

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2007009456801**

TO: Department of Enforcement ("Enforcement")
Financial Industry Regulatory Authority ("FINRA")¹

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

Pursuant to NASD Rule 9216 of FINRA Code of Procedure, Respondent Merrill Lynch, Pierce, Fenner & Smith, Incorporated (the "Firm" or "Merrill Lynch") 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 Merrill Lynch 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

Merrill Lynch, a Delaware corporation with its principal place of business in New York, is a member organization of NYSE Euronext² ("NYSE") and FINRA. The Firm is a global investment banking and multi-service brokerage firm and operates in 37 countries and has more than \$1.6 trillion in total client assets. The Firm employs approximately 55,000 people worldwide, including more than 25,000 registered employees.

¹ In July 2007, the NASD, Inc. became FINRA.

² On March 7, 2006, the NYSE Group, Inc. was formed from the merger of the New York Stock Exchange LLC and Archipelago Holdings, Inc. On April 4, 2007, NYSE Euronext was formed from the merger of NYSE Group, Inc. and Euronext N.V.

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OVERVIEW

From at least January 2001 until January 2006, as a result of certain operational and supervisory deficiencies, Merrill Lynch failed to timely and consistently update the Firm's record system relating to certain investment advisory and fee-based accounts. Specifically, when clients changed investment advisors or terminated enrollment in certain investment advisory or fee-based accounts, Merrill Lynch failed to consistently make changes in account proxy delivery addresses and/or remove traits that suppressed trade confirmation delivery in the Firm's record systems. In addition, the Firm failed to maintain written supervisory procedures and a reasonable system of follow-up and review with respect to such operational changes. As a consequence, certain proxy materials were misdelivered when clients changed programs and certain clients did not receive trade confirmations after they terminated enrollment in such programs. The operational deficiency affected at least 42,626 accounts, some of which were dormant.

FACTS

Merrill Lynch offers its retail clients several types of account relationships, including various investment advisory and fee-based programs. When a client enrolls in such a program, the Firm adds certain account traits to the client's profile in a Firm record system known as KDI.³ The account traits identify the program in which the client has enrolled, the investment manager designated for the investment advisory account and other related information. Further, the Firm allows investment advisory account holders the option to have proxies sent to their investment advisor, to suppress delivery on non-voting duplicate proxies to the client and to suppress the delivery of trade confirmations for trades executed in that account. If the client elects not to receive proxies and/or trade confirmations, account traits suppressing delivery of proxies and/or trade confirmations must be added to the client's records in the KDI system.

Further, the Firm must modify the relevant account traits in KDI if a client decides to change or terminate enrollment in certain investment advisory and fee-based programs, or change delivery instructions with respect to proxy materials or trade confirmations, or to change the designated investment advisor. Specifically, the Firm must update the client's account information in KDI to change the address to which proxies are sent and change or remove the proxy delivery and trade confirmation suppression traits.

Prior to January 2006, the Firm's process for making such changes in the KDI system was manual. If a client chose to change or terminate his or her enrollment in certain investment advisory or fee-based programs, or change delivery instructions with respect to proxy material or trade confirmations, a Firm employee in the retail branch office would cause these changes to be transmitted to the Firm's Client Account

³ The Firm's KDI system is a client account record management system, which contains client identification information, account record information and account traits. Certain elements of this information also are stored by the Firm in separately maintained product client databases.

Services Managed Solutions Operations ("CAS") department. CAS was responsible for making changes to the KDI system.

Updating the appropriate information in the KDI system was manually intensive and over time, the amount of regulatory data required to complete the account updating process increased. During the relevant period, Merrill Lynch did not have adequate written procedures detailing the process pursuant to which CAS was to make the appropriate changes to the KDI system. Further, the Firm failed to implement a reasonable system of follow-up and review to ensure that these changes were made. As a result, accounts were affected in various ways; not all affected accounts experienced the same miscoding errors. Sometimes none of the requested changes were made to the client's profile. At other times, if the client elected to change more than one item, the proxy delivery address was changed but the trade confirmation suppression trait was not removed, or vice versa. As a consequence, proxy materials were misdirected to the incorrect investment manager, and trade confirmations continued to be suppressed despite a change in client instructions.

In January 2006, the Firm instituted a system improvement by automating the process by which it updated investment advisory and fee-based account election changes. As a result, branch office employees initiated and completed the entire account election updating process. After the Firm automated the CAS process and procedure, some clients who did not previously receive proxies began receiving them and notified the Firm. The Firm began to investigate the problem in March 2006 and eventually discovered all of the errors described above that had occurred prior to the January 2006 automation. The Firm subsequently self-reported the results of its review to Enforcement. Additionally, the Firm initiated an internal review in order to test the effectiveness of its system improvements and to further mitigate the likelihood of future occurrences.

In order to determine the scope of the operational problem and the number of affected accounts, the Firm conducted a review and reconciliation process. The review and reconciliation process did not definitively determine the number of affected accounts, in part because KDI does not maintain historical information for accounts that have been inactive for more than 18 months. The reconciliation process, however, identified at least 64,160 instances of incorrect KDI coding errors that affected at least 42,626 accounts, including approximately 21,534 investment advisory or fee-based accounts with incorrect trade confirmation suppression traits. A majority of the affected accounts were closed, dormant or maintained a balance of less than \$100. In September 2006, the Firm sent explanatory letters to affected clients who held account balances of \$100 or greater, unless the nature of the operational error related only to the misdelivery of proxy materials.

With respect to the 42,626 investment advisory or fee-based accounts with incorrect proxy delivery traits: (i) 6,514 remained open as active brokerage accounts, (ii) 10,055 investment advisory accounts reflected incorrect proxy delivery addresses, (iii) 24,428 accounts had zero balances, and (iv) 1,628 accounts maintained balances of less than

\$100. Of the 21,534 investment advisory accounts that had incorrect trade suppression traits, (i) 16,523 accounts were dormant, and (ii) 5,011 were active accounts. Included in the 5,011 active accounts were 999 accounts that received trade confirmations despite having an incorrect KDI program trait.

Separate and apart from the foregoing investment advisory and fee-based accounts, the Firm identified 1,178 active general brokerage accounts for which account profile information had been entered into the KDI system regarding delivery of proxy material and trade confirmations in anticipation of such accounts being enrolled in certain investment advisory or fee-based programs. When those clients did not complete the enrollment process, the delivery of proxy material and trade confirmations were affected in a manner similar to that described above.

To identify any residual problems, on August 31, 2006, the Firm developed daily and weekly reconciliation processes to compare KDI to the Firm's investment advisory client databases.

VIOLATIVE CONDUCT BY RESPONDENT

Pursuant to NASD Rule 3010(a), the Firm was required to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable rules and regulations. NASD Rule 3010(b) requires the Firm to establish and enforce written supervisory procedures. The Firm failed to establish a reasonable supervisory system to update the relevant client profiles in its KDI system for the affected investment advisory and fee-based programs. While Merrill Lynch established a manual update procedure, the Firm failed to establish a reasonable system to monitor for the proper completion of the manual process. Additionally, the Firm failed to have adequate written procedures regarding the process for implementing updates to the affected programs. As a result, CAS used inconsistent methods to update the KDI system. By virtue of the foregoing, the Firm violated NASD Rules 3010(a) and (b) and 2110.

NASD Rule 2260(a)(1)(A) requires member firms to promptly forward proxy materials to the beneficial owner or the beneficial owner's designated investment adviser. The Firm caused proxies to be delivered to the wrong address when certain clients in the affected investment advisory or fee-based accounts either (i) changed investment advisors, (ii) changed investment advisory or fee-based programs, or (iii) terminated their enrollment in the affected programs. The client's original investment advisor continued to receive proxies that should have been delivered to either another investment advisor or the client. By virtue of not delivering proxies to the correct address, the Firm violated NASD Rules 2260 and 2110.

Further, Section 10 of the Securities Exchange Act of 1934, and Rule 10b-10(a) thereunder ("Exchange Act Rule"), and NASD Rule 2230 require that broker dealers provide customers written notice of any transaction effected in their account "at or before" the completion of the transaction. Merrill Lynch's operational problem also resulted in the Firm's failure to deliver trade confirmations to certain clients who terminated enrollment in the affected investment advisory and fee-based programs and the misdelivery of trade confirmations to certain clients who changed investment advisors or investment advisory or fee-based programs. Although the affected clients continued to receive monthly account statements that reflected details about the transactions executed in their respective accounts, the monthly account statements were not produced prior to or contemporaneously with securities transactions. By not delivering trade confirmations to Firm customers "at or before completion" of each transaction, the Firm violated Exchange Act Rule 10b-10(a) and NASD Rules 2230 and 2110.

Lastly, NASD Rule 3110 requires member organizations to make and preserve books and records prescribed by Exchange Act Rule 17a-3, in the format, medium and retention period defined by Exchange Act Rule 17a-4. Due to the Firm's failure to consistently and timely update the information described above in the Firm's KDI system, the Firm violated Exchange Act Rule 17a-3 and NASD Rules 3110 and 2110.

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

Censure; and a \$175,000 fine.

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 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, Merrill Lynch 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.

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

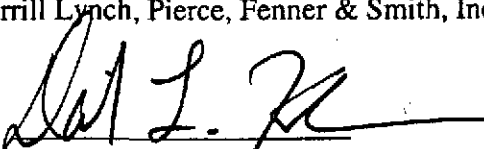
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
- B. If this AWC is not accepted, its submission will not 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 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 NASD Rule 8310 and IM-8310-3;
 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 right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party; and
 5. the Firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. I have submitted an Election of Payment form showing the method by which I propose to pay the fine imposed. The Firm 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.
- 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. Merrill Lynch 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.

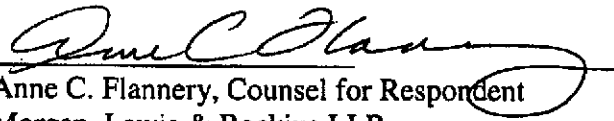
Merrill Lynch certifies that it has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

FEB. 14, 2008
Date

Merrill Lynch, Pierce, Fenner & Smith, Incorporated.

By: 
David Kornblau
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Reviewed by:


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Accepted by FINRA:

2/26/08
Date

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


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