

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

BALANCE SHEET
AS OF JUNE 29, 2007
(UNAUDITED)

* * * * *

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 29, 2007 (UNAUDITED)

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

ASSETS		LIABILITIES AND STOCKHOLDERS' EQUITY	
<i>Cash and cash equivalents</i>	\$ 335,285	Liabilities:	
<i>Cash and securities segregated for regulatory purposes or deposited with clearing organizations</i>	1,135,434	<i>Securities financing transactions:</i>	
<i>Securities financing transactions:</i>		Payables under securities loaned transactions	25,000
Receivables under resale agreements	9,432,501	<i>Trading liabilities, at fair value</i>	
Receivables under securities borrowed transactions	<u>131,790</u>	Contractual agreements	\$ 1,184,020
	<u>9,564,291</u>	Equities and convertible debentures	<u>671,294</u>
<i>Trading assets, at fair value (includes securities pledged as collateral that can be sold or repledged of \$603,020)</i>			<u>1,855,314</u>
Contractual agreements	1,281,715	<i>Payables to affiliated companies</i>	127,235
Equities and convertible debentures	<u>551,410</u>	<i>Other payables:</i>	
	<u>1,833,125</u>	Customer and non-customer proprietary balances	37,901,304
<i>Receivables from affiliated companies</i>	24,892,251	Brokers and dealers	1,450,930
<i>Other receivables:</i>		Interest and other	<u>57,294</u>
Customer and non-customer proprietary balances	8,233,324		<u>39,409,528</u>
Brokers and dealers	847,411	<i>Other liabilities</i>	201,435
Interest and other	<u>26,955</u>	Total liabilities	<u>41,618,512</u>
	<u>9,107,690</u>	<i>Subordinated borrowings</i>	3,350,000
<i>Exchange Memberships, at cost</i>	33,630	Stockholders' Equity:	
<i>Equipment and facilities (net of accumulated depreciation and amortization of \$16,834)</i>	8,667	Preferred stock, \$1,000 liquidation preference per share; par value \$1 per share; 10,000 shares authorized; 3,370 shares issued and outstanding	3,370
<i>Loans receivable</i>	98,208	Common stock, par value \$1 per share; 50,000 shares authorized; 3,000 shares issued and outstanding	3
<i>Goodwill and other intangible assets</i>	32,996	Paid-in capital	1,431,631
<i>Other assets</i>	<u>67,277</u>	Retained earnings	<u>705,338</u>
Total Assets	<u>\$47,108,854</u>	Total stockholders' equity	<u>2,140,342</u>
		Total Liabilities and Stockholders' Equity	<u>\$47,108,854</u>

See Notes to Balance Sheet.

MERRILL LYNCH PROFESSIONAL CLEARING CORP.

NOTES TO BALANCE SHEET (UNAUDITED)

AS OF JUNE 29, 2007

(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 non-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 with accounting principles generally accepted in the United States of America, which include industry practices.

Financial Instruments—Fair value is used to measure many of our financial instruments. 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 early adopted the provisions of SFAS No. 157, Fair Value Measurements (“SFAS No. 157”) in the first quarter of 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. The impact of adopting SFAS No. 157 did not have a material effect on retained earnings.

The Company also early adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS No. 159”) in the first quarter of 2007 for certain financial instruments. Such instruments include resale agreements. The impact of adopting SFAS No. 159 did not have a material effect on retained earnings.

In presenting the Balance Sheet, management makes estimates regarding valuations of assets and liabilities requiring fair value measurements. These assets and liabilities include trading assets and liabilities and certain receivables under resale agreements.

Use of Estimates—In presenting the Balance Sheet, management makes estimates regarding certain trading inventory valuations, the outcome of litigation, the carrying amount of goodwill and other intangible assets, the realization of deferred tax assets and tax reserves, certain costs allocated by ML&Co., valuation of employee stock options, 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. It is possible that such changes could occur in the near term.

Substantially all financial instrument assets and liabilities are carried at fair value or amounts that approximate fair value. Fair values of financial instruments are disclosed in Note 3.

Trading Assets and Liabilities—Fair values of trading securities are based on quoted market prices. See the *Trading Assets and Liabilities* section for additional information.

Legal and Other Reserves—In accordance with Statement of Financial Accounting Standards (“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.

Impairment of Goodwill and Other Intangible Assets—SFAS No. 142 *Goodwill and Other Intangible Assets*, requires the Company to make certain subjective and complex judgments, including assumptions and estimates used to determine the fair value. The estimates used are based on historical experience, current knowledge, and available external information about future trends.

Employee Stock Options—The fair value of stock options is estimated as of the grant date based on the 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. 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—Deferred tax assets and liabilities are recorded for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the Balance Sheet. The Company assesses its ability to realize deferred tax assets primarily based on the earnings history and future earnings potential of the legal entity to which the deferred tax assets are attributable as discussed in SFAS No. 109, *Accounting for Income Taxes*. See Note 11 to the Balance Sheet for further discussion of income taxes.

Balance Sheet Captions—The following are descriptions related to specific balance sheet captions. Refer to the related footnotes for additional information.

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.

Cash and Securities Segregated for Regulatory Purposes or Deposited with Clearing Organizations—Cash and securities segregated for regulatory purposes or deposited with clearing organizations include cash and securities segregated in compliance with federal and other regulations and represent funds deposited by customers and funds accruing to customers as a result of trades or contracts. Also included are funds segregated in a special reserve account for the benefit of customers under Rule 15c3-3 of the SEC as well as funds segregated and held in separate accounts in accordance with Section 4d(2) and Regulation 30.7 of the Commodity Exchange Act.

Securities Financing Transactions—The Company enters into 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. The Company also engages in securities financing for customers through margin lending. See *Customer and Non-customer Proprietary Transactions* section of this note for additional information.

Resale agreements are accounted for as collateralized financing transactions and are recorded at their contractual amounts, plus accrued interest. 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 valued daily, and the Company may require counterparties to deposit additional collateral, when appropriate. Substantially all 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 may use 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. The Company receives collateral in the form of cash for securities loaned transactions. 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.

All firm-owned securities pledged to counterparties where the counterparty has the right, by contract or custom, to sell or repledge the securities are disclosed parenthetically in *Trading assets* on the Balance Sheet.

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

Trading assets and other cash instruments are recorded on a trade date basis at fair value. 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"). Fair values of trading assets and liabilities are based on quoted market prices.

Derivatives—A derivative is an instrument whose value is "derived" from an underlying instrument or index, such as a future, forward, swap or option contract, or other financial instrument 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).

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts ("embedded derivatives") and for hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the Balance Sheet and measure those instruments at fair value. Derivatives are often referred to as off-balance sheet instruments since neither their notional amounts nor the underlying instruments are reflected on the balance sheet; however, the fair values of trading derivatives are recorded in trading assets and liabilities. The fair value of all derivatives is recorded on a net-by-counterparty basis on the Balance Sheet where management believes the legal right of setoff exists under an enforceable netting agreement. Derivative instrument transactions are included in *Contractual agreements* on the Balance Sheet.

Fair values for certain exchange-traded derivatives, principally futures and options, are based on quoted market prices. Fair values for over-the-counter (“OTC”) derivative financial instruments, principally options, represent amounts estimated to be received from or paid to a third party in settlement of these instruments. These derivatives are determined using external pricing services.

Valuation adjustments are an integral component of the mark-to-market process and are taken for individual positions where either the sheer size of the trade or other specific features of the trade or particular market (such as counterparty credit quality or concentration or market liquidity) requires the valuation to be based on more than the simple application of the pricing models.

Other Receivables and Payables

Customer and Non-customer Proprietary Transactions—Customer and non-customer proprietary 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. 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”) 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.

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.

Borrowing Activities—Funding is principally obtained through loans from ML&Co. See Note 2, Related Party Transactions, for more discussion.

Stock Based Compensation—ML&Co. adopted the provisions of Statement No. 123 (revised 2004), *Share-Based Payment*, a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* (“SFAS No. 123R”) beginning in the first quarter of 2006. Under SFAS No. 123R, compensation expenses for share-based awards that do not require future service are recorded immediately, and share-based awards that require future service continue to be amortized into expense over the relevant service period. ML&Co. adopted SFAS No. 123R under the modified prospective method whereby the provisions of SFAS No. 123R are generally applied only to share-based awards granted or modified subsequent to adoption. Thus, for ML&Co., SFAS No. 123R required the immediate expensing of share-based awards granted or modified in 2006 to retirement-eligible employees, including awards that are subject to non-compete provisions.

Prior to the adoption of SFAS No. 123R, the Company had recognized expense for share-based compensation over the vesting period stipulated in the grant for all employees. This included those who had satisfied retirement eligibility criteria but were subject to a non-compete agreement that applied from the date of retirement through each applicable vesting period. Previously, ML&Co. had accelerated any unrecognized compensation cost for such awards if a retirement-eligible employee left the Company. However, because SFAS No. 123R applies only to awards granted or modified in 2006, expenses for

share-based awards granted prior to 2006 to employees who were retirement-eligible with respect to those awards must continue to be amortized over the stated vesting period.

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

Equipment and Facilities—Equipment and facilities primarily consist of technology hardware and software, 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. Maintenance and repair costs are expensed as incurred.

Loans Receivable—Loans receivable consists primarily of non-purpose loans extended to clients which are carried at amounts that approximate fair value.

Goodwill and Other Intangible Assets—Goodwill represents the cost of acquired businesses in excess of fair value of the related net assets at acquisition. In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 142, goodwill and indefinite-lived intangible assets are tested annually (or more frequently under certain conditions) for impairment. Other intangible assets are amortized over their useful lives. There are no intangible assets that were considered to be indefinite-lived at June 29, 2007. 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. Accordingly, no goodwill impairment loss has been recognized.

Other Assets and Other Liabilities—Other assets consist primarily of deferred taxes, 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.

Income Taxes—The results of operations of the Company are 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 and state and local tax expense based on a consolidated composite state tax rate. In addition, the Company files tax returns in certain states on a stand-alone basis. ML&Co. is under examination by the Internal Revenue Service (the “IRS”) in states in which it has significant business operations, such as New York. The tax years under examination vary by jurisdiction. IRS audits are in progress for the tax years 2004-2006. The IRS field audit for the 2004 and 2005 tax years is expected to be completed in 2008. New York State and New York City audits have commenced for the years 2002-2006.

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*. Accordingly, deferred taxes are adjusted to reflect the tax rates at which future taxable amounts will likely be settled or realized. The effects of tax rate changes on future deferred tax liabilities and deferred tax assets, as well as other changes in income tax laws, are recognized in the period during which such changes are enacted. Deferred tax assets and liabilities are included in *Other assets* on the Balance Sheet. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. See Note 11 for additional information.

New Accounting Pronouncements— On February 15, 2007 the Financial Accounting Standards Board (“FASB”) issued Statement No. 159, *The Fair Value Option for Financial Assets and Liabilities* (“SFAS No. 159”). 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, with changes in fair value 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. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007 provided that the entity: makes that choice in the first 120 days of that fiscal year; has not yet issued financial statements for any interim period of the fiscal year of adoption; and also elects to apply the provisions of Statement No. 157, *Fair Value Measurements* (“SFAS No. 157”). The Company adopted SFAS No. 159 in the first quarter of 2007. The impact of adopting SFAS No. 159 did not have a material effect on retained earnings.

In September 2006, the FASB issued SFAS No. 157. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and enhances disclosure about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category, including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 with early adoption permitted. The Company adopted SFAS No. 157 in the first quarter of 2007. The impact of adopting SFAS No. 157 did not have a material effect on the retained earnings.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company’s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 was adopted by the Company beginning in the first quarter of 2007 and the Company recognized no change to beginning retained earnings and to the liability for unrecognized tax benefits.

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 resale agreements and securities borrowed transactions to finance firm inventory positions, and obtain securities for settlement with affiliates.

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.

Receivables from affiliated companies are comprised of:

Receivables from affiliated companies	\$ 24,892,251
Receivables under resale agreements	9,432,501
Cash and securities segregated for regulatory purposes or deposited with clearing organizations	360,000
Receivables under securities borrowed transactions	131,790
Interest and other receivables	<u>1,497</u>
	<u>\$ 34,818,039</u>

Payables to affiliated companies are comprised of:

Subordinated borrowings	\$ 3,350,000
Payables to affiliated companies	127,235
Payables under securities loaned transactions	<u>25,000</u>
	<u>\$ 3,502,235</u>

3. TRADING AND RELATED 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 rates, equity and commodity prices 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.

The Company seeks to mitigate market risk associated with trading inventories by employing hedging strategies that correlate rate, price, and spread movements of trading inventories and related financing and hedging activities. The Company uses a combination of cash instruments and derivatives to hedge its market exposures. The following discussion describes the types of market risk faced by the Company.

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.

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 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.

Concentration 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 29, 2007, the Company's most significant concentration of credit risk was with the U.S. Government and its agencies. The Company does not have direct exposure to 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 29, 2007 totaled \$9,432,501, all of which was from an affiliated company.

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 29, 2007 were \$1,281,715 in trading assets and \$1,184,020 in trading liabilities.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company early adopted the provisions of SFAS No. 157 and SFAS No. 159 in the first quarter of 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. SFAS No. 157 nullifies the guidance provided by EITF 02-3 that prohibits recognition of day one gains or losses on derivative transactions

where model inputs that significantly impact valuation are not observable. In addition, SFAS No. 157 prohibits the use of block discounts for large positions of unrestricted financial instruments that trade in an active market and requires an issuer to incorporate changes in its own credit spreads when determining the fair value of its liabilities.

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 Consolidated 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 (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).

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 29, 2007:

	Fair Value Measurements on a Recurring Basis			
	As of June 29, 2007			
	Level 1	Level 2	Level 3	Total
Assets:				
Securities segregated for regulatory purposes	\$ 224,435	\$ 543	\$ -	\$ 224,978
Receivables under resale agreements	9,432,501	-	-	9,432,501
Trading assets, excluding contractual agreements	551,410	-	-	551,410
Contractual agreements	1,281,715	-	-	1,281,715
Receivables from affiliated companies ⁽¹⁾	24,892,251	-	-	24,892,251
Liabilities:				
Trading liabilities, excluding contractual agreements	\$ (671,294)	\$ -	\$ -	\$ (671,294)
Contractual agreements	(1,184,020)	-	-	(1,184,020)

(1) Receivables from affiliated companies consist of trading assets, trading liabilities and contractual agreements.

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.

For the six months ended June 29, 2007, the difference between fair value and the aggregate contractual principal amount of receivables under resale for which the fair value option has been elected was not material to the Balance Sheet.

5. SECURITIES FINANCING TRANSACTIONS

The Company enters into resale agreements and securities borrowed transactions to accommodate customers, finance firm inventory positions, obtain securities for settlement, and 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 29, 2007, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was \$165,776,330, of which \$67,325,090 was received from affiliated companies. The fair value of these securities that had been sold

or repledged was \$134,869,411, of which \$42,633,549 have been sold or repledged to affiliated companies.

6. SUBORDINATED BORROWINGS

At June 29, 2007, the amount available on the Company's revolving subordinated borrowing with ML&Co. was \$3,850,000, of which \$2,850,000 was outstanding, with a maturity date of April 30, 2009. 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 29, 2007, the entire amount borrowed under this agreement was outstanding.

During the period from June 30, 2007 to August 31, 2007, the Company reduced its outstanding balance of the revolving subordinated borrowing by a net amount of \$350,000.

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 29, 2007, the Company issued and redeemed preferred stock, representing the Company's Joint Back Office arrangements with clients, of 150 and 350 shares, respectively. At June 29, 2007, there were 3,370 preferred and 3,000 common shares issued and outstanding.

8. COMMITMENTS, CONTINGENCIES AND GUARANTEES

Leases—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 (exclusive of potential sublease rentals) with initial or remaining terms exceeding one year as of June 29, 2007, are presented below:

	Total
2008	\$ 4,964
2009	5,261
2010	5,388
2011	5,070
2012	4,279
2013 and thereafter	<u>7,963</u>
Total	<u>\$ 32,925</u>

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 \$6,752. 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 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.

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.

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, and state and local tax expense based on a consolidated composite state tax rate. At June 29, 2007, the Company had a current tax payable to ML&Co. of \$42,187 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 29, 2007, which are included in *Other assets*, are comprised of:

Net operating loss	\$ 11,400
Stock options	2,337
Restricted stock/Restricted Units	2,946
Deferred liability on intangible asset	(4,823)
Other, net	<u>2,028</u>
Net deferred tax asset	<u>\$ 13,888</u>

No valuation allowance was required at June 29, 2007.

At June 29, 2007, the Company had U.S. net operating loss carryforwards of approximately \$30,767, which is available to offset future taxable income, if any, for fiscal years ending in 2007 through 2025.

ML&Co. is under examination by the Internal Revenue Service (“IRS”), and other states in which ML&Co. has significant business operations, such as New York. The tax years under examination vary by jurisdiction. An IRS examination covering the years 2001-2003 was completed in 2006. The IRS audits are also in progress for the tax years 2004-2006. The IRS field audit for 2004 and 2005 tax years is expected to be completed in 2007. New York State and City audits for the years 1997-2001 were also completed in the third quarter of 2006 and did not have a material impact.

ML&Co. regularly assesses the likelihood of additional assessments in each of the tax jurisdictions resulting from these examinations. Tax reserves have been established which ML&Co. believes to be adequate in relation to the potential for additional assessments. ML&Co. will adjust the level of reserves when there is more information available, or when an event occurs requiring a change to the reserves. The reassessment of tax reserves could have a material impact on the Company’s effective tax rate.

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 Commodity Futures Trading Commission (“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 29, 2007, the Company’s regulatory net capital of \$1,664,324 was 82.77% of ADI and exceeded the minimum requirement of \$73,699 by \$1,590,625.

The Company is also subject to the customer protection requirements of Rule 15c3-3 under the Act. For the June 29, 2007 customer reserve computation, \$360,000 and \$250,022 in cash deposited at affiliates and a third party institution, respectively, have 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 29, 2007, securities with a contract value of \$5,545,000 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 29, 2007, assets segregated and held in separate accounts totaled \$1,621,470 and exceeded requirements by \$502,292.

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For additional information, the Company's 2006 annual audited report, filed pursuant to the Rule 17a-5 under the Securities Exchange Act of 1934, is available for examination and photocopying at the Company's headquarters at 222 Broadway, New York, New York 10038 and the Northeast Regional Office of the Securities Exchange Commission.