

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT

20042000136-01

TO: Market Regulation Department
NASD

RE: Merrill, Lynch, Pierce, Fenner & Smith, Inc., Respondent
Broker-Dealer
CRD No. 7691

Pursuant to Rule 9216 of NASD Code of Procedure, Merrill, Lynch, Pierce, Fenner & Smith, Inc. ("MLCO" 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 in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against MLCO alleging violations based on the same factual findings.

MLCO understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Market Regulation and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs, pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against MLCO; and
3. If accepted:
 - a. this AWC will become part of the firm's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against MLCO;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about the firm's disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. MLCO 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 allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects the firm's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

MLCO also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

MLCO has been a member of NASD since January 26, 1937 and its registration remains effective. The firm has the following relevant disciplinary history:

- On September 20, 2004, an AWC became final in which MLCO was censured and fined \$27,000 for violations of NASD Rules 2110, 6420(a) and 6620(a);
- On August 20, 2004, an AWC became final in which MLCO was censured and fined \$9,000 for violations of NASD Rules 3370 and 6130(d);
- On December 23, 2003, NASD accepted an AWC in which MLCO was censured and fined \$9,000 for violation of NASD Rule 6130(d);
- On August 27, 2003, NASD accepted an AWC in which MLCO was censured and fined \$8,000 for violations of NASD Rules 2110 and 6620(a);
- On June 23, 2003, NASD accepted an AWC in which MLCO was censured and fined \$12,500 for violations of NASD Rules 2110, 2320(g), 3010, and 3110(b)(2) and SEC Rule 11Ac1-4;
- On April 21, 2003, NASD accepted an AWC in which MLCO was censured and fined \$10,000 for violations of NASD Rules 2110 and 6955(a);
- On December 3, 2002, NASD accepted an AWC in which MLCO was censured and fined \$7,500 for violations of NASD Rules 2110 and 6620(a);
- On August 30, 2002, NASD accepted an AWC in which MLCO was censured and fined \$7,500 for violation of NASD Rule 6130(d);
- On November 1, 2000, NASD accepted an AWC in which MLCO was censured and fined \$25,000 for violations of NASD Rules 2110 and 3010;
- On October 27, 2000, NASD accepted an AWC in which MLCO was censured and fined \$97,000 for violations of NASD Rules 2110, 2320, 3010, 3370, 4613(e), 4642, 6130, 6420 and 6620, and SEC Rule 11Ac1-4; and
- On March 31, 2000, NASD accepted an AWC in which MLCO was censured and fined \$9,000 for violations of NASD Rules 2110 and 3010 and SEC Rules 17a-3 and 17a-4.

I.

WAIVER OF PROCEDURAL RIGHTS

MLCO specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against MLCO;
- B. To be notified of the Formal 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 NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, MLCO specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

MLCO further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of 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.

II.

ACCEPTANCE AND CONSENT

In Market Regulation Review No. 20042000136/MRD200342538, the Market Regulation Department staff (the "staff") conducted a Trading and Market Making Surveillance Examination of MLCO's compliance with applicable trade reporting rules and other regulations. The on-site portion of this examination was conducted from October 27 through November 7, 2003. The staff conducted a review, for trade dates September 24 and 25, 2003 (unless otherwise stated), of:

- 37 customer sale orders, for compliance with NASD Rules 3110 and 3370;
- 13 proprietary sale transactions, for compliance with NASD Rule 3370 and SEC Rule 10a-1;
- 121 sales in NNM securities, for compliance with NASD Rule 6130;
- one short sale in CQS securities, for compliance with SEC Rule 10a-1;
- 50 limit orders in market making securities, for compliance with NASD Rule 2110 and IM-2110-2;
- 25 "non-displayed" limit orders to price improve marketable orders received, for compliance with NASD Rule 2320;
- 22 market orders executed as principal, for compliance with NASD Rule 2320;

- 68 limit and market orders executed in a principal or riskless principal capacity, for compliance with capacity reporting under NASD Trade Reporting and ACT Rules;
 - 25 orders executed as agency/principal and/or riskless principal from the trade date September 24, 2004, for compliance with the SEC Section 28(e) safe harbor on soft dollar compensation;
 - one open buy limit order and stop sell limit order in securities traded ex-dividend, for compliance with NASD Rule 3220;
 - trades reported and modified through a mixed capacity regulatory report, for compliance with NASD Rule 6130;
 - 16 trades in NNM or SC securities reported with a .PRP modifier, for compliance with NASD Rules 4632 and 2320;
 - 25 trades reported in market making securities from the trade date September 25, 2003, for compliance with SEC Rule 11Ac1-5;
 - four categories (29 total orders) of security/size/order data statistics published on the firm's monthly order execution report from the monthly report of September 2003, for compliance with SEC Rule 11Ac1-5;
 - data published on the firm's quarterly order routing report from the third quarter of 2003, for compliance with SEC Rule 11Ac1-6;
 - the firm's establishment and implementation of "regular and rigorous" reviews of the execution quality of orders sent to other market centers for execution based on written supervisory procedures in effect during September 2003, for compliance with NASD Rules 2320 and 3010;
 - 24 customer transactions in OTCBB and/or OTC equity securities, for compliance with NASD Rules 3110(b) and 2320;
 - 11 persons engaged in the firm's trading and market making activities from trading staff in September 2003, for compliance with NASD Registration rules;
 - 288 order/trade records prepared and maintained for the above samples, for compliance with NASD Rule 3110 and SEC Rules 17a-3 and 17a-4;
 - 492 trades reported to ACT, for compliance with NASD Trade Reporting and ACT rules;
 - 186 customer trade confirmations, for compliance with SEC Rule 10b-10; and
 - the firm's establishment and implementation of a supervisory system and written procedures based on the supervisory system in effect during September 2003, for compliance with NASD Rule 3010.
- A. MLCO hereby accepts and consents, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD 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 NASD:
1. MLCO failed to submit, for the offsetting "riskless" portion of three transactions in Nasdaq National Market Securities ("NNM"), either a clearing-only report with a capacity indicator of "riskless principal" or a non-tape, non-clearing report with a capacity indicator of "riskless principal."

2. MLCO incorrectly designated as ".PRP" through ACT last sale reports of two transactions in NNM securities.
3. The conduct described in paragraphs one and two constitutes separate and distinct violations of NASD Marketplace Rule 4632.
4. In seven instances, MLCO failed to report the correct time of execution through ACT the last sale reports of transactions in eligible securities for which MLCO has recording and reporting obligations under NASD Marketplace Rules 6954 and 6955.
5. MLCO failed to report to ACT the correct symbol indicating whether MLCO executed 10 transactions in eligible securities as principal, riskless principal or agent.
6. MLCO failed to report to ACT the correct symbol indicating whether two transactions in eligible securities were a buy, sell, sell short, sell short exempt or cross.
7. The conduct described in paragraphs four through six constitutes separate and distinct violations of NASD Marketplace Rule 6130(d).
8. MLCO failed, within 90 seconds after execution, to transmit through ACT last sale reports of three transactions in Consolidated Quotation System ("CQS") securities and failed to designate through ACT such last sale reports as late.
9. The conduct described in paragraph eight constitutes separate and distinct violations of NASD Marketplace Rule 6420(a).
10. MLCO failed to report through ACT the correct price in one last sale report of a transaction in a CQS security.
11. The conduct described in paragraph ten constitutes a violation of NASD Marketplace Rule 6420(c)(3).
12. For the month of September 2003, MLCO made available a report on the covered orders in national market system securities that it received for execution from any person. This report included incomplete information as to the cumulative number of shares of covered orders cancelled prior to execution.
13. For the month of September 2003, MLCO made available a report on the covered orders in national market system securities that it received for execution from any person. This report included incorrect information as to the inclusion of "not held" orders.

14. The conduct described in paragraph 13 constitutes separate and distinct violations of SEC Rule 11Ac1-5.
15. MLCO failed, in six instances involving two orders, to provide written notification disclosing to its customer its correct capacity to the transaction.
16. MLCO failed, in two instances, to provide written notification disclosing to its customer the correct reported price.
17. The conduct described in paragraphs 15 and 16 constitute separate and distinct violations of SEC Rule 10b-10.
18. MLCO failed to show the correct time of receipt and execution on the memorandum of one brokerage order, and the correct time of execution on the memorandum of two brokerage orders.
19. MLCO failed to show the terms and conditions on the memorandum of five brokerage orders
20. The conduct described in paragraphs 18 and 19 constitute separate and distinct violations of SEC Rule 17a-3 and NASD Conduct Rule 3110.
21. MLCO's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to the applicable securities law and regulations, and Rules of NASD, concerning the registration of associated persons, the frontrunning of orders in CQS securities, SEC Rule 11Ac1-5, SEC Rule 11Ac1-6, and NASD's three quote rule. Specifically, the MLCO's supervisory system did not include written supervisory procedures providing for: (1) identification of the person(s) responsible for supervision with respect to the applicable rules; (2) a statement of the supervisory step(s) to be taken by the identified person(s); (3) a statement as to how often such person(s) should take such step(s); and (4) a statement as to how the completion of the step(s) included in the written supervisory procedures should be documented.
22. The conduct described in paragraph 21 constitutes a violation of NASD Conduct Rules 3010 and 2110.

B. MLCO also consents to the imposition, at a maximum, of the following sanctions:

A censure and a fine of \$45,000 (composed of a \$7,500 for the violations of the transaction reporting rules, a \$7,500 fine for the violations of the ACT rules, a \$10,000 fine for the violations of SEC Rule 11Ac1-5, a \$5,000 fine for the violations of SEC Rule 10b-10, a \$5,000 fine for the violations of the record keeping rules, and \$10,000 for the supervisory violations), and an undertaking to revise the firm's written supervisory procedures with respect to the areas described in paragraph 21. Within 30 business days of acceptance of this AWC by the NAC, a registered

principal of the Respondent shall submit to the **COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850**, a signed, dated letter, providing the following information: (1) a reference to this matter; (2) a representation that the firm has revised its written supervisory procedures to address the deficiencies described in paragraph 21; and (3) the date the revised procedures were implemented.

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

III.

OTHER MATTERS

- A. MLCO understands that the firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. MLCO understands that MLCO 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 NASD, nor does it reflect the views of NASD or its staff.
- B. MLCO agrees to pay any monetary sanctions imposed on MLCO upon notice that this AWC has been accepted and that such payments are due and payable and has attached an Election of Payment form showing the method by which MLCO proposes to pay any fine imposed.
- C. MLCO specifically and voluntarily waives any right to claim that the firm is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

Merrill, Lynch, Pierce, Fenner & Smith Inc. certifies that the firm has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce MLCO to submit it.

1/10/06
Date

Respondent
Merrill, Lynch, Pierce, Fenner & Smith Inc.

By: David L. Kornblau
Name: David L. Kornblau
Title: First Vice President and
General Counsel
Global Regulatory Affairs

Reviewed by:

David Marcus
Counsel for Respondent
David Marcus

Accepted by NASD:

3/22/06
Date

Thomas R. Gira
Thomas R. Gira
Executive Vice President and Deputy
Department of Market Regulation

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