BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 15, 2006

David Teitelbaum, Esq.
Sidley Austin Brown & Wood LLP
1501 K Street, N.W.
Washington, DC 20005

Dear Mr. Teitelbaum:

This is in response to your letter of December 21, 2005, on behalf of Merrill Lynch Bank USA ("ML Bank"), Salt Lake City, Utah, requesting an exemption from section 23A of the Federal Reserve Act and the Board's Regulation W to permit the bank to acquire certain credit facilities from its affiliate, Merrill Lynch International ("MLI"), London, England.[1]

You have indicated that Merrill Lynch & Co. ("ML & Co."), New York, New York, proposes to reorganize its hedge fund and "Fund of Funds" lending business by having MLI transfer approximately $[ ] in aggregate outstanding loans (collectively "Loans" and singularly "Loan"), with a total facility amount of $[ ], to its affiliate, ML Bank. The purchase price for the Loans would be $[ ], approximately equal to the funded portion of the Loans.

Section 23A and Regulation W limit the amount of "covered transactions" between a bank (including an insured industrial loan company like ML Bank) and any single affiliate to 10 percent of the bank's capital stock and surplus and limit the amount of covered transactions between a bank and all its

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[1] 12 U.S.C. § 371c; 12 CFR part 223. ML Bank is a Utah-chartered industrial loan company ("ILC"). Although ILCs generally are not "banks" for purposes of the Bank Holding Company Act, ILCs generally are subject to sections 23A and 23B of the Federal Reserve Act because of their status as insured depository institutions. See 12 U.S.C. § 1828(j).

affiliates to 20 percent of the bank's capital stock and surplus. "Covered transactions" include a bank's purchase of assets from an affiliate and a bank's extension of credit to an affiliate. The statute and regulation also require a bank to secure its extensions of credit to, and certain other covered transactions with, affiliates with prescribed amounts of collateral. In addition, section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate and require that all covered transactions between a bank and an affiliate be on terms that are consistent with safe and sound banking practices.

As an asset purchase, ML Bank's purchase of the Loans from MLI would be a covered transaction subject to the quantitative and qualitative limits of section 23A and Regulation W.[2] The value of this covered transaction for purposes of Regulation W would be approximately $[ ] -- the purchase price paid by ML Bank for the Loans plus the unfunded but committed portion of the loan facilities.[3]

To facilitate the reorganization, ML Bank has requested an exemption from section 23A and Regulation W to acquire the Loans. Section 23A and Regulation W specifically authorize the Board to exempt, in its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds the exemption to be in the public interest and consistent with the purposes of section 23A.[4]

The Board has in the past approved exemptions under section 23A for one-time asset transfers that are part of a corporate reorganization and that are structured to ensure the quality of the transferred assets.[5] As in previous cases reviewed by the Board, the proposed transaction is part of a one-time corporate reorganization. ML & Co. is consolidating its hedge fund and "Fund of Funds"

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[2] See 12 U.S.C. § 371c(b)(7)(C); 12 CFR 223.3(h)(3).

[3] See 12 CFR 223.22(a).

[4] 12 U.S.C. § 371c(f)(2); 12 CFR 223.43(a).

[5] See, e.g., Board letters dated November 22, 2005, to Robin J. Maxwell, Esq. (The Royal Bank of Scotland Group plc); May 14, 2004, to James E. Scott, Esq. (Citigroup Inc.); and February 10, 2004, to David Teitelbaum, Esq. (Merrill Lynch).

lending business into ML Bank. ML Bank expects that the reorganization would allow it to operate more profitably and efficiently, thereby allowing the bank to extend additional credit into the market and serve its customers better.

ML Bank has represented that none of the Loans' borrowers is a hedge fund or "Fund of Funds" managed by ML Bank or by an affiliate of ML Bank and that the borrowers are contractually prohibited both from using the proceeds of the Loans to purchase shares of funds that are sponsored or advised by an affiliate of ML Bank and from pledging such shares as collateral for a Loan. ML Bank has also represented that none of the Loans would be a low-quality asset (as defined in Regulation W). In addition, directors of ML Bank have reviewed and approved the transaction. Moreover, ML & Co. has committed that, for a two-year period after the asset purchase, it will either (i) make quarterly cash contributions to ML Bank equal to the book value, plus any write-downs taken by the bank, of any Loan that becomes a low-quality asset (as defined in Regulation W) during the quarter; or (ii) repurchase, on a quarterly basis, any Loan that becomes a low-quality asset at a price equal to the book value plus any write-downs taken by the bank.

In light of these considerations and all facts and circumstances of this case, the transaction described above appears to be consistent with safe and sound banking practices and on terms that would ensure the quality of the assets transferred. Accordingly, the proposed transaction appears to be consistent with the purposes of section 23A. The Director of the Division of Banking Supervision and Regulation, pursuant to authority delegated by the Board, with the concurrence of the General Counsel and after consultation with staff of the Federal Deposit Insurance Corporation, hereby grants the requested exemption.

This determination is specifically conditioned on compliance by ML Bank, MLI, and ML & Co. with all the commitments and representations made in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing in connection with granting the exemption and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and circumstances surrounding the proposed transaction and may be revoked in the event of any material change in those facts and circumstances or any failure by ML Bank, MLI, or ML & Co. to observe any of its commitments or representations. Granting this exemption does

not represent a determination concerning the permissibility of any other transactions engaged in by ML Bank, MLI, or ML & Co. that are subject to section 23A or Regulation W.

Sincerely,

/s/ Robert deV. Frierson

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of San Francisco
Federal Deposit Insurance Corporation