

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. E9B20030421-04

TO: Department of Enforcement
NASD

RE: Merrill Lynch, Pierce, Fenner & Smith Inc.
BD No. 7691

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

We understand 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 Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), 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 us; and
3. If accepted:
 - a. this AWC will become part of our permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against us;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about our 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. we 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 findings in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects our testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

We also understand that our 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:

Merrill Lynch has been a member of NASD since 1937. It maintains its principal place of business in New York City and has branch offices throughout the country.

I.

WAIVER OF PROCEDURAL RIGHTS

We specifically and voluntarily waive the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against us;
- 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, we specifically and voluntarily waive 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.

We further specifically and voluntarily waive 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

- A. We hereby accept and consent, without admitting or denying the 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:

SUMMARY

The conduct described in this AWC occurred in Merrill Lynch's Financial Advisory Center ("FAC"), located in Hopewell, New Jersey and Jacksonville, Florida. The FAC was originally designed as a centralized "call center," a place where customers could call with questions or requests about their accounts and initially held only a small number of customer accounts. In or about 2000, however, the FAC became an integral part of an overall strategy Merrill Lynch implemented to improve its retail business by "segmenting" customer accounts. Within a year, Merrill Lynch began transferring thousands of smaller customer accounts from branch offices throughout the country to the FAC based on asset size. Generally, smaller accounts with assets of \$100,000 or less, or those with minimal transactional activity, were moved to the FAC, in part so that Merrill Lynch's full service Financial Advisors in branch offices could devote more attention to larger accounts.

Typically, the first notice that customers received that their accounts had been transferred from a branch location to the FAC was a letter "welcoming" them to the FAC. The introductory letter promised round-the-clock customized, financial advice (including stocks and bonds) from a "team of Merrill Lynch professionals." The FAC registered representatives often had five years or less brokerage experience; when making recommendations regarding securities, they were limited to mutual funds and were permitted to recommend equities or bonds only if requested to do so by the client. None of these facts was disclosed to the transferred customers.

Once the accounts were enrolled at the FAC, its registered representatives, referred to as Investment Service Advisors ("ISAs"), solicited those customers for securities transactions, generating millions of dollars in annual gross revenues for Merrill Lynch. At its peak size in 2002, the FAC had approximately 1.3 million accounts holding approximately \$20 billion in assets. That year, FAC had gross revenues of approximately \$210 million.

Despite this level of activity, from 2001 through 2004, Merrill Lynch lacked an adequate supervisory system and written supervisory procedures for the FAC. Among other things, the firm failed to: establish, maintain and enforce reasonable procedures regarding mutual fund recommendations (including switch transactions); place a sufficient number of properly trained and qualified supervisors to monitor activities within the FAC; conduct annual compliance audits for the FAC's two most active years; and provide adequate disclosure to customers regarding mutual fund share class choices.

During this period, several ISAs recommended certain mutual fund switch transactions that violated NASD Conduct Rule 2310, the suitability rule. Specifically, these ISAs failed to obtain sufficient information about customers' current financial circumstances and investment objectives and made recommendations that did not result in a net economic advantage for customers. Certain of the switches were unnecessary because reasonable free-exchange alternatives were available for customers within their existing mutual fund families. Moreover, certain of these ISAs made false representations and/or omitted material facts in connection with the unsuitable switch transactions. The net effect of these violations was that these customers incurred unnecessary charges, higher expenses and a new contingent deferred sales charge ("CDSC") period from their mutual fund trades.

Throughout this period, Merrill Lynch also allowed sales managers, who were referred to as "Lead Advisors," to exercise direct supervisory responsibility over the ISAs. The majority of the Lead Advisors, however, were not properly registered as securities principals and, therefore, lacked the required qualifications and experience to supervise their teams. Despite the fact that thousands of trades were generated daily by approximately 300 ISAs, there were only approximately three to six registered principals reviewing all of the ISA's transactions. Those registered principals were administrative managers employed in the FAC who reported to the FAC's Director of Compliance and Risk Management.

In 2002, the FAC conducted three sales contests that violated NASD Conduct Rule 2830, the non-cash compensation rule, because they favored the sale of Merrill Lynch's proprietary mutual funds ("MLIM"). NASD Conduct Rule 2830 prohibits non-cash compensation arrangements between members and their associated persons for sales of mutual funds and variable contracts that are not based on concepts of "total production" and "equal weighting." The firm offered and awarded various forms of non-cash compensation, such as rock concert tickets, sporting events and dinners, to the contest winners. Merrill Lynch also failed to maintain a supervisory system and written procedures reasonably designed to achieve compliance with Conduct Rule 2830.

BACKGROUND

FAC Operations

As noted above, the FAC was originally designed as a centralized call center. The FAC initially serviced approximately 50,000 accounts, but in or about 2000, the FAC became an integral part of an overall strategy that Merrill Lynch implemented to improve its retail business by segmenting customer accounts based on asset size. Merrill Lynch envisioned, in part, that its Financial Advisors in branch offices would be able to devote more time to advising clients with larger accounts and smaller asset-sized or less active accounts were sent to a central location for servicing.

Within a year, Merrill Lynch began moving accounts from branch offices throughout the country to the FAC based on asset size. Generally, smaller accounts with household assets of \$100,000 or less, or those with minimal transactional activity, were sent to the FAC.

Merrill Lynch still transfers accounts to the FAC from branch locations, but the most active period of transfers was between March 2001 and August 2002, when more than one million customer accounts were transferred to the FAC.

Merrill Lynch did not seek customers' consent before moving their accounts to the FAC. Typically, the first notice that Merrill Lynch provided customers, whose accounts were transferred to the FAC, was a form letter "welcoming" them to the FAC and assuring financial advice "24 hours a day, seven days a week." The letter advised customers, among other things, that they would receive assistance, personalized guidance and investment strategies from a team of Merrill Lynch professionals. Also attached to the introductory letter was a pamphlet reinforcing these notions of enhanced service and investment advice for the new FAC accounts.

Many of the ISAs had five years or less brokerage experience and were only permitted to make recommendations relating to mutual funds. Unlike Financial Advisors in branch offices, ISAs were permitted to recommend equities or bonds only if requested to do so by the client. Transferred customers were not told this.

Customers transferred to the FAC no longer had a single registered representative assigned to their account; rather, any of the ISAs in the FAC might communicate with them about existing or new investments. Each time a customer called, they would be routed to an available ISA. Likewise, any of a number of ISAs could reach out to a given customer. FAC customers generally did not receive commission discounts on transactions. They paid the same commission rates on trades as they would have had their accounts remained with a full service Financial Advisor in a branch.

As the accounts migrated to the FAC in large numbers, Merrill Lynch solicited those customers for securities transactions, generating millions of dollars in annual gross revenues for Merrill Lynch. Certain ISAs employed an aggressive sales approach with those customers. The firm required ISAs to contact customers on an unsolicited basis through letters and phone calls and review their portfolios with them on a semi-annual basis. ISAs also distributed asset allocation portfolios for customers that were often accompanied by a recommendation to purchase new securities. ISAs typically made up to 20 outbound calls a day to newly transferred customers, "welcoming them" to the FAC.

ISAs were divided into "teams" and Merrill Lynch required them to achieve certain levels of production. Accordingly, the firm offered the ISAs, who were salaried employees, *substantial bonuses for increased production, including the sales of mutual funds*. For a certain period, ISAs were also paid bonuses based on "new money" production -- additional assets invested in existing accounts. The FAC management had sales contests and ISAs competed individually and as teams for awards and recognition based on overall production. The awards in most cases were either pewter statues of bulls (the Merrill Lynch brand logo), dinners or concerts. The firm also awarded expense credits based solely on MLIM sales, which as discussed further herein, violated NASD Conduct Rule 2830.

Many of the customers transferred to the FAC had longstanding mutual fund positions. Since ISAs were permitted to recommend equities or bonds only if requested to do so by the client, a frequently recommended securities transaction was a mutual fund "switch," a trade in which one mutual fund is sold and the proceeds are used to purchase another. As the number of accounts grew at the FAC, there was a corresponding increase in switching activity. For example, for the week ending December 7, 2001, there were approximately 762 switches that appeared on the FAC's Mutual Fund Liquidation Report, and for the week ending March 22, 2002, there were approximately 1,324 switches on the Report.

As the flow of accounts to the FAC increased, there was a corresponding increase in account assets and account activity within the FAC. By the end of 2001, there were approximately 800,000 accounts. At its peak size in June 2002, the FAC had approximately 1.3 million accounts with approximately \$20 billion in assets. Approximately 300 ISAs were recommending between 1,500-2,000 mutual fund switches a week. Those ISAs were generating approximately \$200,000 a day for Merrill Lynch in gross revenues.

Underlying Misconduct at the FAC Involving Mutual Fund Switch Transactions

From 2001-2003, certain ISAs engaged in a pattern of mutual fund switch recommendations that violated NASD Conduct Rule 2310, the suitability rule, because the ISAs failed to obtain sufficient information about customers' current financial circumstances and investment objectives, and made recommendations that did not result in a net economic advantage for customers, yet provided an increased financial benefit for the ISAs.

NASD Conduct Rule 2310 requires that brokers only recommend sales and purchases of securities that they have reasonable grounds to believe are suitable for a customer based upon that customer's disclosed financial situation and needs. To gather such information, brokers are required to obtain information concerning a customer's current financial status, tax status and investment goals/objectives. Certain of the ISAs violated this aspect of the rule by failing to update and obtain pertinent information from the customer to whom they were recommending a switch.

Despite the complexity of mutual fund switches and the fact that an ISA's first contact with a customer may have been when he was recommending a transaction, many of the calls between the ISAs and customers in which a switch was recommended lasted less than ten minutes.

This failure to gather customer suitability information was aggravated by the circumstances at the FAC, where many of the customers had account information that had not been updated in several years and where the account information that was on file at the FAC was often incomplete.

Furthermore, there was a pattern of mutual fund switch recommendations by certain ISAs that violated Merrill Lynch's own procedures and were unsuitable because they required customers to pay unnecessary costs and higher expenses. Merrill Lynch's compliance outline advised ISAs that they could not recommend a switch "unless it will result in a net investment advantage for the client, considering all financial and other factors, including sales charges and tax consequences." ISAs were also required to consider the availability of a free or low-cost exchange before recommending switches.

Many of the switches did not provide customers with such a "net investment advantage," for several reasons, including:

- Certain customers were switched between funds with similar investment objectives, while either incurring a CDSC, or assuming significantly higher annual (12b-1) fees, because the customers were switched from Class A mutual fund shares to Class B or Class C shares.

- Certain customers, who were switched between funds with different investment objectives, were not afforded the opportunity to avoid the adverse financial consequences described above by either maintaining their existing mutual funds or effecting a "free exchange" into comparable funds within the same fund family.

In recommending the unsuitable switches, certain ISAs also misrepresented and omitted material facts to Merrill Lynch customers, including the following:

- Recommending that customers switch from one fund to another, without disclosing the name of the fund being recommended, or other relevant information about the fund such as its investment objectives and the costs/expenses associated with the share class recommended.
- Misrepresenting that the recommended switch would be at "no cost" or words to that effect, without advising them their new mutual fund shares would require them to pay higher 12b-1 fees, and could subject them to CDSC charges if sold within a certain period.
- Misrepresenting the performance differences between the switched funds.
- Recommending that customers should switch from one mutual fund to another, while failing to disclose the cost saving options available through different share class options or free exchanges.

SUPERVISORY DEFICIENCIES

As noted above, from 2001 through 2004, Merrill Lynch failed to have a supervisory system and procedures that were reasonably designed to achieve compliance with the laws, regulations and rules applicable to mutual fund recommendations (including switch transactions), required disclosures to customers, sales contests, and registration of FAC personnel. In 2003 and 2004, Merrill Lynch made certain improvements to its supervisory system by enhancing exception reports and expanding the FAC administrative manager staff. Despite these improvements, Merrill Lynch's supervisory system in the FAC was still not reasonably designed to achieve compliance with applicable laws during this period. Specifically, Merrill Lynch failed to maintain, update and enforce reasonable internal policies, systems and procedures for FAC in the following respects:

Inadequate Resources and Systemic Failures

Given the large number of ISAs and customer transactions during the relevant time period, the FAC had a pressing need for licensed and experienced supervisors. Merrill Lynch, however, failed to place a sufficient number of properly trained and qualified securities supervisors in the FAC.

Merrill Lynch also failed to supply the FAC with adequate supervisory tools, such as automated systems, to review customer accounts and transactions. Further, Merrill Lynch did not provide the FAC with transaction reports that contained sufficient information to perform a meaningful suitability review of underlying transactions. For example, the firm utilized a daily trade blotter that identified all of the prior day's transactions within the FAC, but failed to identify the ISA (or their "team") who entered the transaction, and frequently omitted information regarding customer investment objectives. Moreover, with the average daily trading volume in FAC accounts increasing from 2,756 in 2001 to 4,840 in 2002, the daily trade blotters that Merrill Lynch utilized for supervision became so voluminous that it was unreasonable to expect principals to conduct a meaningful review of the transactions, resulting in many trades that were either not reviewed, or not reviewed in reasonable detail, to assess compliance with suitability requirements and other rules.

Despite the thousands of trades generated daily, there were only approximately three to six registered principals performing a manual review of the transactions of 300 ISAs via the above referenced trade blotters. Those individuals were administrative managers employed in the FAC who reported to the FAC's Director of Compliance and Risk Management. There were also insufficient exception reports to identify transactions that warranted heightened scrutiny, such as larger dollar transactions.

Due to additional deficiencies in the supervisory systems that Merrill Lynch employed in the FAC, supervisors also lacked the ability to perform a reasonable review of ISA activity through other measures. Merrill Lynch provided the FAC with a computer-based note system to maintain a record of ISAs' notes of recommendations and conversations with customers, but this system was unreliable and subject to recurring technological problems that prevented ISAs from consistently recording account information and notes. Moreover, although ISAs were required to use the system to record notes, they frequently failed to do so and the FAC management failed to enforce or supervise this requirement adequately.

Inadequate Supervision of Mutual Fund Transactions

The FAC's ability to utilize Merrill Lynch's supervisory systems and written procedures was not adequate to monitor mutual fund transactions by ISAs. The primary supervisory tool that FAC principals used to review mutual fund switches was a weekly exception report entitled the "Mutual Fund Liquidation Report." This report listed mutual fund purchase transactions greater than \$250 that generated production credits in accounts that also effected another mutual fund purchase or sale transaction (other than an exchange) within twenty-five days prior to the purchase transaction. The report, however, failed to identify the ISA who recommended the purchase and sale transactions.

Many of the switches that appeared on the Mutual Fund Liquidation Report were not subject to any supervisory review because they fell below a CDSC threshold that Merrill Lynch established for FAC in early 2002 for the sending of a letter ("switch letter") to a client highlighting the transaction. If a switch resulted in a CDSC above that threshold, an administrative manager sent a switch letter to the customer. Merrill Lynch increased its CDSC threshold on several occasions to reduce the number of switch transactions requiring a switch letter. For example, after initially setting the CDSC threshold at \$300, Merrill Lynch raised it to \$500 in April 2002 and to \$1,000 in September 2002. These changes were requested by the FAC administrative managers who were unable to send switch letters to customers for all of the switches that met the initial CDSC review threshold in effect at the time.

As a result, however, certain of the administrative managers with responsibility to review periodically the Mutual Fund Liquidation Report reviewed only those switch transactions that generated a CDSC above the threshold for sending switch letters. These supervisors did not review mutual fund switches that failed to generate a CDSC, such as the sale of Class A mutual fund shares, or that incurred a CDSC below the prescribed threshold. Consequently, thousands of mutual fund switches either were not reviewed or were not adequately reviewed.

Furthermore, even where a mutual fund switch triggered supervisor review, that review was frequently cursory and/or inadequately documented. Administrative managers did not frequently consult with ISAs about the basis for switches.

The form switch letters that FAC sent to customers whose switches reached the CDSC threshold oftentimes contained an inaccurate statement. Specifically, the letters represented that the administrative manager signing the letter had confirmed with the ISA (who had recommended the switch) that such ISA had discussed with the customer the costs associated with the switch. In fact, however, the administrative manager rarely discussed this issue with the ISA prior to sending the letters.

Beginning in or about August 2001, Merrill Lynch provided ISAs with a mutual fund share class script that was to be used in explaining to prospective investors important distinctions between mutual fund share classes. The script outlined the costs and expenses and other distinctions among the three primary mutual fund share classes: Class A, Class B, and Class C shares. For example, it referenced the higher annual expenses of Class B and Class C shares relative to Class A shares, and the CDSCs associated with the early sale of Class B or Class C shares. Although Merrill Lynch instructed ISAs to use the script as disclosure guidance for communicating important facts to customers in connection with mutual fund transactions, it did not implement any supervisory measures to reasonably determine that ISAs were following this important guidance. As described in greater detail above, Merrill Lynch did not require FAC supervisors, who were already randomly listening to recorded calls between ISAs and customers, to verify that the ISAs were complying with their disclosure obligations under the matrix.

Deficient Written Supervisory Procedures

Merrill Lynch failed to establish, maintain and enforce reasonable written procedures regarding mutual fund switches executed by ISAs. The firm's written supervisory procedures, among other things, failed to describe in reasonable detail the steps that supervisors were to follow in order to supervise switching activity, the frequency of those steps, and how they would be documented.

Compliance Audit Failures

In 2001 and 2002, Merrill Lynch failed to conduct annual compliance audits of the FAC. Additionally, the firm conducted a compliance audit of the FAC in 2003, but the audit failed to address any of the supervisory deficiencies that are the subject of this AWC.

Based on the foregoing, Merrill Lynch violated NASD Conduct Rules 3010 and 2110.

FAILURE TO REGISTER PRINCIPALS

Merrill Lynch allowed its Lead Advisors, primarily sales managers, to exercise direct supervisory responsibility over the ISAs. For example one of the supervisory functions Lead Advisors performed was to pre-approve all transactions recommended by ISAs in the \$50,000-\$100,000 range. The majority of the Lead Advisors, however, were not properly registered as principals and, therefore, lacked sufficient qualifications to supervise the ten to twelve ISAs that were in their teams.

Based on the foregoing, Merrill Lynch violated NASD Membership and Registration Rule 1021(a) and NASD Conduct Rule 2110.

VIOLATIVE SALES CONTESTS

NASD Conduct Rule 2830 prohibits non-cash compensation arrangements between members and their associated persons for sales of mutual funds and variable contracts that are not based on concepts of "total production" and "equal weighting."

In 2002, the FAC conducted three sales contests that were based on, and designed to promote, MLIM sales. The firm offered and awarded non-cash compensation to the contest winners. For example, one contest rewarded the six ISAs who sold the most MLIM products with tickets to a rock concert. Another contest offered a total of \$10,000 in expense credits (called "prizes") to the top four teams in terms of MLIM sales. The winning teams could use the expense credits to attend concerts, dinners and sporting events at Merrill Lynch's expense. The third contest awarded a dinner in Princeton to 20 MLIM sales contest participants with the head of MLIM and other Merrill Lynch management.

These sales contests, along with several other contests based on overall production, contributed to a dramatic increase in the volume of MLIM sales by the FAC. For example, in the first half of 2002, gross sales of MLIM products increased from \$36.4 million in the first quarter to \$138.7 million in the second quarter - a 281% increase.

The three FAC sales contests described above violated the non-cash compensation provisions of NASD Conduct Rule 2830 as Merrill Lynch only rewarded ISAs for sales of MLIM products, and not for sales of the other mutual funds it distributed.

Merrill Lynch also failed to establish and maintain a supervisory system and written procedures reasonably designed to achieve compliance with NASD Conduct Rule 2830.

Based on the foregoing, Merrill Lynch violated NASD Conduct Rules 2830, 3010 and 2110.

B. We also consent to the imposition, at a maximum, of the following sanctions:

A censure and a fine of \$5 million.

In addition, Merrill Lynch shall comply with the following undertakings within the time periods specified (unless otherwise extended by NASD staff following a written request by Merrill Lynch):

- (1) Sales Contest Prohibition: For three (3) years from the date of issuance of this AWC, Merrill Lynch shall prohibit any sales contests to promote the sale of mutual funds or other securities by registered personnel employed at the FAC.
- (2) Special Supervisory Measures: Until such time as Merrill Lynch has provided the certification required by paragraph (4)(d) below, the firm shall: require ISAs to obtain the prior approval of a registered securities principal for any mutual fund switch recommendation, and conduct, on a semi-annual basis, compliance audits of the FAC equivalent to those it conducts of its larger-sized branch offices.
- (3) Monitoring of Customer Calls: Until such time as Merrill Lynch has provided the certification required by paragraph (4)(d) below, the firm shall require a random review by registered securities principals of no less than five (5) recorded telephone conversations with customers per month for each ISA to determine, among other things, adherence to firm compliance policies and procedures, and to the applicable laws, regulations and rules, covering investment recommendations and appropriate disclosures. Such reviews shall be documented by the registered securities principals.

(4) Retention of an Independent Consultant and Implementation of New Procedures:

- a. Within 60 days of the issuance of this AWC, Merrill Lynch shall retain an independent consultant ("consultant") not unacceptable to the staff of NASD. The consultant's compensation and expenses shall be borne exclusively by Merrill Lynch. The consultant shall review and make written recommendations for revision of the firm's policies, practices, and supervisory and compliance procedures and systems in the following areas relative to the FAC: mutual fund recommendations (including switch transactions) and required disclosures to customers, ISA compensation, sales contests, and registration of FAC supervisory personnel. The consultant shall also undertake a review of the resources employed by Merrill Lynch, assess the adequacy of such resources, and make written recommendations concerning the firm's resource needs in order to comply with the laws, regulations and rules applicable to those areas enumerated above.
- b. Merrill Lynch shall fully cooperate with the consultant, and shall provide the consultant with access to its files, books, records, and personnel as reasonably requested for the review. Merrill Lynch must not place restrictions on the consultant's communications with NASD staff. Upon request, Merrill Lynch will make available to NASD any and all communications between the consultant and the firm, and any documents that the consultant reviewed or relied upon in connection with the retention.
- c. At the conclusion of the consultant's review, which in no event shall be more than 90 days after the consultant is retained, the consultant shall submit to Merrill Lynch and NASD staff a written report detailing the consultant's determinations and recommendations. If Merrill Lynch accepts all the consultant's recommendations, it shall adopt and implement the recommendations within 120 days after delivery of the written report. If Merrill Lynch determines that any recommendations are unduly burdensome or impractical, the firm shall, within 30 days after delivery of the written report, propose an alternative that is reasonably designed to achieve the same objective(s). Merrill Lynch shall submit such proposed alternatives in writing simultaneously to the consultant and NASD staff. Within 30 days of receipt of any proposed alternate procedure, the consultant shall: (i) reasonably evaluate the alternative procedure and determine whether it will achieve the same objective as the consultant's original recommendation; and (ii) provide the firm with a written decision reflecting his or her determination. Merrill Lynch will abide by the consultant's ultimate determination with respect to any proposed alternative procedure and, within 120 days of delivery of the consultant's decision as to proposed alternative procedures, must adopt and implement all recommendations deemed appropriate by the consultant.
- d. Within 120 days after delivery of the consultant's written report, or, if Merrill Lynch proposes alternative procedures, within 120 days of delivery of the

consultant's decision regarding alternative procedures, an officer of Merrill Lynch shall certify in writing to NASD that the firm has implemented each of the consultant's recommendations. This certification shall also describe the specific actions taken by the firm, including the systems and procedures developed and implemented that are reasonably designed to achieve future compliance with the laws, regulations and rules applicable to mutual fund recommendations (including switch transactions), required disclosures to customers, ISA compensation, sales contests, and registration of FAC personnel.

- e. During the period that the consultant has been retained, and for a period of two years following the date of the conclusion of the consultant's work as described herein, neither Merrill Lynch, nor any of its affiliates, nor any of Merrill Lynch's or its affiliates' principals, agents, officers, directors or employees acting in their capacities as such, may employ or otherwise hire the consultant in any other capacity. Any firm with which the consultant is affiliated or of which he or she is a member, and any person or firm engaged to assist the consultant in the performance of his or her duties shall not, without prior written consent of NASD staff, enter into any employment, consulting or other professional relationship with Merrill Lynch or any of its affiliates, or any of Merrill Lynch's or its affiliates' directors, officers, employees, or agents in their capacity as such for the period of the engagement and for a period of two years after the engagement.

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

III.

OTHER MATTERS

- A. We understand that we may attach a Corrective Action Statement to this AWC, which is a statement of demonstrable corrective steps taken to prevent future misconduct. We further understand that we 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. We agree to pay any monetary sanctions imposed on us upon notice that this AWC has been accepted and that such payments are due and payable and have attached an Election of Payment form showing the method by which we propose to pay any fine imposed.
- C. We specifically and voluntarily waive any right to claim we are unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

We certify that we have read and understand all of the provisions of this AWC and have 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 us to submit it.

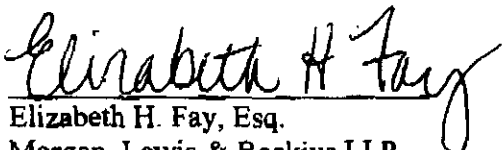
Merrill Lynch, Pierce, Fenner & Smith Inc.

Date

By:

Barry J. Mandel
Senior Vice President

Reviewed by:


Elizabeth H. Fay, Esq.

Morgan, Lewis & Bockius LLP

Counsel for Merrill Lynch, Pierce, Fenner & Smith Inc.

Accepted by NASD:

Date

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

Michael J. Newman
Regional Counsel
NASD Department of Enforcement
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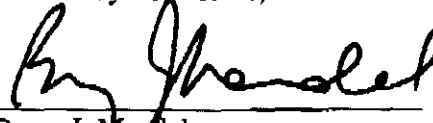
NASD District Director
Gary K. Liebowitz
NASD, District 9-New Jersey
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(732) 596-2025

We certify that we have read and understand all of the provisions of this AWC and have 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 us to submit it.

2/23/06
Date

Merrill Lynch, Pierce, Fenner & Smith Inc.

By:


Barry J. Mandel
Senior Vice President

Reviewed by:

Elizabeth H. Fay, Esq.
Morgan, Lewis & Bockius LLP
Counsel for Merrill Lynch, Pierce, Fenner & Smith Inc.

Accepted by NASD:

3/15/06
Date

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


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