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Merrill Lynch Derivative Products AG | 2005 Annual Report







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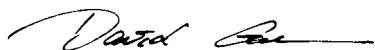
We enclose for your review the audited financial statements of Merrill Lynch Derivative Products AG (“MLDP”), for the years ended December 30, 2005 and December 31, 2004. A comparative analysis of MLDP’s swap portfolio is also included.

MLDP’s revenues for 2005 were \$57.1 million, of which intermediation income accounted for 56% of total revenues. Operating expenses were \$4.9 million for 2005 and net earnings were \$49.5 million.

The notional principal of MLDP’s swap transactions with third parties decreased \$15.7 billion to \$82.7 billion at December 30, 2005, down 16% from \$98.4 billion at December 31, 2004. MLDP had 1,832 transactions with 179 unaffiliated counterparties at December 30, 2005 compared to 2,006 transactions with 192 unaffiliated counterparties at December 31, 2004.

MLDP had total swap contracts, at fair value, of \$2.343 billion with unaffiliated third parties at December 30, 2005. Swap contracts totaling \$135 million receivable, represented the fair value of contracts with affiliates. A significant portion of MLDP’s swap contracts with third parties were with Aaa/AAA, Aa1/AA+, and Aa2/AA credit rated counterparties. Although MLDP is not subject to the Bank of International Settlements (“BIS”) capital requirements, MLDP evaluates its capital in terms of this internationally recognized measure of financial condition. The minimum requirement for Tier 1 capital to cover credit risk calculated using BIS standards was approximately \$49.2 million.

Sincerely,



David Gu

Chairman of the Board

Merrill Lynch Derivative Products AG

Statements of Earnings

for the years ended Dec 30, 2005 and Dec 31, 2004

(U.S. Dollars)	30/12/2005	31/12/2004
REVENUES		
Intermediation income from affiliates	32,067,300	38,096,300
Interest	12,508,800	6,775,100
Interest from affiliate	12,401,800	4,871,000
Administration income from affiliate	132,000	90,000
TOTAL REVENUES	57,109,900	49,832,400
EXPENSES		
Professional fees	2,161,900	1,951,300
Compensation & benefits	1,151,400	1,111,100
Communications & technology	818,600	890,600
Occupancy & related depreciation	166,500	174,100
Management fees	200,000	108,300
Market development	73,100	31,100
Bank transaction fees	86,800	74,000
Other	271,800	249,900
TOTAL EXPENSES	4,930,100	4,590,400
EARNINGS BEFORE INCOME TAXES	52,179,800	45,242,000
Income tax expense	2,646,800	1,867,500
NET EARNINGS	49,533,000	43,374,500
OTHER COMPREHENSIVE LOSSES (NET OF TAX):		
Accumulated other comprehensive expense	211,800	1,048,400
Comprehensive Earnings	49,321,200	42,326,100

See Notes to the Financial Statements

Balance Sheets

at Dec 30, 2005 and Dec 31, 2004

(U.S. Dollars)	30/12/2005	31/12/2004
ASSETS		
Cash and Cash Equivalents	4,064,100	2,861,400
Receivables		
Interest	3,232,000	1,029,200
Deferred Income taxes	714,100	350,000
Income taxes receivable current	–	7,240,800
Broker dealer receivable	28,702,800	12,523,800
Affiliated companies	141,401,900	385,828,000
Swap Assets		
Swap Contracts	2,208,469,500	2,708,316,800
Investment Securities – at fair value		
U.S. Government and agencies obligations	259,092,300	133,661,500
Foreign Government obligations		79,522,800
Corporate debt	263,607,300	267,333,400
Equipment and leasehold improvements	20,600	–
(net of accumulated depreciation and amortization of \$1,163,500 in 2005 and \$1,157,200 in 2004)		
Other Assets		
Prepaid management and rating agency fees	94,200	224,000
TOTAL ASSETS	2,909,398,800	3,598,891,700
LIABILITIES AND STOCKHOLDER'S EQUITY		
Overdrafts	16,255,400	400
Swap Liabilities		
Swap contracts	2,250,490,900	2,753,606,400
Unamortized swap payments	51,618,900	48,898,300
Other payables		
Income taxes payable current	385,300	1,170,800
Accounts payable & accrued expenses	13,585,500	394,100
Broker dealer payable	16,446,000	14,967,400
Affiliated companies	32,837,600	29,884,100
TOTAL LIABILITIES	2,381,619,600	2,848,921,500
STOCKHOLDERS' EQUITY		
Common Stock (\$2,772.09 par value 70,000 shares authorised issued and outstanding)	194,046,500	194,046,500
Paid in Capital (\$97,023,300 restricted as to distribution by legal regulation)	156,753,500	156,753,500
Net unrealized losses on investment securities	(397,700)	(356,000)
Retained Earnings	177,376,900	399,526,200
TOTAL STOCKHOLDERS' EQUITY	527,779,200	749,970,200
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	2,909,398,800	3,598,891,700

See Notes to the Financial Statements



Statements of Cash Flows

for the years ended Dec 30, 2005 and Dec 31, 2004

(U.S. Dollars)	30/12/2005	31/12/2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	49,533,000	43,374,500
Non cash items included in net earnings:		
Amortization of net discount on investment securities	(7,055,300)	(5,042,000)
Depreciation & amortization	6,300	12,000
(Increase)/decrease in operating assets:		
Interest receivable	(2,202,800)	(497,700)
Affiliated companies receivable	244,426,100	(135,025,900)
Broker dealer receivable	(16,179,000)	(8,832,200)
Prepaid management and rating agency fees	129,800	(49,000)
Swap contracts	(3,268,200)	(1,862,800)
Current income taxes receivable	7,240,800	(7,240,800)
Increase/(decrease) in operating liabilities:		
Unamortised swap payments	2,720,600	1,240,500
Current income taxes payable	(785,500)	(6,223,700)
Broker dealer payable	1,478,600	13,002,700
Accounts payable & accrued expenses	13,191,400	46,600
Affiliated companies payables	2,953,500	13,321,300
CASH (UTILISED)/PROVIDED BY OPERATING ACTIVITIES	292,189,300	(93,776,500)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from/(payments for):		
Drafts payable	16,255,000	(2,464,600)
Dividends paid on common stock	(271,682,300)	(6,735,300)
Dividends paid on preferred stock	—	(2,368,400)
CASH UTILISED FOR FINANCING ACTIVITIES	(255,427,300)	(11,568,300)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from/(payments for):		
Maturities of investment securities	1,065,668,100	1,350,634,400
Purchases of investment securities	(1,101,200,500)	(1,243,491,000)
Purchases of fixed assets	(26,900)	—
CASH (UTILISED)/PROVIDED BY INVESTING ACTIVITIES	(35,559,300)	107,143,400
INCREASE/(DECREASE) IN CASH	1,202,700	1,798,600
Cash at beginning of year	2,861,400	1,062,800
CASH AT END OF YEAR	4,064,100	2,861,400

Supplemental Disclosure of Cash Flow information Income tax payments totaled \$3,408,800 in 2005 and \$13,102,100 in 2004 via inter-company reimbursement. Interest payments totaled \$1,043,500 in 2005 and \$552,400 in 2004.

Supplemental Disclosure of Non Cash Investing Activities Net decrease in fair value of investment securities available-for-sale totaled \$41,700 and \$1,048,000, net of applicable income tax benefit at December 30, 2005 and December 31, 2004, respectively.

See Notes to the Financial Statements

Statement of Changes in Stockholders' Equity
for the years ended Dec 30, 2005 and Dec 31, 2004

(U.S. Dollars)	30/12/2005	31/12/2004
COMMON STOCK		
Balance, end of year	194,046,500	194,046,500
PAID-IN CAPITAL		
Balance, end of year	156,753,500	156,753,500
TOTAL CAPITAL	350,800,000	350,800,000
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Balance, beginning of year	(356,000)	692,400
Transfer to deferred tax asset	170,100	–
Net unrealized gain/(losses) on AFS securities, net of applicable income tax benefit	(211,800)	(1,048,400)
Balance, end of year	(397,700)	(356,000)
RETAINED EARNINGS		
Balance, beginning of year	399,526,200	365,255,400
Net Earnings	49,533,000	43,374,500
Dividends declared and paid:		
Preferred Stock	–	(2,368,400)
Common Stock	(271,682,300)	(6,735,300)
Balance, end of year	177,376,900	399,526,200
TOTAL STOCKHOLDERS' EQUITY	527,779,200	749,970,200

See Notes to the Financial Statements



Notes to the Financial Statements

for the years ended Dec 30, 2005 and Dec 31, 2004

1. Summary of Significant Accounting Policies

Description of Business

Merrill Lynch Derivative Products AG (MLDP), a subsidiary of Merrill Lynch & Co., Inc. ("ML&Co.") is organized to transact business in interest rate and currency swaps and related derivative products with counterparties rated A3 or better by Moody's Investors Service Inc., (Moody's) and A – or better by Standard & Poor's Ratings Group (S&P), or counterparties acceptable to the rating agencies. Also, MLDP guarantees specific swap transactions of certain Merrill Lynch affiliates.

MLDP conducts its business in global financial markets primarily located in the European, North American and Asian-Pacific regions. MLDP's financial results are closely tied to its level of intermediation revenues, which are influenced by a number of factors including economic and market conditions, political events, and investor sentiment. The reaction of participants in financial markets to a particular condition or event is unpredictable, and can result in volatility in the marketplace. While higher volatility can increase risk, it may also increase the volume of business transactions. Other global market and economic conditions, including the level and volatility of interest rates, currency valuations, competitive conditions, and the size, number, and timing of transactions may also affect MLDP's earnings. As a result, MLDP's earnings can vary significantly from year to year, and from quarter to quarter.

MLDP and Merrill Lynch Capital Services, Inc. (MLCS) have entered into an Intermediation and Security Agreement ("the Agreement") that governs the operations and activities of MLDP. In 2005 this agreement was amended to now include Merrill Lynch Capital Markets Bank (MLCMB). The Agreement requires that all transactions be introduced through MLCS or MLCMB and, with certain very limited exceptions, for each deal transacted by MLDP with a counterparty, MLDP is required to enter into an offsetting transaction with MLCS or MLCMB. MLCS and MLCMB are required to post collateral based on a formula outlined in the Agreement. The formula is based on the fair value of MLCS and MLCMB swaps with MLDP, calculations of certain market and credit exposures in the swap portfolio, and minimum collateral requirement.

MLDP has also entered into a Management Agreement which provides for the management of its operations by an unaffiliated third party in the event of early termination as defined in the Agreement.

Basis of Presentation

All amounts disclosed in these financial statements are expressed in U.S. Dollars and are prepared in accordance with generally accepted accounting principles and prevailing industry practices of the United States of America. Transactions denominated in currencies other than U.S. Dollars are converted to Dollars at the spot rate with the resulting gain or loss reflected in earnings of the current period.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States and prevailing industry practices requires management to make estimates that affect the reported amounts and disclosure of contingencies in the financial statements. Actual results could differ materially from those estimates.

Certain reclassifications and format changes have been made to prior year amounts to conform to the current year presentation.

The years ended December 30, 2005 and December 31, 2004 were 52 week periods.

Fair Value

Fair Value of Financial Instruments – The carrying amounts of the Company's financial instruments, which include all receivables and payables, approximate their respective fair values.

Trading Assets and Liabilities

Fair values of trading securities are based on quoted market prices, pricing models (utilizing indicators of general market conditions and other economic measurements), or management's estimates of amounts to be realized on settlement, assuming current market conditions and an orderly disposition over a reasonable period of time. Estimating the fair value of certain illiquid securities requires significant management judgment. Merrill Lynch values trading security assets at the institutional bid price and recognizes bid/offer revenues when assets are sold. Trading security liabilities are valued at the institutional offer price and bid-offer revenues are recognized when the positions are closed.

MLDP enters into interest rate and currency swaps, swap options, caps and floors, and forward rate agreements which are carried at their fair values. Balances with the same counterparty are offset, where applicable, according to the provisions of master netting agreements.

Fair values for over-the-counter ("OTC") derivative financial instruments, principally forwards, options, and swaps, represent the present value of amounts estimated to be received from or paid to a third-party in settlement of these instruments. These derivatives are valued using pricing models based on the net present value of estimated future cash flows and directly observed prices from exchange-traded derivatives, other OTC trades, or external pricing services, while taking into account the counterparty's credit ratings, or Merrill Lynch's own credit ratings, as appropriate. Obtaining the fair value for OTC derivatives contracts requires the use of management judgment and estimates.



New and/or complex instruments may have immature or limited markets. As a result, the pricing models used for valuation often incorporate significant estimates and assumptions, which may impact the results of operations reported in the financial statements. For long-dated and illiquid contracts, extrapolation methods are applied to observed market data in order to estimate inputs and assumptions that are not directly observable. This enables Merrill Lynch to mark-to-market all positions consistently when only a subset of prices are directly observable. Values for OTC derivatives are verified using observed information about the costs of hedging the risk and other trades in the market. As the markets for these products develop, Merrill Lynch continually refines its pricing models based on experience to correlate more closely to the market risk of these instruments. Unrealized gains at the inception of the derivative contract are not recognized unless the valuation model incorporates significant observable market inputs.

Valuation adjustments are an integral component of the fair valuation 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 simple application of the pricing models.

Cash and Cash Equivalents

Merrill Lynch defines cash and cash equivalents as short term, highly liquid securities, federal funds sold, and interest bearing deposits with original maturities of 90 days or less, that are not used for trading purposes.

Investment Securities

MLDP's investment securities are classified as "available for sale" and reported at fair value. Fair value is based on quoted market prices where available or pricing models, utilizing indicators of general market conditions or other economic measurements. Net unrealized investment gains and losses on these securities are reported as a separate component of accumulated other comprehensive income, net of applicable income taxes.

Eligible securities are limited to obligations of the U.S. Government and its agencies, municipals, and instruments issued or guaranteed by entities with long-term debt ratings of Aaa by Moody's and AAA by S&P. Pursuant to MLDP's investment policy, investments are restricted to issues with a remaining term to maturity of less than ten years. At December 30, 2005 approximately 72% of MLDP's investments had a maturity of less than 180 days.

Equipment and Facilities

Equipment and facilities, consisting of Office equipment, Computer equipment and Leasehold improvements, are reported at historical cost, net of accumulated depreciation and amortization. Facilities are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or the term of the lease. Equipment is depreciated using the straight-line method over the estimated useful life of the asset.

Interest Receivables and Payables

Interest receivable includes interest receivable on corporate and governmental obligations. Affiliated companies receivable includes interest receivable related to the intercompany advance. Affiliated payables includes interest payable related to the intercompany advance from ML&Co.

Prepaid Management Fee

A management fee is paid to the contingent manager obligated under the Management Agreement referred to previously, on a semi-annual basis, for services to be rendered in the following six-month period. These fees are amortized on a monthly basis over the term of the manager's obligation. Rating agency fees are paid quarterly to obtain counterparty risk ratings. These fees are amortized monthly.

Brokers dealer Receivables and Payables

Receivables from brokers and dealers include amounts receivable for securities not delivered by Merrill Lynch to a purchaser by the settlement date ("fails to deliver"), deposits for securities borrowed, margin deposits, commissions, and net receivables arising from unsettled trades. Payables to brokers and dealers include amounts payable for securities not received by Merrill Lynch from a seller by the settlement date ("fails to receive"), deposits received for securities loaned, and net payables arising from unsettled trades. Brokers and dealers receivables and payables also include amounts related to futures contracts transacted on behalf of Merrill Lynch customers.

Securities received as Collateral

MLDP receives collateral from MLCS and MLCMB under the terms of the Intermediation Agreement. Conservative valuations are applied to ensure that market value of the underlying collateral remains sufficient relative to the exposure. Collateral is valued daily, and MLDP may require MLCS and/or MLCMB to deposit additional collateral when appropriate.

Intermediation Revenues

A single up-front payment based on the present value of a stated percentage of the notional principal is payable in full on the effective date for each new swap transaction. A portion of these payments are recorded as unamortized swap payments and are amortized over the life of the swaps. These unamortized swap payments represent a liability for losses associated with early swap terminations and third party credit losses. The carrying value of unamortized swap payments approximates their fair value.

Income Taxes

MLDP is subject to Swiss corporate income taxes. In addition, to the extent that income is earned in the United States, it is subject to United States Federal, state and local taxes.

It is the policy of ML&Co. to allocate the current and deferred taxes associated with operating results to its subsidi-



aries in a manner which approximates the separate company method. ML&Co. and its affiliates use the asset and liability method in providing income taxes on all transactions that have been recognized in the financial statements.

MLDP provides for deferred income taxes resulting from temporary differences which arise from recording specific transactions, including certain reserves and the unrealized gains (losses) from investment securities available-for-sale, in different years for income tax reporting purposes than for financial reporting purposes.

Dividends

MLDP Holdings Inc. (the "Parent") received common stock dividends of \$271,682,300 and \$6,735,300 during 2005 and 2004, respectively, from MLDP.

New Accounting Pronouncements

In November 2005, the FASB issued FSP 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, which in conjunction with the Emerging Issues Task Force ("EITF") 03-1 resulted in additional disclosures for securities in an unrealized loss position effective for year-end 2003. Merrill Lynch previously implemented the disclosure requirements of EITF 03-1 in its December 26, 2003 Financial Statements. See Note 3 to the Consolidated Financial Statements for additional information.

2. Trading Assets and Liabilities

MLDP enters into derivative transactions, including interest rate and currency swaps, swap options, caps, and floors, and forward rate agreements, denominated in US and non-US currencies, as an intermediary between MLCS or MLCMB and counterparties rated A3 or better by Moody's or A- or better by S&P, or counterparties acceptable to both rating agencies. Swap agreements between counterparties entail the exchange of periodic payments based on specific interest rates applied to a specific notional or contractual amount.

Normally swap participants are exposed to off-balance sheet market risk, associated with unfavourable changes in underlying interest rates, currency exchange rates and other market rates. However, it is MLDP's policy to mitigate these risks through the execution of offsetting transactions with MLCS or MLCMB for each deal transacted. On a very limited basis, and only with respect to certain swaps, MLDP is not required to enter into fully offsetting transactions with MLCS. Rather, MLDP hedges the market risk of these swaps through the combination to the investment of the proceeds of the swap, and the execution of a hedging swap with MLCS.

Concentrations of Credit Risk

MLDP is exposed to credit risk associated with the execution of transactions with MLCS, MLCMB and other counterparties. The notional or contractual values of derivative agreements do not represent exposure to credit risk, which is limited to the current cost of replacing those contracts in a gain position. Credit risk represents the amount of accounting loss that MLDP would incur if a counterparty failed to perform its obligations under contractual terms and any collateral held, in respect of such counterparty, was deemed worthless. At December 30, 2005, MLDP had concentrations of credit risk in excess of \$50,000,000 per counterparty aggregating \$2,416,186,500 with 17 unaffiliated counterparties, MLCMB and MLCS. These counterparties, other than MLCS and MLCMB, had credit ratings ranging from Moody's Aaa to Aa3 and S&P's AAA to AA-.

At December 31, 2004, MLDP had concentrations of credit risk in excess of \$50,000,000 per counterparty aggregating \$3,121,056,800 with 21 unaffiliated counterparties and MLCS/MLCMB. These counterparties, other than MLCS/MLCMB, had credit ratings ranging from Moody's Aaa to Aa3 and S&P's AAA to AA-.

Pursuant to the Agreement, MLDP receives collateral from MLCS and MLCMB, including US Treasury Notes and Bills, to provide for potential portfolio credit and market exposures. At December 30, 2005 and December 31, 2004, MLDP received collateral with fair value totaling \$3,496,884,800 and \$2,728,789,100, respectively. MLDP may require counterparties to post collateral from time to time, however at December 30, 2005 and December 31, 2004, MLDP did not require collateral from any counterparty. MLDP also pledges collateral to certain counterparties, under standard trading terms. Under the terms of the Agreement, MLDP is entitled to pledge collateral received from MLCS and MLCMB to meet client obligations. MLDP's pledged collateral cannot be sold by MLDP's counterparties. At December 30, 2005 and December 21, 2004 no collateral was pledged to counterparties.

In addition to these specific exposures, MLDP's most significant industry concentration is with financial institutions. MLDP also has significant concentrations with certain sovereign governments. These concentrations arise in the normal course of MLDP's derivatives activities. MLDP's credit exposure arises from the risk of non performance of its counterparties in fulfilling their contractual obligations pursuant to its derivative transactions. This risk of non performance can be directly impacted by volatile or illiquid trading markets which may impair the counterparties' abilities to satisfy their obligations. As discussed above, certain provisions of the Agreement provide collateral for such portfolio concentration exposures.

Credit reserve calculation

There were no changes in the credit reserve requirement calculation during 2005.

For further analysis of credit and currency risk, see Portfolio Highlights on Page 20.



THE NOTIONAL OR CONTRACTUAL AMOUNTS OF MLDP'S FINANCIAL INSTRUMENTS ARE SET FORTH BELOW:

**(Notional or contractual amounts
in U.S. Dollar Millions)**

	30/12/2005	31/12/2004
Transactions with Third Parties and MLCS/MLCMB:		
Interest Rate and Currency Swaps-Third Parties	78,316	93,163
Interest Rate and Currency Swaps-MLCS/MLCMB	78,316	93,163
Options, Caps and Floors-Third Parties	4,391	5,236
Options, Caps and Floors-MLCS/MLCMB	4,391	5,236
Affiliate Transactions Guaranteed by MLDP:		
Interest Rate and Currency Swaps-Affiliate incl. MLCS/MLCMB	12,284	15,979
Options, Caps and Floors-Third Parties incl. MLCS/MLCMB	817	791

End of Period and Average Fair Value – The amounts presented below represent end of period and average fair values for MLDP's derivative financial instruments. Average fair values are derived using month end balances. The amounts include netting of offsetting transactions, where appropriate.

(U.S. Dollars)	End of Period Fair Value		Average Fair Value	
	30/12/2005	31/12/2004	30/12/2005	31/12/2004
SWAP CONTRACTS-ASSETS				
Third parties	2,342,983,300	3,687,152,500	2,799,746,500	2,656,754,300
MLCS	(179,916,200)	(978,835,700)	(453,282,700)	(297,203,800)
MLCMB	45,402,400	–	45,402,400	–
TOTAL	2,208,469,500	2,708,316,800	2,391,866,200	2,359,550,500
SWAP CONTRACTS-LIABILITIES				
Third parties	2,250,490,900	2,753,606,400	2,392,438,800	2,405,031,700



3. Investment Securities

Investment securities accounted for under SFAS No. 115 are classified as available-for-sale, held-to maturity, or trading as described in Note 1 to the Financial Statements.

MLDP's available-for-sale investment securities subject to SFAS No. 115 at December 30, 2005 and December 31, 2004 are as follows:

DECEMBER 30, 2005:

SECURITY TYPE (U.S. Dollars)	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
U.S. Government and agencies' obligations	259,731,500	259,092,300	—	(639,200)
Foreign government obligations	—	—	—	—
Corporate debt	263,730,000	263,607,300	—	(122,700)
TOTAL DEBT SECURITIES	523,461,500	522,699,600	—	(761,900)

MATURITIES

Due in one year or less	458,461,500	458,293,500
Due after one year through five years	65,000,000	64,406,100
TOTAL	523,461,500	522,699,600

DECEMBER 31, 2004:

SECURITY TYPE (U.S. Dollars)	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
U.S. Government and agencies' obligations	133,667,500	133,661,500	—	(6,000)
Foreign government obligations	79,595,900	79,522,800	—	(73,100)
Corporate debt	267,610,300	267,333,400	—	(276,900)
TOTAL DEBT SECURITIES	480,873,700	480,517,700	—	(356,000)

MATURITIES

Due in one year or less	450,940,600	450,615,300
Due after one year through five years	29,933,100	29,902,400
TOTAL	480,873,700	480,517,700

The majority of the unrealized losses relate to mortgage and asset-backed securities and U.S. Government and agencies securities. The majority of the investments are AAA-rated debentures and mortgage-backed securities issued by U.S. agencies. These investments are not considered other-than-temporarily impaired because MLDP has the ability and intent to hold the investments for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investment.

4. Commitments, Contingencies and Guarantees

MLDP guarantees specific swap obligations of certain affiliates. These affiliate guarantees are considered contingent liabilities for MLDP's calculation of the minimum collateral requirement. At December 30, 2005 and December 31, 2004, MLDP guaranteed certain transactions of affiliates under these arrangements, the fair value of these swap obligations totalling \$2,782,822,700 and \$2,500,074,000 respectively.

Guarantees

MLDP enters into certain derivative contracts that meet the accounting definition of a guarantee under FIN 45. FIN 45 defines guarantees to include derivative contracts that contingently require a guarantor to make payment to a guaranteed party based on changes in an underlying (such as changes in the value interest rates, security prices, currency rates, indices, etc) that relate to an asset, liability or equity security of a guaranteed party. Derivatives that meet the FIN 45 definition of guarantees include certain written options and swaptions. MLDP does not monitor whether its clients enter into these derivative contracts for speculative purposes or to protect against changes in an underlying that relates to an asset, liability of equity security of the client. Accordingly, MLDP has disclosed information about certain types of written options that can potentially be used by clients to protect against changes in an underlying.

For certain derivative transactions such as written interest rate caps and written currency options, the maximum payout is not quantifiable, because, for example, the rise in interest rates could theoretically be unlimited. In addition, MLDP does not monitor its exposure to derivatives in this manner. Instead, the notional value of these contracts has been included to provide information about these contracts. However, it should be noted that the notional value significantly overstates the exposure to these contracts.

MLDP records all derivative transactions at fair value on its balance sheet. As noted above, MLDP does not monitor its exposure to derivative contracts in terms of maximum payout. Instead, a risk framework is used to define risk tolerances and establish limits to ensure that certain risk-related losses occur within acceptable, predefined limits. MLDP economically hedges its exposure to these contracts by entering into a variety of offsetting derivative contracts and security positions.



TYPE OF GUARANTEE (U.S. Dollar Millions)	Maximum Payout/Notional	Carrying Value
Derivative contracts ¹⁾	2,198	18

(U.S. Dollar Millions)	Maximum Payout/ Notional	Less than 1 Year	1 – 3 Years	4 – 5 Years	Over 5 Years
Derivative contracts ¹⁾	2,198	1,000	361	740	97

¹⁾ As noted above, the notional value of derivative contracts is provided instead of the maximum payout amount.

5. Related Party Transactions

MLDP received Intermediation fees from Merrill Lynch Capital Services (MLCS) of \$29,062,600 in 2005 and \$38,096,300 in 2004 and from Merrill Lynch Capital Markets Bank (MLCMB) of \$3,004,700 in 2005 per the Intermediation and Security Agreement outlined in note 1. MLCS provides certain services to MLDP under the Agreement and acts as paying agent in the calculation and processing of swap payments. Professional fees incurred for services rendered by MLCS as paying agent were \$135,000 in 2005 and 2004.

MLDP provides operational procedures for MLCS under the Business Plan for Standard Bank South Africa Intermediation Agreement. Professional fees incurred for services rendered by MLDP were \$132,000 in 2005 and \$90,000 in 2004.

MLDP received Interest from a loan to Merrill Lynch Luxembourg Finance S.A. (MLLFSA) of \$12,401,800 and \$4,871,000 in 2005 and 2004 respectively. The loan outstanding as at 30 December 2005 and 31 December 2004 was \$141,401,900 and \$385,828,000, respectively.

Merrill Lynch Capital Markets AG (“MLCM”) provides certain accounting and computer support services to MLDP under a Service Agreement. The agreement also includes the provision of premises. Professional fees incurred for services rendered by MLCM were \$402,100 in 2005 and \$402,700 in 2004.

MLID Delaware provides certain services in the processing of swap payments. Professional fees incurred for services rendered by MLFSL were \$278,400 in 2005 and \$288,200 in 2004.

6. Income Taxes

Income tax consisted of:

(U.S. Dollars)	30/12/2005	31/12/2004
U.S. Federal:		
Current	2,345,100	4,634,600
US Branch Profits Tax at 5% of fall in net equity	–	450,000
U.S. State and Local:		
Current	102,000	201,700
Swiss:		
Current Tax prior year	(200,300)	(3,692,800)
Current Tax current year	400,000	274,000
Deferred	–	–
TOTAL	2,646,800	1,867,500

A reconciliation of the statutory U.S. Federal income tax rate to MLDP's effective tax rate is as follows:

(U.S. Dollars)	30/12/2005	31/12/2004
U.S. statutory Federal income tax rate	35.0%	35.0%
U.S. Branch Profits Tax	0%	5%
U.S. state and local income taxes net of Federal benefit	1.5%	1.5%
Swiss operations, net	(31.4%)	(37.4%)
TOTAL	5.1%	4.1%

As part of the consolidated group, MLDP transfers to ML&Co. its current U.S. Federal, state and local tax liabilities. During 2005 and 2004, MLDP transferred \$3,408,800 and \$11,324,300 to ML&Co. At December 30, 2005 and December 31, 2004, MLDP had U.S. current taxes payable to ML&Co. of \$209,100 and \$1,170,800 respectively. At December 30, 2005 MLDP had a U.S. deferred tax asset of \$364,100 and at December 31, 2004 a deferred tax asset of \$170,100. During 2005 MLDP received a net Swiss tax refund of \$6,606,300 and paid Swiss tax of \$4,259,700 in 2004. At December 30, 2005, MLDP had Swiss taxes payable of \$176,200. At December 31, 2004, MLDP had Swiss taxes receivable of \$7,240,800. At December 30, 2005 and December 31, 2004, MLDP had a Swiss deferred tax asset of \$350,000.



Portfolio Highlights for the years ended Dec 30, 2005 and Dec 31, 2004

CREDIT RISKS

Measured by notional principal, the below tables contain the proportion of MLDP's third party swap portfolio in each rating category. The total notional size of the portfolio on December 30, 2005 and December 31, 2004 was \$82.7 billion and \$98.4 billion, respectively.

(% of Portfolio)	30/12/2005	31/12/2004
MOODY'S RATING		
Aaa	51	55
Aa1	4	2
Aa2	15	19
Aa3	11	10
A1 to A3	17	13
Acceptable unrated counterparties	2	1

(% of Portfolio)	30/12/2005	31/12/2004
S&P'S RATING		
AAA	43	48
AA+	5	0
AA	16	24
AA-	8	8
A+ to A-	21	11
Acceptable unrated counterparties	7	9

The total positive net exposure to third parties was \$2,343 million and \$3,687 million at December 30, 2005 and December 31, 2004, respectively. The tables below contain the proportion of positive net exposures to third parties by credit ratings.

(% of Portfolio)	30/12/2005	31/12/2004
MOODY'S RATING		
Aaa	43	62
Aa1	6	1
Aa2	20	15
Aa3	8	10
A1 to A3	22	11
Acceptable unrated counterparties	1	1

(% of Portfolio)	30/12/2005	31/12/2004
S&P'S RATING		
AAA	35	58
AA+	7	0
AA	24	19
AA-	1	4
A+ to A-	30	17
Acceptable unrated counterparties	3	2

The fair value of MLDP's portfolio with MLCS/MLCMB at December 30, 2005, was \$135 million receivable compared with \$979 million payable at December 31, 2004. MLDP held collateral totaling \$3,497 million, (risk adjusted fair value \$3,212 million), at December 30, 2005 and \$2,729 million, (risk adjusted fair value \$2,476 million) at December 31, 2004, to cover the direct potential exposure to MLCS, MLCMB and other counterparties.

Portfolio Highlights for the years ended Dec 30, 2005 and Dec 31, 2004

PRODUCT COMPOSITION

On December 31, 2005, MLDP's portfolio contained 1,832 third party transactions with a total U.S. Dollar equivalent notional of \$82.7 billion as compared with 2,006 third party transactions with a total U.S. Dollar equivalent notional of \$98.4 billion as of December 31, 2004. The table below describes the allocation by notional principal among the product categories.

(% of Portfolio)	30/12/2005	31/12/2004
PRODUCT		
Interest Rate Swaps	66	69
Currency Swaps	28	26
Interest Rate and Currency Options	6	5

CURRENCY COMPOSITION

MLDP had swap positions denominated in 11 currencies at December 30, 2005 and at December 31, 2004. The relative composition of the portfolio, weighted by notional principal, is noted in the table below.

(% of Portfolio)	30/12/2005	31/12/2004
CURRENCY		
U.S. Dollar	40.9	38.7
Euro	33.4	35.4
Canadian Dollar	13.6	12.4
Japanese Yen	3.8	3.9
British Pound	3.8	3.7
Swiss Franc	2.4	3.1
Australian Dollar	1.2	1.6
Danish Krona	0.4	0.5
Swedish Krona	0.3	0.5
Norwegian Kroner	0.1	0.1
New Zealand Dollar	0.1	0.1



Portfolio Highlights for the years ended Dec 30, 2005 and Dec 31, 2004

MATURITY PROFILE

The average maturity of the portfolio was 7.69 years at December 30, 2005 and 8.15 years at December 31, 2004. The following table indicates the proportion of transactions, by notional principal, in each time band.

(% of Portfolio)	30/12/2005	31/12/2004
MATURITY		
Less than 3 years	51	46
3 – 5 years	14	23
5 – 10 years	22	19
Greater than 10 years	13	12

COUNTERPARTIES

Active unaffiliated counterparties, categorized by country in the table below, totaled 179 and 192 at December 30, 2005 and December 31, 2004, respectively.

(No. of Counterparties)	30/12/2005	31/12/2004
COUNTRY		
United States	66	71
Australia	21	21
Canada	17	17
Germany	14	15
United Kingdom	8	10
France	8	9
Spain	8	9
Netherlands	7	7
Sweden	5	5
Supranationals	5	1
Norway	4	4
Austria	3	5
Denmark	3	4
Ireland	2	4
Finland	2	2
Belgium	2	2
Switzerland	1	2
Luxembourg	1	2
Japan	1	1
Ivory Coast	1	0
New Zealand	0	1

Independent Auditors' Report

To the Board of Directors and Stockholders of Merrill Lynch Derivative Products AG

We have audited the accompanying balance sheets of Merrill Lynch Derivative Products AG (the "Company"), as of December 30, 2005 and December 31, 2004 and the related statements of earnings, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company at December 30, 2005 and December 31, 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

DELOITTE AG


Pavel Nemecek


Stephan Schmidli
Auditor in charge

Zurich, 23 April, 2006



Contact

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Merrill Lynch is a firm with strong,
forward momentum – in our
financial performance, our prospects
for growth, our client relationships
and the communities where we
live and work. With the interests
of our employees, clients and
shareholders aligned, we face the
future with a clear sense of
purpose and enthusiasm for the
opportunities that lie ahead.



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