

**NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. EAF03007200-01**

**TO: Department of Enforcement
NASD**

**RE: Merrill Lynch, Pierce, Fenner & Smith Incorporated, Respondent
Member Firm
BD No. 7691**

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

Merrill Lynch 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") 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 it; and**
- 3. If accepted:**
 - a. this AWC will become part of Merrill Lynch's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against it;**
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Merrill Lynch's disciplinary records;**
 - 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. 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 allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects Merrill Lynch's**

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

Merrill Lynch 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, through its predecessors, has been an NASD member since 1937. Merrill Lynch's principal offices are located in New York, New York. Merrill Lynch has not been the subject of any prior relevant disciplinary action.

I.

WAIVER OF PROCEDURAL RIGHTS

Merrill Lynch 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 ("SEC") 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 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. Findings

Merrill Lynch 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:

Summary

This matter arises from a review of Merrill Lynch's sales of Class B and Class C shares of mutual funds¹ between January 1, 2002 and September 30, 2003 (the "review period"). Within the review period, Merrill Lynch's clients purchased Class B and Class C shares through its registered representatives, known as financial advisors ("FAs"). In connection with numerous transactions it recommended, Merrill Lynch did not consider or adequately disclose, at the point of purchase, on a consistent basis, that an equal investment in Class A shares would generally have been more economically advantageous for certain clients.

In particular, the firm's practices did not consistently give adequate consideration to whether large investments in Class A shares of mutual funds, generally beginning at the \$50,000 investment level, would entitle investors to breakpoint discounts on sales charges. Investors may be entitled to breakpoints based upon a single mutual fund purchase, multiple purchases in the same "family of funds," and/or mutual fund investments held, at the time of the new purchase, by members of the client's "household," as that term is defined in the prospectus of the fund in which the shares are being purchased. Unlike Class A shares, Class B shares are subject to contingent deferred sales charges ("CDSCs") for a period of time, generally six years, as well as higher ongoing Rule 12b-1 fees for as long as the Class B shares are held or until they convert to Class A shares, which generally occurs after 8 years. The reduced initial sales charges, along with the general absence of any CDSC and the generally lower ongoing expenses associated with Class A shares, will affect the return realized on mutual fund investments.

In addition, Merrill Lynch's supervisory procedures and compliance policies during the review period were not reasonably established, maintained and/or enforced so that the firm, at the point of each purchase, provided adequate disclosure of, or consideration to, on a consistent basis, the benefits of the various mutual fund share classes as they applied to each individual client's circumstances.

¹ For the purpose of this matter, mutual fund is defined as an open-end investment company registered under the Investment Company Act of 1940.

As a result of the foregoing, Merrill Lynch violated NASD Conduct Rules 2110, 2310, and 3010.

Accordingly, Merrill Lynch will undertake a remediation plan that includes more than 105,000 transactions involving at least 23,000 client households.

Share Classes

1. Merrill Lynch sells mutual funds that offer different classes of shares representing interests in the same portfolio of securities, but differing in the structure and amount of sales charges paid directly by shareholders and continuous, asset-based fees assessed on each shareholder's investment.
2. Generally, Class A shares are subject to a front-end load or initial sales charge when purchased and incur ongoing fees and expenses paid out of fund assets, including Rule 12b-1 fees that are typically 0.25 percent. The initial sales charge is paid by the investor and reduces the amount of the investor's money available to purchase shares of the fund. The majority of the initial sales charge is paid to the selling broker-dealer as a commission. Typically, the percentage of the investment paid as an initial sales charge decreases as the size of the investment increases. This concept applies to both single purchases and to multiple purchases in the same family of funds that may be aggregated with an investor's other investments, as well as investments by that investor's household, as permitted by a fund's prospectus. For most investments in which the total dollar amount invested in a fund family is \$1 million or more, the initial sales charge is generally waived.² These discounts are commonly referred to as "breakpoints" and the discounts typically increase at each of the \$50,000, \$100,000, \$250,000, \$500,000 and \$1 million levels.
3. Generally, Class A share investments that, when aggregated, fall below \$50,000 are subject to an initial sales charge that can range from 3.00 to 5.50 percent. However, for an investment: (i) between \$50,000 and \$99,999 the sales charge can range from 2.50 to 4.50 percent; (ii) between \$100,000 and \$249,999 the sales charge can range from 2.00 to 3.50 percent; (iii) between \$250,000 and \$499,999 the sales charge can range from 1.50 to 2.50 percent; (iv) between \$500,000 and \$999,999 the sales charge can range from 1.25 to 2.00 percent; and (v) of \$1 million or more reduces the sales charge to zero. These breakpoints reduce the commissions paid to the selling broker-dealers by a corresponding amount. Investors can receive the benefits of breakpoint discounts by, among other ways, making a single investment, aggregating purchases, employing rights of accumulation or utilizing letters of intent.³

² A CDSC, generally totaling 1.00 percent, is typically charged for redemptions that occur within the first year following such an investment.

³ A right of accumulation permits an investor or an eligible group of related investors (e.g., the investor, the spouse and minor children) to "accumulate" or combine existing holdings of shares of a particular fund complex with additional purchases of shares of the same fund complex for the purpose of achieving breakpoints and associated discounts. Investors may also qualify for breakpoints by executing a letter of intent, which is an agreement to make multiple purchases of Class A shares issued by a

4. Class B shares do not carry any front-end sales charge. Instead of a front-end sales charge, Class B shares may be subject to a CDSC if redeemed prior to the expiration of the holding period specified in the prospectus. The amount of the CDSC is generally calculated as a percentage of the lesser of the initial amount invested or the investment's value at the time of the sale, declines each year and eventually disappears entirely. Class B shares generally incur significantly higher ongoing fees and expenses than Class A shares. Annual Rule 12b-1 fees are typically 1.00 percent, in contrast to Class A shares which are typically 0.25 percent. Class B shares usually convert to Class A shares, at no cost to the investor, after eight years.
5. Class C shares typically do not carry a front-end sales charge but may be subject to a 1.00 percent CDSC if the shares are redeemed within one year. In comparison to Class A shares, Class C shares generally incur significantly higher ongoing fees and expenses, including annual Rule 12b-1 fees that are typically 1.00 percent. Class C shares never convert to Class A shares, thereby subjecting investors to higher expenses as long as the investors hold the Class C shares.
6. The different sales charges, availability of breakpoints and the amount of ongoing fees and expenses, including Rule 12b-1 fees, associated with different share classes have a direct effect on a mutual fund investment's return. The significance of these differences is that, at certain dollar levels, assumed investment rates of return and over certain holding periods, an equal investment in Class A shares generally will yield a better return than a similar investment in Class B or Class C shares.
7. With Class B shares, the mutual fund distributor, which is generally an affiliate of the mutual fund, advances a commission to the selling broker-dealer. Broker-dealers and their representatives may receive greater commissions from the sale of Class B shares than from the sale of the same amount of Class A shares if the sale would qualify for certain breakpoint discounts. Mutual fund complexes, through their distributors, recoup the commissions they advance for Class B shares through the higher Rule 12b-1 fees and/or the CDSC. The different fee structures and characteristics of Class A, Class B and Class C shares, including the availability of breakpoint discounts with regard to purchases of Class A shares, are described in the mutual fund prospectuses and statements of additional information.
8. On certain occasions during the review period clients purchased Class B and/or Class C shares of mutual funds through Merrill Lynch where, depending upon among other things, the amount of the investment, assumed investment rate of return and the client's individual circumstances (including the client's contemplated holding period), they would have expected to earn a better return had they purchased Class A shares instead. Specifically, these clients made purchases of Class B and/or Class C shares in various mutual funds which, had they purchased Class A shares, could have qualified for breakpoints, through single purchases, aggregating multiple purchases, employing rights of accumulation or utilizing letters of intent. In some instances,

fund family over a period of time, usually around 13 months, which, when aggregated, equal an amount that qualifies for a breakpoint discount.

Merrill Lynch received greater commissions, totaling approximately \$14 million, when clients purchased Class B shares than it would have received had such clients instead purchased Class A shares of the same mutual funds.

Suitability Violations

9. NASD Conduct Rule 2310 requires that, before recommending a transaction, a member firm and its registered representatives shall have reasonable grounds for believing, on the basis of information furnished by the client, and after reasonable inquiry concerning the client's investment objectives, financial situation, and needs, that the recommended transaction is suitable for the client. Further, NASD has long held that in recommending a transaction, a registered representative has an obligation to avoid increasing the costs that his or her clients pay. Also, a registered representative's recommendations must be consistent with his or her client's best interests.
10. In recommending the purchase of mutual funds, a member firm and its registered representatives must determine the suitability of the particular mutual fund, as well as the suitability of the class of shares to be purchased. Primary considerations include the client's personal and financial circumstances and investment objectives, the investment amount, the expected term of the investment, and the fees and expenses associated with each class of shares. These individual considerations, among others, must be balanced at the point of purchase by the member firm.
11. In recommending a particular share class, a member firm and its registered representatives should, among other things, weigh the potential effect that the comparative sales loads, including the availability of breakpoints, and ongoing fees and expenses, could have on the investment over the investor's contemplated holding period.
12. In certain instances during the review period, Merrill Lynch did not disclose at the point of purchase or adequately consider, on a consistent basis, the foregoing elements when making recommendations to clients to purchase Class B and Class C shares instead of Class A shares. In one instance, a Merrill Lynch client invested a total of \$100,000 in Class B shares of a bond fund. By purchasing Class B shares instead of Class A shares, the client was subjected to additional fees and expenses, and CDSCs if the investment was redeemed in whole or in part within six years. A quantitative analysis at the point of purchase would have revealed that if the client were to sell the Class B shares at the end of any of the first 3 years following the investment, the client, under the hypothetical setting,⁴ would be disadvantaged by more than \$1,550.⁵ The analysis also would have revealed that, assuming the client

⁴ The example assumes an annualized rate of return, before expenses, of 5.00 percent. Also, the example utilizes the breakpoints, annual expenses applicable for each class, including Rule 12b-1 fees, and the CDSC schedule applicable to Class B shares, which are set forth in the relevant fund prospectus and, where appropriate, the statement of additional information for the fund.

⁵ The results could have been obtained by using either the "NASD Mutual Fund Expense Analyzer" or the "SEC Mutual Fund Cost Calculator," which have been available to the public since January 2002, and 2001, respectively.

did not sell the initial investment, the year-end economic disadvantage would continue over time, up through and following the date upon which the Class B shares would automatically convert to Class A shares.

13. By virtue of the aforementioned conduct, Merrill Lynch violated NASD Conduct Rules 2110 and 2310.

**Merrill Lynch's Supervisory Procedures and Compliance Policies
Regarding Class B and Class C Shares Were Inadequate**

14. During the review period, Merrill Lynch provided FAs and supervisors with guidance in determining which share class may be the most appropriate for clients. For example, the firm's Branch Office Policy Manual contained information on the factors to consider in recommending any share class of a mutual fund. FAs were required to recommend the mutual fund share class that, under the circumstances of any transaction, appeared to be the most appropriate for the client. Supervisors were required to assess the suitability of certain transactions by considering various factors.
15. Additionally, during the review period, with limited exceptions, Merrill Lynch prohibited: purchase orders for Class B shares equaling \$250,000 or greater and purchase orders for Class C shares equaling \$1,000,000 or greater. Merrill Lynch also required supervisors to "carefully scrutinize" purchase orders for Class B shares equaling \$100,000 or greater and (a) document the supervisor's review, and (b) determine whether the transaction was appropriate.
16. Merrill Lynch's maintenance of its policies and procedures was inadequate because it did not consistently require the application of the criteria described above in reviewing recommendations to clients as to which share class appeared to be the most suitable given that client's individual circumstances and investment objectives, assumed investment rate of return and contemplated holding period. Similarly, Merrill Lynch's policies and procedures did not adequately consider how breakpoints, including those that could be achieved through various available aggregation rights, could affect the relative economic performance of an equal investment in Class A, Class B or Class C shares of a mutual fund.
17. Merrill Lynch also did not adequately maintain its policies and procedures so that, in recommending mutual fund shares to clients, it disclosed at the point of purchase, on a consistent basis: (i) that certain share classes were subject to higher annual fees that might have a negative effect on the clients' investment return, and (ii) that at certain breakpoint levels, an equal investment in Class A shares might yield a higher return for the period that clients anticipated holding the investment.
18. Merrill Lynch failed reasonably to enforce consistently certain of its written policies and procedures relating to the purchase of mutual funds. Specifically, while Merrill Lynch's policies generally prohibited purchases of Class B shares totaling \$250,000 or greater, there were at least 20 such purchases during the review period. Although

Merrill Lynch's policies required that a supervisor document his or her review of single-ticket Class B share purchases of \$100,000 or greater, in many cases inadequate documentation existed to demonstrate that such supervisory review occurred.

19. In July 2003, Merrill Lynch began to implement a number of enhancements to its compliance policies and supervisory systems and procedures regarding mutual fund share class recommendations. The enhanced policies and procedures: take into account the aggregation of household assets in determining appropriate share class recommendations; require additional client disclosures; and employ system edits to block certain transactions.
20. In connection with the aforementioned conduct, Merrill Lynch failed to establish, maintain and enforce supervisory and compliance policies and procedures that were reasonably designed to achieve compliance with NASD Conduct Rules 2110 and 2310, and therefore, violated NASD Conduct Rules 2110 and 3010.

B. Sanctions

Respondent consents to the imposition, at a maximum, of the following sanctions:

1. A censure.
2. A fine of \$14 million.
3. Respondent agrees to complete the following undertakings⁶:
 - a. Merrill Lynch shall create a list of clients who purchased (i) \$50,000 or more of Class B shares in any single fund family between January 1, 2002 and the effective date of this AWC (the "relevant time period"), which shall be aggregated by household⁷ and fund family in determining if the \$50,000 threshold was met; and (ii) Class C shares during the relevant time period which, when aggregated by client household and fund family, total \$500,000 or more and involve payment of a front-end load, or \$1 million or more where no front-end load was paid. The list must include at least the client's name(s) and contact information, a firm-designated household identification number, the trade date, fund name, fund symbol and number of shares purchased, and the gross principal amount invested for every purchase. Every purchase transaction on the list is deemed a "Qualifying Purchase". When determining the list of Qualifying Purchases, Merrill Lynch shall make such calculations based on the effective date of the AWC. However, Qualifying Purchases

⁶ Certain types of accounts, e.g., 401K Plan accounts for which Merrill Lynch is the record keeper, and transactions, e.g., mutual funds purchased in annuity contract sub accounts, are excluded from these undertakings based on the fact that they are subject to specific contractual pricing terms or the "point of purchase" occurred away from Merrill Lynch.

⁷ "Household" includes all accounts that are related by at least two of the following three factors: (1) tax identification/social security numbers, (2) address, and (3) last or "key" name.

shall not include the following items i.- ii., and may not, at Merrill Lynch's option, include the following items iii.- viii.:

- i. Purchases of Class B shares, which, when aggregated with other Class B share purchases at the firm by the same household in the same fund family during the relevant period, total less than \$100,000, and involve a mutual fund that imposes a Class A share initial sales charge exceeding 4.00 percent for purchase amounts less than \$100,000;
- ii. Purchases of Class B and Class C shares which were later cancelled at no cost to the client;
- iii. Purchases of Class B and Class C shares for which clients have previously settled and signed releases of claims against Merrill Lynch;
- iv. Purchases of Class B shares, which, when aggregated with other Class B share purchases at the firm by the same household in the same fund family during the relevant period, total less than \$100,000, and where the client (1) entered into a systematic withdrawal plan at the time of the Class B share purchase, and immediately began receiving systematic withdrawals from the Class B share purchase without incurring CDSCs, or (2) chose not to reinvest all capital gains and dividends from the Class B share purchase;
- v. Purchases of Class B shares, which, assuming a 5.00 percent annual rate of return and considering all expenses, are projected to have a higher redemption value, determined as of the end of each year following the purchase date, in comparison to Class A shares in two or more years during the period beginning with the effective date of the AWC and ending on the date the Class B shares are scheduled to automatically convert to Class A shares under the terms of the fund prospectuses in effect at the time of the purchase;
- vi. Purchases of Class B and Class C shares where the gross principal amount invested was \$250 or less;
- vii. Purchases of Class B shares which, when aggregated with other Class B share purchases at the firm by the same household in the same fund family during the relevant period, total less than \$100,000, and involve a mutual fund listed in "Schedule A" (attached); and
- viii. Purchases of Class B shares which, when aggregated with other Class B share purchases at the firm by the same household in the same fund family during the relevant period, total less than \$250,000, and involve a mutual fund listed in "Schedule B" (attached).

- b. Merrill Lynch may further remove Qualifying Purchases as long as it provides NASD with quantitative proof that the client could not materially benefit⁸ from having the particular transaction converted to Class A shares and the removal of such Qualifying Purchase is not unacceptable to NASD.
- c. Within 120 days from the effective date of the AWC, Merrill Lynch shall offer any client, who made a Qualifying Purchase(s) and still holds all, or any portion of, such shares, the option of converting such Class B and/or Class C shares into Class A shares in such a manner that each client is placed in substantially the same financial position, based on actual fund performance, in which such client would have been with respect to the Qualifying Purchase(s) had the client purchased Class A shares instead of Class B and/or Class C shares.⁹
- d. Clients electing to convert any Qualifying Purchase shall receive:
 - i. an amount of Class A shares equal to what the client could have purchased on the date of the Qualifying Purchase utilizing the same amount of money, before application of any fees or expenses, invested in the Qualifying Purchase and applying the breakpoint sales charges associated with the Class A shares calculated as described herein; and
 - ii. an additional amount of Class A shares equal to the value of all reinvestment shares the client would have acquired if they had initially purchased Class A shares.
- e. Merrill Lynch shall pay cash to those clients who made a Qualifying Purchase(s) and sold some or all of their Class B and/or Class C shares comprising the Qualifying Purchase(s) to place them in substantially the same financial position, based on actual fund performance and redemption value in which such clients would have been had the clients purchased Class A shares instead of Class B and/or Class C shares.
- f. In performing the undertakings set forth in d. and e., above, each client shall be entitled to breakpoints to the full extent permitted by the prospectus and/or SAI for each relevant fund.¹⁰

⁸ Merrill Lynch will not be required to offer a client conversion if the client would not materially benefit from an offer of conversion because either the annual expense differential between Class A shares and Class B and/or Class C shares, the CDSC schedule, and/or the conversion year quantitatively are such that Class B and/or Class C shares may be substantially equal, or more appropriate, compared to Class A shares of the same fund, at particular investment levels.

⁹ In addition to the Qualifying Purchase, any conversion will also take into account any shares acquired through reinvestment of distributions paid on the Qualifying Purchase.

¹⁰ If the firm's offer to convert and/or its cash payment relates to a Qualifying Purchase of Class B shares, the firm may elect, in lieu of including all eligible assets noted in the relevant fund's prospectus/SAI, to include only the balance of all Class B share investments held in accounts maintained with the firm to be aggregated in accordance with the relevant fund's prospectus/SAI to determine the applicable breakpoints at the time of the Qualifying Purchase, including investments made before the relevant time period and held at the time of the Qualifying Purchase. Similarly, if the firm's offer to convert and/or cash payment relates to a Qualifying Purchase of Class C shares, the firm may elect to include only the balance of all Class C share investments held in accounts maintained with the firm to be aggregated in accordance with the relevant fund's prospectus/SAI in determining the applicable breakpoints at the time of the Qualifying Purchase, including investments made before the relevant time period and held at the time of the Qualifying Purchase. In addition, the firm may elect to utilize its own

- g. In the event that any client who made a Qualifying Purchase(s) elects to convert any of those purchases to Class A shares from Class B or Class C shares, and Merrill Lynch is unable to effectuate such conversion for any reason, Merrill Lynch shall pay cash to such client in an amount that will place the client in substantially the same financial position, based on actual fund performance and liquidation value, that such client would have been in as of the effective date of the AWC had the client made his or her Qualifying Purchase(s) in Class A shares instead of Class B and/or Class C shares.
- h. When calculating the financial position of any client for purposes of conversion, Merrill Lynch shall make such calculation based on the date of conversion, or on such date immediately prior to the date of conversion sufficient to allow the execution of the necessary transactions. When calculating the financial position of any client for purposes of a cash payment, Merrill Lynch shall make such calculation as of the date the Qualifying Purchase was redeemed, in the case of closed or partially closed positions or, in the event that the cash payment is required as a substitute for conversion, as of the effective date of the AWC.
- i. Within 60 days from the effective date of the AWC, Merrill Lynch shall submit to NASD for review a sample letter in plain English: (i) offering clients, according to the particular characteristics of their account and purchases, the opportunity to convert any or all of their Qualifying Purchases; (ii) explaining the economic advantages and disadvantages to the client of the options; and (iii) stating that the client should consult with a tax advisor to determine whether the conversion carries any federal, state, or local tax consequences. The letter shall not be unacceptable to NASD. In the event that a client is entitled to a cash payment, and is also eligible to convert Class B shares that the client continues to hold, Merrill Lynch shall specify in its communication to the client that the cash payment is not in lieu of the client's right to convert all remaining eligible Class B and/or Class C share holdings. Clients shall have 60 days from the mailing of the letters to accept the offer and advise Merrill Lynch of their decision to accept.
- j. Merrill Lynch shall complete the remediation process within 270 days from the effective date of the AWC.
- k. Within 330 days following the effective date of the AWC, Merrill Lynch shall file a report with NASD, through which it will identify and account for:
 - i The Qualifying Purchases, including the client's name(s) and contact information, a firm-designated household identification number, the

methodology for including accounts in the aggregation of assets for determining breakpoints, if such methodology generally provides broader criteria for inclusion of accounts than the relevant fund's prospectus/SAI. In connection with the foregoing, the firm must assume that a client would have executed Letters of Intent to the greatest extent offered by the relevant fund's prospectus/SAI.

trade date, fund name, fund symbol, number of shares purchased, and the gross principal amount invested for each Qualifying Purchase;

- ii The transactions the firm removed from the list of Qualifying Purchases and the specific basis for each removal;
- iii Those transactions for which clients received a letter offering conversion;
- iv Those transactions for which clients received a cash payment, including the amount paid. Any cash payments resulting from the firm's inability to effect conversion shall be duly noted;
- v How the firm created and staffed a response center to field and respond to client inquiries, including, the number of individuals used to staff the response center, how the response center staff members were trained to respond to client inquiries, how and by whom the response center was supervised, and what tools and information were used to respond to client inquiries;
- vi Each client who had a Qualifying Purchase and contacted the firm concerning remediation, including a statement that the firm maintained a record of each client inquiry; and
- vii Each transaction for which the client accepted the firm's offer of conversion, including the number of shares and value transferred.

The firm's report must be submitted to NASD, certified to, and signed under penalty of perjury by, an officer of Merrill Lynch who is currently registered with NASD. Merrill Lynch shall preserve for a period of not less than three years from the effective date of the AWC and make available to NASD the records underlying the report.

- l. Merrill Lynch shall retain, at its own expense, an Independent Examiner, who shall not be unacceptable to NASD, to examine the firm's performance of its obligations under the terms of the AWC as reflected in its certified report.
- m. Merrill Lynch shall exclusively bear all costs, including compensation and expenses, associated with the retention and performance of the Independent Examiner. At the conclusion of the examination, but not later than 420 days following the effective date of the AWC, Merrill Lynch shall require the Independent Examiner to submit a written Final Report to Merrill Lynch and to NASD. The Final Report must recite the efforts the Independent Examiner undertook to examine Merrill Lynch's execution of its undertakings as reflected in its report, as well as the Independent Examiner's assessment of the firm's performance of its obligations in connection with its report.

- n. To ensure the independence of the Independent Examiner, Merrill Lynch: (i) shall not have the authority to terminate the Independent Examiner, without the prior written approval of NASD; (ii) shall compensate the Independent Examiner, and persons engaged to assist the Independent Examiner, for services rendered pursuant to the AWC at their reasonable and customary rates; and (iii) shall not be in and shall not have an attorney-client relationship with the Independent Examiner and shall not seek to invoke any such privilege or similar privilege or doctrine between it and the Independent Examiner to prevent the Independent Examiner from transmitting any information, reports or documents to NASD.
- o. To further ensure the independence of the Independent Examiner, for the period of the engagement and for a period of two years from completion of the engagement, Merrill Lynch, its present or former affiliates, directors, officers, employees, and agents acting in their capacity shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with the Independent Examiner. Further, Merrill Lynch, its present or former affiliates, directors, officers, employees, and agents acting in their capacity shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with any firm with which the Independent Examiner is affiliated in performance of his or her duties under the AWC, or agents acting in their capacity, for the period of the engagement and for a period of two years after the engagement without prior written consent of NASD.
- p. Merrill Lynch shall cooperate fully with the Independent Examiner and shall provide the Independent Examiner with prompt access to Merrill Lynch's files, books, records and personnel as the Independent Examiner reasonably deems necessary or appropriate in fulfilling any function or completing any task described in these undertakings.
- q. For good cause shown, and upon receipt of a timely request from Merrill Lynch, NASD may extend any of the procedural dates set forth above.

III.

OTHER MATTERS

- A. Merrill Lynch understands that it may attach to this AWC a Corrective Action Statement that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that in this Statement it may not deny the charges or make any statement that is inconsistent with the AWC. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.
- B. Merrill Lynch agrees to pay any monetary sanctions imposed on it within 20 days of notice that this AWC has been accepted.

C. Merrill Lynch 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.

The undersigned certifies on behalf of Merrill Lynch that I 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 me to submit it.

Merrill Lynch, Pierce, Fenner
& Smith Incorporated

October 24, 2005
Date

By: Richard Weinberg
Name: Richard Weinberg
Title: First Vice President

Reviewed by:

MORGAN, LEWIS & BOCKIUS LLP

TEO
Ben A. Indek, Esq.
Counsel for Respondent

Accepted by NASD:

12.19.05
Date

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

David A. Greene

David A. Greene,
Deputy Regional Chief Counsel
NASD Department of Enforcement
300 South Grand Ave., Suite 1600
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SCHEDULE A

\$50,000 - \$99,999

AGGBX
GTHBX
DLTBX
DPIBX
DRCBX
PGMBX
PMCBX
PMDBX
PMMNX
PMUBX
PRCBX
PRNBX
XLSBX
DIMBX
PBCMX
PBHMX
PBHYX
PBNJX
PBNYX
PBPAX
PCAIX
PFABX
PMHYX
PMINX
PRGLX
SYLBX
HBDIX

SCHEDULE B

\$100,000 - \$249,999

GACBX
MBIFX
NBBGX
DIMBX
DRCBX
PGMBX
PMMNX
PMUBX
PRCBX
PRNBX
DLTBX
FPABX
LEIBX
FKSBX
NAGOX
PBCMX
PBHMX
PBNJX
PBNYX
PBPAX
PCAIX
PFABX
PMHYX
PMINX
SYLBX
FPABX
MGRBX