

BEFORE THE DIRECTOR OF THE DEPARTMENT OF FINANCE
OF THE STATE OF IDAHO

In the matter of)
MERRILL LYNCH, PIERCE, FENNER) Docket No. 2009-7-14
& SMITH INCORPORATED,)
Respondent.) ADMINISTRATIVE CONSENT ORDER

WHEREAS, Merrill, Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a broker-dealer registered in the state of Idaho, with a Central Registration Depository ("CRD") number of 7691; and

WHEREAS, coordinated investigations into Merrill Lynch's activities in connection with its marketing and sale of financial instruments known as auction rate securities ("ARS") to retail and other customers have been conducted by a multistate task force; and

WHEREAS, Merrill Lynch has cooperated with regulators conducting the investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the investigations; and

WHEREAS, Merrill Lynch has advised regulators of its agreement to resolve the investigations relating to its marketing and sale of ARS on the terms specified in this Administrative Consent Order (the "Order"); and

WHEREAS, Merrill Lynch agrees to implement certain changes with respect to its marketing and sale of ARS, and to make certain payments in accordance with the terms of this Order; and

WHEREAS, Merrill Lynch elects to permanently waive any right to a hearing and appeal under Idaho Code § 30-14-604 with respect to this Order; and

WHEREAS, solely for the purposes of terminating the multistate task force investigations, including the investigation by the Idaho Department of Finance ("Department"), and in settlement of the issues contained in this Order, Merrill Lynch, without admitting or denying the Statement of Facts and Conclusions of Law contained in this Order, and without an adjudication of any issue of law or fact, consents to the entry of this Order.

1 NOW, THEREFORE, the Department, as administrator of the Uniform Securities Act (2004)
2 (“Act”), Idaho Code § 30-14-101 et. seq., hereby enters this Order:

3 I.

4 STATEMENT OF FACTS

5 A. Background Mechanics of Auction Rate Securities.

6 1. ARS as a general term refers to long-term debt or equity instruments tied to short-term
7 interest rates that are reset periodically through an auction process.

8 2. At auction, ARS always trade at par, with the yield of the instruments being adjusted by
9 the movements of interest rates set by the Dutch auction.

10 3. In the Dutch auction, a security holder had three options, the holder could: (1) hold; (2)
11 purchase or sell; or (3) purchase and hold at rate.

12 4. Investors looking to acquire ARS bid into the auction at the rate and quantity that they
13 were willing to hold the securities.

14 5. Orders for the available quantity of ARS are then filled, starting with the lowest bid rate
15 up until all the shares offered for sale in the auction are allocated.

16 6. The rate at which the final share from the auction is allocated is the clearing rate, and
17 sets the rate to be paid for the entire issue until the next auction.

18 7. If there are not enough purchasers the auction fails, no shares change hands, and the rate
19 resets to a rate that is prescribed in the instrument’s offering documents.

20 B. Merrill Lynch Marketed And Sold Auction Rate Securities As Safe, Liquid Short-
21 Term Investments.

22 1. Merrill Lynch Marketed Auction Rate Securities as Safe, Liquid Investments.

23 8. Merrill Lynch marketed and sold ARS as money market like instruments, which were
24 safe and liquid.

25 9. Merrill Lynch additionally used research pieces to market ARS to customers.
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1 10. Financial advisers (“FAs”) would often forward Merrill Lynch marketing pieces to
2 customers to reassure them of the safety and value of the instruments.

3 11. FAs who sold ARS were not required to provide customers with disclosures, instead
4 customers would receive customer’s trade confirmations directing customers to where they could
5 access Merrill Lynch’s “Auction Rate Practices and Procedures.”

6 12. On March 15, 2006, Merrill Lynch ended its practice of sending ARS purchasers a
7 “Master Purchasers Letter.” The Master Purchasers Letter was a disclosure document that all
8 purchasers of ARS had been required to sign and return to Merrill Lynch.

9 13. Merrill Lynch’s policies and procedures did disclose some important elements of its
10 ARS program, including that Merrill Lynch plays multiple roles in the ARS market, that Merrill
11 Lynch’s interest may differ from those of its clients who purchased ARS, that Merrill Lynch is
12 permitted but not obligated to submit orders for its own account and routinely does, and that a
13 purchaser’s ability to sell the purchaser’s ARS may be limited.

14 14. Yet, since Merrill Lynch FAs were not required to affirmatively disclose these practices
15 prior to selling a client ARS, purchasers were largely unaware of Merrill Lynch’s practices in
16 supporting its ARS program.

17 15. Merrill Lynch did not undertake any analysis of whether any customers actually went to
18 the website discussing its practices and procedures to review them.

19 2. Merrill Used Triple-A Rating as a Selling Point for Auction Rate Securities
20 Even After it had Allowed to Fail Certain Triple-A Rated Auction Rate
21 Securities.

22 16. The fact that its ARS carried a AAA rating was an important marketing point for
23 Merrill Lynch. The AAA rating on ARS was routinely touted in marketing materials, as well as
24 research pieces that discussed ARS and their safety.

25 17. Marketing materials produced by the ARS desk promoted ARS as follows:

- 26 • **Auction Market Securities provide many advantages for investors**
 - Large and liquid market with over \$306 billion currently outstanding

- High quality credits with over 92% of the market rated AAA
- Incremental yield to comparable securities such as commercial paper and money market funds
- Taxable, tax advantaged and tax exempt investment options

18. A triple-A rating is a long term credit rating.

19. The AAA rating on Merrill Lynch's ARS do not speak to an investor's ability to liquidate the instrument through auction at par.

20. A number of the collateralized debt obligations and other auction rate securities underwritten and offered by Merrill Lynch carried the AAA rating from major rating agencies.

21. In August 2007, as described below, Merrill ceased supporting the auctions of a number of its triple-A rated action rate securities.

22. Those securities became illiquid and subsequently lost most of their market value.

23. Despite the fact that Merrill had failed a number of triple-A auction-rate securities in August 2007, subsequent to August 2007, Merrill continued to use the AAA rating as a selling point for auction rate securities.

24. Merrill Lynch was aware—yet did not disclose to investors--that certain auction rate securities retained their triple-A rating after their auctions had failed.

25. Merrill Lynch was aware—yet did not disclose to investors--that the triple-A rating did not provide protection against Merrill deciding to no longer support its auction program.

26. Nonetheless, Merrill Lynch relied heavily on the triple-A rating to convince investors the auction rate securities it was selling were safe and principal protected.

C. Merrill Lynch's Auction Rate Securities Program Stands in Contrast to its Representations to Customers.

1. Merrill Lynch's Auction Rate Program Provided Issuers with Inexpensive Financing and Generated Substantial Fees for Merrill Lynch.

27. Merrill Lynch's ARS program was funded by issuers of ARS, who paid Merrill Lynch fees to underwrite securities and remarket them.

28. The ARS market allowed issuers to achieve long-term financing at short-term rates.

1 29. The Merrill Lynch ARS program had four branches, an investment bank that
2 underwrote ARS, the ARS desk that acted as a remarketing agent for the securities, a sales force that
3 sold ARS to retail and other clients, and a research division that assisted the ARS desk in placing ARS.

4 30. The ARS that Merrill Lynch underwrote then sold to its clients consisted of auction
5 preferred shares ("APS"), with perpetual maturity, with dividends that reset every 7 to 35 days at
6 auction, or long-term debt instruments, issued by municipalities and student loan organizations with
7 maturities of 20-40 years with interest rates that reset through the same process.

8 31. Due to the upward sloping yield curve, issuers of long-term instruments would typically
9 have to pay higher interest rates.

10 32. By supporting the auction mechanism, both in its role as a remarketing agent and by
11 purchasing ARS at auction to avoid failures, Merrill Lynch allowed issuers to have long-term financing
12 at short-term rates.

13 33. Purchasers of ARS were willing to accept short-term rates because they believed they
14 would have access to their principal on short-term notice at the next auction, and they would get a
15 slightly higher rate than a money market fund because they would have to wait until the next auction to
16 access their money.

17 34. This belief was cultivated by Merrill Lynch and other broker-dealers who used their
18 own capital to ensure auctions did not fail, and generally touted the 20-year track record of very rare
19 failures, and creating the impression with investors that there was a deep liquid market for the
20 securities.

21 35. Due to the practice of Merrill Lynch and other broker-dealers of placing support bids,
22 for the 20 years prior to August of 2007 there had been only a handful of failed auctions that prevented
23 investors from accessing their principal.

24 2. Merrill Lynch Generated Significant Fees by Underwriting Auction Rate
25 Securities with Constrictive Maximum Rates and Selling them to Clients.

- 26 a. Merrill Lynch Generated Significant Fees Underwriting Auction Rate
 Securities and Distributing Them To Clients.

1 36. The investment bank at Merrill Lynch generated significant fees from underwriting new
2 issuances of ARS. From 2001 through 2008 Merrill Lynch underwrote approximately \$13 billion of
3 APS, earning \$130 million of underwriting fees.

4 37. In order to help move new issues Merrill Lynch awarded FAs who placed new ARS
5 issues with a placement credits.

6 b. Merrill Lynch Underwrote Auction Rate Securities With Restrictive
7 Maximum Rates, Which Allowed The Securities To Achieve AAA
8 Ratings.

9 38. Upon information and belief 92% of the auction rate securities that Merrill Lynch
10 underwrote received a AAA rating from rating agencies such as Fitch and Moodys, and 97% had
11 ratings of AA or better.

12 39. AAA ratings from agencies such as Fitch and Moodys signify the rating agencies'
13 assessment that there is a high likelihood that the security will pay interest or dividends as well as
14 principal when due in a timely manner.

15 40. Maximum rate provisions place a ceiling on the rate of interest at which an auction can
16 clear, and additionally provide the rate the issuer must pay should auctions fail.

17 41. When evaluating whether an issuer could make payments as due on its ARS, rating
18 agencies would look at the terms of the instrument to determine how much interest it may be obligated
19 to pay. The maximum rate places an absolute cap on the interest or dividend the instrument will pay,
20 restricting its potential obligations, therefore making it easier for the instrument to achieve a AAA
21 rating.

22 42. Once Merrill Lynch stopped placing support bids in the auctions for which it was the
23 lead broker-dealer, there were auction failures across its program.

24 43. When auctions fail the rate resets to the maximum rate.

25 44. The ARS with high maximum rates, typically municipal auction rate certificates
26 ("ARCS") with maximum rates in the range of 12-15%, have drawn investor interest and have cleared
without Merrill Lynch's support.

1 45. The ARS with low maximum rates, typically taxable and tax-exempt APS with
2 maximum rates in the range of 3-5%, have not drawn investor interest and without Merrill Lynch's
3 support have continued to fail, leaving investors with illiquid instruments.

4 c. Merrill Lynch Additionally Received Fees To Remarket The Auction
5 Rate Securities It Underwrote.

6 46. When Merrill Lynch underwrote an issue of ARS, it typically served as the broker-
7 dealer or remarketing agent for the issue.

8 47. Merrill Lynch would typically receive a fee of 25 basis points of the value of the ARS
9 for which it acted as remarketing agent.

10 48. Merrill Lynch would share a portion of this fee with FAs in order to incentivize them to
11 place clients into ARS.

12 49. Prior to every auction for which Merrill Lynch was the sole or lead broker-dealer,
13 Merrill Lynch would provide "price talk," a range of bids provided to FAs indicating where Merrill
14 Lynch expected auctions to clear.

15 50. All ARS for which Merrill Lynch acted as sole broker-dealer were placed through
16 Merrill Lynch FAs.

17 51. Under Merrill Lynch's ARS program, as remarketing agent, the ARS desk had the
18 option but not the obligation to bid in auctions.

19 52. Until August of 2007 Merrill Lynch had a policy of placing support bids into every
20 auction for which it was sole or lead broker-dealer.

21 53. In August of 2007 Merrill Lynch withdrew its support for certain CDO-backed ARS.

22 54. When placing a support bid, Merrill Lynch would bid for the entire notional value of
23 the issue being auctioned, regardless of the size or volume of buy, sell, or hold orders Merrill Lynch
24 had received.

25 55. By placing support bids for the entire notional value of the issue being auctioned,
26 Merrill Lynch ensured that no auctions in its ARS program would fail.

 56. Merrill Lynch often set the rate at which the auctions would clear with its support bids.

1 57. For the period of January 3, 2006, through May 27, 2008, 5892 auctions for which
2 Merrill Lynch was the sole lead dealer would have failed but for Merrill Lynch's support bid.

3 58. Investors were not provided with information about the volume of shares that moved at
4 auction.

5 59. Investors were not provided with information about the level of support from Merrill
6 lynch that was required to clear the auction.

7 60. Investors were not informed of how many ARS Merrill Lynch was carrying on its own
8 inventory as a result of supporting auctions.

9 **D. Auction Rate Securities Inventory Concerns At Merrill Lynch**

10 1. Weakness in the Credit Markets Initiated Inventory Concerns In Summer Of
11 2007.

12 61. Beginning in late July 2007, certain negative market influences surrounding
13 collateralized debt obligations ("CDOs") and collateralized loan obligations ("CLOs") and a credit
14 crunch began to negatively impact Merrill Lynch's auction market business.

15 62. As investors began selling these ARS due to concerns about their credit quality (despite
16 the fact that many were triple-A rated), Merrill Lynch purchased ARS into its own inventory to make
17 sure those auctions did not fail.

18 63. At a certain point, Merrill Lynch decided to limit the amount of inventory of these
19 instruments it was taking on and ceased submitting support bids, thus allowing the auctions to fail.

20 64. Merrill Lynch FAs began to seek answers to questions concerning ARS as early as
21 August 7, 2007.

22 65. FAs from all over the United States sent emails and made telephone calls to request
23 information from the Global Markets & Investment Banking staff managing the Merrill Lynch Auction
24 Trading Desk.

25 66. The Auction Desk and the Financial Products Group, along with several of the
26 supposedly independent research analysts for closed-end funds and Fixed Income/Cash, organized and
participated in Sales Calls during the second and third week of August 2007 in an effort to clear

1 auctions, reduce the rates of important issuers, and maintain a strong interest in ARS among the Merrill
2 Lynch FAs all over the country.

3 2. Communications With Issuers And Others Expressing Concern About The
4 Auction Markets.

5 67. As early as August 3, 2007, senior management of Merrill Lynch was requesting a
6 sample term sheet for AMPS to understand the liquidity and downgrade risk.

7 68. In August 2007, representatives from major issuers in the closed-end fund investment
8 world were also trying to get a sense of the risks and demand reductions for their preferred shares.

9 69. None of these growing risks concerning weak demand in the ARS market were
10 disclosed to Merrill Lynch clients during the third quarter of 2007.

11 70. Upon information and belief, Merrill Lynch began, in late 2007, discussing with issuers,
12 concerns with the auction markets.

13 3. Merrill Lynch Surpasses Its Inventory Limit In September 2007, As ARS
14 Market Conditions Worsened.

15 71. In late September, inventory levels rose significantly and the Auction Desk was fast
16 approaching its limit of \$1 billion dollars.

17 72. In addition, Merrill Lynch had certain lenders that provided financing for its inventory
18 of auction rate securities.

19 73. Those lenders had previously accepted auction rate securities as collateral for the loans.

20 74. In the Fall of 2007, certain of these lenders became uncomfortable with the liquidity of
21 auction rate securities and ceased accepting them as collateral.

22 75. Merrill did not inform its retail and other customers, to whom it was marketing auction
23 rate securities as principal protected cash-like instruments, that entities that financed its inventory no
24 longer accepted certain auction rate securities (even some rated AAA) as collateral.

25 E. **Merrill Lynch's Consolidated Effort to Reduce Inventory – A Three Pronged**
26 **Approach.**

1. Calming Fears, Providing Assurances And Motivating Additional Sales Of
Auction Rate Securities Through Sales Calls with FAs.

1 76. Just after the first hint of investor concern with the auction market, the Auction Desk
2 and Sales and Trading immediately mobilized to stem the tide of negative news. Managers moved
3 quickly to set up sales calls to provide assurances to FAs and to motivate future sales of ARS.

4 77. In late November and early December, with inventory backing up and reaching new
5 highs at Merrill Lynch, a decision was made to do another national sales call. The formula would be
6 similar to the successful call made previously in August. Auction Desk personnel would be joined by a
7 member or members of the Research Department to reassure and motivate FAs to concentrate on
8 selling Auction Desk inventory.

9 78. During the call, there was no discussion regarding the risk of any type of auction
10 failure, or the likelihood or possibility that any market dislocation could result in retail customers' cash
11 becoming illiquid.

12 79. Moreover, there was no discussion about the possibility that Merrill Lynch could decide
13 at any time to stop its support of the auction market or to otherwise withdraw from supporting the
14 auctions that it sole managed or co-managed.

15 80. There was no mention of the fact that with the pressures that existed in the credit market
16 since August 2007, any auction failure by any auction dealer could spread contagion to the rest of the
17 market.

18 2. FA Incentives - Increased Production Credits Sales Drive.

19 81. At various times during the second half of 2007, Merrill Lynch provided incentives in
20 the form of enhanced production credits as a means of motivating FAs to sell ARS to customers and
21 reduce Merrill Lynch's inventory. Typically, FAs earned 12.5 bps on an annualized basis for
22 investments in ARS. FAs would then earn a percentage of the 12.5 bps according to a payout grid.

23 82. During periods where enhanced credits were awarded, FAs could earn as much as 8
24 times that amount (or 100 bps) for sales of ARS. Other enhanced payouts could include payouts of 25
25 bps, or 50 bps. Similar to regular production credits earned, FAs enhanced production credits would be
26 applied to the grid resulting in FAs being paid a certain predetermined percentage of the enhanced
production credit.

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3. Coordination with Research

a. Proactive Involvement From The Supposedly Independent Research Department To Aid In Sales Efforts.

83. Merrill Lynch's Research Department played a pivotal role in assisting sales of Auction Rate Securities.

84. On at least two occasions during the Fall of 2007, Sales and Trading and the Auction Desk made direct and specific requests for the Research Department to draft favorable research pieces regarding the auction market to assist in Sales.

b. Improper Information Sharing –Between Research and Sales and Trading.

85. The task force's investigation revealed frequent communications among research, sales, and trading staff.

86. Merrill Lynch Policy & Procedures Manual (the "Policies Manual") employs a so-called "Chinese Wall," which is designed to prevent "the misuse of material non-public information" and to prevent "even the appearance of impropriety."

87. The "Chinese Wall" is designed to "restrict and monitor the flow of information between the various areas of [Merrill Lynch] such as Global Research, Sales [and] Trading," among others "to avoid the misuse of such information and the appearance of impropriety as well as to manage potential conflicts of interest..."

88. Among those departments that constitute the "Private Side of the Wall" include: "Investment Banking, including Global Capital Markets and Financing (Equity Capital Markets and Debt Capital Markets)," and "other departments or individuals that regularly receive inside information," while the Research Division is on the "Public Side of the Wall."

89. Among the categories of information that cannot be discussed between Sales or Trading and Research are the levels or amounts of inventory that Merrill Lynch maintained for its own account.

90. Such information was discussed.

1 **F. Improper Influence And Pressure Over Supposedly Independent Research**
2 **Personnel.**

3 91. Merrill Lynch permitted its Sales and Trading and Auction Desk personnel to have
4 undue influence over its Research Department regarding its coverage of the auction market.

5 92. In addition to the direct requests of Sales and Trading and the Auction Desk to Research
6 for positive published material related to the auction market, undue influence was also exercised over
7 the content of the published research reports.

8 93. Other times, Auction Desk Personnel attempted to directly influence how Research
9 responded to FA questions during sales calls.

10 **G. Events Leading To Merrill Lynch's Decision To Stop Broadly Supporting Its**
11 **Auction Program.**

12 94. Concerns surrounding the auction market grew more ominous going into the new year
13 and Merrill Lynch's Auction Desk personnel began to brace for the worst.

14 95. Likewise, Inventory concerns at Merrill Lynch continued.

15 96. On January 23, 2008, word began circulating among broker-dealers that Lehman
16 Brothers had a number of auctions fail the previous day.

17 97. Concerns were not shared with FAs or retail customers.

18 98. Between the dates February 1, 2008 and February 8, 2008, staff wrote or contributed to
19 approximately three published research pieces, including: Fixed Income Digest, "Preserve Income Lock
20 in Yields"; Fixed Income Digest Supplement, "Auction Market Securities" and Auction Market Value
21 Sheet, "Back to Basics In The Auction Market." Each of these publications continued to recommend
22 that investors should feel confident about the auction market.

23 99. On or about February 1, 2008, Merrill Lynch's Research Department published a
24 volume of its Fixed Income Digest, entitled "Preserve Income Lock in Yields." The cover page
25 included a section entitled "Preserve Income." The last sentence of the section provided: "For funds
26 that investors need to keep liquid, we continue to find the best value in auction market securities."
 Inside the research piece, there was a subheading: "For Cash Holdings: auction market securities,"
 which recommended, [n]aturally, most investors need to keep some portion of their portfolios in liquid

1 cash-like instruments. We find auction market securities (AMS) to be better alternative than money
2 funds for these purposes for investors with larger amounts to invest.” The section was followed
3 immediately by another section dedicated to: “Answering Your Questions About Auction Market
4 Securities” which responded to common questions relating to the auction markets at the time.

5 100. On February 4, 2008, the Research Department re-published the “Answering
6 Questions” piece on its own as a supplement to the Fixed Income Digest in part, because of questions
7 the Research Department was getting calls and that FAs were likely having a problem locating the
8 information in the otherwise lengthy February 1, 2008 publication.

9 101. On the evening of February 12, 2008, Merrill Lynch executives decided to cease
10 supporting its auction rate securities program and intentionally allowed the vast majority of their
11 auctions to fail the following day.

12 102. Merrill Lynch’s decision to stop broadly supporting its auction program was made
13 without any real consideration or analysis of its effect on retail and other investors holding the
14 securities.

15 **H. Merrill Lynch Has Marked Down Its Own Inventory of Auction Rate Securities,
16 But Still has Not Marked Down The Estimated Value Of The Auction Rate
17 Securities On Its Clients’ Account Statements.**

18 103. Merrill Lynch has marked down the value of its own inventory of auction rate
19 securities, yet has not marked down the value of those same auction rate securities in its client
20 statements.

21 104. According to client statements received by the task force, auction rate securities listed
22 on client statements have not been marked down to reflect their illiquidity. Their “estimated market
23 value” is still listed as 100 percent of par. Certain of the exact same instruments held by Merrill Lynch
24 in its inventory have been marked down from par.

25 **II.**

26 **CONCLUSIONS OF LAW**

1. The Department has jurisdiction over this matter pursuant to Idaho Code § 30-14-101

1 et. seq.

2 2. The above conduct is in violation of Idaho Code § 30-14-412(d)(13) and IDAPA
3 12.01.08.104.11

4 3. The Department finds the following relief appropriate and in the public interest.

5 **III.**

6 **ORDER**

7 On the basis of the Statement of Facts, Conclusions of Law, and Merrill Lynch's consent to the
8 entry of this Order,

9 **IT IS HEREBY ORDERED:**

10 1. This Order concludes the investigation by the Department and any other action that the
11 Department could commence under applicable Idaho law on behalf of the State of Idaho as it relates to
12 Merrill Lynch, relating to the marketing and sales of ARS by Merrill Lynch, provided however, that
13 excluded from and not covered by this paragraph 1 are any claims by the Department arising from or
14 relating to the "Order" provisions contained herein.

15 2. This Order is entered into solely for the purpose of resolving the referenced multistate
16 investigation, and is not intended to be used for any other purpose.

17 3. Merrill Lynch will CEASE AND DESIST from violating the Act and will comply with the
18 Act.

19 4. Merrill Lynch shall pay fines and/or penalties totaling \$125 million (the "Total
20 Penalty") to the Commonwealth of Massachusetts and the other states, which shall be allocated at the
21 Commonwealth of Massachusetts and the other states' discretion, to resolve all underlying conduct
22 relating to the sale of auction rate securities. Merrill Lynch shall pay \$306,733.86 of the Total Penalty
23 to the Department. [The monies received by Department pursuant to this paragraph shall be deposited
24 to the Securities Investor Education and Training Fund as per Idaho Code § 30-14-601(e). In the event
25 another state securities regulator determines not to accept Respondents' settlement offer, the total
26 amount of the payment to the Department shall not be affected, and shall remain at \$306,733.86.

1 5. Definitions and Buyback Offer. Merrill Lynch will provide liquidity to Eligible
2 Investors by buying Eligible Auction Rate Securities that have failed at auction at least once between
3 February 13, 2008, and the date of this Offer, at par, in the manner described below.

4 “Eligible Auction Rate Securities,” for purposes of this Order, shall mean auction rate securities
5 publicly issued by municipalities or closed-end funds or backed by student loans and purchased at
6 Merrill Lynch on or before February 13, 2008. Notwithstanding any other provision, Eligible Auction
7 Rate Securities shall not include privately issued or placed auction rate securities that are unregistered
8 and/or offered pursuant to SEC Rule 144A, or other exemptions of the Securities Act of 1933.

9 “Eligible Investors,” for purposes of this Settlement, shall mean:

10 (i) Natural persons (including their IRA accounts, testamentary trust and estate accounts,
11 custodian UGMA and UTMA accounts, and guardianship accounts) who purchased Eligible Auction
12 Rate Securities at Merrill Lynch:

13 (ii) All small business and not for profit clients in Merrill Lynch’s Global Wealth
14 Management Group who purchased Eligible Auction Rate Securities at Merrill Lynch that had \$100
15 million or less in assets in their accounts with Merrill Lynch, net of margin loans, as of August 7, 2008,
16 or, if the customer was not a customer of Merrill Lynch as of August 7, 2008, as of the date that the
17 customer terminated its customer relationship with Merrill Lynch. Notwithstanding any other
18 provision, “small business and not for profit clients” does not include broker-dealers or banks acting as
19 conduits for their customers.

20 6. Tranche I Eligible Investors. No later than September 26, 2008, Merrill Lynch shall
21 have offered to purchase at par, plus any accrued but unpaid interest or dividends, Eligible Auction
22 Rate Securities for which auctions are not successfully auctioning from Eligible Investors who had less
23 than \$4 million in assets at Merrill Lynch as of August 7, 2008. Merrill Lynch’s offer to purchase such
24 securities from Eligible Investors will remain open from October 1, 2008, through January 15, 2010,
25 and Merrill Lynch shall promptly purchase such securities from any Eligible Investor who accepts this
26 offer between January 2, 2009, and January 15, 2010.

1 For purposes of this Settlement, legal entities forming an investment vehicle for closely related
2 individuals, including but not limited to IRA accounts, Trusts, Family Limited Partnerships and other
3 legal entities performing a similar function, charities and non-profits, and small businesses who had
4 less than \$4 million in assets at Merrill Lynch shall be covered by Section III.5(i).

5 7. Tranche II Eligible Investors. No later than December 18, 2008, Merrill Lynch shall
6 have offered to purchase at par, plus any accrued but unpaid interest or dividends, Eligible Auction
7 Rate Securities from other Eligible Investors who purchased Eligible Auction Rate Securities from
8 Merrill Lynch prior to February 13, 2008, and who had less than \$100 million in assets at Merrill
9 Lynch as of August 7, 2008.

10 Merrill Lynch's offer to purchase such securities from Eligible Investors shall remain open
11 from January 2, 2009 through January 15, 2010, and Merrill Lynch shall promptly purchase such
12 securities from any investor who accepts this offer between January 2, 2009, and January 15, 2010.

13 8. Asset Amounts. Merrill Lynch shall calculate investor asset amounts as of August 7,
14 2008, for all Eligible Investors with assets with Merrill Lynch as of that date. For Eligible Investors
15 with no assets at Merrill Lynch as of that date, Merrill Lynch shall calculate investor asset amounts as
16 of the date such investor removed their assets from Merrill Lynch.

17 9. Notice and Assistance. Merrill Lynch shall provide prompt notice to customers of the
18 settlement terms, and Merrill Lynch shall establish a dedicated telephone assistance line, with
19 appropriate staffing, to respond to questions from customers concerning the terms of the settlement.

20 10. Relief for Eligible Investors Who Sold Below Par. No later than October 1, 2008, any
21 investor covered by Section III.5 that Merrill Lynch can reasonably identify who sold Eligible Auction
22 Rate Securities below par between February 13, 2008, and October 1, 2008, shall be paid by Merrill
23 Lynch the difference between par and the price at which such investor sold the Eligible Auction Rate
24 Securities.

25 11. Consequential Damages Claims. No later than October 1, 2008, Merrill Lynch shall
26 make reasonable efforts promptly to notify those Eligible Investors covered by Section III.5 above who
own Eligible Auction Rate Securities, pursuant to the terms of the settlement, that an independent

1 arbitrator, under the auspices of the Financial Industry Regulatory Authority (FINRA), shall be
2 available for the exclusive purpose of arbitrating any Eligible Investor's consequential-damages claim.
3 Merrill Lynch shall consent to participate in the North American Securities Administrators
4 Association's ("NASAA") Special Arbitration Procedures (the "SAP") established specifically for
5 arbitrating any Eligible Investor's consequential damages claim arising from their inability to sell
6 Eligible Auction Rate Securities. Nothing in this Offer shall serve to limit or expand any party's rights
7 or obligations as provided under the SAP. Arbitration shall be conducted before a single non-industry
8 arbitrator and Merrill Lynch will pay all forum and filing fees.

9 Arbitrations asserting consequential damages of less than \$1 million will be decided through a
10 single chair-qualified public arbitrator who will be appointed through the FINRA list selection process
11 for single arbitrator cases. In arbitrations where the consequential damages claimed are greater than or
12 equal to \$1 million, the parties can, by mutual agreement, expand the panel to include three public
13 arbitrators who will be appointed through FINRA's list procedure.

14 Any Eligible Investors who choose to pursue such claims through the SAP shall bear the burden
15 of proving that they suffered consequential damages and that such damages were caused by their
16 inability to access funds invested in Eligible Auction Rate Securities at Merrill Lynch as of February
17 13, 2008. In the SAP, Merrill Lynch shall be able to defend itself against such claims; provided,
18 however, that: Merrill Lynch shall not contest liability for the illiquidity of the underlying ARS
19 position or use as part of its defense any decision by an Eligible Investor not to borrow money from
20 Merrill Lynch. Special or punitive damages shall not be available in the SAP¹.

21 All customers, including but not limited to Eligible Investors who avail themselves of the relief
22 provided pursuant to this Order, may pursue any remedies against Merrill Lynch available under the
23 law. However, Eligible Investors that elect to utilize the SAP are limited to the remedies available in
24 that process and may not bring or pursue a claim relating to Eligible Auction Rate Securities in another
25 forum.

26 ¹ However, it is agreed by the parties that "consequential damages" shall have a meaning separate and apart from
"punitive or special damages." Under no circumstances should this provision be read to mean that a consequential damages
claim may not be maintained due to any state law which may categorize consequential damages as a subset within punitive
and/or special damages.

1 12. Institutional Investors Not Covered By Section III.5. Merrill Lynch shall endeavor to
2 continue to work with issuers and other interested parties, including regulatory and other authorities and
3 industry participants, to expeditiously and on a best efforts basis provide liquidity solutions for
4 investors who purchased Eligible Auction Rate Securities from Merrill Lynch and are not entitled to
5 participate in the buyback described in Section III.5 above (referred to herein as "Institutional
6 Investors").

7 Beginning January 2, 2009, and then quarterly after that, Merrill Lynch shall submit a written
8 report to a representative specified by NASAA outlining the efforts in which Merrill Lynch has
9 engaged and the results of those efforts with respect to Merrill Lynch Institutional Investors' holdings
10 in Eligible Auction Rate Securities. Merrill Lynch shall confer with the representative no less
11 frequently than quarterly to discuss Merrill Lynch's progress to date. Such quarterly reports shall be
12 submitted within 20 days following the end of each quarter and continue until no later than January 15,
13 2010. Following every quarterly report, the representative shall have the option of requiring a meeting
14 between the State and Merrill Lynch to advise Merrill Lynch of any concerns and, in response, Merrill
15 Lynch shall detail the steps that Merrill Lynch plans to implement to address such concerns. The
16 reporting or meeting deadlines set forth above may be amended with written permission from the
17 representative.

18 13. Relief for Municipal Issuers. Merrill Lynch shall refund refinancing fees to municipal
19 auction rate issuers that issued such Eligible Auction Rate Securities in the initial primary market
20 through Merrill Lynch between August 1, 2007, and February 13, 2008, and refinanced those securities
21 through Merrill Lynch after February 13, 2008. Refinancing fees are those fees paid to Merrill Lynch
22 in connecting with a refinancing and are exclusive of legal fees and any other fees or costs not paid to
23 Merrill Lynch in connection with the transaction.

24 14. No Disqualification. The Order entered pursuant to this Offer hereby waives any
25 disqualification contained in the laws of the State of Idaho, or rules or regulations thereunder, including
26 any disqualifications from relying upon the registration exemptions or safe harbor provisions that
Merrill Lynch or any of its affiliates may be subject to. The Order entered pursuant to this Offer also is

1 not intended to subject Merrill Lynch or any of its affiliates to any disqualifications contained in the
2 federal securities laws, the rules and regulations thereunder, the rules and regulations of self regulatory
3 organizations or various states' or U.S. Territories' securities laws, including, without limitation, any
4 disqualifications from relying upon the registration exemptions or safe harbor provisions. In addition,
5 this Order is not intended to form the basis for any such disqualifications.

6 15. Nothing herein shall preclude the State of Idaho, its departments, agencies, boards,
7 commissions, authorities, political subdivisions and corporations (collectively, "State Entities"), other
8 than the Department of Finance and only to the extent set forth in paragraph 1 above, and the officers,
9 agents or employees of State Entities from asserting any claims, causes of action, or applications for
10 compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief
11 against Merrill Lynch in connection with certain auction rate securities sales practices at Merrill Lynch.

12 16. For any person or entity not a party to the Order issued pursuant to this Offer, this Offer
13 and the Order do not limit or create any private rights or remedies against Merrill Lynch including,
14 without limitation, the use of any e-mails or other documents of Merrill Lynch or of others for auction
15 rate securities sales practices, limit or create liability of Merrill Lynch, or limit or create defenses of
16 Merrill Lynch, to any claims.

17 17. In Consideration of the Settlement the Department will:

18 a. Except as allowed by paragraph 17(b), terminate the investigation by the Department and
19 any other action that the Department could commence on behalf of the State of Idaho as it relates to Merrill
20 Lynch's underwriting, marketing, and sales of Eligible Auction Rate Securities, provided, however, that
21 excluded from and not covered by this paragraph are any claims by the Department arising from or
22 relating to the "Order" provisions contained herein.

23 b. Refrain from further investigation and from taking legal action, if necessary, against
24 Merrill Lynch with respect to Institutional Investors until a date after December 31, 2009.

25 c. Not seek additional monetary penalties from Merrill Lynch relating to the issues raised
26 by the Department relating to Merrill Lynch's marketing and sale of Eligible Auction Rate Securities to

1 investors and the firm permitting trading in auction rates securities by any individuals affiliated with
2 Merrill Lynch.

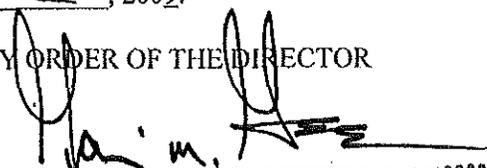
3 18. Failure to Comply With Terms of Settlement. If after this settlement is executed,
4 Merrill Lynch fails to comply with any of the terms set forth herein, the State may institute an action to
5 vacate this Order. Upon issuance of an appropriate order, after an opportunity for a fair hearing, a state
6 may reinstitute the actions and investigations referenced in this Order.

7 19. This Order and any dispute related thereto shall be construed and enforced in
8 accordance with, and governed by, the laws of the State of Idaho without regard to any choice of law
9 principles.

10 20. This Order shall be binding upon Merrill Lynch and its successors and assigns as well
11 as to successors and assigns of relevant affiliates with respect to all conduct subject to the provisions
12 above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions,
13 events, and conditions.

14 Dated this 18TH day of JUNE, 2009.

15 BY ORDER OF THE DIRECTOR

16
17 
18 GAVIN GEE
19 Director
20 Idaho Department of Finance

