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**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
No. 2005002254701**

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

RE: Merrill Lynch, Pierce, Fenner & Smith, Inc., Respondent, CRD # 7691

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent 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. Respondent 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, Pierce Fenner & Smith, Inc. ("Merrill Lynch" or the "Firm"), CRD # 7691, has been a registered broker-dealer and a member of FINRA since January 26, 1937. Merrill Lynch is a full service brokerage firm headquartered in New York, New York and has 814 active branches and 28,232 registered representatives.

The Firm has relevant disciplinary history. In February 2008, the Firm submitted an AWC consenting to findings that from January 1, 2002 through December 31, 2004, it failed to establish, maintain and enforce a supervisory system and procedures reasonably designed to: (i) identify certain opportunities for investors to purchase mutual funds at net asset value ("NAV") under NAV transfer programs, and (ii) provide eligible investors with the benefits of available NAV transfer programs.

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OVERVIEW

Between March 2003 and August 2006 (the "relevant period"), Merrill Lynch underwrote 114 initial public offerings ("IPO") of Closed End Funds ("CEFs"). The CEFs at issue were generally intended for use as long-term income producing investments. Since the sales charges to the customers who purchased at the time of the initial public offering were built into the offering price of the CEF, the market price of the CEFs generally declined after the stabilization period.

Despite being aware that CEFs purchased at the initial public offering were most suitable for long-term investments and that the sales charges applied to purchases at the initial public offering made short-term trading of these CEFs generally unsuitable, Merrill Lynch did not have adequate systems and procedures reasonably designed to detect and prevent unsuitable short-term trading of CEFs purchased at the initial public offering. As a result, the Firm failed to detect and prevent certain of its registered representatives from engaging in unsuitable short-term trading of CEFs purchased at the initial public offering, which resulted in customer losses of more than \$3 million.

By virtue of the above, Merrill Lynch violated NASD Conduct Rules 3010(a), 3010(b) and 2110.

FACTS AND VIOLATIVE CONDUCT

Background on Closed End Funds

CEFs are investment companies that sell a fixed number of shares in an initial public offering, after which the shares typically trade on a secondary market. The sales charges to the customer are built into the offering price of the CEF purchased at the initial public offering. During the relevant period, the CEFs at issue included a sales load of 4.5%, from which the underwriters' fee and sales concession were paid. The proceeds, after the expenses, were then invested by the CEF based on the investment objectives of the CEF.

The CEFs had a "stabilization period," which was the period of time immediately following the first trading following the initial distribution of the IPO in which the lead underwriter (at least in theory) generally supported the price of the fund. The CEFs' prospectuses noted that the underwriter may purchase common shares to stabilize the fund's price or to reduce short positions, and that this may cause the price of the common shares to be higher than it might otherwise be. Stabilization periods did not exceed 90 days and were generally shorter in duration.

Following the IPO, the price of CEF shares in the secondary market was determined by the market and may have reflected either a premium or a discount of the shares' net asset value ("NAV") excluding the offering expenses. Since expenses to the customer at the time of the IPO were built into the offering price of the CEF, its market price generally declined after the stabilization period. Without trading at a discount or a premium, all

other factors being equal, it would have been reasonable to expect the market price of the CEF at the end of the stabilization period to be approximately 4.5% below the initial offering price.

CEF IPOs also had a penalty bid period, which was the period of time following the initial public offering during which the selling concession paid to the registered representative could be reversed if the shares purchased in the IPO were sold by the customer. The penalty bid period varied from fund to fund, but was generally 30 to 90 days after the initial public offering. It was imposed at the discretion of the lead underwriter.

One regulatory concern relating to CEFs is the potential for registered representatives to earn high fees by soliciting their customers to purchase CEFs at the initial public offering and sell them shortly after the expiration of the penalty bid period, in order to use the proceeds to purchase another CEF at the initial public offering.

Merrill Lynch's CEF Program

During the relevant period, Merrill Lynch underwrote 114 IPOs of CEFs. The CEFs at issue were generally designed as long-term income producing investments. Generally, the registered representative selling the CEF shares at the initial public offering received a sales concession of 3% of the amount invested, applied to his commission grid or payout percentage.¹

Merrill Lynch offered IPOs of CEFs to its customers on a regular basis and solicited purchases of CEFs. Merrill Lynch marketed its CEFs as products which were suitable for investors seeking diversification and trading flexibility. Merrill Lynch specifically listed the following benefits when describing CEFs to its customers: professional management; variety of fund types and sectors for portfolio diversification; daily liquidity on an exchange; and no minimum investment requirements. During the relevant period, the Firm sold approximately \$16 billion of CEFs at initial public offerings to its retail customers and earned approximately \$735 million in revenue from these sales.

Merrill Lynch Failed To Reasonably Supervise Sales of CEFs

During the relevant period, Merrill Lynch failed to establish and maintain a system and procedures that were reasonably designed to supervise its registered representatives' sales of CEFs to their customers. Despite being aware that CEFs purchased at the initial public offering were most suitable for long-term investments and that the sales charges applied to purchases at the initial public offering made short-term trading of these CEFs generally unsuitable, the Firm did not have a system and procedures reasonably designed to detect and prevent potentially harmful short-term trading of CEFs purchased at the initial public

¹ During a portion of the relevant period, the registered representatives received both the sales concession and a fee on the assets invested in fee-based accounts at Merrill Lynch. Beginning on November 5, 2004, fees in Merrill Lynch fee-based accounts were not assessed on the value of CEFs bought at the initial public offering for 190 days from the date of purchase.

offering. As a result, the Firm failed to detect and prevent certain of its registered representatives from engaging in unsuitable short-term trading of CEFs purchased at the initial public offering, which resulted in losses to customers.

During the relevant period, Merrill Lynch made available to its registered representatives a CEF "fact sheet" that described CEFs generally. While this fact sheet noted that each new CEF was offered only by a prospectus that contained more complete details concerning investment objectives, risks and fees, the fact sheet itself did not contain any language describing CEFs as long-term investments. Nor did it provide any information about the impact of the sales charges on the NAV. The Firm also provided its registered representatives with an investor guide, advisor guide and prospectus for each CEF, which generally disclosed sales charges, investment objectives and product-specific risks, including the increased risk of loss associated with sales shortly after the initial offering. The Firm, however, did not provide any other product-specific information or training to its registered persons regarding the impact of the sales charges on the short-term sales of CEFs.

During the relevant period, the Firm's written procedures did not address short-term trading of CEFs purchased at the initial public offering specifically, and did not provide supervisors with any guidance or warning about the potential abuses and disadvantages relating to the short-term trading of CEFs purchased at the initial public offering. Without adequate guidance, branch managers were not on notice that there was any potential problem with short-term sales of CEFs bought at the initial public offering.

Furthermore, Merrill Lynch did not have adequate systems or procedures to detect short-term trading of CEFs purchased at the initial public offering or whether any of its registered representatives were engaging in a pattern of or in high volumes of short-term trading of CEFs. The only way in which a branch manager would have been able to determine that a specific CEF bought by a customer at the initial public offering was sold shortly after it was purchased was by noting the sale date in the customer's account and trying to match that with a purchase date in the customer's account several months earlier. As such, Merrill Lynch managers had no practical way to determine how long a CEF had been held by a customer before the sale. In order to detect patterns or high volumes of short-term trading of CEFs purchased at the initial public offering by individual representatives, a branch manager had to review the registered representative's individual customer accounts and check for recurring short-term purchases and sales of CEFs in the accounts.

As a result of the above supervisory failures, certain Merrill Lynch registered representatives recommended to clients CEF purchases at the initial public offering and subsequent short-term sales without having a sufficient understanding of the effects that the sales charges and other pricing considerations had on their clients' investments. These recommendations were unsuitable and the unsuitable short-term sales of the CEFs resulted in customer losses of more than \$3 million.

By virtue of the above, Merrill Lynch violated NASD Rules 3010 (a) and (b) and 2110.

OTHER FACTORS

In determining the appropriate sanctions, FINRA considered the following factors: (1) prior to FINRA initiating its investigation, the Firm initiated a self-review upon receiving an anonymous tip regarding potential unsuitable short-term sales of CEFs; (2) after conducting an extensive and thorough review, the Firm identified the causes of the violations and corrected its systems and procedures to prevent future violations; and (3) before the completion of FINRA's investigation, the Firm made extraordinary remediation to customers.

Specifically, after the receipt of an anonymous tip and prior to the initiation of FINRA's investigation into unsuitable short-term sales of CEFs, Merrill Lynch promptly took proactive remedial actions by engaging outside counsel to conduct a self-review of all CEF sales between March 2003 and March 2006. Following completion of the review, the Firm instituted a new training requirement on CEFs, instituted a new system component to detect and prevent unsuitable short-term sales of CEFs, and updated its written procedures to address CEF issues.

Following the self-review, Merrill Lynch sanctioned 13 registered representatives, who the firm found to have made unsuitable CEF recommendations. In July 2007, after FINRA began its investigation, but before the investigation was completed, the Firm paid in excess of \$3 million in remediation to approximately 330 accounts, which constitutes all of the customers of the 13 registered representatives it sanctioned, including approximately 175 accounts of brokers who FINRA did not recommend charging with suitability violations and approximately 155 accounts of brokers who FINRA recommended charging with suitability violations. In addition, following the completion of FINRA's investigation, Merrill Lynch made full remediation of approximately \$221,000 to the customers of one additional registered representative who FINRA recommended charging with suitability violations.

SANCTIONS

B. Respondent also consents to the imposition of the following sanctions:

1. A censure;
2. A fine in the amount of \$150,000.

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

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

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

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Formal Complaint issued specifying the allegations against the Firm;
- 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 National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent 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.

Respondent 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 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 Respondent'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 8310 and IM-8310-3; 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 Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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; that 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 Respondent to submit it.

May 11, 2009

Date

Merrill Lynch, Pierce, Fenner & Smith
Incorporated

By: Michael M. Brennan

Reviewed by:

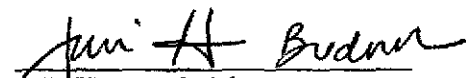
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Accepted by FINRA:

7/28/09
Date

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


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