David

OFFICE OF
THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 18, 1985

Roger E. Birk, Chairman
Merrill Lynch & Co., Inc.
One Liberty Plaza
165 Broadway
New York, New York 10080

Dear Roger:

Thanks very much for your excellent letter of November 13, 1984. Appropriate offices of the Commission and the self-regulatory organizations are reviewing the matters raised in your letter. This is a brief progress report.

1. Changes in Net Capital Requirements

As to whether it would be appropriate to eliminate the net capital rule and rely on the customer protection rule, the Commission has published the attached "concept release" soliciting comments on the specific issues you have raised and others.

2. Unnecessary Examination Requirements

With reference to the suggestions to revise SRO examinations to reflect the fact that employees of broker-dealers perform increasingly specialized functions, I have asked the Market Regulation Division to pursue this idea with the NASD and other SROs.

The Division is also analyzing the propriety of narrower examinations for specialized categories of membership. For example, the examination for employees performing ministerial functions could be less comprehensive than the Series 7 exam.

The Division has also discussed with the NASD a proposed rule change that would require employees of banks, savings and loan associations, and other financial institutions who participate in securities transactions to be subject to NASD examination requirements. */

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*/ NASD, Notice to Members 83-73 (December 20, 1983).

3. Duplicative Filing Requirements

The staff is working with the state securities commissioners, the SROs and the SIA on simplified U-4 and U-5 forms for securities salespersons and B-D forms for broker-dealers. Significant progress in drafting these forms has been made. Hopefully, the revisions can be put into effect this year. In addition, work is continuing on incorporating broker-dealer registration with the states and the SROs into the CRD system--which will result in a single filing for Form B-D filings and amendments as is now the case for Forms U-4 and U-5. Several states will be participating in the EDGAR pilot--which offers the promise of a single electronic registration to satisfy Commission and blue-sky requirements. We understand discussions are also continuing between the NASD and NFA on further integration of disclosure requirements for associated persons involved in both the securities and commodities business.

We are working with the states on a uniform investment adviser registration form and central registration system, and supporting NASAA's efforts to standardize all state investment adviser financial and examination requirements.

Representatives of Merrill Lynch have been extremely helpful in these efforts and the staff is looking forward to continuing to work with them.

4. Unnecessary Regulation of Canadian Affiliates

The Commission staff was not aware that the New York Stock Exchange requires Canadian registered representatives of member firms to pass the Series 7 exam, even though they sell only non-U.S. securities, and do business only with Canadian nationals. I have asked Market Regulation to review this matter with the NYSE.

5. Integration of State and Federal Regulations

I share your concerns in this area, which will be included on the agenda for the February 14th and 15th SEC-NASAA conference. At last year's conference, a NASAA committee was formed to address the lack of uniformity in state regulation of investment companies. In September, NASAA adopted the committee's recommendations to simplify and standardize certain state requirements for mutual fund and unit investment trust registrations, filing of advertising

and treatment of over-sales. The proposed procedures and requirements are substantially identical to those imposed under the Investment Company Act. Much more remains to be done to implement such uniformity in this and many other areas.

6. Recognition of Internal Disciplinary Actions

A firm's duty to supervise, codified in Section 15(b)(4)(E) of the Exchange Act, does not make a firm or its supervisors guarantors of employee conduct. The section provides a "due diligence" defense, based upon a showing that there are established procedures and a system for applying them that could reasonably be expected to prevent violations and that the firm reasonably discharged the duties arising from those procedures. Where a firm has such procedures, follows them, detects misconduct, and takes prompt remedial action, which may include the imposition of penalties on erring employees, the Commission should not take action against the firm for failure to supervise.

7. Section 11(a) of the Exchange Act

Section 11(a) of the Exchange Act restricts the use of stock exchange memberships in trading for managed institutional and certain proprietary accounts. The Commission implemented rules designed to ease the impact of the section shortly after it was adopted in 1975. I have asked the staff to review the section. If it continues to impose unnecessary burdens, Congressional action may be necessary.

8. Section 13(f) of the Exchange Act

The Commission receives approximately 60 public inquiries per week for 13(f) information. Vendors also tabulate and sell the information. However, the Commission is sensitive to legitimate needs for confidentiality. On December 5, 1984, the Commission published a proposal to amend the instructions to Form 13F to provide an automatic initial one-year grant of confidential treatment to open risk arbitrage positions. Certain representations are required by the reporting firm. A copy of the proposal is enclosed.

9. Sections 13(d) and 16(a) of the Exchange Act

These Sections are under current review by the Division of Corporation Finance. Your suggestions are appreciated and will be included in their review.

10. Regulation of Money Market Fund Transactions

You recommended a thorough review of the regulation of money market funds to assure efficiency and to avoid unnecessarily restrictive regulation. You cited the requirement that only persons registered with the NASD may accept customer orders to buy or to sell money market funds and questioned whether money market funds transactions must always have written or specific trade-by-trade authorization. The Commission has recently revised confirmation requirements for money market fund transactions, reducing paperwork and processing requirements, and will carefully consider your recommendations for additional improvements.

As noted above, the staff is considering whether the SROs should adopt specialized rules for employees who perform ministerial functions, for example, persons who merely accept customer orders. That effort should include persons who accept orders for shares of money market funds. With respect to unauthorized trading, I understand the staff once questioned whether Merrill Lynch's procedures constituted unauthorized trading, but that the issue was favorably resolved.

11. Money Market Fund Shareholder Voting Requirements

With reference to the quorum problems of money market funds, I expect favorable action in the near future.

12. Trading with Affiliates

You recommended that we explore granting relief in the area of money market funds trading with affiliates. As you note, this is an area governed by Section 17 of the Investment Company Act. I understand that Merrill Lynch money market funds have obtained exemptive relief under Sections 6(c) and 17(b) of the Investment Company Act to allow the funds to purchase short-term U.S. Government and agency securities, short-term bank money instruments and commercial paper from Merrill Lynch affiliates. (See Investment Company Act Releases Nos. 9392 (Aug. 10, 1976), 11783 (May 19, 1981) and 13598 (Oct. 26, 1983)). Because of the wide variety of principal

transactions between money market funds and affiliated persons, they are being processed on a case-by-case basis, but as in other areas, rules will be proposed to deal with repetitive situations.

13. Burdensome Position Limit Requirements

You note that SRO options position limit rules can have the effect of constraining the maximum usage of options by mutual funds, particularly large funds or fund complexes. Since these funds are interested primarily in utilizing options for hedging and related purposes, this is a result the Commission wishes to avoid. The Commission is working with the principal options exchanges on two undertakings which should ameliorate this problem.

The Commission and the exchanges have been expanding position limits as it has become clear that the previous limits did not raise serious manipulation or market disruption concerns. As you note, in the past limits have been raised in four stages from an initial level of 500 contracts to a current ceiling of 4,000 contracts for options on the largest individual stocks. Next month the Commission expects to consider exchange proposals to double the maximum position and exercise limits.

A second question is when related accounts should be aggregated for position limit purposes. This has proven to be a difficult area for the exchanges to provide interpretive guidance because of the wide variety of circumstances in which accounts may be interrelated. The Commission staff and the exchanges have been reviewing this area. They share your view that fund accounts that are managed and controlled independently and that have distinct investment policies should not be aggregated. The Commission expects to receive exchange rule filings providing additional guidance on this question in the near future.

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Thanks again for your constructive suggestions.

Sincerely,

John S.R. Shad

Enclosure