

STATE CORPORATION COMMISSION

AT RICHMOND, OCTOBER 24, 2006

COMMONWEALTH OF VIRGINIA, ex rel.

STATE CORPORATION COMMISSION

v.

CASE NO. SEC-2006-00070

MERRILL LYNCH, PIERCE, FENNER
& SMITH, INCORPORATED,

Defendant

SETTLEMENT ORDER

The State Corporation Commission ("Commission") entered into a Settlement Order ("2004 Settlement") with Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Defendant" or "Merrill Lynch"), Case No. SEC-2003-00041, on January 30, 2004, based on an investigation conducted by the Division of Securities and Retail Franchising ("Division"), and pursuant to § 13.1-518 of the Virginia Securities Act ("Act"), § 13.1-501 *et seq.* of the Code of Virginia. That Order, among other things, provided that: (1) the Defendant would make restitution to two (2) Virginia investors; and (2) the Defendant would not violate the Act in the future. The Defendants complied with those terms and a Final Order was entered on October 17, 2006. An additional provision of the 2004 Settlement provided that Merrill Lynch would agree to engage a third party examiner to conduct eight randomly selected branch examinations in the eastern third of the United States of America that were outside of the Commonwealth of Virginia, that employed Virginia registered agents and that maintained at least 250 Virginia customer accounts. The eight branch offices to be examined would be selected by the Division for examination. The Division also conducted a separate staff examination of Merrill Lynch's Richmond, Virginia branch office. The third party examiner issued reports which included criticisms of certain

aspects of Merrill Lynch's supervision relating to Financial Foundation Reports ("FFRs"), mutual fund switch letters and the sale of class B and C shares, Merrill Lynch Unlimited Advantage ("MLUA") accounts, retention of books and records, and testing for discrepancies of client information. The third party examiner filed its Final Report with the Division on June 9, 2005. The information generated by the Final Report, along with the results of the Division's examination, were submitted to and discussed with Merrill Lynch.

Based upon the results of the reports and discussions with Merrill Lynch, the Division alleges that the Defendant: (1) violated Securities Rule 21 VAC 5-20-260 B by failing to exercise diligent supervision over the securities activities of all of its agents, including instances of over-burdened branch management; (2) violated Securities Rule 21 VAC 5-20-280 A 3 by failing to maintain all information known about customers contained in the FFRs and Merrill Lynch's internal computer designation for client account profiles ("KDIs"), including the failure to reconcile such information between the FFRs and the KDI system, and by failing to establish a supervisory review to ensure that appropriate disclosures were documented when it offered only the State of Maine 529 Plan without comparison of this plan to Virginia's in-state 529 Plan; and (3) violated Securities Rule 21 VAC 5-20-280 A 12 by failing to consistently notify certain clients with MLUA accounts of the difference between the fees they had incurred in the MLUA program and the standard transaction charges they would have been charged had the account not been in MLUA.

The Commission is authorized by § 13.1-506 of the Act to revoke the Defendant's registration, by § 13.1-519 of the Act to issue temporary or permanent injunctions, by § 13.1-518 A of the Act to impose costs of investigation, by § 13.1-521 A of the Act to impose certain

monetary penalties, and by § 12.1-15 of the Code of Virginia to settle matters within its jurisdiction.

The Defendant neither admits nor denies these allegations but admits to the Commission's jurisdiction and authority to enter this Settlement Order.

As a proposal to settle all matters arising from these allegations, the Defendant has made an offer of settlement to the Commission wherein the Defendant will abide by and comply with the following terms and undertakings:

(1) Merrill Lynch instituted new procedures to help confirm that client information submitted with a FFR is accurate, consistent, and up to date with the information appearing on Merrill Lynch's records. This is in addition to Merrill Lynch sending clients Data Validation Letters. Merrill Lynch is currently in the process of building a Client Data repository whose purpose is to support the multiple client data related processes that are part of its Global Private Client business sector. This effort has been scoped as a multi-year program with multiple incremental implementations. The size and scope of this project are consistent with similar efforts for other large companies that are attempting the transition from an account-centric to client-centric service model. The Client Experience Data Program, which encompasses this effort, is in its initial stages. The initial stages focus on building the data stores and data processing infrastructure and architecture required to eventually support a client-centric service environment. Implementation of this initial stage is planned for 2007. As Merrill Lynch begins to upgrade its system and at each material stage of the implementation program, Merrill Lynch will notify the Division of the implementation, including a description of the phase being implemented. Merrill Lynch will also notify the Division when the upgrade is completed.

Merrill Lynch has also issued a Global Compliance Alert ("Alert") discussing the importance of updating client information when new information becomes available. This Alert has been sent to all U.S. and Non-U.S. Global Private Client branch office employees to remind them that as they learn of any changes in a client's personal and financial situation they must update the appropriate client profile pages on the appropriate Merrill Lynch workstation. The Alert also instructed branch employees who are introducing clients to a FFR (or similar planning tool) that they must compare the information collected to the client profile information contained on the KDI system. Any material differences with the client information will have to be confirmed with the client and the KDI system will have to be updated accordingly. The information to be reconciled includes: (i) income; (ii) net worth; (iii) employer or employment status/retirement; (iv) marital status; (v) investment objective; and (vi) risk tolerance.

(2) Merrill Lynch is revising certain 529 plan policies and procedures to include expanded suitability requirements and documented disclosures, and has revised its educational requirements for its Financial Advisors regarding the sale of 529 plans to clients.

Merrill Lynch Financial Advisors, when soliciting sales of an out-of-state 529 plan, will:

- (i) document appropriate factors considered in connection with making a recommendation to purchase the plan;
- (ii) require written acknowledgment from the client that they are aware of applicable state benefits and received the disclosure required by the Municipal Securities Rulemaking Board ("MSRB") with respect to out-of-state 529 plans;
- (iii) require manager approval prior to opening an out-of-state 529 plan account; and
- (iv) retain evidence that the client received the disclosure required by the MSRB with respect to sales of out-of-state 529 plans.

(3) Merrill Lynch will require its Financial Advisors to deliver a MLUA Guide to customers prior to enrolling in the program. In 2002, Merrill Lynch implemented the Utilization Report for the MLUA program and has continually enhanced the Utilization Report and MLUA program to include notifying customers, or terminating their account, when the accounts are identified by certain criteria as potentially being under-utilized for a specified period of time. The Utilization Report aids managers in their supervision of MLUA by identifying those accounts that should be evaluated further in light of their level of activity to determine whether traditional, commission-based pricing may be more appropriate for the customer and, with the Utilization Report, Merrill Lynch provided detailed review guidelines and instructions for client contact by branch managers. In addition, in January 2002, Merrill Lynch updated its *Compliance Outline for Financial Advisors* to include a MLUA Utilization section, and in June 2004, Merrill Lynch issued a *Compliance Bulletin* entitled "Important Considerations In Choosing An Account Pricing Program Like Unlimited Advantage." In 2004, Merrill Lynch also enhanced MLUA by implementing certain parameters to document whether MLUA accounts were opened and maintained only when appropriate.

Merrill Lynch will continue to maintain, utilize, and enhance, when necessary, the Utilization Report (or similar report) it created in 2002 to determine whether its clients' objectives coincide with the features of the MLUA program. Merrill Lynch will also continuously monitor and scrutinize, when necessary, its agents' activities to confirm whether MLUA accounts are established for a client only when it is anticipated such an account will be beneficial to the client. Merrill Lynch intends to accomplish this undertaking by: (1) mandating asset thresholds to enroll in the MLUA program; (2) establishing price ceilings on the annual fee charged to clients; (3) requiring its agents to interact with clients to complete questionnaires that

will be designed to elicit clients' objectives; (4) enhancing the "Welcome Kit" clients receive when establishing an account by including the results of the aforesaid questionnaire in the "Welcome Letter" that is sent to clients; and (5) refraining from using the asset value of underwritten securities for a period of 190 days in calculating fees that are charged to clients' MLUA accounts.

(4) Merrill Lynch agrees to pay the costs associated with the Division's investigation in the amount of seventy-five thousand dollars (\$75,000) pursuant to § 13.1-518 of the Act. This sum shall be paid within ten (10) business days of entry of this Order and made payable to the Division.

The Division has recommended that the Commission accept the offer of settlement of the Defendant.

The Commission, having considered the record herein, the offer of settlement of the Defendant, and the recommendation of the Division, is of the opinion that the Defendant's offer should be accepted.

Accordingly, IT IS THEREFORE ORDERED THAT:

(1) The offer of the Defendant in settlement of the matter set forth herein be, and it is hereby, accepted;

(2) The Defendant fully comply with the aforesaid terms and undertakings of this settlement; and

(3) The Defendant pay to the Division the amount of seventy-five thousand dollars (\$75,000) to defray the cost of investigation.

(4) The Commission shall retain jurisdiction in this matter for all purposes, including the institution of a show cause proceeding, or taking such other action it deems appropriate, on account of the Defendant's failure to comply with the terms and undertakings of the settlement.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:
Andrew Kandel, First Vice-President/Assistant General Counsel, Merrill Lynch, Pierce, Fenner & Smith, Incorporated, 222 Broadway, 13th Floor, New York, New York 10038; Neal E. Sullivan, Esquire, Bingham McCutchen LLP, 2020 K Street, N.W., Washington, D.C. 20006; and the Commission's Office of General Counsel and Division of Securities and Retail Franchising.

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Defendant

ADMISSION AND CONSENT

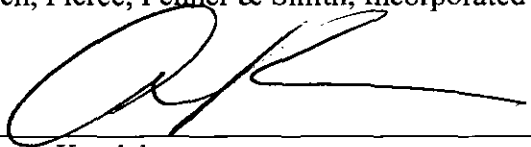
The Defendant, Merrill Lynch, Pierce, Fenner & Smith, Incorporated, admits to the jurisdiction of the State Corporation Commission ("Commission") as to the party and subject matter hereof, neither admits nor denies the allegations made herein by the Division of Securities and Retail Franchising, and hereby consents to the form, substance and entry of the foregoing Settlement Order.

The Defendant further states that no offer, tender, threat or promise of any kind whatsoever has been made by the Commission or any member, subordinate, employee, agent or representative thereof in consideration of the foregoing Settlement Order.

Merrill Lynch, Pierce, Fenner & Smith, Incorporated

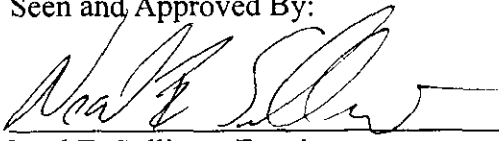
Date: 10-20-06

By:



Andrew Kandel
First Vice-President/Assistant General Counsel

Seen and Approved By:



Neal E. Sullivan, Esquire
Bingham McCutchen LLP