

MERRILL LYNCH PROFESSIONAL CLEARING CORP.
(S.E.C. I.D. No. 8-33359)

BALANCE SHEET
AS OF JUNE 27, 2008
(UNAUDITED)

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MEMBERS
NEW YORK STOCK EXCHANGE, INC.
AND OTHER PRINCIPAL U.S. EXCHANGES

222 BROADWAY, NEW YORK, NY 10038

A Guaranteed Subsidiary of
Merrill Lynch, Pierce, Fenner & Smith Incorporated

MERRILL LYNCH PROFESSIONAL CLEARING CORP.

BALANCE SHEET AS OF JUNE 27, 2008

(Dollars in Thousands, Except Share and Per Share Amounts)

ASSETS		LIABILITIES AND STOCKHOLDERS' EQUITY	
<i>Cash and cash equivalents</i>	\$ 33,462	Liabilities:	
<i>Cash and securities segregated for regulatory purposes or deposited with clearing organizations</i>	791,999	<i>Securities financing transactions:</i>	
<i>Securities financing transactions:</i>		Payables under repurchase agreements	\$ 1,882,160
Receivables under resale agreements	4,039,119	Payables under securities loaned transactions	71
Receivables under securities borrowed transactions	<u>128,222</u>		<u>1,882,231</u>
	<u>4,167,341</u>	<i>Trading liabilities, at fair value</i>	
<i>Trading assets, at fair value</i>		Derivative contracts	268,100
Derivative contracts	283,250	Equities	<u>563,630</u>
Equities	<u>63,327</u>		<u>831,730</u>
	<u>346,577</u>	<i>Payables to affiliated companies</i>	1,317
<i>Receivables from affiliated companies</i>	10,276,122	<i>Other payables:</i>	
<i>Other receivables:</i>		Customer and non-customer balances	23,588,893
Customer and non-customer balances	12,346,896	Brokers and dealers	255,165
Brokers and dealers	2,794,132	Interest and other	<u>132,670</u>
Interest and other	<u>357,514</u>		<u>23,976,728</u>
	<u>15,498,542</u>	<i>Other liabilities</i>	147,732
<i>Loans receivable</i>	91,915	<i>Subordinated borrowings</i>	2,150,000
<i>Exchange Memberships, at cost</i>	33,624	Stockholders' Equity:	
<i>Goodwill and intangible assets</i>	37,904	Preferred stock, \$1,000 liquidation preference per share; par value \$1 per share; 10,000 shares authorized; 2,675 shares issued and outstanding	2,675
<i>Equipment and facilities— (net of accumulated depreciation and amortization of \$20,001)</i>	6,245	Common stock, par value \$1 per share; 50,000 shares authorized; 3,000 shares issued and outstanding	3
<i>Other assets</i>	<u>154,461</u>	Paid-in capital	1,431,631
Total Assets	<u>\$31,438,192</u>	Retained earnings	<u>1,014,145</u>
		Total stockholders' equity	<u>2,448,454</u>
		Total Liabilities and Stockholders' Equity	<u>\$31,438,192</u>

See Notes to Balance Sheet.

MERRILL LYNCH PROFESSIONAL CLEARING CORP.

NOTES TO BALANCE SHEET (UNAUDITED)

AS OF JUNE 27, 2008

(Dollars in Thousands, Except Share and Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business— Merrill Lynch Professional Clearing Corp. (the “Company”) is registered as a broker-dealer with the Securities and Exchange Commission (“SEC”) and as a futures commission merchant with the Commodity Futures Trading Commission (“CFTC”). Services provided to clients include prime brokerage, securities financing, brokerage and clearing services to broker-dealers, introducing broker-dealers and other professional trading entities on a fully-disclosed basis. The Company also trades as an option market maker on the International Securities Exchange (“ISE”). The Company is a guaranteed subsidiary of Merrill Lynch, Pierce, Fenner & Smith Incorporated (“MLPF&S”). MLPF&S is a wholly-owned subsidiary of Merrill Lynch & Co., Inc. (“ML&Co.”).

Basis of Presentation— The Balance Sheet is presented in accordance U.S. Generally Accepted Accounting Principles, which include industry practices.

Use of Estimates— In presenting the Balance Sheet, management makes estimates regarding:

- Valuations of assets and liabilities requiring fair value estimates;
- The outcome of litigation;
- The realization of deferred taxes and the recognition and measurement of uncertain tax positions;
- The carrying amount of goodwill and other intangible assets;
- The amortization period of intangible assets with definite lives;
- Certain allocated liabilities, including valuation of share-based payment compensation arrangements, by ML&Co.; and
- Other matters that affect the reported amounts and disclosure of contingencies in the Balance Sheet.

Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ from those estimates and could have a material impact on the Balance Sheet, and it is possible that such changes could occur in the near term.

Fair Value Measurement— The Company accounts for its financial instruments at fair value or considers fair value in its measurement. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., the exit price). The Company accounts for certain financial assets and liabilities at fair value under various accounting literature, including Statement of Financial Accounting Standards (“SFAS”) No. 133, *Accounting for Derivative Instruments and Hedging Activities* (“SFAS No. 133”) and SFAS No. 159, *Fair Value Option for Certain Financial Assets and Liabilities* (“SFAS No. 159”). The Company also accounts for certain assets at fair value under applicable industry guidance, namely broker-dealer and investment company accounting guidance.

The Company early adopted the provisions of SFAS No. 157, *Fair Value Measurements* (“SFAS No. 157”) in 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair

value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements.

Fair values for certain exchange-traded derivatives, principally futures and certain options, are based on quoted market prices.

Legal Reserves— The Company regularly cooperates with regulatory inquiries and may be the subject of investigations and/or proceedings by governmental and self-regulatory agencies. In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company will accrue a liability when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. In many lawsuits and arbitrations, including class action lawsuits, it is not possible to determine whether a liability has been incurred or to estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case no accrual is made until that time. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, the Company cannot predict what the eventual loss or range of loss related to such matters will be.

Goodwill and Intangible Assets— Goodwill represents the cost of acquired businesses in excess of fair value of the related net assets at acquisition. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, (“SFAS No. 142”) goodwill is tested annually (or more frequently under certain conditions) for impairment. Intangible assets consist primarily of value assigned to customer relationships. Intangible assets with definite lives are tested for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (“SFAS No. 144”), whenever certain conditions exist which would indicate the carrying amount of such assets may not be recoverable. Intangible assets with definitive lives are amortized over their respective estimated useful lives.

Employee Stock Options— The fair value of stock options is estimated as of the grant date based on a Black-Scholes option pricing model. The Black-Scholes model takes into account the exercise price, expected life of the option, current price of the underlying stock and its expected volatility, expected dividends and the risk-free interest rate for the expected term of the option. Certain model inputs require management to exercise judgment. The expected life of the option is based on an analysis of an employee’s historical exercise behavior. The expected volatility is based on ML&Co’s historical monthly stock price volatility for the same number of months as the expected life of the option. The fair value of the option, estimated at grant date, is not adjusted for subsequent changes in assumptions.

Income Taxes— The Company provides for income taxes on all transactions that have been recognized in the Balance Sheet in accordance with SFAS No. 109, *Accounting for Income Taxes* (“SFAS No. 109”). Accordingly, deferred taxes are adjusted to reflect the tax rates at which future taxable amounts will likely be settled or realized. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. The Company assesses its ability to realize deferred tax assets primarily based on the earnings history and other factors of the Company through which the deferred tax assets will be realized as discussed in SFAS No. 109.

The Company recognizes and measures its unrecognized tax benefits in accordance with Financial Accounting Standards Board (“FASB”) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”). The Company estimates the likelihood, based on their technical merits, that tax positions will be sustained upon examination based on the facts and circumstances and information available at the end of each period. The Company adjusts the level of unrecognized tax benefits when there is more information available, or when an event occurs requiring a change. The reassessment of unrecognized tax benefits could have a material impact on the Company’s effective tax rate in the period in which it occurs.

Balance Sheet Captions— The following are descriptions related to specific balance sheet captions.

Cash and Cash Equivalents— The Company defines cash equivalents as short-term, highly liquid securities and interest-earning deposits with maturities, when purchased, of 90 days or less, other than those used for trading purposes. The amounts recognized for cash and cash equivalents in the Balance Sheet approximate fair value amounts.

Cash and Securities Segregated for Regulatory Purposes or Deposited with Clearing Organizations— The Company maintains relationships with clients and therefore it is obligated by rules mandated by its primary regulators, including the SEC and the CFTC in the United States, to segregate or set aside cash and/or qualified securities to satisfy these regulations, which have been promulgated to protect customer assets. In addition, the Company is a member of various clearing organizations at which it maintains cash and/or securities required for the conduct of its day-to-day clearance activities. The amounts recognized for cash and securities segregated for regulatory purposes or deposited with clearing organizations in the Balance Sheet approximate fair value amounts.

Securities Financing Transactions— The Company enters into repurchase and resale agreements and securities borrowed and loaned transactions to accommodate customers, finance firm inventory positions, obtain securities for settlement, and earn residual interest rate spreads (also referred to as “matched-book” transactions). The Company also engages in securities financing for customers through margin lending. See the *Other Receivables and Payables—Customer and Non-customer Transactions* section of this note for additional information.

Resale and repurchase agreements are accounted for as collateralized financing transactions and recorded at their contractual amounts, plus accrued interest. Resale and repurchase agreements recorded at their contractual amounts plus accrued interest approximate fair value since the fair value of these items is not materially sensitive to shifts in market interest rates because of the short-term nature of these instruments or to credit risk because the resale and repurchase agreements are fully collateralized.

The Company’s policy is to obtain possession of collateral with a market value equal to or in excess of the principal amount loaned under resale agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is generally valued daily, and the Company may require counterparties to deposit additional collateral or return collateral pledged, when appropriate.

Substantially all repurchase and resale activities are transacted under master netting agreements that give the Company the right, in the event of default, to liquidate collateral held and to offset receivables and payables with the same counterparty. The Company offsets certain repurchase and resale agreement balances with the same counterparty on the Balance Sheet.

The Company may use qualifying securities received as collateral for resale agreements to satisfy regulatory requirements such as Rule 15c3-3 of the SEC.

Securities borrowed and loaned transactions are recorded at the amount of cash collateral advanced or received. Securities borrowed transactions require the Company to provide the counterparty with collateral in the form of cash, letters of credit, or other securities. The Company receives collateral in the form of cash or other securities for securities loaned transactions. For these transactions, the fees received or paid by the Company are recorded as interest revenue or expense. On a daily basis, the Company monitors the market value of securities borrowed or loaned against the collateral value and the Company may require counterparties to deposit additional collateral or return collateral pledged, when appropriate. The carrying value of these instruments approximates fair value as these items are not materially sensitive to shifts in market interest rates because of their short-term nature and/or their variable interest rates.

Trading Assets and Liabilities— The Company’s trading activities consist of market making in listed options on the ISE. Trading assets and trading liabilities consist of listed options and cash equity securities

used for trading purposes or for managing risk exposure in trading inventory. See the *Derivatives* section for additional information on accounting policy for derivatives.

Trading assets and other cash instruments are recorded on a trade date basis at fair value, which is primarily based on quoted market prices. Included in trading liabilities are securities that the Company has sold but did not own and will therefore be obligated to purchase at a future date (“short sales”).

Derivatives— A derivative is an instrument whose value is “derived” from an underlying instrument or index, such as interest rates, equity securities, currencies, or credit spreads. Derivatives include futures, forwards, swap or option contracts, or other financial instruments with similar characteristics. Derivative contracts often involve future commitments to exchange interest payment streams or currencies based on a notional or contractual amount (e.g., interest rate swaps or currency forwards) or to purchase or sell other financial instruments at specified terms on a specified date (e.g., options to buy or sell securities or currencies). Derivative activity is subject to ML&Co.’s overall risk management policies and procedures.

Other Receivables and Payables—

Customer and Non-customer Transactions— Customer and non-customer securities and commodities transactions are recorded on a settlement date basis. Receivables from and payables to customers and non-customers include amounts due on cash and margin transactions, including futures contracts transacted on behalf of the Company’s customers. Due to their short-term nature, such amounts approximate fair value. Securities owned by customers and non-customers, including those that collateralize margin or other similar transactions, are not reflected on the Balance Sheet.

Brokers and Dealers Receivables and Payables— Receivables from brokers and dealers primarily include amounts receivable for securities not delivered by the Company to a purchaser by the settlement date (“fails to deliver”), margin deposits, commissions and net receivables arising from unsettled trades. Payables to brokers and dealers primarily include amounts payable for securities not received by the Company from a seller by the settlement date (“fails to receive”), and net payables arising from unsettled trades. Due to their short-term nature, the amounts recognized for brokers and dealers receivables and payables approximate fair value.

Interest and Other Receivables and Payables— Interest and other receivables include interest receivable on U.S. Government obligations, customer and non-customer receivables, securities financing transactions and receivables from dividends. Interest and other payables include interest payable for customer and non-customer payables, securities financing transactions and amounts payable for dividends.

Exchange Memberships— Exchange memberships are held at cost and reviewed for impairment.

Equipment and Facilities— Equipment and facilities primarily consist of furniture and fixtures, technology hardware and software, office equipment, and leasehold improvements. Equipment and facilities are reported at historical cost, net of accumulated depreciation and amortization. The cost of certain facilities shared with affiliates is allocated to the Company by ML&Co. based on the relative amount of space occupied.

Depreciation and amortization are computed using the straight-line method. Equipment is depreciated over its estimated useful life, while leasehold improvements are amortized over the lesser of the improvement’s estimated economic useful life or the term of the lease.

Loans Receivable— Loans receivable consists primarily of secured non-purpose loans extended to clients which are carried at the contract amounts. Interest rates are variable and are based on the daily effective Federal Funds rate and the Prime Rate, as disclosed in the Wall Street Journal.

Goodwill and Intangible Assets— ML&Co. has reviewed its goodwill in accordance with SFAS No. 142 and determined that the fair value of the reporting units to which goodwill related exceeded the carrying value of such reporting units. No goodwill impairment has been recognized. Intangible assets with definite lives are amortized over their estimated useful lives.

Other Assets and Other Liabilities— Other assets consist primarily of trade date accrual and deferred tax assets, which are mainly related to a net operating loss available for carryforward and other receivables. Other liabilities consist primarily of accrued expenses, taxes payables and compensation and benefits payable.

Borrowing Activities— The Company's funding needs are generally met by and dependent upon loans principally obtained from ML&Co. See Note 2, "Related Party Transactions," for further discussion.

New Accounting Pronouncements— In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, on Amendment of FASB Statement No. 133* ("SFAS No. 161"). SFAS No. 161 is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. SFAS No. 161 applies to all derivative instruments within the scope of SFAS No. 133. It also applies to non-derivative hedging instruments and all hedged items designated and qualifying as hedges under SFAS No. 133. SFAS No. 161 amends the current qualitative and quantitative disclosure requirements for derivative instruments and hedging activities set forth in SFAS No. 133 and generally increases the level of disaggregation that will be required in an entity's financial statements. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk related contingent features in derivative agreements. SFAS No. 161 is effective prospectively for financial statements issued for fiscal years beginning after November 15, 2008.

In February 2008, the FASB issued Staff Position ("FSP") No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. Under the guidance in FSP FAS 140-3, there is a presumption that the initial transfer of a financial asset and subsequent repurchase financing involving the same asset are considered part of the same arrangement (i.e. a linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing will be evaluated as two separate transactions under SFAS No. 140. FSP FAS 140-3 is effective for new transactions entered into in fiscal years beginning after November 15, 2008. Early adoption is prohibited. The Company is currently evaluating the impact of FSP FAS 140-3 on the Balance Sheet.

2. RELATED PARTY TRANSACTIONS

The Company has transactions with ML&Co., MLPF&S, Merrill Lynch Government Securities, Inc. ("MLGSI") and other companies affiliated by common ownership.

The Company enters into repurchase and resale agreements and securities borrowed and loaned transactions with other companies affiliated by common ownership to finance firm inventory positions and obtain securities for settlement.

The Company clears certain securities and commodities transactions through an affiliated company on a non-disclosed basis. Receivables from affiliated companies consist of omnibus accounts for securities and commodities transactions with MLPF&S on behalf of the Company’s clients. Payables to affiliated companies consist of loans from ML&Co. which are due on demand and bear interest based on ML&Co.’s average cost of funds.

Related party receivables are comprised of:

Receivables from affiliated companies	\$ 10,276,122
Receivables under resale agreements	4,039,119
Receivables under securities borrowed transactions	<u>128,222</u>
	<u>\$ 14,443,463</u>

Related party payables are comprised of:

Subordinated borrowings	\$ 2,150,000
Payables under repurchase agreements	1,882,160
Payables to affiliated companies	1,317
Payables under securities loaned transactions	<u>71</u>
	<u>\$ 4,033,548</u>

3. TRADING ACTIVITIES

Certain client trading activities, the Company’s selective proprietary positions, and the option market maker trading activities expose the Company to market and credit risks. These risks are managed in accordance with established risk management policies and procedures put in place by ML&Co.

Market Risk—Market risk is the potential change in an instrument’s value caused by fluctuations in interest and currency exchange rates, equity and commodity prices, credit spreads, or other risks. The level of market risk is influenced by the volatility and the liquidity in the markets in which financial instruments are traded.

Interest Rate Risk—Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. Interest rate swap agreements, Eurodollar futures, and U.S. Treasury securities and futures are common interest rate risk management tools. The decision to manage interest rate risk using futures or swap contracts, as opposed to buying or selling short U.S. Treasury or other securities, depends on current market conditions and funding considerations.

Equity Price Risk—Equity price risk arises from the possibility that equity security prices will fluctuate, affecting the value of equity securities and other instruments that derive their value from a particular stock. Instruments typically used by the Company to manage equity price risk include equity options and stocks. Equity options, for example, can require the writer to purchase or sell a specified stock at a future date.

Counterparty Credit Risk—The Company is exposed to risk of loss if an issuer or a counterparty fails to perform its obligations under contractual terms and the collateral held, if any, is deemed worthless (“default risk”).

The Company has established policies and procedures for mitigating credit risk on principal transactions, including reviewing and establishing limits for credit exposure, limiting transactions with specific counterparties, maintaining qualifying collateral and continually assessing the creditworthiness of counterparties.

In the normal course of business, the Company executes, settles, and finances various customer and non-customer securities and commodities transactions. Execution of these transactions includes the purchase and sale of securities by the Company. These activities may expose the Company to default risk arising from the potential that a customer, non-customer or counterparty may fail to satisfy their obligations. In these situations, the Company may be required to purchase or sell financial instruments at unfavorable market prices to satisfy obligations to its customers, non-customers or counterparties. The Company seeks to control the risks associated with its customer and non-customer margin activities by requiring customers and non-customers to maintain collateral in compliance with regulatory and internal guidelines.

Liabilities to other brokers and dealers related to unsettled transactions (i.e., securities failed-to-receive) are recorded at the amount for which the securities were acquired and are paid upon receipt of the securities from other brokers or dealers. In the case of aged securities failed-to-receive, the Company may be required, under industry regulations, to purchase the underlying securities in the market and seek reimbursement for any losses from the counterparty.

Concentrations of Credit Risk—The Company provides financing and related services to a diverse group of domestic and foreign clients including professional market participants. The Company's exposure to credit risk associated with these transactions is measured on an individual client basis, as well as by groups of clients that share similar attributes. To reduce the potential for risk concentration, credit limits are established and monitored in light of changing client and market conditions.

At June 27, 2008, the Company's most significant concentration of credit risk was with the U.S. Government and its agencies. The Company's indirect exposure results from maintaining U.S. Government and agencies securities as collateral for resale agreements. The Company's direct credit exposure on these transactions is with the counterparty; thus the Company has credit exposure to the U.S. Government and its agencies only in the event of the counterparty's default. Securities issued by the U.S. Government and its agencies held as collateral at June 27, 2008 totaled \$4,039,119, all of which was from affiliated companies.

The Company's most significant industry credit concentration is with financial institutions, including both affiliates and third parties. Financial institutions include other brokers and dealers, commercial banks, financing companies, insurance companies, and investment companies. This concentration arises in the normal course of the Company's brokerage, trading and financing activities.

Trading Derivatives—The fair values of the Company's trading derivatives, which consisted of futures and listed options, as of June 27, 2008 were \$283,250 in trading assets and \$268,100 in trading liabilities.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company adopted the provisions of SFAS No. 157 and SFAS No. 159 in 2007.

Fair Value Measurements — SFAS No. 157 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements. The Company accounts for a significant portion of its financial instruments at fair value or considers fair value in their measurements.

Fair Value Hierarchy

In accordance with SFAS No. 157, the Company has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets and liabilities recorded on the Balance Sheet are categorized based on the inputs to the valuation techniques as follows:

Level 1. Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access (examples include active exchange-traded equity securities, listed derivatives, most U.S. Government and agency securities, and certain other sovereign government obligations).

Level 2. Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

- a) Quoted prices for similar assets or liabilities in active markets (for example, restricted stock);
- b) Quoted prices for identical or similar assets or liabilities in non-active markets (examples include corporate and municipal bonds, which trade infrequently);
- c) Pricing models whose inputs are observable for substantially the full term of the asset or liability (examples include most over-the-counter derivatives, including interest rate and currency swaps); and
- d) Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability (examples include certain residential and commercial mortgage related assets, including loans, securities and derivatives).

Level 3. Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability (examples include private equity investments, certain residential and commercial mortgage related assets (including loans, securities and derivatives), and long-dated or complex derivatives including certain foreign exchange options and long dated options on gas and power).

As required by SFAS No. 157, when the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. Thus, a Level 3 fair value measurement may include inputs that are observable (Levels 1 and 2) and unobservable (Level 3). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Level 1 and 2 financial instruments entered into by the Company that economically hedge certain exposures to the Level 3 positions.

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities.

Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in/out of the Level 3 category as of the beginning of the quarter in which the reclassifications occur.

The following table presents the company fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of June 27, 2008:

Fair Value Measurements on a Recurring Basis				
As of June 27, 2008				
	Level 1	Level 2	Level 3	Total
Assets:				
Trading assets, excluding				
derivative contracts	\$ 63,327	\$ -	\$ -	\$ 63,327
Derivative contracts	283,250	-	-	283,250
Liabilities:				
Trading liabilities, excluding				
derivative contracts	\$ (563,630)	\$ -	\$ -	\$ (563,630)
Derivative contracts	(268,100)	-	-	(268,100)

Fair Value Option — SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities. Changes in fair value for assets and liabilities for which the election is made will be recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The Company did not elect the fair value option for any of its financial instruments that are under the scope of this pronouncement. As a result, SFAS No. 159 did not have an impact on the Balance Sheet as of June 27, 2008.

5. SECURITIES FINANCING TRANSACTIONS

The Company enters into repurchase and resale agreements and secured borrowing and lending transactions to finance trading inventory, to obtain securities for settlement, to meet customers' needs and to earn residual interest rate spreads.

Under these agreements and transactions, the Company receives collateral, including U.S. Government and agencies, and equity securities. The Company receives collateral in connection with resale agreements, securities borrowing transactions, customer margin loans, and other loans. Under many agreements the Company is permitted to sell or repledge the securities received as collateral and deliver to counterparties to cover short positions. At June 27, 2008, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was \$132,687,754, of which \$36,185,673 was received from affiliated companies. The fair value of these securities that had been sold or repledged was \$103,090,386, of which \$32,291,785 have been sold or repledged to affiliated companies.

6. SUBORDINATED BORROWINGS

At June 27, 2008, the amount available on the Company's revolving subordinated borrowing with ML&Co. was \$3,850,000, of which \$1,650,000 was outstanding, with a maturity date of April 30, 2010. This borrowing, which has been approved for regulatory capital purposes, bears interest at variable rates based on one month LIBOR (London Interbank Offered Rate).

On March 27, 2007, the Company entered into a subordinated loan agreement with ML&Co. for \$500,000, with a maturity date of April 30, 2010. This borrowing, which has been approved for regulatory capital purposes, bears interest at variable rates based on one month LIBOR (London Interbank Offered Rate). At June 27, 2008, the entire amount borrowed under this agreement was outstanding.

As of August 29, 2008, the Company decreased its outstanding balance of the revolving subordinated borrowing by \$950,000.

7. STOCKHOLDERS' EQUITY

The Company is authorized to issue 10,000 shares of \$1 par value preferred stock, with a liquidation preference of \$1,000, and 50,000 shares of \$1 par value common stock. During the period ended June 27, 2008, the Company issued and redeemed preferred stock, representing the Company's Joint Back Office arrangements with clients, of 300 and 725 shares, respectively. At June 27, 2008, there were 2,675 preferred and 3,000 common shares issued and outstanding.

8. COMMITMENTS, CONTINGENCIES AND GUARANTEES

Commitments—The Company has entered into various non-cancelable, long-term lease agreements for premises and equipment that expire through the year 2017. Future minimum rental commitments with initial or remaining terms exceeding one year as of June 27, 2008, are presented below:

Year Ending	Total
2009	\$ 5,768
2010	5,901
2011	5,515
2012	4,501
2013	4,357
Thereafter	<u>3,986</u>
Total	<u>\$ 30,028</u>

The minimum rental commitments shown above have not been reduced by \$502 of minimum sublease rentals to be received in the future under non-cancelable subleases. The amounts in the above table do not include amounts related to lease renewal or purchase options or escalation clauses providing for increased rental payments based upon maintenance, utility and tax increases.

Guarantees—The Company has one guarantee on behalf of a client with a foreign stock exchange for approximately \$7,875. The guarantee is secured by the assets in the client's accounts and has no expiration. No contingent liability is recorded on the Balance Sheet since this transaction is fully collateralized.

The Company provides guarantees in the form of standby letters of credit. The Company also provides guarantees to securities clearinghouses and exchanges. Under the standard membership agreement, members are required to guarantee the performance of other members. Under the agreements, if another member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet shortfalls. The Company's liability under these arrangements is not quantifiable and could exceed the cash and securities it has posted as collateral. However, management believes the potential for the Company to be required to make payments under these arrangements is remote. Accordingly, no contingent liability is carried on the Balance Sheet for these transactions.

The Company also obtains letters of credit from issuing banks to satisfy various counterparty collateral requirements in lieu of depositing cash or securities collateral. Letters of credit aggregated \$430,000 at June 27, 2008.

In connection with its prime brokerage business, the Company provides to counterparties guarantees of the performance of its prime brokerage clients. Under these arrangements, the Company stands ready to meet the obligations of its clients with respect to securities transactions. If the client fails to fulfill its obligation, the Company must fulfill the client's obligation with the counterparty. The Company is secured by the assets in the client's account as well as any proceeds received from the securities transaction entered into by the Company on behalf of the client. No contingent liability is carried on the Balance Sheet as the Company believes that potential for loss under these arrangements is remote.

In connection with its securities clearing business, the Company performs securities execution, clearance and settlement services on behalf of other broker-dealer clients for whom it commits to settle, with the applicable clearinghouse, trades submitted for or by such clients. Trades are submitted either individually, in groups or series, or if specific arrangements are made with a particular clearinghouse and client, all transactions with such clearing entity by such client. The Company's liability under these arrangements is not quantifiable and could exceed any cash deposit made by a client. However, management believes the potential for the Company to be required to make unreimbursed payments under these arrangements is remote due to the contractual requirements associated with clients' activity and the regular review of clients' capital. Accordingly, no contingent liability is carried on the Balance Sheet for these transactions.

9. EMPLOYEE BENEFIT PLANS

The Company provides retirement and other post employment benefits to its employees under plans sponsored by ML&Co.

Defined Contribution Plans—The U.S. defined contribution plan consists of the 401(K) Savings & Investment Plan ("401(K)"). This plan covers substantially all U.S. employees who have met service requirements.

Defined Benefit Pension Plans—ML&Co. has purchased a group annuity contract which guarantees the payment of benefits vested under a U.S. defined benefit plan that was terminated in accordance with the applicable provisions of the Employee Retirement Income Security Act of 1974. The Company also maintains arrangements to provide certain supplemental benefits for certain U.S. employees.

10. EMPLOYEE INCENTIVE PLANS

The Company participates in several employee compensation plans sponsored by ML&Co. which provide eligible employees with stock, options to purchase shares, and deferred cash compensation. These plans include the Long-Term Incentive Compensation Plans ("LTICP"), the Equity Capital Accumulation Plan ("ECAP"), and the Employee Stock Purchase Plan ("ESPP").

LTICP and ECAP—LTICP and ECAP provide for grants of equity and equity-related instruments of ML&Co. to certain key employees of the Company. LTICP consist of the Long-Term Incentive Compensation Plan, a shareholder approved plan used for grants to executive officers, and the Long-Term Incentive Compensation Plan for Managers and Producers, a broad-based plan which was approved by ML&Co.'s Board of Directors, but has not been shareholder approved. LTICP provide for the issuance of Restricted Shares, Restricted Units, and Non-qualified Stock Options, as well as Incentive Stock Options, Performance Shares, Performance Units, Performance Options, Stock Appreciation Rights, and other securities of ML&Co. ECAP, a shareholder-approved plan, provides for the issuance of Restricted Shares,

as well as Performance Shares. All plans under LTICP and ECAP may be satisfied using either treasury or newly issued shares of ML&Co. As of June 27, 2008, no instruments other than Restricted Shares, Restricted Units, Non-qualified Stock Options, Performance Options and Stock Appreciation Rights had been granted.

ESPP—The ESPP, which is approved by ML&Co.’s shareholders, allows eligible employees to invest from 1% to 10 % of their eligible compensation to purchase ML&Co.’s common stock, subject to legal limits. Beginning January 15, 2005, purchases were made at a discount equal to 5% of the average high and low market price on the relevant investment date.

11. INCOME TAXES

The Company is included in the consolidated U.S. federal income tax return, and certain combined and unitary state tax returns of ML&Co. ML&Co. allocates federal income taxes to its subsidiaries in a manner that approximates the separate company method. In addition, the Company files tax returns in certain states on a stand-alone basis. At June 27, 2008, the Company had a current tax payable to ML&Co. of \$40,804 recorded in *Other liabilities*.

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the Balance Sheet. These temporary differences result in taxable or deductible amounts in future years.

The Company’s deferred tax assets at June 27, 2008, which are included in *Other assets*, are comprised of:

Net operating loss	\$ 8,292
Deferred compensation	3,530
Stock options	2,099
Depreciation and amortization	2,392
Other, net	<u>(2,511)</u>
Net deferred tax asset	<u>\$ 13,802</u>

No valuation allowance was required at June 27, 2008.

At June 27, 2008, the Company had U.S. net operating loss carryforwards of approximately \$8,292, which is available to offset future taxable income, if any, for fiscal years ending in 2009 through 2027.

The Company had unrecognized tax benefits as of December 28, 2007 of \$11,648 in accordance with FIN 48. Of this total, approximately \$7,313 (net of federal benefit of state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective tax rate in future periods.

ML&Co. is under examination by the Internal Revenue Service (“IRS”) and states in which it has significant business operations, such as New York. The tax years under examination vary by jurisdiction.

Below is a chart of tax years that remain subject to examination by major tax jurisdiction:

Jurisdiction	Years Subject to Examination
US Federal	2005-2007
New York State and City	2002-2007
Massachusetts	2004-2007
California	1997-2007
Illinois	2004-2007
New Jersey	2004-2007
Pennsylvania	2004-2007

The IRS audit for the year 2004 was completed in the second quarter of 2008. IRS audits for the years 2005 and 2006 may be completed during the next twelve months. It is also reasonably possible that audits in states may conclude in 2008. While it is reasonably possible that a significant reduction in unrecognized tax benefits may occur within 12 months of June 27, 2008, quantification of an estimated range cannot be made at this time due to the uncertainty of the potential outcome of outstanding issues.

12. REGULATORY REQUIREMENTS

As a registered broker-dealer and futures commission merchant, the Company is subject to the higher of the net capital requirements of Rule 15c3-1 under the Securities Exchange Act of 1934 (the "Act") and the capital requirements of the CFTC of Rule 1.17. The Company computes its net capital under the alternative method permitted by Rule 15c3-1 which requires that minimum net capital shall not be less than 2% of aggregate debit items ("ADI") arising from customer transactions. The CFTC also requires that minimum net capital should not be less than 8% of the customer risk maintenance margin requirement plus 4% of the non-customer risk margin requirement. At June 27, 2008, the Company's regulatory net capital of \$1,346,119 was 17.70% of ADI and exceeded the minimum requirement of \$152,094 by \$1,194,025.

The Company is also subject to the customer protection requirements of Rule 15c3-3 under the Act. For the June 27, 2008 customer reserve computation, \$20 in cash deposited at a third party institution has been segregated in a special reserve account for the exclusive benefit of customers.

The Company also is required to perform a computation of reserve requirements for Proprietary Accounts of Introducing Brokers ("PAIB") pursuant to Rule 15c3-3 of the Act. At June 27, 2008, securities with a contract value of \$1,430,000 obtained under resale agreement with an affiliate have been segregated in a special reserve account for the exclusive benefit of PAIB.

As a futures commission merchant, the Company is required to perform computations of the requirements of Section 4d(2) and Regulation 30.7 under the Commodity Exchange Act. As of June 27, 2008, assets segregated and held in separate accounts totaled \$2,492,999 and exceeded requirements by \$597,548.

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