered duplicate trade confirmations and account statements to another broker-dealer for accounts owned by those customers.

For example:

- One Firm FA opened individual and joint accounts for his brother and his brother's wife. The FA's brother also was an associated person of another broker-dealer (and the supervisory principal who approved the Client Profiles at the opening of the account knew or should have known this). Notwithstanding that, Merrill Lynch sold IPO shares on at least 18 occasions to accounts in which the FA's brother had a beneficial interest.

- One customer was registered with another member firm from January 2012 to the end of the Relevant Period. Merrill Lynch received a letter in February 2012 from the other member firm authorizing the customer to maintain an account at the Firm, pursuant to NYSE Rule 407. Notwithstanding that, Merrill Lynch sold IPO shares to him on at least 232 occasions.

By virtue of the foregoing, Respondent Merrill Lynch violated FINRA Rules 5130 and 2010.

B. Merrill Lynch Failed to Implement Supervisory Systems and Procedures Reasonably Designed to Achieve Compliance with Rule 5130

1. Merrill Lynch's Supervisory System Was Not Reasonably Designed

NASD Rule 3010(a)[3] and FINRA Rule 3110(a) require members to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. The duty to supervise includes the responsibility to investigate "red flags" that suggest that misconduct may be occurring and to act upon the results of such investigation. To comply with its supervisory duties, a firm's supervisory system also must include adequate

[3] NASD Rule 3010 was superseded by FINRA Rule 3110 effective December 1, 2014.

training of the firm's associated persons. As described below, the Firm failed to use information in its records to prevent the sale of IPO shares to clients who were restricted persons; failed to reasonably respond when it learned that it had sold IPO shares to immediate family members of Merrill Lynch FAs; and failed to reasonably train its employees to achieve compliance with Rule 5130.

a. Merrill Lynch Did Not Respond Adequately to Information Indicating Customers Were Restricted Persons

As described above, Merrill Lynch possessed information that certain customers buying an IPO were restricted persons under Rule 5130. Merrill Lynch failed to integrate this information into its IPO systems and procedures and, as a result, sold IPO shares to restricted persons throughout the Relevant Period.

During the Relevant Period, Merrill Lynch conducted post-trade reviews of sales transactions, including sales of IPO shares. However, even when Merrill Lynch's post-trade review identified and cancelled a transaction involving the sale of IPO shares to an account owned by a Firm employee or a Firm employee's immediate family member, Merrill Lynch did not take reasonable steps to prevent that same account from purchasing IPO shares in the future. For example, in November 2013, Merrill Lynch flagged an IPO transaction in an account belonging to an immediate family member of a Firm FA. The Firm cancelled this particular transaction but sold IPO shares to the same account in July 2014.

b. Merrill Lynch Failed to Reasonably Respond When It Learned It Had Sold IPOs to Restricted Persons

Merrill Lynch became aware that it had been selling IPO shares to accounts in which restricted persons held a beneficial interest in or around May 2012, when an employee in the Firm's Albany, New York complex noticed that an FA had sold Facebook IPO shares to an account owned by a customer with the same last name as the FA. Merrill Lynch confirmed that the customer was the FA's father and, thus, a restricted person under Rule 5130. In September 2012, Merrill Lynch commenced an internal review limited to determining whether it had sold IPO shares to other customer accounts owned by immediate family members of Merrill Lynch FAs.

As of August 2013, when Merrill Lynch completed its review, the Firm was aware that, on at least 272 occasions between January 2012 and May 2013, it had sold IPO shares to at least 80 accounts in which immediate family members of FAs held a beneficial interest. Despite changes to its supervisory systems following this review, Merrill Lynch continued selling IPO shares to some of the same accounts it already had identified as belonging to immediate family members of Merrill Lynch FAs.

c. Merrill Lynch Failed to Provide Reasonable Training on Rule 5130 to its Employees

Merrill Lynch also failed to provide reasonable training to its employees who were responsible for ensuring the Firm's compliance with Rule 5130. From at least January 2010 to September 2014, Merrill Lynch provided no training to its employees on Rule 5130, including the rule's definition of the term "restricted person." In September 2014, Merrill Lynch began offering training relating to Rule 5130 to some of its employees, but Merrill Lynch did not offer this training to all of its employees who were involved in effecting IPO transactions.

2. Merrill Lynch's Written Procedures Were Not Enforced

NASD Rule 3010(b)(1) and FINRA Rule 3110(b)(1) require that each member establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. At all relevant times, the Firm's written procedures prohibited the sale of shares in equity IPOs to accounts in which a restricted person held an interest. The Firm did not enforce those written procedures. As described above, the Firm did not integrate into its systems information that it had that certain customers buying IPOs were restricted persons under Rule 5130, thereby allowing 120 different FAs located in 79 of the Firm's branch offices to make at least 1,462 sales of IPO shares in 325 different offerings to 149 customer accounts in which restricted persons held a beneficial interest.

By virtue of the foregoing, Respondent Merrill Lynch violated FINRA Rule 3110(a) and (b), NASD Rule 3010(a) and (b), and FINRA Rule 2010.

B. Merrill Lynch also consents to the imposition of the following sanctions:

1. A censure;

2. A fine in the amount of $5,500,000; and

3. Disgorgement of the revenues Merrill Lynch received on the violative transactions, which is ordered to be paid to FINRA in the amount of $490,530, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621, from the date of revenue was earned for each violative transaction until the date this AWC is accepted by the NAC.

The fine in this matter relates to Merrill Lynch's violations of FINRA Rule 5130 and FINRA Rule 3110(a) and (b) and NASD Rule 3010(a) and (b). For the Firm's violations of Rule 5130, and consistent with the FINRA Sanctions Guidelines, the staff imposed a fine consisting of an amount per each violative transaction plus the transaction profit attributable to each restricted buyer who is not subject to FINRA

jurisdiction. An additional fine was imposed for the Firm's violation of FINRA's supervision rules.

Respondent Merrill Lynch agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. The Firm has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

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

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

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent 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, Respondent 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.

Respondent 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

Respondent 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 the Firm; and

C. If accepted:

1. this AWC will become part of the Firm'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 accordance with FINRA Rule 8313;

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

4. The Firm 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 Firm 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. The Firm 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 understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that the Firm 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.

12/14/2018
Date

Respondent
Merrill Lynch, Pierce, Fenner & Smith Inc.

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Reviewed by:

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Accepted by FINRA:

12/20/2018
Date

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

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