

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
EAF0300610002

TO: Department of Enforcement
NASD

RE: Merrill Lynch, Pierce, Fenner & Smith Inc. (BD #7691)

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

Respondent 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 Enforcement and National Adjudicatory Council ("NAC"), 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 Respondent; and
3. If accepted:
 - a. this AWC will become part of Respondent's permanent disciplinary records and may be considered in any future actions brought by NASD or any other regulator against Respondent;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondent'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. Respondent 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 Respondent's testimonial

obligations or right to take legal positions in litigation in which NASD is not a party.

Respondent 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:

Merrill Lynch, Pierce, Fenner & Smith Inc. (CRD #7691) is a broker-dealer with headquarters in New York, New York. The firm has been an NASD member since 1937. Merrill Lynch has over 25,000 registered personnel in 651 branches. The firm has no relevant disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

Respondent 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 it;
- 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, 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 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. Respondent hereby accepts and consents, without admitting or denying the allegations, 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, to the entry of the following findings by NASD:
1. Merrill Lynch and its registered representatives periodically provide information to customers about the mortgage programs of an affiliate, Merrill Lynch Credit Corp. ("MLCC"). One of these programs, known as Mortgage 100, provides customers with up to 100% financing of a home mortgage loan collateralized in part by a pledge of securities in their Merrill Lynch accounts. Merrill Lynch's registered representatives receive production credit when a referral of a customer to MLCC results in the customer obtaining a mortgage loan from MLCC. The amount of the credit ranges between 25 basis points and 75 basis points of the amount of the loan, depending on the number of successful referrals generated by the registered representative.
 2. Under the Mortgage 100 program, customers pledge an interest in securities held in their Merrill Lynch brokerage accounts instead of making a down payment for the purchase or refinance of a home. If the value of pledged assets falls below a required maintenance value, the customer may receive a collateral call from MLCC. Furthermore, MLCC, pursuant to the pledge agreement, may instruct Merrill Lynch to liquidate the pledged collateral account without notice to the borrower if the value of the pledged assets in the pledged collateral account falls below a predetermined minimum value or if a collateral call is not met within five business days. Liquidation of the pledged asset account does not constitute a default on the mortgage loan itself. If a liquidation is done, the pledged assets are sold and the cash proceeds remain in the borrower's pledged collateral account until the borrower's mortgage is repaid or refinanced, the borrower authorizes the use of a portion of the assets in the pledged collateral account to reduce the balance due on the mortgage to the market value of the property, or the borrower deposits additional assets to bring the value of the account back up to the maintenance value.
 3. During 2003, Merrill Lynch established a link on its public website to the MLCC website. The link allowed Merrill Lynch customers to view information about various MLCC mortgage programs, including Mortgage 100. The material concerning Mortgage 100 identified the NASD member firm Merrill Lynch and stated several times that a requirement of the Mortgage 100 program was that the customer pledge eligible securities currently maintained in a domestic Merrill Lynch brokerage account. As a result, the material available through the Merrill Lynch website by way of the link was advertising material under Conduct Rule 2210(a)(1).

4. The advertisement (in the form of website content) included statements and representations which were misleading or unbalanced, including a compounding chart captioned "Look at how your down payment can grow over the next seven years." The chart illustrated potential growth in the value of securities held in the pledged asset account using several different assumed rates of return, including a 15% rate. The chart and caption were exaggerated and promissory in their presentation of potential growth and failed to disclose the hypothetical nature of the illustration. In addition, the advertisement failed to disclose material information about the Mortgage 100 program, such as that MLCC could liquidate the pledged assets without contacting the customer, that MLCC had the ability to choose which securities would be sold in order to maintain sufficient equity in the pledged collateral account, and that the customer could incur further losses if additional assets needed to be deposited into the pledged collateral account. The chart was removed from the website in October 2003 after Merrill Lynch was contacted by NASD.
5. The statements described above that were available on the Merrill Lynch website by way of link to the MLCC website failed to comply with the requirement of Conduct Rule 2210(d)(1)(A) that advertising materials contain a fair and balanced presentation of the risks as well the benefits of the particular services offered and provide a sound basis for evaluating the facts in regard to any particular service, and failed to comply with Conduct Rule 2210(d)(1)(B), which prohibits misleading or exaggerated statements or claims.
6. Since at least August 2003 until March 2005, Merrill Lynch had no supervisory or other procedures in place relating to the activities of the firm's registered representatives in connection with the Mortgage 100 program. Merrill Lynch failed to establish any guidelines or procedures for monitoring or overseeing the activities of the firm's registered representatives in connection with recommendations that customers participate in the Mortgage 100 program. In addition, the firm did not utilize any procedures, exception reports or other documents that might assist managers, compliance personnel or other staff in reviewing accounts that utilized the Mortgage 100 program.
7. As a result, Merrill Lynch failed to establish and maintain procedures, including written supervisory procedures, or a supervisory system, reasonably designed to achieve compliance in connection with the firm's activities relating to the Mortgage 100 program. Merrill Lynch therefore violated Conduct Rule 3010.

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

1. A censure; and
2. A fine in the amount of \$50,000.
3. Within 90 days after issuance of the AWC, an officer of Merrill Lynch shall certify to NASD that it has reviewed its procedures regarding the Mortgage 100 program and that the firm has established systems and procedures reasonably designed to achieve compliance with applicable laws, regulations and rules relating to that program.

III.

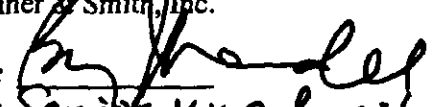
OTHER MATTERS

- A. Respondent understands that it 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 NASD, nor does it reflect the views of NASD or its staff.
- B. Respondent agrees to pay any monetary sanctions imposed on it 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 it proposes to pay any fine imposed.
- C. Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

Respondent 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, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce it to submit it.

July 14, 2005
Date

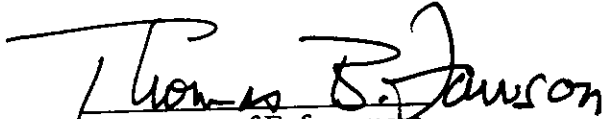
Respondent Merrill Lynch, Pierce,
Fenner & Smith, Inc.

By: 

Its: Scott Vice President and
General Counsel for Litigation,
Regulatory Affairs and
Employment Law

Accepted by NASD:

7/29/05
Date


Department of Enforcement
on behalf of the Director of ODA,
pursuant to delegated authority

Corrective Action Statement of Merrill Lynch, Pierce, Fenner & Smith, Incorporated

This Corrective Action Statement is submitted by the Respondent. It does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD, or its staff.

With regard to the disclosure concerning Mortgage 100, Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill Lynch") requested its affiliate, Merrill Lynch Credit Corporation ("MLCC") redraft the disclosure to address the concerns of the NASD staff. MLCC agreed and has revised the disclosure with regard to some advertising and marketing materials and is in the process of completing the revision with regard to all advertising that specifically describes the Mortgage 100 program.

The current disclosure language reads as follows:

Merrill Lynch's Mortgage 100®/Parent Power®¹ program requires the pledge of eligible securities owned by an individual and maintained in a Merrill Lynch, Pierce, Fenner & Smith, Incorporated brokerage account. Member, Securities Investor Protection Corporation (SIPC). Mortgage 100®/Parent Power® may not be suitable for everyone and a default on your mortgage could result in both the loss of your home and your securities. Should the value of the securities pledged as collateral decrease below a certain level (as specified within the loan documents), the deposit of additional assets and/or liquidation of assets may be required. Merrill Lynch may liquidate some or all of the securities in the account without contacting you. You are not entitled to an extension of time to meet a collateral call or choose which securities in your account are sold to meet the collateral call. Liquidation may result in adverse tax consequences. Mortgage interest may not be deductible if tax-exempt obligations are pledged as additional collateral. Trading within the brokerage account for the 100% financing programs is subject to restrictions.

With regard to supervisory procedures, Merrill Lynch issued a Procedure Bulletin on March 18, 2005, entitled "MLPF&S Evaluation of Mortgage 100 and Parent Power." The Procedure Bulletin sets forth guidelines that an Office Management Team ("OMT") may use to assess the suitability of 100% financing of a home mortgage by a particular client with respect to the leverage which results in the pledged collateral account. MLCC, not Merrill Lynch, assesses the creditworthiness of the client and makes the lending decision.

The Procedure Bulletin sets forth a number of factors to be considered by the OMT, including:

- Investment objectives, risk tolerance, and financial situation, as indicated on the investor profile;
- Current assets and securities-based debt, if any;

¹ Parent Power is a 100% financing mortgage program that allows parents or other qualified sponsors to assist their adult children or an acceptable third party to purchase a home with the parents/sponsors pledging assets in a securities account in the same manner as Mortgage 100.

- Client's understanding of the risks of Mortgage 100/Parent Power (collateral calls, reduced liquidity, maintenance of collateral account at Merrill Lynch); and
- Client's relative sophistication and investment history, considering the client's occupation, types of investments, account activity, and securities based debt experience.

The new supervisory procedures and disclosure language evidence the Firm's continuing commitment to improve its compliance with evolving regulatory standards.