

Provider's rights and remedies being of paramount importance to the Unaffiliated Provider, which could result in the Unaffiliated Provider exhibiting a greater willingness to declare a Defeasance Event or to rely on a clause permitting it to avoid liability to the Fund than would a Merrill Lynch Affiliate in similar circumstances. Applicants further argue that a Merrill Lynch Affiliate may assume a greater risk to itself by avoiding a Defeasance Event for the same fee charged by an Unaffiliated Provider without creating additional risk to the Fund or its shareholders by allowing a greater portion of the Fund's assets to remain invested in the Portfolio Component. Applicants also argue that the use of a Merrill Lynch Affiliate as Protection Provider may lower the cost of Principal Protection since there is a limited universe of Protection Providers with which a Fund may enter into a Protection Agreement. In addition, because a Merrill Lynch Affiliate may have a greater comfort level with the Formula and certain investment strategies to be used by the Advisers than an Unaffiliated Provider, applicants state that this may allow the Merrill Lynch Affiliate to enter into a Hedging Transaction with an Unaffiliated Provider for a lower fee or spread than would be available through a counterparty unaffiliated with the Fund.

4. Applicants submit that the conditions applicable to each Affiliated Protection Arrangement will ensure that such arrangement will be reasonable and fair to each Fund and that no Merrill Lynch Affiliate will be able to engage in overreaching. Applicants state that a Fund will not be able to participate in an Affiliated Protection Arrangement until after a bidding process has been completed in which the Fund receives at least two bona fide offers for Principal Protection from an Unaffiliated Provider not seeking to hedge with a Merrill Lynch Affiliate, and that a Merrill Lynch Affiliate will not have an unfair advantage over other bidders in winning the bid. A Fund may not accept a bid or subsequently enter into an Affiliated Protection Arrangement unless it has been approved by the Fund's Board, including a majority of Independent Trustees, who must determine that entering into the Affiliated Protection Arrangement is in the best interests of the Fund and its shareholders and meets the standards specified in section 17(b) of the Act. In addition, applicants state that if a Fund enters into an Affiliated Protection Arrangement, the Fund's

Board will establish a Committee to represent the Fund's interests if a Protection Event should occur. Lastly, applicants state that the Board will approve the Approved Shortfall Amount to be submitted for payment to the Affiliated Protection Provider and that the Fund will not accept a lesser amount in settlement of its claim without a further Commission exemptive order.

5. Applicants submit that an Affiliated Protection Arrangement will be consistent with the policies of each Fund, as recited in its registration statement. Applicants further submit that an Affiliated Protection Arrangement, subject to the conditions set forth in the application, will be consistent with the purposes fairly intended by the policy and provisions of the Act and will be in the best interests of each Fund and its shareholders.

#### *C. Section 17(d) of the Act*

1. Section 17(d) of the Act and rule 17d-1 under the Act generally prohibit any affiliated person of, or principal underwriter for, a registered investment company, or any affiliated person of, or principal underwriter, acting as principal, from effecting any transaction in connection with any joint enterprise or other arrangement or profit-sharing plan in which the investment company participates, unless an application regarding the joint transaction has been filed with the Commission and granted by order. Under rule 17d-1, in passing upon such applications, the Commission considers whether the participation of the registered investment company in the joint transaction is consistent with the provisions, policies and purposes of the Act and the extent to which such participation is on a basis different or less advantageous than that of other participants.

2. Applicants state that the fee paid to a Merrill Lynch Affiliate pursuant to an Affiliated Protection Arrangement (either by the Fund directly under a Protection Agreement or indirectly through a Hedging Transaction) may be deemed to involve a joint enterprise or joint arrangement or profit sharing plan under section 17(d) and rule 17d-1 because a Merrill Lynch Affiliate may be in control of, controlled by or under common control with the Adviser of a Fund, and the Merrill Lynch Affiliate's compensation as the Protection Provider or Hedging Counterparty will be based on the Fund's assets. In addition, the Merrill Lynch Affiliate might make a profit or suffer a loss depending on the performance of the Fund. Applicants also state that an Affiliated Protection

Arrangement could be deemed to involve a joint enterprise or joint arrangement because of the coordination and possible ongoing negotiations between a Fund and a Merrill Lynch Affiliate in managing the Fund's risk exposure.<sup>9</sup> Applicants thus request an order pursuant to section 17(d) and rule 17d-1.

3. Applicants state that the purpose of section 17(d) is to avoid overreaching by and unfair advantage to insiders. Applicants submit that the conditions proposed in the application will ensure that a Fund and its shareholders are treated fairly and not taken advantage of by a Merrill Lynch Affiliate. Applicants submit that a Fund and its shareholders will benefit from the participation of a Merrill Lynch Affiliate in an Affiliated Protection Arrangement. For these reasons, applicants state that the proposed arrangement satisfies the standards of section 17(d) and rule 17d-1.

#### **Applicants' Conditions**

Applicants agree that any order granting the requested relief shall be subject to the following conditions:

1. Prior to recommending to the Board that a Fund enter into an Affiliated Protection Arrangement, the Adviser will conduct a competitive bidding process in which the Adviser solicits bids on at least three Protection Agreements that would not constitute Affiliated Protection Arrangements. At a reasonable amount of time prior to the date bids are to be submitted, the Adviser will solicit bids by supplying prospective bidders with a bid invitation letter that includes any requirement for a potential Protection Provider to include audited financial statements in the Fund's registration statement, a copy of the relevant sections of a draft prospectus of the Fund, and a draft of the Protection Agreement. Initial bids will be due at the same time, and no bidder will have access to any competing bids prior to its own submission. After initial bids are received, the Adviser will negotiate in good faith with each of the bidders to obtain more favorable terms for the Fund. During these negotiations, all bidders will have access to equal information about competing bids. At the end of this process, all bidders who

<sup>9</sup>For example, applicants state that a Merrill Lynch Affiliate could seek to request that a Fund's assets be invested not to seek to maximize the Fund's return, but in a manner designed to protect the Merrill Lynch Affiliate's interest by over-allocating the Fund's assets to the Protection Component so as to minimize the risk that a Merrill Lynch Affiliate would be called upon to make a payment under an Affiliated Protection Arrangement.