

finalized, are not materially different from the terms of the accepted bid.

5. The Board will exercise oversight responsibilities in connection with any Protection Agreement and will establish a special committee (the "Committee"), a majority of the members of which will be Independent Trustees, if the Fund enters into an Affiliated Protection Arrangement. If a Trigger Event or a Defeasance Event occurs under the Protection Agreement (each, a "Protection Event"), the Adviser will be required to notify the Committee as soon as practicable, and absent special circumstances, before a decision is reached by the Protection Provider and the Adviser as to how to effect any necessary cure. On or about the Maturity Date, the Board will review information comparing the aggregate Protected Amount with the Fund's total NAV on the Maturity Date, and will review and approve the amount of any Shortfall to be submitted for payment to the Protection Provider under the Protection Agreement (including the amount of any required Adviser Payment to the Fund) (the "Approved Shortfall Amount").

Applicants' Legal Analysis

A. Section 12(d)(3) of the Act

1. Section 12(d)(3) of the Act generally prohibits a registered investment company from acquiring any security issued by any person who is a broker, dealer, investment adviser, or engaged in the business of underwriting. Rule 12d3-1 under the Act exempts certain transactions from the prohibition of section 12(d)(3) if certain conditions are met. One of these conditions, set forth in rule 12d3-1(c), provides that the exemption provided by the rule is not available when the issuer of the securities is the investment adviser, promoter, or principal underwriter of the investment company, or any affiliated person of such entities. In addition, rule 12d3-1(b) does not permit a registered investment company to (i) own more than five percent of a class of equity securities of an issuer that is engaged in securities related activities; (ii) own more than ten percent of such an issuer's debt securities; or (iii) invest more than five percent of the value of its total assets in the securities of any such issuer. Section 6(c) of the Act authorizes the Commission to exempt any person or transaction from any provision of the Act to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly

intended by the policies and provisions of the Act.

2. Applicants state that by virtue of entering into an Affiliated Protection Arrangement with a Merrill Lynch Affiliate that is a broker, dealer, underwriter or investment adviser to a registered investment company or an investment adviser registered under the Investment Advisers Act, a Fund may be deemed to have acquired a security from the Merrill Lynch Affiliate.⁸ In addition, applicants state that it is possible that a Protection Agreement entered into by the Fund (whether pursuant to an Affiliated Protection Agreement or otherwise) may represent more than ten percent of the debt securities of a Protection Provider that is involved in securities related activities or more than five percent of the total assets of the Fund. Therefore, applicants seek an exemption from section 12(d)(3) to the extent necessary to permit the Fund to enter into Affiliated Protection Arrangements with a Merrill Lynch Affiliate or a Protection Agreement with another Protection Provider that is involved in securities related activities.

3. Applicants state that section 12(d)(3) was intended to prevent investment companies from exposing their assets to the entrepreneurial risks of securities related businesses and to prevent reciprocal practices between investment companies and securities related businesses. Applicants assert that the proposed transactions are consistent with the policy and intent underlying section 12(d)(3). In terms of the risk-preventing element of section 12(d)(3), applicants state that the Adviser and Board, when evaluating the credentials of a prospective Protection Provider, will take into account the Protection Provider's creditworthiness, any ratings assigned by a nationally recognized statistical ratings organization ("NRSRO"), and the availability of audited financial statements. Applicants state that the purpose of the Fund's Protection Agreement is to provide Principal Protection for the Fund, not to reward a Merrill Lynch Affiliate (or any other broker-dealer) for sales of Fund shares. Moreover, applicants believe that the conditions set forth in the application will ensure that each Fund is operated in the interests of its shareholders and not in the interests of a Merrill Lynch

Affiliate or any other Protection Provider.

B. Section 17(a) of the Act

1. Section 17(a)(1) and (2) of the Act generally prohibit the promoter or principal underwriter, or any affiliated person of the promoter or principal underwriter, of a registered investment company, acting as principal, knowingly to sell or purchase any security or other property to or from such investment company. Section 2(a)(3) of the Act defines an "affiliated person" of another person to include, among other things: (a) Any person directly or indirectly owning, controlling, or holding with power to vote 5% or more of the outstanding voting securities of the other person; (b) any person 5% or more of whose outstanding voting securities are directly or indirectly owned; and (c) any person directly or indirectly controlling, controlled by, or under common control with, the other person. Section 17(b) of the Act authorizes the Commission to exempt a proposed transaction from the terms of section 17(a) if evidence establishes that the terms of the proposed transaction are reasonable and fair and do not involve overreaching, and the proposed transaction is consistent with the policies of the registered investment company involved and the purposes of the Act.

2. Applicants state that depending on the structure of a Protection Agreement, it might be deemed to be a security or other property, and the Fund's entering into a Protection Agreement with a Merrill Lynch Affiliate might be deemed to be the acquisition of a security or other property from a Merrill Lynch Affiliate. In addition, applicants state that if a Merrill Lynch Affiliate were to serve as a Hedging Counterparty to an Unaffiliated Provider, the Merrill Lynch Affiliate might under certain circumstances be deemed to be indirectly involved in the sale of a security or other property to the Fund. Applicants request an exemption under sections 6(c) and 17(b) to permit the proposed transactions.

3. Applicants submit that the involvement of a Merrill Lynch Affiliate in an Affiliated Protection Arrangement will benefit a Fund and its shareholders given the expertise of the Merrill Lynch Affiliates in structuring and providing credit enhancements for Principal Protection arrangements, and the alignment of interests that exist between the Merrill Lynch Affiliates and the Funds. Applicants argue that the relationship of a Fund and Unaffiliated Provider may be more adversarial, with the protection of the Unaffiliated

⁸ Applicants state that depending on the structure of the Protection Agreement, while certain types of Protection Agreements would not meet the definition of "security" contained in section 2(a)(36) of the Act such as insurance contracts, certain types of derivative agreements may be deemed to constitute securities.