Via e-mail

May 9, 2005

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

Re: <u>File No. S7-11-04: Request for Comments Regarding Mutual Fund Redemption Fees</u>

Ladies and Gentlemen:

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") appreciates the opportunity to provide additional comments on new rule 22c-2 that the Securities and Exchange Commission (the "Commission") has adopted under the Investment Company Act of 1940 ("Investment Company Act").[1]

By way of background, Merrill Lynch had commented on the Commission's proposal to institute a mandatory 2% redemption fee for all fund redemptions within a minimum 5-day holding period (the "Original Proposal").[2] Merrill Lynch is registered as a broker-dealer under Section 15 of the Securities Exchange Act of 1934, as amended (the "1934 Act"), and as an investment adviser under Section 203 of the Investment Advisers Act of 1940, as amended (the "Advisers Act"). In addition to offering Merrill Lynch proprietary funds, Merrill Lynch supports approximately 140 fund companies and currently offers approximately 12,250 individual mutual fund share classes on behalf of its customers. Merrill Lynch has approximately 11.7 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 2004, Merrill Lynch executed over 150 million fund transactions (excluding money market transactions) for these customers. Currently, Merrill Lynch supports the transactions of over $300 billion in mutual fund assets.

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[1] *Mutual Fund Redemption Fees; request for additional comment*, Release No. IC-26782 (March 11, 2005) ("Adopting Release").

[2] *Mandatory Redemption Fees for Redeemable Fund Securities*, Release No. IC-26375A (March 5, 2004) ("Proposing Release").

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 Financial Data Services, Inc. ("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.

We commend the Commission's recent efforts to prevent the dilution of shareholder interests caused by frequent and excessive trading. However, we believe that redemption fees are simply one of several tools and not necessarily the best one for preventing short-term trading. Indeed, a 2% redemption fee may not be related to the types of dilutions that result from short-term trading activities. We recommend that the Commission continue to enhance the role of fund directors by allowing fund boards to adopt policies and procedures that best enables them to protect the interest of fund shareholders in light of all the circumstances before them. The Commission can further assist fund directors by issuing a release that defines certain parameters regarding the implementation of redemption fees as we will outline below.

In particular, we are pleased to provide the following specific comments to the Commission's request on this important topic:

- We do not believe that the Commission should require a specific uniform percentage amount for redemption fees, but believe that any such amount should be assessed as determined by the fund directors.

- Similarly, we do not believe that there should be a mandatory time period within which redemption fees may be applied. We do, however, suggest that the time period for imposing redemption fees should be reasonable, and believe that a time period of up to 90 days would be reasonable. This time period would exclude investors from being assessed redemption fees who are participants in products and services where there is quarterly portfolio rebalancing.

- We support a *de minimis* exception to imposing redemption fees, at least initially, and suggest that an appropriate *de minimis* exception amount should be $10,000. We suggest that this exception be applied in all circumstances, whether a financial emergency or otherwise. We endorse this threshold amount because we believe that funds have the ability to detect short-term trading at this and any other level and can identify and reject trades that are part of a pattern of short-term trading detrimental to the fund. Accordingly, we believe that *bona fide* smaller trades should be excepted from the imposition of redemption fees.

However, we also suggest that the Commission study the *de minimis* approach to determine if it should eventually be supplemented or replaced by one or more transaction type or account attribute exceptions. We do not think there is a current analysis that is thorough and comprehensive enough to provide a firm basis for establishing certain transaction and account exceptions. By implementing a *de minimis* exception, the Commission would afford funds the ability to implement redemption fee programs in a prompt manner, while the Commission could then vet proposed transaction and account type exceptions.

- Should the Commission determine that there is sufficient information available to provide transaction type and account type exceptions to redemption fees, we would propose that redemption fees should apply only to "participant-directed transactions" for retirement plans and variable life annuities. Such a more narrow application of redemption fees for such products would focus the application of redemption fees on those transactions that may involve abusive short-term trading, and eliminate routine plan and related non-participant directed transactions.

- We believe that there should be industry standardization as to the type of accounts and types of transactions that should be excepted from the imposition of redemption fees. We believe that uniformity is required and is critical for efficient and effective implementation. We believe that non-standardized redemption fee exemptions could result in unfair and inequitable redemption fees imposed on investors.

- We do believe that a standardized lotting methodology should be required, and we believe that such a method should be "first-in, first-out" or "FIFO". We believe that adoption of a FIFO methodology would greatly hasten implementation, as much of the mutual fund industry already have systems in place that can more easily accommodate a FIFO methodology. Also, FIFO would be more fair to smaller investors who participate in periodic investment plans or that otherwise add to their investments over time.

- We urge the Commission to require all funds to use a standard electronic format for disclosure of redemption fee information to the distribution organization community. For example, those funds whose shares are traded via the NSCC should use the NSCC Profile and the funds should be required to keep and maintain their Profile current and accurate.

- We also urge the Commission to require that share lot history accompany any shares being transferred. Simply stated, the inability of the fund and/or intermediary to properly and timely convey the history should not result in a cost to the individual shareholder.

- We believe that intermediaries, if involved in the transaction, should calculate, collect, and remit the redemption fees monthly to the fund. More frequent transmission of the collected funds would add to the costs involved and the monthly remissions of redemption fees is already largely adopted in the mutual fund industry as standard.

- We believe that intermediaries and mutual funds should be allowed to enter into any reasonable agreement pursuant to which mutual funds are provided with individual client's tax identification numbers ("TIN") (alone or in combination with the individual client's account number or "BIN") to enable the fund to determine that redemption fees are being applied and, more importantly, to enable the fund to detect and deter market-timing trading activity.

- We believe, however, that there are some practical issues with the concept of intermediary agreements. Several permutations can exist within the definition of intermediary and such complexity can create significant implementation issues for broker-dealers, as well as funds. We believe that the Commission should consider alternatives to requiring "intermediaries" to enter into agreements as contemplated by the rule.

- We also believe that the Commission should work with industry members to establish reasonable, agreed-upon procedure reviews to be conducted on those organizations calculating, collecting, and remitting redemption fees, rather than mandate a process that might prove to be more costly, more cumbersome, and less effective in attaining the goals of detecting and deterring market timing.

While we share the Commission's desire to ensure that funds do not bear the costs of short-term or frequent trading strategies, we believe that redemption fees cannot be a complete solution to the issue of short-term trading. We continue to believe that requiring funds to use fair value pricing would be the most effective and least costly way to achieve the Commission's objectives.

Thank you again for the opportunity to provide further comments to the Commission on this important aspect of mutual fund activity.

Very truly yours,

William A. Bridy
First Vice President