

STATE OF ALASKA  
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT  
DIVISION OF BANKING, SECURITIES, AND CORPORATIONS  
P.O. BOX 110807  
JUNEAU, ALASKA 99811-0807

IN THE MATTER OF

MERRILL LYNCH, PIERCE, FENNER &  
SMITH, INC.

ADMINISTRATIVE CONSENT ORDER  
No. 02-10 S

DEF  
AND LOCUS  
FINDINGS OF FACT

1. Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") is a broker-dealer registered in the State of Alaska.
2. The Division Of Banking, Securities, And Corporations of the State of Alaska, (the "division") has undertaken an investigation (the "Investigation") into the activities of Merrill Lynch relating to certain research practices at Merrill Lynch.
3. The Attorney General of the State of New York ("New York AG") conducted an investigation (the "New York Investigation") into research practices at Merrill Lynch.
4. 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 Merrill Lynch (the "Dinallo Affidavit"), which is on file in the New York Proceeding.
5. The New York AG and Merrill Lynch have entered into an agreement, dated May 21, 2002 (the "May 21 Agreement"), a copy of which has been provided to the division, 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.
6. Pursuant to the May 21 Agreement, Merrill Lynch 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.

7. Merrill Lynch and the division are desirous of avoiding multiple investigations in light of the above-referenced changes that are being implemented at Merrill Lynch and Merrill Lynch's agreement to make certain payments.

8. Merrill Lynch admits the jurisdiction of the division, and neither admits nor denies the Findings of Fact and Conclusions of Law, and consents to the entry of this Order by the division.

## II.

### CONCLUSIONS OF LAW

1. The division has jurisdiction over this matter pursuant to AS 45.55, the Alaska Securities Act (the Act).
2. The division finds the following relief appropriate and in the public interest.

## III.

### ORDER

#### IT IS HEREBY ORDERED:

1. This Order concludes the Investigation by the division and any other action that the division could commence under applicable state law on behalf of Alaska as it relates to Merrill Lynch, its affiliates, current or former employees, officers and directors of Merrill Lynch relating to research practices at Merrill Lynch.
2. This Order is entered into solely for the purpose of resolving the division's Investigation, and is not intended to be used for any other purpose.
3. **It is further administratively Ordered that:**
  - (a) Merrill Lynch will comply with the Alaska Securities Act and regulations thereunder.
  - (b) As of the date hereof, Merrill Lynch will state on each Merrill Lynch Global Equity research report whether Merrill Lynch received or is entitled to receive compensation over the past 12 months, or whether Merrill Lynch is entitled to receive compensation

1 from any publicly announced equity underwriting or merger and acquisition transaction  
2 for each company covered by the research report (the "Covered Company").

3 Notwithstanding the foregoing, as of July 8, 2002, the disclosures regarding

4 investment banking compensation referred to in Paragraph 3(b) shall be replaced with  
5 the disclosures required by NYSE Rule 472(k)(1)(ii) and NASD Rule 2711 (h)(2)(A)(ii).

6 (c) As of the date hereof, Merrill Lynch will include a prominent legend on the first page of  
7 each Merrill Lynch Global Equity research report that investors should assume that  
8 Merrill Lynch is seeking or will seek investment banking or other business from the  
9 Covered Company.

10 (d) As of the date hereof, Merrill Lynch will include on each Merrill Lynch Global Equity  
11 research report specific disclosure on a percentage basis, the aggregate distribution,  
12 calculated quarterly, of the intermediate-term rating category used by Merrill Lynch, for

13 (i) all stocks in the sector or industry group applicable to the Covered  
14 Company;

15 (ii) all stocks in the sector or industry group applicable to the Covered  
16 Company for which, over the prior 12 months, Merrill Lynch  
17 performed services in publicly announced equity underwritings and  
18 merger and acquisition transactions for which compensation was  
19 received or to which Merrill Lynch is entitled, until the effective date  
20 of any applicable rules promulgated by any self-regulatory  
21 organization to which Merrill Lynch is subject;

22 (iii) all stocks covered by Merrill Lynch Global Equity research; and

23 (iv) all stocks covered by Merrill Lynch Global Equity research for which,  
24 over the prior 12 months, Merrill Lynch performed services in publicly  
25 announced equity underwriting or merger and acquisition  
26 transactions for which compensation was received or to which Merrill  
27 Lynch is entitled, until the effective date of any applicable rules

1 promulgated by any self-regulatory organization to which Merrill  
2 Lynch is subject.

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4 **Research Changes**

5 4. Merrill Lynch agrees to adopt and enforce policies implementing the practices and  
6 procedures set forth in Paragraphs 5-15 with respect to its U.S.-based equity research analysts  
7 and equity securities covered by such analysts by no later than July 1, 2002, unless otherwise  
8 set forth below.

9 **Analyst Compensation**

10 5. Merrill Lynch will separate completely the evaluation and determination of compensation  
11 for U.S.-based equity research analysts from Merrill Lynch's investment banking business by  
12 complying with Paragraphs 6-9 below. Going forward, Merrill Lynch will consider the  
13 implementation of such additional procedures as it deems appropriate to further effectuate the  
14 provisions of Paragraphs 6-9. All research analyst employment contracts entered into starting  
15 as of the date hereof will make specific reference to the Merrill Lynch policies implemented to  
16 effectuate the prohibitions set forth in Paragraph 7 of this Order.

17 6. Merrill Lynch agrees that research analysts will be compensated for only those activities  
18 and services intended to benefit Merrill Lynch investor clients. The activities and services that  
19 research analysts are expected to perform for the benefit of Merrill Lynch investor clients  
20 include:

- 21 (a) formulation of research recommendations and preparation of research reports;  
22 (b) communication of investment information to investor clients;  
23 (c) cooperation, accessibility and responsiveness consistent with serving investor  
24 clients; and  
25 (d) participation in the identification and evaluation of potential investment  
26 opportunities, including providing input into whether a potential investment  
27 opportunity is appropriate for Merrill Lynch investor clients.

7. With respect to analyst compensation, Merrill Lynch will prohibit:

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- (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.

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8. Merrill Lynch agrees that managers in Merrill Lynch'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:

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- (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 Merrill Lynch's institutional sales, equity trading, and private client divisions, but not from the investment banking division.

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9. Executive management may discuss with Research Management overall costs, budgets, resource allocation and the retention and recruitment of research analysts.

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## Research Recommendations Committee

10. On or before September 1, 2002, Merrill Lynch 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 Merrill Lynch'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 Merrill Lynch's Equity Commitment Committee or any other group authorized to commit Merrill Lynch to a public equity underwriting.
- (e) The RRC Chairperson will report to the Director of Global Research.

1 11. As soon as practicable, but no later than December 31, 2002, Merrill Lynch will  
2 implement a system to monitor electronic communications between investment bankers and  
3 equity research analysts.

4 **Solicitation of Investment Banking Business**

5 12. Merrill Lynch agrees that:

- 6 (a) Research analyst participation with investment bankers in solicitations for any  
7 potential investment banking transaction must be approved in advance by  
8 Research Management.
- 9 (b) Effective September 1, 2002, before any research analyst participates in a  
10 solicitation with investment bankers for any potential investment banking  
11 transaction, such analyst must disclose such intended participation to a member  
12 of the RRC.
- 13 (c) Effective September 15, 2002, each equity research report covering a particular  
14 company will disclose whether, since July 1, 2002, any research analyst covering  
15 such company has participated in a solicitation with or at the request of  
16 investment bankers for an investment banking transaction underwritten by Merrill  
17 Lynch. Commencing on July 1, 2003, such disclosure will be made for the  
18 immediately preceding 12 month period.
- 19 (d) Upon execution of this Order, Merrill Lynch will prohibit analysts, investment  
20 bankers, or any other employees of Merrill Lynch from promising, implying,  
21 offering, or communicating in any way that a specific recommendation or change  
22 of an existing recommendation will be made in exchange for the awarding of an  
23 investment banking transaction to Merrill Lynch.
- 24 (e) Upon execution of this Order, Merrill Lynch will prohibit analysts from changing  
25 any research recommendation because of the subject company's decision not to  
26 retain Merrill Lynch for investment banking services.  
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**Disclosure During Solicitation of Public Equity Underwriting**

13. On or before September 1, 2002, Merrill Lynch 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) Merrill Lynch 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) Merrill Lynch 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.

**Termination of Coverage**

14. Whenever Merrill Lynch terminates coverage of any issuer, Merrill Lynch will publish a report disclosing:

- (a) Merrill Lynch'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.

**Compliance Monitor**

15. Merrill Lynch agrees that:

- (a) Starting on or before September 1, 2002 and continuing for a period of one year, Merrill Lynch 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 Merrill Lynch 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



1 of actual or perceived undue influence or pressure from investment banking or  
2 any other source.

3 (d) The Compliance Monitor will report directly to the General Counsel for Litigation,  
4 Compliance, Regulatory and Governmental Affairs.

5 16. Nothing herein shall be construed to require that Merrill Lynch or any of its affiliates,  
6 agents, or employees, act in any manner inconsistent with any laws, rules, or regulations,  
7 including those imposed by their governing self-regulatory organizations.

8 **No Disqualifications**

9 17. Neither this settlement, nor any acts performed and documents executed in furtherance  
10 of this Order: (a) may be deemed or used as an admission of, or evidence of, the validity of  
11 any wrongdoing or liability including, but not limited to the assertions in the Dinallo Affidavit, or  
12 anything contained in the New York State Supreme Court Order, dated April 8, 2002; or (b)  
13 may be deemed or used as an admission of, or evidence of, any such alleged fault or  
14 omission by Merrill Lynch & Co., Henry Blodget, Justin Baldauf, Kirsten Campbell, Virginia  
15 Syer Genereux, Sofia Ghachem, Thomas Mazzucco, Edward McCabe and Deepak Raj, or  
16 any of them, in any civil, criminal, or administrative proceeding in any court, administrative  
17 agency, or other tribunal; nor shall this Order confer any rights upon any persons or entities  
18 who were not a party to this Order.

19 18. This Order is not intended to indicate that Merrill Lynch or any of its affiliates or current  
20 or former employees should be subject to any disqualifications contained in the federal  
21 securities law, the rules and regulations thereunder, the rules and regulations of self regulatory  
22 organizations or various states' securities laws including any disqualifications from relying  
23 upon the registration exemptions or safe harbor provisions, and this Order is not intended to  
24 form the basis of any such disqualification.

25 19. For any person or entity not a party to this Order, this Order, including, but not limited to  
26 Paragraph 17 above, does not limit or create any private rights or remedies against Merrill Lynch  
27 including, without limitation, the use of the Dinallo Affidavit, any e-mails or other documents of

1 Merrill Lynch or of others for research practices, limit or create liability of Merrill Lynch, or limit or  
2 create defenses of Merrill Lynch to any claims.

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4 20. Nothing herein is intended to or shall be construed to have created, compromised, settled  
5 or adjudicated any claims, causes of action, or rights of any person whomsoever, other than as  
6 between the division and Merrill Lynch in accordance with this Order.

7 21. Any violation of the May 21 Agreement shall be deemed violation of this Order. Should  
8 Merrill Lynch fail to abide by the terms and conditions of this Order or the May 21 Agreement,  
9 nothing contained herein shall be construed to prevent the division from exercising the authority  
10 to impose any remedy under AS 45.55 and 3 AAC 08 against Merrill Lynch.

11 22. This Order shall not disqualify Merrill Lynch or any of its affiliates or current or former  
12 employees from any business that they otherwise are qualified or licensed to perform under  
13 applicable state law and this Order is not intended to form the basis for any disqualification.

14 23. Merrill Lynch shall pay the sum of \$500,000 to the division.

15 24. This payment is contingent upon written agreement, by the appropriate securities  
16 Agency of all 50 states, the District of Columbia, and Puerto Rico, that the respective payment  
17 (referenced in Paragraph 24 of the May 21 Agreement) is made to each such Agency in  
18 consideration of the conclusion of any investigation by each such respective Agency, the  
19 District of Columbia, and Puerto Rico and any action that each such respective Agency, the  
20 District of Columbia, and Puerto Rico could commence with respect to research practices at  
21 Merrill Lynch. Merrill Lynch agrees and acknowledges that as to the Division of Banking,  
22 Securities, and Corporations, State of Alaska, this Order fully satisfies and complies with such  
23 contingency and with the contingency set forth in the third sentence of paragraph 24 of the May  
24 21 Agreement, which is fully incorporated into this Order.

25 25. If payment required pursuant to paragraph 23 is not made by Merrill Lynch for failure of  
26 any contingency set forth in paragraph 24, the division may vacate this Order at its sole  
27 discretion, upon 10 days notice to Merrill Lynch and without opportunity for administrative  
hearing.

**General Provisions**

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2 26. This Order and any dispute related thereto shall be construed and enforced in  
3 accordance with, and governed by, the laws of the State of Alaska.

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5 27. The parties represent, warrant and agree that they have received independent legal  
6 advice from their attorneys with respect to the advisability of executing this Agreement.

7 WHEREFORE, the following signatures are affixed hereto this \_\_\_\_\_ day of \_\_\_\_\_,  
8 2002.

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

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11 By: /s/ Barry Mandel  
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13 [NAME & TITLE OF SIGNER]  
14 Barry Mandel, Senior Vice President  
15 Division of Banking, Securities, and Corporations

16 By: /s/ Franklin T. Elder  
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18 Administrator of Securities  
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**CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY MERRILL LYNCH**

Merrill Lynch hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

Merrill Lynch admits the jurisdiction of the division, neither admits nor denies the Findings of Fact and Conclusions of Law contained in the Order; and consents to entry of this Order by the division as settlement of the issues contained in this Order.

Merrill Lynch states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Barry Mandel represents that ~~he/she~~ is Senior Vice President of Merrill Lynch and that, as such, has been authorized by Merrill Lynch to enter into this Order for and on behalf of Merrill Lynch.

Dated this 4th day of August, 2002

By: /s/ Barry Mandel  
Merrill Lynch, Pierce, Fenner & Smith, Inc.