Bond Indices | Global
08 August 2011

Proposed changes in bond index rules

Phil Galdi +1 646 556 2908
Research Analyst
MLPF&S
phil.galdi@baml.com

Preston Peacock +1 646 556 2949
Research Analyst
MLPF&S
preston.peacock@baml.com

See Team Page for Full List of Contributors

Proposed index rule changes under consideration

A number of rule changes that will impact selection criteria and calculation methodologies for the BofA Merrill Lynch Bond Indices are under consideration. Details of all proposed changes are outlined in this report.

Public commentary period

We will accept comments on these proposed changes prior to reaching any final decisions. Comments should be emailed to the BofA Merrill Lynch Bond Index group (mlindex@ml.com). All comments should be submitted no later than September 30, 2011. **Note: It is important that you register your vote even if you are in full agreement with the proposed rule changes.**

Final decisions will be announced in October

The rule changes outlined in this document are preliminary. After carefully considering all comments received, BofA Merrill Lynch, at its sole discretion, will make a final decision on those changes that are to be implemented. The official list of approved rule changes will be published in October. Any one or more of the preliminary changes included in this report may be modified or eliminated completely from the final list of rule changes. Similarly, new changes, not included in this report, may be introduced in the final list of rule changes.

All final changes will take effect on Dec. 31, 2011

Unless otherwise noted, those changes that are officially adopted and announced in October will take effect on December 31, 2011, and new selection criteria will be incorporated in the Indices beginning with the January 2012 constituent lists.

Custom indices that are based off indices affected by these rule changes will automatically pick up the new rules unless the sponsor of the index notifies us in advance of their desire to modify the rules for their custom benchmark.

BofA Merrill Lynch, at its sole discretion, reserves the right to issue rule changes apart from this standard cycle in the event that such a change is deemed necessary in order to deal with extraordinary circumstances including, but not limited to, changes in data availability.

Table of Contents

Access to BofA Merrill Lynch Global Indices:
Bloomberg: IND<GO>
Institutional website: www.baml.com/markets
Public website: www.mlindex.ml.com

BofA Merrill Lynch Index Hotline:
New York: +1 646-556-2900
London: +44 20 7995 3927
Email: mlindex@ml.com

Refer to important disclosures on page 12 to 13. Link to Definitions on page 11.

Modification of general rating methodologies

Recent events have highlighted the potential for far-reaching unintended consequences of various rating agency actions on the composition of a number of our flagship high grade and high yield indices. The following rule changes and clarifications are intended to deal with these extreme scenarios, however unlikely they may be. As things stand now, none of these rule changes and clarifications is expected to have an impact on index composition. Rather, they will ensure that the index universes remain stable and are not unduly affected by technical factors.

1. Sovereign debt rating criteria in single currency indices

Currently, our single currency Broad Market Indices require that all of their constituents be rated investment grade. That implies that the rating requirement also applies to local currency sovereign debt. Logically, a sovereign issuer should always qualify for inclusion in its own domestic market index. Therefore, with the exception of the Euro Broad Market Index, local currency sovereign debt will be explicitly exempt from the rating criteria of single currency indices.

At the time the Euro Indices were launched we had considered the unique situation of multiple countries sharing a common currency and explicitly required that Euro sovereigns individually meet the rating criteria for the index. That decision was reaffirmed a year ago when we removed Greece from the Index and more recently with the removal of Portugal. Accordingly, we will continue to require Euro sovereigns to meet the bond rating criteria of the Euro Broad Market Index. In addition, unless otherwise specified in the rules for a given index, bond rating criteria will apply to all local currency sovereign debt in multi-currency indices such as the Global Broad Market and Global Government Indices,.

2. Country rating criteria in single and multi-currency indices

Currently we apply country rating criteria to the constituencies of many of our indices. Specifically, the investment grade broad market index series and the high yield index series both require that issuers have an investment grade rated country of risk. The purpose of this rule is to place some degree of control over the extent to which foreign names qualify for a “domestic” market index. However, as written, the country rating criteria is not sufficiently narrow in scope and technically applies to foreign and domestic issuers alike.

As with local sovereign debt, it would make no sense for domestic market issuers to be excluded from their own index. Therefore, country criteria for any single currency index will only apply to offshore issuers. That means that U.S. issuers automatically qualify for inclusion in the US Broad Market and US High Yield Indices (provided they meet all other requirements), U.K. issuers automatically qualify for inclusion in the Sterling Broad Market and Sterling High Yield Indices, etc.

For euro currency indices that employ country criteria, the requirements will continue to apply to Euro member countries individually unless otherwise specified in the rules for a given index. It should be noted that another rule change has been proposed that will potentially drop country criteria rating currently used in many of the euro currency indices in favor of new country selection criteria (see below). Adoption of this rule change will allow otherwise qualifying non-sovereign debt of below investment grade Euro member countries to re-enter the Euro Broad Market and Euro High Yield Indices at the end of the year.

These same "home" country principles will apply to credit indices that include a fixed list of currencies. For example, U.S., U.K. and Canadian non-sovereign issuers will be exempt from the country criteria of the Global High Yield Index, but issuers of all other countries, including Euro members, need to pass any country filters that may apply. Likewise, U.S., U.K., Canada, Japan and Australia non-sovereign issuers will be exempt from the country criteria of the Global Broad Market Index, though local currency sovereign debt of those countries must continue to meet the bond rating criteria for this index.

3. U.S. Mortgage pass-through and CMO ratings

Though they are not actually rated by the rating agencies, we have traditionally assigned AAA composite ratings to all mortgage pass-through and Agency CMO constituents. The assumed ratings were implicitly derived from the AAA ratings of the U.S. Treasury, Fannie Mae and Freddie Mac. However, with those ratings no longer certain, we have formalized a method for deriving mortgage pass-through and CMO ratings, as follows:

- Ginnie Mae collateral will be assigned the U.S. Treasury local currency long term sovereign debt rating. As with Treasuries, Ginnies will be exempt from the bond rating criteria for the US Broad Market Index.

- Fannie Mae and Freddie Mac collateral will be assigned the senior unsecured debt ratings of their respective agencies.

Country criteria for high grade and high yield indices

Proposed change: Effective December 31, 2011 country rating criteria will no longer apply to the investment grade Global Broad Market Index, the Global High Yield Index, or any of their sub-indices. Instead, new criteria will be imposed requiring that the issuer's country of risk be an FX G10 member, a Western European country or a U.S./Western European territory.

Comments: Currently, high grade and high yield index constituents must have a country of risk that is investment grade based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings. Over the past few years, sovereign debt ratings have become increasingly volatile. During that time we have seen a number of "developed market" countries downgraded to below investment grade, while a growing number of "emerging markets" countries are now rated investment grade. The divergent trends have caused a slow but steady changing of the guard in index constituents, with prospects of more to come. In determining our proposed course of action, we considered three alternatives:

1. **Keep the existing country rating criteria**, whereby securities need to have an investment grade rated country or risk in order to qualify for the high grade and high yield indices.

2. **Eliminate all country criteria** and determine inclusion in the high grade and high yield indices solely on the basis of the bond rating.

3. **Replace the country rating criteria** with a filter that restricts high grade and high yield index country exposures to FX G10 members, Western European countries and U.S./Western European territories.

While each approach has its own merits, we propose the adoption of option 3. This method brings the index country exposures closer in line with what they were when these indices were first introduced (and what many investors had intended for their portfolios), while continuing to draw a line between countries that can be included in high grade and high yield indices on one side, and emerging market indices on the other. Additionally, this approach is more desirable than the current method as it will reduce the potential for rebalancing volatility.

Our first order of business is to determine the future course of action for existing indices. Assuming this rule change is adopted as proposed, we would then anticipate building new indices that follow the traditional country rating criteria for those that prefer to continue to use that methodology. We also anticipate building a new series of investment grade and below investment grade indices that blend developed and emerging market countries into a single benchmark (i.e., option 2). Likewise, if the proposed rule change is voted down and the existing indices remain status quo, then we would anticipate building new indices that follow the option 2 and 3 approaches.

Impact of proposed change: As of June 30, 2011, a change from a country ratings based criteria to inclusion of only FX G10 members, Western European countries and U.S./Western European territories would result in the removal of ten countries that currently have greater than a 0.05% share of the Global Broad Market Index (2.81% combined allocation)(Table 1). The impact would be greater on the Global High Yield Index where 20 countries with a combined allocation of 9.00% would be removed (Table 2). In addition, Greek corporates would enter the Global High Yield Index where they would hold a 0.62% share (3.81% for the Euro High Yield Index).

Impact of alternative approach: If, instead of the proposed change, we were to completely drop all country criteria (option 2), there would be virtually no change in the country exposures of the high grade Global Broad Market Index and its regional sub-indices as few issuers break their country ceiling. However, in the Global High Yield Index nine countries, including Greece, would be added while none would be dropped (Table 3). The largest of the new additions would be Venezuela, with a weight of 1.12%.

Note: The pro-forma analyses are as of June 30. On that date, Portugal held a 0.34% share of the Global Broad Market Index (0.23% sovereign and 0.11% non-sovereign) and a 0.12% share of the Global High Yield Index. Subsequently, Portugal has been removed from both indices. However, adoption of the proposed rule change would allow for the re-entry of its non-sovereign debt.

Table 1: Impact on high grade broad market indices of removal of country rating criteria and inclusion of only FX G10 countries, Western Europe and U.S./Western European territories

		Current weight				Pro-forma weight				Difference			
Country	Impact	GBMI	US00	EMU0	UK00	GBMI	US00	EMU0	UK00	GBMI	US00	EMU0	UK00
United States	Increase	39.15%	88.82%	2.31%	4.39%	40.49%	91.80%	2.34%	4.41%	1.35%	2.98%	0.03%	0.02%
Japan	Increase	18.62%	0.32%	0.18%	0.25%	19.26%	0.33%	0.18%	0.25%	0.64%	0.01%	0.00%	0.00%
Germany	Increase	6.53%	0.88%	22.02%	3.46%	6.76%	0.91%	22.31%	3.48%	0.22%	0.03%	0.29%	0.02%
France	Increase	5.99%	0.51%	21.08%	2.41%	6.20%	0.53%	21.37%	2.42%	0.21%	0.02%	0.28%	0.01%
United Kingdom	Increase	5.32%	1.18%	3.03%	79.53%	5.50%	1.22%	3.08%	79.94%	0.18%	0.04%	0.04%	0.41%
Italy	Increase	4.23%	0.30%	15.36%	1.05%	4.37%	0.31%	15.57%	1.05%	0.15%	0.01%	0.21%	0.01%
Canada	Increase	3.60%	1.27%	0.35%	0.18%	3.72%	1.32%	0.36%	0.18%	0.12%	0.04%	0.00%	0.00%
Spain	Increase	3.02%	0.15%	11.02%	0.63%	3.12%	0.16%	11.17%	0.63%	0.10%	0.01%	0.15%	0.00%
Netherlands	Increase	1.98%	0.40%	6.12%	1.11%	2.04%	0.42%	6.20%	1.12%	0.07%	0.01%	0.08%	0.01%
Hungary	Drop	0.06%	0.05%	0.13%	0.11%	0.00%	0.00%	0.00%	0.00%	-0.06%	-0.05%	-0.13%	-0.11%
Qatar	Drop	0.08%	0.16%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.08%	-0.16%	0.00%	0.00%
UAE	Drop	0.09%	0.12%	0.04%	0.04%	0.00%	0.00%	0.00%	0.00%	-0.09%	-0.12%	-0.04%	-0.04%
Hong Kong	Drop	0.10%	0.14%	0.06%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.10%	-0.14%	-0.06%	0.00%
Israel	Drop	0.14%	0.08%	0.03%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.14%	-0.08%	-0.03%	0.00%
Russia	Drop	0.26%	0.47%	0.10%	0.12%	0.00%	0.00%	0.00%	0.00%	-0.26%	-0.47%	-0.10%	-0.12%
Brazil	Drop	0.31%	0.66%	0.10%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.31%	-0.66%	-0.10%	0.00%
Poland	Drop	0.43%	0.06%	0.35%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.43%	-0.06%	-0.35%	0.00%
Mexico	Drop	0.49%	0.42%	0.11%	0.16%	0.00%	0.00%	0.00%	0.00%	-0.49%	-0.42%	-0.11%	-0.16%
South Korea	Drop	0.86%	0.31%	0.04%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.86%	-0.31%	-0.04%	0.00%

Note: countries with less than a +/- 0.05% change in weight are not shown in the above table

Source: BofA Merrill Lynch Bond Indices

Table 2: Impact on high yield indices of removal of country rating criteria and inclusion of only FX G10 countries, Western Europe and U.S./Western European territories

		Current weight			Pro-forma weight			Difference		
Country	Impact	HW00	H0A0	HE00	HW00	H0A0	HE00	HW00	H0A0	HE00
United States	Increase	68.28%	82.12%	6.07%	74.63%	90.84%	6.32%	6.35%	8.72%	0.25%
Greece	Add	0.00%	0.00%	0.00%	0.62%	0.02%	3.81%	0.62%	0.02%	3.81%
United Kingdom	Increase	4.37%	1.44%	7.34%	4.77%	1.59%	7.64%	0.41%	0.15%	0.30%
Germany	Increase	3.12%	0.29%	18.66%	3.41%	0.32%	19.42%	0.29%	0.03%	0.77%
France	Increase	2.46%	0.31%	14.52%	2.68%	0.35%	15.12%	0.23%	0.03%	0.60%
Canada	Increase	2.39%	2.16%	1.13%	2.61%	2.39%	1.17%	0.22%	0.23%	0.05%
Italy	Increase	2.17%	0.41%	12.12%	2.38%	0.46%	12.62%	0.20%	0.04%	0.50%
Netherlands	Increase	1.94%	0.75%	7.99%	2.12%	0.83%	8.32%	0.18%	0.08%	0.33%
Spain	Increase	0.97%	0.33%	4.61%	1.06%	0.36%	4.80%	0.09%	0.03%	0.19%
Ireland	Increase	0.95%	0.33%	4.34%	1.04%	0.36%	4.51%	0.09%	0.03%	0.18%
Luxembourg	Increase	0.94%	0.34%	4.33%	1.03%	0.38%	4.51%	0.09%	0.04%	0.18%
New Zealand	Increase	0.75%	0.74%	0.94%	0.82%	0.82%	0.98%	0.07%	0.08%	0.04%
Thailand	Drop	0.06%	0.07%	0.00%	0.00%	0.00%	0.00%	-0.06%	-0.07%	0.00%
Barbados	Drop	0.07%	0.08%	0.00%	0.00%	0.00%	0.00%	-0.07%	-0.08%	0.00%
Chile	Drop	0.08%	0.09%	0.00%	0.00%	0.00%	0.00%	-0.08%	-0.09%	0.00%
Croatia	Drop	0.09%	0.00%	0.59%	0.00%	0.00%	0.00%	-0.09%	0.00%	-0.59%
South Korea	Drop	0.11%	0.14%	0.00%	0.00%	0.00%	0.00%	-0.11%	-0.14%	0.00%
Saudi Arabia	Drop	0.11%	0.14%	0.00%	0.00%	0.00%	0.00%	-0.11%	-0.14%	0.00%
Singapore	Drop	0.12%	0.15%	0.00%	0.00%	0.00%	0.00%	-0.12%	-0.15%	0.00%
Czech Republic	Drop	0.16%	0.00%	1.03%	0.00%	0.00%	0.00%	-0.16%	0.00%	-1.03%
Colombia	Drop	0.20%	0.24%	0.00%	0.00%	0.00%	0.00%	-0.20%	-0.24%	0.00%
Poland	Drop	0.23%	0.03%	1.32%	0.00%	0.00%	0.00%	-0.23%	-0.03%	-1.32%
Hong Kong	Drop	0.28%	0.34%	0.00%	0.00%	0.00%	0.00%	-0.28%	-0.34%	0.00%
Hungary	Drop	0.29%	0.00%	1.89%	0.00%	0.00%	0.00%	-0.29%	0.00%	-1.89%
South Africa	Drop	0.36%	0.12%	1.73%	0.00%	0.00%	0.00%	-0.36%	-0.12%	-1.73%
India	Drop	0.51%	0.62%	0.00%	0.00%	0.00%	0.00%	-0.51%	-0.62%	0.00%
Kazakhstan	Drop	0.64%	0.73%	0.26%	0.00%	0.00%	0.00%	-0.64%	-0.73%	-0.26%
UAE	Drop	0.71%	0.72%	0.48%	0.00%	0.00%	0.00%	-0.71%	-0.72%	-0.48%
Mexico	Drop	0.85%	0.98%	0.32%	0.00%	0.00%	0.00%	-0.85%	-0.98%	-0.32%
China	Drop	1.05%	1.28%	0.00%	0.00%	0.00%	0.00%	-1.05%	-1.28%	0.00%
Russia	Drop	1.28%	1.56%	0.00%	0.00%	0.00%	0.00%	-1.28%	-1.56%	0.00%
Brazil	Drop	1.83%	2.23%	0.00%	0.00%	0.00%	0.00%	-1.83%	-2.23%	0.00%

Note: countries with less than a +/- 0.05% change in weight are not shown in the above table

Source: BofA Merrill Lynch Bond Indices

Table 3: Alternate impact on high yield indices of removal of all country criteria

		Current weight			Alternate weight			Difference		
Country	Impact	HW00	H0A0	HE00	HW00	H0A0	HE00	HW00	H0A0	HE00
Venezuela	Add	0.00%	0.00%	0.00%	1.12%	1.36%	0.00%	1.12%	1.36%	0.00%
Indonesia	Add	0.00%	0.00%	0.00%	0.89%	1.08%	0.00%	0.89%	1.08%	0.00%
Greece	Add	0.00%	0.00%	0.00%	0.54%	0.01%	3.53%	0.54%	0.01%	3.53%
Ukraine	Add	0.00%	0.00%	0.00%	0.40%	0.49%	0.00%	0.40%	0.49%	0.00%
Argentina	Add	0.00%	0.00%	0.00%	0.34%	0.41%	0.00%	0.34%	0.41%	0.00%
Turkey	Add	0.00%	0.00%	0.00%	0.30%	0.37%	0.00%	0.30%	0.37%	0.00%
Jamaica	Add	0.00%	0.00%	0.00%	0.28%	0.34%	0.00%	0.28%	0.34%	0.00%
Philippines	Add	0.00%	0.00%	0.00%	0.08%	0.10%	0.00%	0.08%	0.10%	0.00%
El Salvador	Add	0.00%	0.00%	0.00%	0.06%	0.07%	0.00%	0.06%	0.07%	0.00%
China	Decrease	1.05%	1.28%	0.00%	1.00%	1.22%	0.00%	-0.05%	-0.06%	0.00%
Russia	Decrease	1.28%	1.56%	0.00%	1.22%	1.49%	0.00%	-0.06%	-0.07%	0.00%
Brazil	Decrease	1.83%	2.23%	0.00%	1.75%	2.13%	0.00%	-0.08%	-0.10%	0.00%
Netherlands	Decrease	1.94%	0.75%	7.99%	1.86%	0.72%	7.71%	-0.08%	-0.03%	-0.28%
Italy	Decrease	2.17%	0.41%	12.12%	2.08%	0.39%	11.69%	-0.09%	-0.02%	-0.43%
Canada	Decrease	2.39%	2.16%	1.13%	2.29%	2.06%	1.09%	-0.10%	-0.10%	-0.04%
France	Decrease	2.46%	0.31%	14.52%	2.35%	0.30%	14.01%	-0.11%	-0.01%	-0.51%
Germany	Decrease	3.12%	0.29%	18.66%	2.99%	0.28%	18.00%	-0.13%	-0.01%	-0.66%
United Kingdom	Decrease	4.37%	1.44%	7.34%	4.18%	1.37%	7.08%	-0.19%	-0.07%	-0.26%
United States	Decrease	68.28%	82.12%	6.07%	65.40%	78.44%	5.85%	-2.88%	-3.68%	-0.22%

Note: countries with less than a +/- 0.05% change in weight are not shown in the above table
Source: BofA Merrill Lynch Bond Indices

Treatment of contingent capital securities

Comments: We specifically exclude contingent capital securities that have automatic triggers which convert principal into common equity (e.g., LLOYDS 6.439% 2020). However, we do include contingent capital securities with loss-absorption provisions (e.g., RABOBK 8.375 2016), that convert into preference shares (e.g., HSBC 5.3687 Perpetual, callable in 2014), that have alternative coupon satisfaction mechanisms (e.g., ABNANV 4.31 2016) or those with cumulative and non-cumulative coupon deferrals (e.g., BBT 6.75% 2036 and HSBC 8.208% Perpetual-2015).

Due to uncertainty concerning the final outcome of Basel III requirements, relatively few contingent capital securities have been issued and their inclusion/exclusion has not had a big impact on the indices either way. However, the potential remains for significant issuance of these securities. As such, though we are not proposing a change, we use this opportunity to reiterate our current policies with respect to these instruments.

Qualification of Treasury Bills in Brazil government bond indices

Proposed change: Effective December 31, 2011, Brazil Treasury Bills (Letras do Tesouro Nacional) will qualify for inclusion in all Brazil Government Bond Indices and associated parent and sub-indices, provided they meet all other size and maturity requirements for those indices.

Comments: Typically Treasury Bills are issued with less than one year to maturity and thus do not qualify for inclusion in most bond indices. In some instances, bills can be issued with maturities that are slightly longer than a year. To avoid having these instruments enter the bond indices for a brief while, bills were categorically excluded from all government bond indices. However, Brazil has a large bill program with maturities at time of issue of as long as 4 years. Since these securities are similar in nature to zero coupon bonds, which do qualify for inclusion in government bond indices, an exception will be made for the Brazil Government Bond Index to allow for their inclusion.

Impact: As of June 30, 2011, BRL 278bn in index-qualifying Treasury Bills would have entered the Brazil Government Index under the new rule, nearly tripling the total market capitalization of that index (Table 5). The addition of the bills would have reduced the Brazil Government Index duration by just over a year to 1.94 years and would have increased its yield by 8 basis points to 12.71%.

Table 4: Qualifying Brazil Government Bills

Ticker	Maturity	Face Value (local in bln)	Issue date	Maturity at time of issue
BLTN	7/1/2012	171.7	1/8/2010	2.5
BLTN	7/1/2013	66.6	3/4/2011	2.3
BLTN	1/1/2015	54.6	1/7/2011	4.0
BLTN	1/1/2013	45.5	9/3/2010	2.3
BLTN	4/1/2013	35.4	12/3/2010	2.3
BLTN	1/1/2014	10.1	7/8/2011[1]	2.5

[1] Issued after June 2011 and therefore not included in June 30 pro-forma analysis

Source: BofA Merrill Lynch Bond Indices

Table 5: Pro-forma impact of inclusion of Brazil Bills (as of June 30, 2011)

	Actual	Pro-forma	Change
Market capitalization (BRL in bln)	143.2	421.1	277.9
Duration	3.07	1.94	-1.13
Yield	12.63	12.71	0.08
% weight of Brazil Govts in:			
Latin America Local Currency Sovereign (WSVL)	35.5%	63.4%	27.9%
Emerging Markets Sovereign (WSBV)	3.4%	10.1%	6.6%
World Sovereign (WSOV)	0.4%	1.2%	0.8%
Global Sovereign Broad Market Plus (G0PG)	0.4%	1.3%	0.9%
Global Broad Market Plus (GBMP)	0.2%	0.7%	0.5%
Broad Latin America Bond (LATS)	20.0%	20.0%	0.0%
Local Debt Markets Plus (LDMP)	6.0%	10.0%	4.0%

Source: BofA Merrill Lynch Bond Indices

Use of German Pfandbrief ratings

Proposed change: Effective December 31, 2011, composite ratings for German Pfandbriefe will be determined solely on the basis of the individual bond rating and will no longer use any issuer ratings (either Pfandbrief or senior unsecured debt ratings).

Comments: Only a handful of Pfandbriefe remain that do not have individual bond ratings from one or more of the rating agencies. Therefore there is no longer a need to allow for alternate rating sources.

Impact: As of June 30, 2011, only 2 bonds with a total face value of €500mn remained in the index. As such, their removal will have a negligible impact on the indices.

Treatment of insured bonds in the U.S. municipal sector map

Proposed change: Effective December 31, 2011 a revised sector classification schema will go into effect that eliminates the insured categories from all taxable and tax-exempt municipal security classifications (Tables 6 and 7). Insured municipal securities will be classified based on the bond's purpose regardless of any credit enhancement or guarantee by an insurance company. However, the Refunded category in the sector classification schema will remain intact and bonds will be reclassified into that sector upon refunding.

Comments: In the past, an insured muni bond traded very differently than its uninsured counterpart, but since the financial crisis there has been very little differentiation between the two. Furthermore, by combining the two groups we can get a broader view of the performance of bonds issued for a particular purpose. As such we believe it no longer makes sense to segregate insured bonds from uninsured bonds.

Impact: The change in sector classification will have no impact on the constituencies of our existing municipal sector sub-indices as they have always been based purely on the bond's purpose and have included both insured and refunded bonds. Though the existing sector indices will be unchanged, we plan to introduce a new series of muni sector indices that will exclude refunded bonds, but continue to include insured bonds. The change in the sector classification schema will affect profile analyses created on our index system that segment the index by sector classification. However, a separate insured flag is available as a bucketing attribute in our web-based profiling tool for those that want to continue to segregate these securities.

Table 6: BofA Merrill Lynch Index sector classification schema – U.S. Tax-Exempt Municipals

Level 1 – Asset class	Level 2 – Group	Level 3 – Category	Level 4 – Sub-category
U.S. Tax-Exempt Municipals (MUNI)	Refunded (REFD)	Refunded (Refd)	Pre-Refunded (Pref)
			ETM (Etm)
	GO (GO)	GO - State (Gost)	GO - State (Gost)
		GO - Local (Golo)	GO - Local (Golo)
	Revenue (REV)	Revenue - Airport (Airp)	Revenue - Airport (Airp)
		Revenue - Education (Edu)	Revenue - Education (Edu)
		Revenue - Health (Heal)	Revenue - Health (Heal)
		Revenue - Hospitals (Hosp)	Revenue - Hospitals (Hosp)
		Revenue - Pollution Control (Pcr)	Revenue - Pollution Control (Pcr)
		Revenue - Industrial Development Revenue (Idr)	Revenue - Industrial Development Revenue (Idr)
		Revenue - Leasing COPS & Appropriations (Leas)	Revenue - Leasing COPS & Appropriations (Leas)
		Revenue - Single Family Housing (Shng)	Revenue - Single Family Housing (Shng)
		Revenue - Multi-Family Housing (Mhng)	Revenue - Multi-Family Housing (Mhng)
		Revenue - Tax (Taxr)	Revenue - Tax (Taxr)
		Revenue - Tobacco (Tob)	Revenue - Tobacco (Tob)
		Revenue - Toll & Turnpike (Toll)	Revenue - Toll & Turnpike (Toll)
		Revenue - Transportation (Trns)	Revenue - Transportation (Trns)
		Revenue - Power (Powr)	Revenue - Power (Powr)
		Revenue - Utilities - Other (Utly)	Revenue - Utilities - Other (Utly)
		Revenue - Water & Sewer (Watr)	Revenue - Water & Sewer (Watr)
		Revenue - Misc (Misc)	Revenue - Misc (Misc)

Source: BofA Merrill Lynch bond indices

Table 7: BofA Merrill Lynch Index sector classification schema – Quasi & Foreign Governments (including U.S. Taxable Municipals)

Level 1 – Asset class	Level 2 – Group	Level 3 – Category	Level 4 – Sub-category
Quasi & Foreign Government (QGVT)	Quasi & Foreign Government (QGVT)	Agency (Agcy)	Agency (Agcy)
		Foreign Sovereign (FSov)	Foreign Sovereign (FSov)
		Government Guaranteed (Guar)	Government Guaranteed (Guar)
		Local-Authority (LGvt)	Local-Authority (LGvt)
		U.S. Taxable Municipal (TaxM)	Pre-Refunded (TPre)
			ETM (TEtm)
			GO - State (TGos)
			GO - Local (TGol)
			Revenue - Airport (TAir)
			Revenue - Education (TEdu)
			Revenue - Health (THlt)
			Revenue - Hospitals (THos)
			Revenue - Pollution Control (TPcr)
			Revenue - Industrial Development Revenue (TIdr)
			Revenue - Leasing COPS & Appropriations (TLea)
			Revenue - Single Family Housing (TShn)
			Revenue - Multi-Family Housing (TMhn)
			Revenue - Tax (TTax)
			Revenue - Tobacco (TTob)
			Revenue - Toll & Turnpike (TTol)
			Revenue - Transportation (TTrn)
			Revenue - Power (TPow)
			Revenue – Utilities - Other (TUtl)
			Revenue – Water & Sewer (TWtr)
			Revenue – Misc (TMis)
		Supranational (Supr)	Supranational (Supr)

Source: BofA Merrill Lynch bond indices

Link to Definitions
Credit
Click here for definitions of commonly used terms.

Important Disclosures

BofA Merrill Lynch Research personnel (including the analyst(s) responsible for this report) receive compensation based upon, among other factors, the overall profitability of Bank of America Corporation, including profits derived from investment banking revenues.

BofA Merrill Lynch Global Credit Research analysts regularly interact with sales and trading desk personnel in connection with their research, including to ascertain pricing and liquidity in the fixed income markets.

Other Important Disclosures

Officers of MLPF&S or one or more of its affiliates (other than research analysts) may have a financial interest in securities of the issuer(s) or in related investments.

BofA Merrill Lynch Global Research policies relating to conflicts of interest are described at http://www.ml.com/media/43347.pdf.

"BofA Merrill Lynch" includes Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S") and its affiliates. Investors should contact their BofA Merrill Lynch representative or Merrill Lynch Global Wealth Management financial advisor if they have questions concerning this report.

Information relating to Non-US affiliates of BofA Merrill Lynch and Distribution of Affiliate Research Reports:

MLPF&S distributes, or may in the future distribute, research reports of the following non-US affiliates in the US (short name: legal name): Merrill Lynch (France): Merrill Lynch Capital Markets (France) SAS; Merrill Lynch (Frankfurt): Merrill Lynch International Bank Ltd., Frankfurt Branch; Merrill Lynch (South Africa): Merrill Lynch South Africa (Pty) Ltd.; Merrill Lynch (Milan): Merrill Lynch International Bank Limited; MLI (UK): Merrill Lynch International; Merrill Lynch (Australia): Merrill Lynch Equities (Australia) Limited; Merrill Lynch (Hong Kong): Merrill Lynch (Asia Pacific) Limited; Merrill Lynch (Singapore): Merrill Lynch (Singapore) Pte Ltd.; Merrill Lynch (Canada): Merrill Lynch Canada Inc; Merrill Lynch (Mexico): Merrill Lynch Mexico, SA de CV, Casa de Bolsa; Merrill Lynch (Argentina): Merrill Lynch Argentina SA; Merrill Lynch (Japan): Merrill Lynch Japan Securities Co., Ltd.; Merrill Lynch (Seoul): Merrill Lynch International Incorporated (Seoul Branch); Merrill Lynch (Taiwan): Merrill Lynch Securities (Taiwan) Ltd.; DSP Merrill Lynch (India): DSP Merrill Lynch Limited; PT Merrill Lynch (Indonesia): PT Merrill Lynch Indonesia; Merrill Lynch (Israel): Merrill Lynch Israel Limited; Merrill Lynch (Russia): Merrill Lynch CIS Limited, Moscow; Merrill Lynch (Turkey): Merrill Lynch Yatirim Bankasi A.S.; Merrill Lynch (Dubai): Merrill Lynch International, Dubai Branch; MLPF&S (Zürich rep. office): MLPF&S Incorporated Zürich representative office; Merrill Lynch (Spain): Merrill Lynch Capital Markets Espana, S.A.S.V.; Merrill Lynch (Brazil): Bank of America Merrill Lynch Banco Múltiplo S.A.

This research report has been approved for publication and is distributed in the United Kingdom to professional clients and eligible counterparties (as each is defined in the rules of the Financial Services Authority) by Merrill Lynch International and Banc of America Securities Limited (BASL), which are authorized and regulated by the Financial Services Authority and has been approved for publication and is distributed in the United Kingdom to retail clients (as defined in the rules of the Financial Services Authority) by Merrill Lynch International Bank Limited, London Branch, which is authorized by the Central Bank of Ireland and is subject to limited regulation by the Financial Services Authority – details about the extent of its regulation by the Financial Services Authority are available from it on request; has been considered and distributed in Japan by Merrill Lynch Japan Securities Co., Ltd., a registered securities dealer under the Financial Instruments and Exchange Act in Japan; is distributed in Hong Kong by Merrill Lynch (Asia Pacific) Limited, which is regulated by the Hong Kong SFC and the Hong Kong Monetary Authority; is issued and distributed in Taiwan by Merrill Lynch Securities (Taiwan) Ltd.; is issued and distributed in India by DSP Merrill Lynch Limited; and is issued and distributed in Singapore by Merrill Lynch International Bank Limited (Merchant Bank) and Merrill Lynch (Singapore) Pte Ltd. (Company Registration No.'s F 06872E and 198602883D respectively) and Bank of America Singapore Limited (Merchant Bank). Merrill Lynch International Bank Limited (Merchant Bank) and Merrill Lynch (Singapore) Pte Ltd. are regulated by the Monetary Authority of Singapore. Merrill Lynch Equities (Australia) Limited (ABN 65 006 276 795), AFS License 235132 provides this report in Australia in accordance with section 911B of the Corporations Act 2001 and neither it nor any of its affiliates involved in preparing this research report is an Authorised Deposit-Taking Institution under the Banking Act 1959 nor regulated by the Australian Prudential Regulation Authority. No approval is required for publication or distribution of this report in Brazil. Merrill Lynch (Dubai) is authorized and regulated by the Dubai Financial Services Authority (DFSA). Research reports prepared and issued by Merrill Lynch (Dubai) are prepared and issued in accordance with the requirements of the DFSA conduct of business rules.

Merrill Lynch (Frankfurt) distributes this report in Germany. Merrill Lynch (Frankfurt) is regulated by BaFin.

This research report has been prepared and issued by MLPF&S and/or one or more of its non-US affiliates. MLPF&S is the distributor of this research report in the US and accepts full responsibility for research reports of its non-US affiliates distributed to MLPF&S clients in the US. Any US person receiving this research report and wishing to effect any transaction in any security discussed in the report should do so through MLPF&S and not such foreign affiliates.

General Investment Related Disclosures:

This research report provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments (e.g., options, futures, warrants, and contracts for differences). This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report.

Securities and other financial instruments discussed in this report, or recommended, offered or sold by Merrill Lynch, are not insured by the Federal Deposit Insurance Corporation and are not deposits or other obligations of any insured depository institution (including, Bank of America, N.A.). Investments in general and, derivatives, in particular, involve numerous risks, including, among others, market risk, counterparty default risk and liquidity risk. No security, financial instrument or derivative is suitable for all investors. In some cases, securities and other financial instruments may be difficult to value or sell and reliable information about the value or risks related to the security or financial instrument may be difficult to obtain. Investors should note that income from such securities and other financial instruments, if any, may fluctuate and that price or value of such securities and instruments may rise or fall and, in some cases, investors may lose their entire principal investment. Past performance is not necessarily a guide to future performance. Levels and basis for taxation may change.

BofA Merrill Lynch is aware that the implementation of the ideas expressed in this report may depend upon an investor's ability to "short" securities or other financial instruments and that such action may be limited by regulations prohibiting or restricting "shortselling" in many jurisdictions. Investors are urged to seek advice regarding the applicability of such regulations prior to executing any short idea contained in this report.

UK Readers: The protections provided by the U.K. regulatory regime, including the Financial Services Scheme, do not apply in general to business coordinated by BofA Merrill Lynch entities located outside of the United Kingdom. BofA Merrill Lynch Global Research policies relating to conflicts of interest are described at http://www.ml.com/media/43347.pdf.

Officers of MLPF&S or one or more of its affiliates (other than research analysts) may have a financial interest in securities of the issuer(s) or in related investments.

In the event that the recipient received this report pursuant to a contract between the recipient and MLPF&S for the provision of research services for a separate fee, and in connection therewith MLPF&S may be deemed to be acting as an investment adviser, such status relates, if at all, solely to the person with whom MLPF&S has contracted directly and does not extend beyond the delivery of this report (unless otherwise agreed specifically in writing by MLPF&S). MLPF&S is and continues to act solely as a broker-dealer in connection with the execution of any transactions, including transactions in any securities mentioned in this report.

Copyright and General Information regarding Research Reports:

Materials prepared by BofA Merrill Lynch Global Research personnel are based on public information. Facts and views presented in this material have not been reviewed by, and may not reflect information known to, professionals in other business areas of BofA Merrill Lynch, including investment banking personnel. BofA Merrill Lynch has established information barriers between BofA Merrill Lynch Global Research and certain business groups. As a result, BofA Merrill Lynch does not disclose certain client relationships with, or compensation received from, such companies in research reports. To the extent this report discusses any legal proceeding or issues, it has not been prepared as nor is it intended to express any legal conclusion, opinion or advice. Investors should consult their own legal advisers as to issues of law relating to the subject matter of this report. BofA Merrill Lynch Global Research personnel's knowledge of legal proceedings in which any BofA Merrill Lynch entity and/or its directors, officers and employees may be plaintiffs, defendants, co-defendants or co-plaintiffs with or involving companies mentioned in this report is based on public information. Facts and views presented in this material that relate to any such proceedings have not been reviewed by, discussed with, and may not reflect information known to, professionals in other business areas of BofA Merrill Lynch in connection with the legal proceedings or matters relevant to such proceedings.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. None of MLPF&S, any of its affiliates or their research analysts has any authority whatsoever to make any representation or warranty on behalf of the issuer(s). BofA Merrill Lynch Global Research policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

Any information relating to the tax status of financial instruments discussed herein is not intended to provide tax advice or to be used by anyone to provide tax advice. Investors are urged to seek tax advice based on their particular circumstances from an independent tax professional.

The information herein (other than disclosure information relating to BofA Merrill Lynch and its affiliates) was obtained from various sources and we do not guarantee its accuracy. This report may contain links to third-party websites. BofA Merrill Lynch is not responsible for the content of any third-party website or any linked content contained in a third-party website. Content contained on such third-party websites is not part of this report and is not incorporated by reference into this report. The inclusion of a link in this report does not imply any endorsement by or any affiliation with BofA Merrill Lynch. Access to any third-party website is at your own risk, and you should always review the terms and privacy policies at third-party websites before submitting any personal information to them. BofA Merrill Lynch is not responsible for such terms and privacy policies and expressly disclaims any liability for them.

All opinions, projections and estimates constitute the judgment of the author as of the date of the report and are subject to change without notice. Prices also are subject to change without notice. BofA Merrill Lynch is under no obligation to update this report and BofA Merrill Lynch's ability to publish research on the subject company(ies) in the future is subject to applicable quiet periods. You should therefore assume that BofA Merrill Lynch will not update any fact, circumstance or opinion contained in this report.

Certain outstanding reports may contain discussions and/or investment opinions relating to securities, financial instruments and/or issuers that are no longer current. Always refer to the most recent research report relating to a company or issuer prior to making an investment decision.

In some cases, a company or issuer may be classified as Restricted or may be Under Review or Extended Review. In each case, investors should consider any investment opinion relating to such company or issuer (or its security and/or financial instruments) to be suspended or withdrawn and should not rely on the analyses and investment opinion(s) pertaining to such issuer (or its securities and/or financial instruments) nor should the analyses or opinion(s) be considered a solicitation of any kind. Sales persons and financial advisors affiliated with MLPF&S or any of its affiliates may not solicit purchases of securities or financial instruments that are Restricted or Under Review and may only solicit securities under Extended Review in accordance with firm policies.

Neither BofA Merrill Lynch nor any officer or employee of BofA Merrill Lynch accepts any liability whatsoever for any direct, indirect or consequential damages or losses arising from any use of this report or its contents.

Team Page

New York

Phil Galdi +1 646 556 2908
Research Analyst
MLPF&S
phil.galdi@baml.com

Mark Goldblatt +1 646 556 2914
Research Analyst
MLPF&S
mark.goldblatt@baml.com

Kevin Horan +1 646 556 2920
Research Analyst
MLPF&S
kevin.horan@baml.com

Preston Peacock +1 646 556 2949
Research Analyst
MLPF&S
preston.peacock@baml.com

Steve Vaccaro +1 646 556 2973
Research Analyst
MLPF&S
steve.vaccaro@baml.com

London

Alberto Ruiz-Sena +44 20 7995 3927
Research Analyst
MLI (UK)
alberto.ruiz-sena@baml.com

Inna Meggs +44 20 7996 0125
Research Analyst
MLI (UK)
inna.meggs@baml.com