/05

Rob Mooney
General Counsel
Private Client Group

Merrill Lynch

Princeton Corporate Campus
800 Scudders Mill Road
CTC-3A
Plainsboro, NJ 08536
609-282-3903
FAX 609-282-1877
RMooney@exchange.ml.com

S7-27-03

February 5, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

Re: File No. S7-27-03: Comments Regarding Proposed Amendments to Rules Governing Pricing of Mutual Fund Shares

Ladies and Gentlemen:

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") appreciates the opportunity to comment on the amendments that the Securities and Exchange Commission (the "SEC" or "Commission") has proposed to Rule 22c-1 under the Investment Company Act of 1940 (the "1940 Act") governing the pricing of mutual fund shares (Release No. IC-26288) (the "Proposing Release"). The Commission proposes to require that, to obtain the current day's price, all purchase and redemption orders must be received by a fund, a single transfer agent designated by the fund (a "designated transfer agent"), or a registered clearing agency no later than the time at which the fund prices its securities (the "Proposal").

As discussed in more detail below, while we share the Commission's desire to quickly, aggressively and efficiently eliminate late trading of mutual fund shares, we believe that, with appropriate safeguards and procedures, certain intermediaries in addition to designated transfer agents and registered clearing agencies should also be permitted to receive purchase and redemption orders up until the time that the fund prices its securities and still obtain the current day's price (typically 4:00 p.m.).[1] We believe

[1] For convenience of reference in this letter, we will assume that all funds price their securities at 4:00 p.m., even though many funds price their securities at times other than 4:00 p.m.

that the goal of eliminating late trading can be achieved in a manner that does not so severely restrict investor choice and flexibility or disadvantage mutual fund investors who purchase fund shares from broker-dealers and other intermediaries.

I. SUMMARY OF COMMENTS

A summary of our comments regarding the proposed amendments to Rule 22c-1 is as follows:

A. Entities other than a fund's single transfer agent or a registered clearing agency should be permitted to accept orders from investors up to 4:00 p.m., provided that each entity implements the protections and safeguards to prevent late trading summarized in Section B. below. These entities include the following:

- Registered broker-dealers and transfer agents such as Merrill Lynch and Financial Data Services, Inc. ("FDS") (its affiliated transfer agent) because (1) the vast majority of these entities have accepted mutual fund orders in full compliance with Rule 22c-1 since its inception; (2) they have developed sophisticated systems that process mutual funds in a highly automated, disciplined and auditable manner to prevent late trading; and (3) they are subject to extensive regulatory oversight by the SEC and/or other regulatory organizations, which oversight includes the processing of fund transactions in accordance with Rule 22c-1.

- Other mutual fund intermediaries such as banks, trust companies, retirement plan administrators, and investment advisers because they too have substantially complied with Rule 22c-1 since its inception and they maintain sophisticated systems to prevent late trading. If the Commission believes that specific regulatory oversight of these entities is critical to the prevention of late trading, we suggest that the Commission consider either (1) requiring them to consent to SEC or other regulatory jurisdiction and inspections with respect to the receipt of fund orders, or (2) requiring that a registered transfer agent, broker-dealer, or other regulated entity accept responsibility for the actions of the unregistered entity with respect to the receipt of fund orders.

- Although Merrill Lynch supports the ability of clearing agencies such as the NSCC to receive mutual fund orders until 4:00 p.m. in accordance with Rule 22c-1, we do not believe that the creation of a mandatory fund transaction "clearinghouse' to receive all mutual fund orders prior to 4:00 p.m. is appropriate because: (1) the volume of transactions for any one entity would place such tremendous stress on the system and it is questionable that any one entity could process the transactions in a timely and adequate manner; (2) the costs and time required to build and maintain a centralized clearinghouse would be quite expensive, and likely would ultimately be borne by mutual fund investors, and (3) due to the reconciliations that would be required, it is unlikely that a clearinghouse would ensure better compliance with Rule 22c-1 than the current system.

B. Any entity that accepts orders on behalf of a fund should be subject to the following requirements:

- the time-stamping of orders, including trade corrections and cancellations, in a manner that cannot be altered; the Commission may wish to consider prohibiting the manual time stamping of orders;
- the retention of time-stamp information as part of the transaction recordkeeping, which should be available for inspection by any fund for which an order is accepted;
- annual certification that the intermediary has policies and procedures in place to prevent late trading and that such late trades were in fact prevented; and
- submission by the intermediary to an annual audit of its controls by an independent public accountant and the resulting report being made available to funds sold through that intermediary.

C. The amendments to Rule 22c-1, as proposed, would have significant adverse consequences for investors and market participants and would impose costs that could be reduced or eliminated by alternative approaches. In particular, we believe that the proposed amendments would:

- significantly disadvantage retail investors and plan participants because it would discourage their purchase of mutual fund shares through Intermediaries such as Merrill Lynch, thus depriving them of the investment advice, choice, flexibility and programs available to them at entities such as Merrill Lynch;
- require substantial modifications to the trading and recordkeeping systems of Intermediaries at a cost that would ultimately be borne by fund investors and retirement plan participants;
- likely reduce the investment choices available in many retirement plans and/or cause retirement plans to select investment vehicles other than mutual funds for inclusion in the plans; and
- adversely impact the services and benefits currently enjoyed by retail investors and retirement plan participants.

II. BACKGROUND

A. Merrill Lynch

Merrill Lynch is registered as a broker-dealer under Section 15 of the Securities Exchange Act of 1934 (the "1934 Act") and as an investment adviser registered under Section 203 of the Investment Advisers Act of 1940 (the "Advisers Act"). In addition to offering the Merrill Lynch proprietary mutual funds, Merrill Lynch has selling agreements with approximately 139 fund companies and currently offers approximately

11,446 individual mutual fund share classes to its customers. Merrill Lynch has approximately 11.1 million customer positions in retail brokerage accounts that are invested in mutual funds and serves approximately 5.4 million additional retirement plan participants who have mutual fund investments. In 2002, Merrill Lynch executed over 132 million fund transactions (excluding money market transactions) for these customers. Currently, Merrill Lynch supports the transactions of over $300 billion in mutual fund assets.

Merrill Lynch is a wholly owned subsidiary of Merrill Lynch & Co., Inc. ("ML&Co."), one of the world's largest financial services firms. Its affiliates include FDS, a registered transfer agent that serves as the transfer agent for Merrill Lynch's proprietary mutual funds, and Merrill Lynch Investment Managers, the investment management unit of ML&Co.

B. Rule 22c-1

Rule 22c-1 under the 1940 Act provides that no mutual fund, and no person designated in the fund's prospectus as authorized to consummate fund transactions, and no principal underwriter or dealer in the fund's shares, shall purchase or sell the fund's securities except at a price based on the current net asset value of the security which is next computed after receipt of the purchase or sale order. The rule does not define what constitutes "receipt." For thirty-five years since the adoption of the rule, however, the SEC staff has consistently taken the position that orders can be considered received for purposes of Rule 22c-1 when received by intermediaries of the fund including broker-dealers and agents of the fund, such as transfer agents, retirement plan administrators, banks, trust companies, registered investment advisers, and other intermediaries (collectively, "Intermediaries").[2]

The Commission is proposing to amend Rule 22c-1 to require that all purchase and redemption orders be received by the fund, its designated transfer agent, or a registered clearing agency no later than the time at which the fund prices its securities (*e.g.*, 4:00 p.m.) to obtain the current day's price. As a result, fund Intermediaries would be required to transmit the orders to one of those entities before 4:00 p.m. for their customers to receive the 4:00 p.m. price.

III. SUGGESTED ALTERNATIVE SOLUTIONS AND PROTECTIONS

A. In General

In the Proposing Release, the Commission sought comment regarding a viable alternative that would allow Intermediaries, with adequate protections, to accept orders

[2] See, *e.g.*, Patrick P. Badamy, M.D., 1972 SEC No-Action Letter (available April 7, 1972); Investment Company Institute, 1973 SEC No-Action Letter (available June 13, 1973); Charles Schwab & Co., Inc., SEC No-Action Letter (available July 7, 1997).

prior to 4:00 p.m. and transmit them to funds or their transfer agents after 4:00 p.m.[3] As discussed in detail below, we believe that this alternative solution is in the best interests of investors and other market participants because it would permit the elimination of late trading while avoiding significant costs and other negative repercussions (which are discussed in more detail in Section IV below).[3] Moreover, from the standpoint of the individual investor, permitting appropriate Intermediaries to receive orders until 4:00 p.m. is a system that the investor understands and will enable investors to continue to manage their portfolios in a familiar and integrated manner. We do not believe that the unlawful actions of a few should drive the Commission to abandon its long-standing policies in this area or dictate more investor restrictive and industry anti-competitive solutions than are otherwise warranted.

B. Entities Permitted to Accept Mutual Fund Orders

For the following reasons, we believe that, in addition to the entities described in the Proposed Rule, it is appropriate for transfer agents, broker-dealers and certain other Intermediaries such as banks, trust companies, retirement plan administrators, and investment advisers to accept orders on behalf of customers until 4:00 p.m. and transmit those orders to the funds after 4:00 p.m., assuming the protections and safeguards discussed in Section III. C below are in place.

1. Transfer Agents

As proposed, the definition of "designated transfer agent" is limited to the "single registered transfer agent . . . that is designated, in the fund's registration statement filed with the Commission, and is required by written contract to receive order information and maintain a record of the date and time it receives the order information." The Commission stated that these transfer agents "will serve to ensure the integrity of fund pricing" because they "are regulated by the Commission and operate large automated processing systems." Thus, the Commission acknowledged that registered transfer agents are sufficiently qualified to receive fund orders in a manner to prevent late day trading.

[3] The Commission indicated that these protections could include the following: (1) electronic or physical time-stamping of orders in a manner that cannot be altered; (2) annual certification that the intermediary has policies and procedures in place to prevent late trades and that such late trades were in fact prevented; and (3) submission by the intermediary to an annual audit of its controls by an independent public accountant.

[3] Legislation recently passed by the U.S. House of Representatives (H.R. 2420) (the "Baker Bill"), provides that trades collected by approved intermediaries (generally broker-dealers, retirement plan administrators, and other regulated entities) prior to 4:00 p.m. can be transmitted to the funds after 4:00 p.m., as long as such intermediaries are subject to: (1) procedures designed to prevent the acceptance of trades by such intermediaries after the time at which net asset value is calculated; and (2) an independent annual audit.

This view is understandable. Registered transfer agents are subject to comprehensive regulation, including the filing of periodic reports, regulatory inspections, recordkeeping and other requirements. The primary business activity of a registered transfer agent is the acceptance and processing of securities transactions. Transfer agents such as FDS maintain detailed procedures covering virtually all aspects of their business and are staffed with highly-trained personnel knowledgeable in the processing of securities transactions.

We see no reason why acceptance of fund orders should be limited to the single transfer agent listed in a fund's registration statement. It is anomalous that the same transfer agent that is allowed to accept orders for certain funds would be deemed unfit to accept orders for other funds. It seems clear that a mutual fund should be able to designate a registered transfer agent other than its primary transfer agent to accept orders on behalf of the fund. Therefore, we propose that the definition of designated transfer agent in the proposed Rule be revised to include "a registered transfer agent ... designated by the fund or the transfer agent designated in its registration statement, and required by written contract to receive fund order information and maintain a record of the date and time it receives the order information."

2. Broker-dealers

We believe that broker-dealers such as Merrill Lynch that have in place the safeguards discussed below should also be allowed to accept orders on behalf of a fund because they possess the same critical attributes to prevent late trading as transfer agents and clearing agencies, the entities the Commission believes "will serve to ensure the integrity of fund pricing," for the following reasons:

First, for over 35 years since the effective date of Rule 22c-1 in 1969, the vast majority of broker-dealers such as Merrill Lynch have accepted orders from their customers on behalf of funds in full compliance with the requirements of the Rule. Rule 22c-1 was adopted by the Commission in October 1968 in an effort to, among other things, eliminate the potentially unfair dilution of fund shares resulting from backward pricing.[4] Prior to the initial effectiveness of Rule 22c-1 in January 1969, the Commission published its staff's view that the Rule "contemplates that the time of receipt of the order by the retail dealer is controlling" for the purposes of determining the price obtained by the broker-dealer's customers.[5] In the 35 years since that time, the overwhelming majority of broker-dealers, including Merrill Lynch, have implemented various policies, procedures and systems (which have evolved over time) that have effectively prevented late trading. During that time, there is no evidence of widespread abuses by broker-dealers with respect to compliance with Rule 22c-1.

Although it appears that the Commission has uncovered violations of Rule 22c-1 by certain broker-dealers in the past year, the Commission in the Proposing Release

[4] *See* Investment Company Act Release No 5519 (Oct. 16, 1968).
[5] Investment Company Act Release No. 5569 (Dec. 27, 1968).

stated that late trading "is not isolated, nor is it limited to any one type of fund or intermediary." In fact, the Commission indicated that "[f]und managers themselves have permitted late trades by favored investors," presumably with the assistance of their designated transfer agents.

Second, like many transfer agents and the NSCC, Merrill Lynch and other broker-dealers operate sophisticated processing systems that are capable of processing large volumes of mutual fund transactions in a highly automated, auditable and disciplined environment. For example, as noted above, Merrill Lynch maintains approximately 16.5 million retail customers and plan participant mutual fund positions and processed approximately 132 million fund transactions for these customers in 2002. By contrast, the NSCC Fund/SERV platform processed approximately 83 million fund transactions in 2002. In addition, the Merrill Lynch order entry system electronically shuts out any mutual fund share order that is not entered into the system by 4:00 p.m. and any order received after 4:00 P.M. is electronically executed the following business day.

Finally, broker-dealers such as Merrill Lynch are subject to comprehensive regulation by the Commission and other regulatory organizations at least equal to that of registered transfer agents or clearing agencies. Broker-dealers are subject to comprehensive regulations and inspections by both the Commission and the NASD. These regulations include Rule 17a-3(a)(b)(i), which requires broker-dealers to record each brokerage order and various information related to the orders, including the time the order was received and the time of entry. In addition, broker-dealers that are acting as a fund principal underwriters or dealers have always been directly subject to the requirements of Rule 22c-1 by its terms. Thus, compliance with Rule 22c-1 is an integral part of the compliance program of broker-dealers such as Merrill Lynch, and presumably an integral part of the SEC's inspection program of broker-dealers.

3. Other Intermediaries

For many of the reasons discussed above, we believe that, assuming the appropriate safeguards are in place, banks, trust companies, retirement plan administrators, and investment advisers and other Intermediaries that are not transfer agents or broker-dealers should also be allowed to accept orders on behalf of a fund. For example, many of these Intermediaries also have large automated processing systems that are capable of processing large volumes of mutual fund transactions in a highly automated, auditable and disciplined environment to prevent late trading. In addition, the vast majority of these entities have accepted fund orders in full compliance with Rule 22c-1 for many years.

If the Commission believes that regulatory oversight of these entities is critical to the prevention of late trading, we suggest that the Commission consider either (1) requiring that unregistered entities that accept fund orders consent to SEC or other appropriate regulatory jurisdiction and inspections with respect to the receipt of such orders, or (2) require that a registered transfer agent, broker-dealer, or other regulated entity accept responsibility for the actions of the unregistered entity. As part of its oversight obligations, the regulating authority would assess the risk profile of organizations accepting orders and determine appropriate inspection and other oversight to ensure compliance with Rule 22c-1.

4. Clearing Agencies

For the reasons discussed above and in the Proposal, Merrill Lynch supports the ability of clearing agencies such as the NSCC to receive mutual fund orders until 4:00 p.m. in accordance with Rule 22c-1. However, we do not believe that the creation of a mandatory mutual fund transaction "clearinghouse' to receive all mutual orders prior to 4:00 p.m. is appropriate for several reasons, including the following.

First, the volume of transactions for any one entity would be tremendous. For example, in 2002, Merrill Lynch executed 9.0 million trades through the NSCC facilities. If all non-proprietary mutual fund transactions for all Merrill Lynch customers were required to be reported through NSCC, the transactions from Merrill Lynch alone would more than double the NSCC's trading volume from 2002. We believe that the substantially increased transaction volume would add extraordinary stress to any one system and would create an industry-wide single point of failure. This risk profile would expand in periods of transaction volatility, such as portfolio re-balancing periods, payroll cycles and fund reorganizations.

Second, the costs and time required to build and maintain a centralized clearinghouse would be quite expensive, and likely would ultimately be borne by mutual fund investors. These costs would likely include: (1) the building of systems by the clearing agency and each entity that distributes mutual fund shares and connecting those systems in an effective way; (2) the costs associated with reconciliations at the clearinghouse, transfer agents, and Intermediaries; and (3) the costs of the clearinghouse's receipt of the increased volume of transactions.

Finally, a centralized clearinghouse would not provide any greater assurance of compliance with Rule 22c-1 than under the current system because, among other reasons, responsibilities would need to be divided among several parties. For example, in connection with the processing of exchange transactions, preliminary estimates would need to be delivered to the clearinghouse because the relevant funds have not yet calculated their respective per share net asset values. These estimates would need to be reconciled to final trading results, and the resolution of any unresolved items would need to be performed by the Intermediaries, which is in possession of the information necessary to perform such reconciliations.

C. Proposed Protections to Prevent Late Trading

1. Operational Safeguards

We believe that all entities that accept mutual fund orders on behalf of a fund, including designated transfer agents and other Intermediaries, should be required to maintain operational safeguards sufficient to prevent late trading. We suggest that the Commission consider imposing one or more of the following requirements on any entity that accepts mutual fund orders.

Date-Time Stamp Required for All Orders. We believe that Intermediaries that accept fund orders should ensure that all orders, regardless of method of receipt (electronic, paper or telephonic), are recorded with a date-time stamp at the time the order is received. This date-time stamp process should not only include all orders, but also include all trade correction and cancellation activities. It is our understanding that most recordkeeping systems already place an electronic date-time stamp and unique transaction identification on each transaction record generated by the system and retain this information through the processing cycle. This date-time stamp process could be enhanced by requiring that it: (1) be secured in such a manner that prevents any post-trade alteration (except through approved trade correction procedures); and (2) be collected as a part of each trade in such a manner that permits dissemination to the fund as part of the trade execution ticket or upon request for review by the fund, the SEC or other regulatory authorities.

The Commission might also consider requiring Intermediaries accepting fund orders to adopt systematic internal clocks, and prohibit manual time-stamping. The cut-off of trade instructions, as well as trade correction and cancellation activities, for a business day are typically controlled by an automated computer routine or may be initiated by an established administrative process that is applied consistently within an organization. These internal clocks can provide assurances that the Intermediary accepted no transactions after 4:00 p.m.

Retention of Time-Stamp Information. To permit comprehensive tracking of trade orders, the Commission should also consider requiring that entities that accept fund orders (including recordkeepers) maintain complete books and records and to make those books and records available upon request by the fund (as well as by the SEC and other regulatory authorities). This right to inspect books and records should be specifically expanded to include obligations to establish audit chains for trade instructions.

2. Annual Certifications

We support a requirement that entities accepting fund orders provide an annual certification to the fund confirming that the Intermediary has proper procedures in place to ensure compliance with the receipt of orders until 4:00 p.m. and to prevent late trading. We agree that the annual certification should also include a statement that, during the relevant period, no late trades were submitted by the Intermediary to the fund or its designated transfer agent.

3. Annual Independent Audits

We also support a requirement that each intermediary be required to submit to an annual audit of its controls by an independent public accountant. We believe that a standardized SAS 70 or similar agreed-to-procedure review by independent public accountants would be appropriate for these purposes. The annual audit should be made available to the fund's chief compliance officer or other appropriate individuals.

4. Irrevocability of Orders

To address the Commission's concerns regarding circumvention of the requirements of Rule 22c-1, the proposed Rule would define an "order" to mandate that it be irrevocable as of the next pricing time after it is received. Merrill Lynch supports efforts to eliminate an entity's ability to cancel, modify, or substitute previously placed orders as contemplated by the proposed Rule's definition of order. However, it is inevitable that mistakes may occur in processing large volumes of daily mutual fund transactions. Errors are typically identified by exception reports generated by recordkeeping systems and through trading supervision activities. In rare cases when a trading error is identified in an amount that is material to the fund, we believe that the Rule should provide a limited exception for corrections. For such errors, we propose that appropriate representatives of the Intermediary and the fund (such as a compliance officer) be permitted to jointly agree to make a correcting entry after 4:00 p.m., as of the 4:00 p.m. cutoff. Any such corrections would be required to include sufficient and substantive evidence documenting the cause of the error and ensure that no late trading or price manipulation is involved.

IV. IMPACT OF THE PROPOSAL

In the Proposing Release, the Commission specifically sought comments on the costs associated with only permitting orders received by funds and their designated transfer agents by 4:00 p.m. to obtain the current day's pricing and whether those costs "are justified by the benefits of the proposed amendments." We believe that the Proposal would have significant adverse consequences for investors and market participants and would impose costs that could be reduced or eliminated by the alternative approaches discussed above.

A. Inequitable Treatment of Retail Investors Who Invest Through Intermediaries

We believe that the proposed amendments would significantly disadvantage retail investors and plan participants because it would discourage their purchase of mutual fund shares through Intermediaries such as Merrill Lynch, thus depriving them of the investment advice, choice, flexibility and programs available to them at entities such as Merrill Lynch.

The products and services available to mutual fund investors at Intermediaries such as Merrill Lynch have evolved over the years to provide investors with the investment advice, choice, flexibility and programs that they need and desire. These include the ability of the investors (1) to select appropriate investments with the assistance of experienced investment professionals, (2) to choose among thousands of different mutual funds (commonly referred to as open architecture), (3) to select the pricing of their fund investments appropriate to their needs through various share classes or fee-based accounts, (4) to participate in discretionary and non-discretionary mutual fund investment advisory and other asset allocation programs across many mutual fund families, and (5) to transfer investments within all these arrangements while being continuously invested in the market.

This structure provides Merrill Lynch clients, and those of other financial Intermediaries, the assurance that they can receive the guidance that they need while being treated on equal footing in the market with those investors who choose to invest directly through fund companies. The SEC Proposal would impair, and in some instances eliminate, that flexibility. Retail investors could be out of the market and uninvested for at least one full business day for certain transactions. [6] In addition, broker-dealer order entry systems would need to suspend accepting orders for non-proprietary mutual fund products earlier in the afternoon than would be the case for the same trade executed directly at the fund. This earlier cutoff time is necessary to accommodate trading calculations, account editing and householding aggregations necessary to satisfy pricing and trade execution.

As the Commission noted in the Proposing Release, these disadvantages would encourage investors to bypass Intermediaries and purchase fund shares directly at a designated transfer agent. The advantages of, and investor demand for, investment advice, guidance, flexibilty and choice in reaching investment decisions cannot be underestimated, and the SEC Proposal disadvantages mutual fund investors by reducing the attractiveness of obtaining such advice and guidance through Intermediary-sold mutual fund shares. Mutual funds and mutual fund Intermediaries should compete on issues such as risk-adjusted performance, client service and pricing and not on order entry timing parameters. Creating discrete trading privileges for investors who transact directly with a mutual fund versus those who choose to work with an Intermediary or who invest through a 401(k) plan is in direct conflict with the fundamental principle of treating shareholders equally and fairly.

B. Substantial Modification Costs to Retail Investors and Retirement Plan Participants

We believe that the proposed amendments would require substantial modifications to the trading and recordkeeping systems of Intermediaries and the costs associated with those modifications would ultimately be borne by fund investors and retirement plan participants.

---

[6] For example, in administering any transaction that involves an exchange between funds, Intermediaries typically enter the orders to sell and purchase fund shares on the same day, utilizing the proceeds of the sale to pay for the purchase. The orders are entered prior to 4 p.m. and transmitted to each mutual fund's transfer agent later that evening. The interval period allows the Intermediary to obtain the prices for the funds being sold and, along with the number of shares being sold, to determine the proceeds of the sale. Those proceeds are then the amount of money available to purchase other funds in the program, assuming there are no investor additions or withdrawals.

Many recordkeeping systems use daily price information to perform and process investment instructions before transaction orders are generated for execution. If orders for mutual fund investments were required to be provided to the fund or its transfer agent before 4:00 p.m., these systems would need to be reconfigured to process transaction instructions without price information or based upon prior day closing price estimates. Because of the volume of transactions undertaken, the myriad trading and fund rules applied, and the variety of reconciliations performed, modifications to these systems are extremely complex and expensive. Further, modifications would be necessary to support revised order entry environments, discretionary mutual fund trading systems, trade clearance interfaces, trade correction applications, introducing firm applications, and reinvestment applications.

These modification costs are likely to be even greater in the retirement plan environment. Many recordkeeping systems require daily price information in performing the processing of investment instructions before transaction orders are generated for execution. If the SEC Proposal is implemented such that retirement plan orders for mutual fund investments must be received by the fund prior to 4:00 p.m., these systems must be reconfigured to process transaction instructions without price information or based on estimated closing prices. Because of the volume of transactions undertaken, the complexity of plan and fund rules applied, and the variety of reconciliations with and between plan trustees and participating fund investment alternatives, modifications to these systems will be protracted and the costs associated with reconfiguring these systems will be substantial.[7]

Ultimately, the costs to modify the trade processing and recordkeeping systems of Intermediaries will be borne by fund investors and plan participants, directly through recordkeeping charges or indirectly through incremental fund-level charges. In addition, these required modification costs could threaten the financial viability of many plan service providers and impair their ability to generate new products and services necessary to meet investor needs and expectations.

C. Reduction in Retirement Plan Investment Choices

The proposed amendments would also likely reduce the investment choices

---

[7] Alternative recordkeeping structures for retirement plans to cope with the SEC Proposal could also raise additional issues. If the plan is segmented into participant level recordkeeping on the records of the fund, then that participant may be subject to higher costs associated with different share class selections. In this regard, plan participants are typically eligible for less expensive fund share classes based on the aggregation of all participants assets in a plan; these discounts may not be available if the fund's designated transfer agent is responsible for maintaining individual participant records. Further, this "retail" shareholder level of service may not be offered to plan participants who maintain very small account balances. Indeed, the services provided to 401(k) and similar plans developed in part to address the problem fund companies experienced in maintaining and processing orders for very small accounts (*e.g.*, new investments of only a few dollars and small account balances). By comparison, the 401(k) recordkeeping industry has been successful in providing individuals with small dollar amounts a means to invest in mutual funds at a reasonable cost.

available in many retirement plans and/or may cause retirement plans to select investment vehicles other than mutual funds for inclusion in those plans.

Retirement plan participant services have also evolved in the last decade to offer participants investment flexibility and a broad array of investment alternatives. This evolution has been driven both by investor demand and the responsiveness of corporate fiduciaries, and includes daily portfolio evaluations, the ability of participants to reallocate investments daily, the ability for accounts to reallocate investment portfolios according to participant-chosen models, and the ability for participants to transfer investments across broad array of investment choices, including mutual funds from a variety of fund families.

Where a plan's investment options are limited to a single fund complex (closed architecture), a fund complex may be capable of continuing to offer plan participants "same day" trading services by, in effect, providing the participant with a level of service similar to that received by shareholders maintaining an account with the fund. However, these services severely limit client investment alternatives. Investments would be restricted to choices involving a single fund family and are likely to be more expensive to participants than through currently available arrangements.

To provide retirement plan participants with the investment choices and daily processing they have come to expect, plan sponsors may seek to include other investment vehicles (such as collective trusts) as investment options. These alternative vehicles may not be subject to the comprehensive regulation and investor protection requirements to which mutual funds are currently subject, including various provisions of the 1940 Act, the Securities Act of 1933, the Securities Exchange Act of 1934, the rules thereunder, and the rules of the National Association of Securities Dealers, Inc.

Additionally, as noted above, the efficiency engendered by daily trading through 401(k) and similar plans has substantially diminished issues relating to uninvested monies held in plan participants' accounts for short periods of time. Delays in participant transaction processing would result in more plan monies held uninvested, and the handling and disposition of lost earnings opportunities for uninvested plan assets is an important plan fiduciary compliance issue.

D. Impact on Investor Services and Other Benefits

The Proposed Rule would also adversely impact the services and other benefits received by retail investors and retirement plan participants. For example, retail customers and retirement plan participants that purchase mutual funds through Intermediaries such as Merrill Lynch currently have the ability to reallocate their assets on any business day. A change to next day pricing in a retirement plan account would constitute a significant adverse change to those participants.

In addition, even though mutual fund investors are generally viewed as "long-term" investors, they remain sensitive to short-term price volatility. For example, plan participants become "short-term" investors whenever they become eligible to receive plan benefits (*e.g.*, if they are considering a plan loan or withdrawal, or approaching termination of employment or retirement). Given the volatility of current markets, even a one day delay may significantly impact a participant's retirement savings.

For both retail investors and retirement plan participants, we believe that the view that investors are insensitive to order entry timing is incorrect. Such sensitivity can be very high for certain customers (such as those in time zones other than eastern standard time), and a regulatory structure that forces investors to make investment decisions for their mutual funds earlier than other investments is likely to confuse and frustrate investors and could precipitate poor decision making.

V. CONCLUSION

Merrill Lynch shares the Commission's desire to restore investor confidence in mutual funds by eliminating all opportunities for late trading. We would not attempt to minimize the seriousness of the late trading and other abuses that have occurred, and we support the efforts to protect the interests of investors and other market participants by vigorously pursuing those individuals who have violated the law.

We also believe, however, that it is not necessary to impose the regime outlined in the Proposal to achieve that end. The Proposal would impose substantial costs and inefficiencies on mutual fund investors that are not required to prevent late trading. Instead, we believe that the alternatives such as that outlined in the Baker Bill, and in the Proposing Release itself, that allow the participation of certain Intermediaries is in the best interest of fund investors, funds, and other market participants. To be sure, this alternative would provide additional protections and safeguards, and we have tried to identify and discuss the most important of these in our letter. We believe that these alternatives and protections can be effectively implemented within a short time-frame and can ensure fair and accurate trading information and oversight.

* * * * *

Again, we appreciate the opportunity to share our thoughts with the Commission regarding the proposed changes to mutual fund pricing. We look forward to working with the Commission toward the amendment of Rule 22c-1 and its successful implementation, and we would be happy to discuss these issues further with you at your convenience.

Sincerely yours,

Robert J. Mooney