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SECURITIES COMMISSIONER



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State Securities Board

KENNETH W. ANDERSON, JR.
MEMBER

MAIL: P.O. BOX 13167
AUSTIN, TEXAS 78711-3167

208 E. 10th Street, 5th Floor
Austin, Texas 78701-2407
Phone (512) 305-8300
FAX (512) 305-8310
<http://www.ssb.state.tx.us>

JACK D. LADD
MEMBER

SSB Docket No. 02-41

IN THE MATTER OF
MERRILL LYNCH, PIERCE, FENNER &
SMITH, INC.

§
§
§

Order No. FIN-1486

TO: Merrill Lynch, Pierce, Fenner & Smith, Inc.
222 Broadway, 13th Floor
New York, New York 10038

ORDER AND UNDERTAKING

Be it remembered that Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Respondent") appeared before the Securities Commissioner of the State of Texas ("Securities Commissioner") and, without admitting or denying any of the allegations contained herein, consented to the entry of this Order and Undertaking, and the Findings of Fact and the Conclusions of Law contained herein.

FINDINGS OF FACT

1. Respondent has waived (a) Respondent's right to notice and hearing in this matter; (b) Respondent's right to appear and present evidence in this matter; (c) Respondent's right to appeal this Order; and (d) all other procedural rights granted to Respondent by The Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-1 et seq. (Vernon 1964 & Supp. 2002)("Texas Securities Act"), and the Administrative Procedure Act, TEX. GOV'T CODE ANN. § 2001.001 et seq. (Vernon Supp. 2002)("Administrative Procedure Act").
2. Respondent is a broker-dealer registered in the State of Texas and admits the jurisdiction of the Texas State Securities Board.
3. The Securities Commissioner has undertaken an inquiry into the activities of Respondent relating to certain research practices.

4. The Attorney General of the State of New York ("New York AG") conducted an investigation (the "New York Investigation") into research practices at Respondent.
5. The New York AG commenced a proceeding on April 8, 2002, pursuant to Section 354 of the General Business Law of the State of New York (Index No. 02/401522) (the "New York Proceeding"), including submission of the Affidavit of Eric R. Dinallo, Chief of Investment Protection Bureau, New York State Department of Law, containing assertions regarding the research practices of Respondent (the "Dinallo Affidavit"), which is on file in the New York Proceeding.
6. The New York AG and Respondent have entered into an agreement, dated May 21, 2002 (the "May 21 Agreement"), a copy of which has been provided to the Texas State Securities Board, which resolved all issues involved in the New York Investigation and the New York Proceeding, prior to the Court making any findings of fact or conclusions of law pursuant to a contested proceeding.
7. Pursuant to the May 21 Agreement, Respondent has agreed to implement certain changes with respect to its Global Equity Research analysts and equity securities covered by such analysts and make certain payments.
8. Respondent and the Securities Commissioner are desirous of avoiding multiple investigations in light of the above-referenced changes that are being implemented at Respondent and Respondent's agreement to make certain payments.
9. Entry of this Order concludes the inquiry by the Securities Commissioner and any other action that the Securities Commissioner could commence under applicable state law on behalf of Texas as it relates to Respondent, its affiliates, current or former employees, and officers and directors of Respondent relating to research practices at Respondent.
10. This Order and Undertaking is entered into solely for the purpose of resolving the Securities Commissioner's inquiry, and is not intended to be used for any other purpose.
11. The parties represent, warrant and agree that they have received independent legal advice from their attorneys with respect to the advisability of executing this Order.

UNDERTAKING

1. Respondent agrees that Respondent will comply with Texas securities law.
2. As of the date hereof, Respondent will state on each Merrill Lynch Global Equity research report whether Respondent received or is entitled to receive compensation over the past 12 months, or whether Respondent is entitled to receive compensation from any publicly announced equity underwriting or merger and acquisition transaction

for each company covered by the research report (the "Covered Company"). Notwithstanding the foregoing, as of July 8, 2002, the disclosures regarding investment banking compensation referred to in Paragraph 3(b) shall be replaced with the disclosures required by NYSE Rule 472(k)(1)(ii) and NASD Rule 2711 (h)(2)(A)(ii).

3. As of the date hereof, Respondent will include a prominent legend on the first page of each Merrill Lynch Global Equity research report that investors should assume that Respondent is seeking or will seek investment banking or other business from the Covered Company.
4. As of the date hereof, Respondent will include on each Merrill Lynch Global Equity research report specific disclosure on a percentage basis, the aggregate distribution, calculated quarterly, of the intermediate-term rating category used by Respondent, for
 - (i) all stocks in the sector or industry group applicable to the Covered Company;
 - (ii) all stocks in the sector or industry group applicable to the Covered Company for which, over the prior 12 months, Respondent performed services in publicly announced equity underwritings and merger and acquisition transactions for which compensation was received or to which Respondent is entitled, until the effective date of any applicable rules promulgated by any self-regulatory organization to which Respondent is subject;
 - (iii) all stocks covered by Merrill Lynch Global Equity research; and
 - (iv) all stocks covered by Merrill Lynch Global Equity research for which, over the prior 12 months, Respondent performed services in publicly announced equity underwriting or merger and acquisition transactions for which compensation was received or to which Respondent is entitled, until the effective date of any applicable rules promulgated by any self-regulatory organization to which Respondent is subject.
5. Respondent has adopted and enforced policies implementing the practices and procedures set forth herein with respect to its U.S.-based equity research analysts and equity securities covered by such analysts on or before July 1, 2002, unless otherwise set forth below.
6. Respondent will separate completely the evaluation and determination of compensation for U.S.-based equity research analysts from Respondent's investment banking business by complying with this Undertaking. Going forward, Respondent will consider the implementation of such additional procedures as it deems appropriate to further effectuate the provisions of the Undertaking. All research analyst employment contracts entered into starting as of the date hereof will make specific reference to the Respondent's policies implemented to effectuate the prohibitions set forth in the Undertaking.

7. Respondent agrees that research analysts will be compensated for only those activities and services intended to benefit Respondent investor clients. The activities and services that research analysts are expected to perform for the benefit of Respondent investor clients include:
 - (a) formulation of research recommendations and preparation of research reports;
 - (b) communication of investment information to investor clients;
 - (c) cooperation, accessibility and responsiveness consistent with serving investor clients; and
 - (d) participation in the identification and evaluation of potential investment opportunities, including providing input into whether a potential investment opportunity is appropriate for Respondent investor clients.

8. With respect to analyst compensation, Respondent will prohibit:
 - (a) anyone responsible for determining research analysts' compensation from soliciting from any analyst, or considering in determining any analyst's compensation, either (i) the amount of investment banking revenue received from clients covered by such analyst, or (ii) the analyst's participation in investment banking transactions, except to the extent such activities and services are intended to benefit investors, as specifically contemplated by Paragraph 6 above;
 - (b) research analysts from being evaluated by investment bankers for any work such analysts may do to generate investment banking business, including participation in investment banking client solicitations;
 - (c) investment bankers from communicating with research analysts or with anyone responsible for determining analysts' compensation for the purpose of calculating or influencing an individual analyst's compensations; and
 - (d) consideration of any such input from investment bankers by anyone responsible for determining research analysts' compensation.

9. Respondent agrees that managers in Respondent's Research Department ("Research Management") and those executive officers more senior to Research Management, subject to review at its discretion by the Board of Directors, will have exclusive responsibility for determining research analyst compensation and will evaluate analysts for compensation purposes based primarily upon:
 - (a) quality of analysts' research and performance of their investment recommendations;

- (b) competitive compensation factors;
 - (c) surveys and input from investor clients; and
 - (d) surveys and input from Respondent's institutional sales, equity trading, and private client divisions, but not from the investment banking division.
10. Executive management may discuss with Research Management overall costs, budgets, resource allocation and the retention and recruitment of research analysts.
11. On or before September 1, 2002, Respondent will establish a Research Recommendations Committee (the "RRC"). The RRC will monitor performance of and supervise equity research recommendations for objectivity, integrity, and a rigorous analytical framework in the development of all recommendations.
- (a) The RRC will be composed of representatives of Respondent's institutional and private client sales management, Research Management and research strategists. It will be chaired by an individual who will be compensated in a fixed amount plus a bonus based primarily on how research recommendations (i.e., currently defined as strong buy, buy, neutral, reduce/sell), perform for investors. Performance will be measured over relevant periods of time by, among other things, absolute price performance against the recommendation definitions included in the research reports and price performance relative to industry and market benchmarks.
 - (b) Initiation of, or change to, any equity research recommendation will require approval by the RRC. Changes to research recommendations may be approved by a member of the RRC and ratified by the RRC.
 - (c) Upon presenting a research recommendation at a meeting of the RRC, the relevant research analyst shall disclose to the RRC any participation by the analyst with investment bankers in an investment banking transaction for the subject company within the last 12 months.
 - (d) A member of the RRC or a member of Research Management, or a compliance manager in the Research Department shall be present at any meeting of Respondent's Equity Commitment Committee or any other group authorized to commit Respondent to a public equity underwriting.
 - (e) The RRC Chairperson will report to the Director of Global Research.
12. As soon as practicable, but no later than December 31, 2002, Respondent will implement a system to monitor electronic communications between investment bankers and equity research analysts.

13. Respondent further agrees that:
 - (a) Research analyst participation with investment bankers in solicitations for any potential investment banking transaction must be approved in advance by Research Management.
 - (b) Effective September 1, 2002, before any research analyst participates in a solicitation with investment bankers for any potential investment banking transaction, such analyst must disclose such intended participation to a member of the RRC.
 - (c) Effective September 15, 2002, each equity research report covering a particular company will disclose whether, since July 1, 2002, any research analyst covering such company has participated in a solicitation with or at the request of investment bankers for an investment banking transaction underwritten by Respondent. Commencing on July 1, 2003, such disclosure will be made for the immediately preceding 12 month period.
 - (d) Upon execution of this Order, Respondent will prohibit analysts, investment bankers, or any other employees of Respondent from promising, implying, offering, or communicating in any way that a specific recommendation or change of an existing recommendation will be made in exchange for the awarding of an investment banking transaction to Respondent.
 - (e) Upon execution of this Order, Respondent will prohibit analysts from changing any research recommendation because of the subject company's decision not to retain Respondent for investment banking services.
14. On or before September 1, 2002, Respondent will establish a policy requiring that the materials used in connection with any solicitation for a public equity underwriting will include a written disclosure that:
 - (a) Respondent prohibits employees from, directly or indirectly, offering a favorable research rating or specific price target, or offering to change a rating or price target to a subject company as consideration or inducement for the receipt of business or for compensation; and
 - (b) Respondent prohibits research analysts from being compensated for involvement in investment banking transactions except to the extent that such participation is intended to benefit investor clients.
15. Whenever Respondent terminates coverage of any issuer, Respondent will publish a report disclosing:
 - (a) Respondent's termination of coverage;

- (b) The rationale for the decision to terminate coverage; and
 - (c) That, effective upon the termination of coverage, the last recommendation issued for the particular stock should not be relied upon going forward.
16. Respondent agrees that:
- (a) Starting on or before September 1, 2002 and continuing for a period of one year, Respondent will designate an employee (the "Compliance Monitor") whose assignment will be to ensure compliance with the policies required by this Order.
 - (b) The Compliance Monitor will be appointed by Respondent subject to the acquiescence of the New York AG, which acquiescence will not be unreasonably withheld.
 - (c) The Compliance Monitor will be available to research analysts to address issues of actual or perceived undue influence or pressure from investment banking or any other source.
 - (d) The Compliance Monitor will report directly to the General Counsel for Litigation, Compliance, Regulatory and Governmental Affairs.

CONCLUSIONS OF LAW

1. The above-recited Findings of Fact are grounds for the issuance of an order pursuant to Section 23-1 of the Texas Securities Act.
2. Nothing herein shall be construed to require that Respondent or any of its affiliates, agents, or employees, act in any manner inconsistent with any laws, rules, or regulations, including those imposed by their governing self-regulatory organizations.
3. Neither this Order of Undertaking, nor any acts performed and documents executed in furtherance of this Order: (a) may be deemed or used as an admission of, or evidence of, the validity of any wrongdoing or liability including, but not limited to the assertions in the Dinallo Affidavit, or anything contained in the New York State Supreme Court Order, dated April 8, 2002; or (b) may be deemed or used as an admission of, or evidence of, any such alleged fault or omission by Merrill Lynch & Co., Henry Blodget, Justin Baldauf, Kirsten Campbell, Virginia Syer Genereux, Sofia Ghachem, Thomas Mazzucco, Edward McCabe and Deepak Raj, or any of them, in any civil, criminal, or administrative proceeding in any court, administrative agency, or other tribunal; nor shall this Order confer any rights upon any persons or entities who were not a party to this Order.

4. This Order is not intended to indicate that Respondent or any of its affiliates or current or former employees should be subject to any disqualifications contained in the federal securities law, the rules and regulations thereunder, the rules and regulations of self regulatory organizations or various states' securities laws including any disqualifications from relying upon the registration exemptions or safe harbor provisions, and this Order is not intended to form the basis of any such disqualification.
5. For any person or entity not a party to this Order, this Order does not limit or create any private rights or remedies against Respondent including, without limitation, the use of the Dinallo Affidavit, any e-mails or other documents of Respondent or of others for research practices, limit or create liability of Respondent, or limit or create defenses of Respondent to any claims.
6. Nothing herein is intended to or shall be construed to have created, compromised, settled or adjudicated any claims, causes of action, or rights of any person whomsoever, other than as between the Securities Commissioner and Respondent in accordance with this Order.
7. Any violation of the May 21 Agreement shall be deemed violation of this Order. Should Respondent fail to abide by the terms and conditions of this Order or the May 21 Agreement, nothing contained herein shall be construed to prevent the Securities Commissioner from exercising the authority to impose any remedy under the Texas Securities Act against Respondent.
8. This Order shall not disqualify Respondent or any of its affiliates or current or former employees from any business that they otherwise are qualified or licensed to perform under applicable state law and this Order is not intended to form the basis for any disqualification.

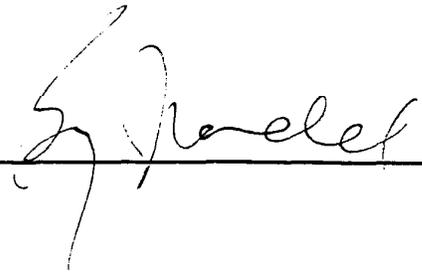
ORDER

1. Pursuant to Section 23-1, Respondent shall pay the sum of Three Million, Four Hundred Seventy-Three Thousand, Seven Hundred and Eighty-Seven Dollars (\$3,473,787), payable to the State of Texas.
2. This Order and any dispute related thereto shall be construed and enforced in accordance with, and governed by, the laws of the State of Texas.

SIGNED AND ENTERED by the Securities Commissioner this 26th day of November, 2002.


DENISE VOIGT CRAWFORD
Securities Commissioner

Merrill Lynch, Pierce, Fenner & Smith, Inc.

By:  _____

Approved as to Form:



David Grauer
Director
Enforcement Division

ACKNOWLEDGMENT

On the 7.7th day of September, 2002, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Respondent"), by and through Barry Mandel, its Senior Vice President, personally appeared before me, executed the foregoing Order and Undertaking, and acknowledged that:

1. Barry Mandel is duly authorized to enter into the foregoing Order on behalf of Respondent;
2. Barry Mandel has read the foregoing Order;
3. Respondent has been fully advised of its rights under the Texas Securities Act and the Administrative Procedure Act;
4. Respondent knowingly and voluntarily consents to the entry of the foregoing Order and Undertaking and the Findings of Fact and Conclusions of Law contained therein; and,
5. Respondent, by consenting to the entry of the foregoing Order, has knowingly and voluntarily waived its rights as set forth therein.

Gloria R. Greco
Notary Public in and for
the State of New York

[affix notary seal here]

My commission expires on: 10/12/03

GLORIA R. GRECO
Notary Public, State of New York
No. 02GR6032008
Qualified in Kings County
Commission Expires October 12, 20 03