Merrill Lynch

MERRILL LYNCH GOVERNMENT SECURITIES INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEET AS OF JUNE 29, 2007

(UNAUDITED)

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(Dollars in Thousands, Except Per Share Amount)

Assets

Cash and Cash Equivalents	$ 1,033,074
Cash and securities segregated for regulatory purposes or deposited with clearing organizations	761,985
Securities Financing Transactions:	
Receivables under resale agreements	117,922,525
Receivables under securities borrowed transactions	36,829,255
Total	154,751,780
Trading Assets, at Fair Value *(includes securities pledged as collateral that can be sold or repledged of $647,193)*	
U.S. Government and agencies	8,716,521
Mortgage-backed	7,642,371
Contractual agreements	1,138,663
Money markets	659,300
Total	18,156,855
Other Receivables:	
Brokers and dealers	2,202,133
Customer	844,977
Affiliates	218,802
Interest	277,566
Other	105,906
Total	3,649,384
Other Assets:	
Equipment and facilities (net of accumulated depreciation and amortization of $10,561)	588
Other	1,973
Total	2,561
Total Assets	$178,355,639

See Notes to Consolidated Balance Sheet (Unaudited).

Liabilities And Stockholder's Equity

Securities Financing Transactions:	
Payables Under Repurchase Agreements	$163,776,682
Trading Liabilities, at Fair Value:	
U.S. Government and agencies	7,650,446
Contractual agreements	1,193,389
Total	8,843,835
Other Payables:	
Customer	1,033,525
Brokers and dealers	544,313
Affiliates	762,011
Interest	107,180
Other	239,801
Total	2,686,830
Subordinated Borrowing	2,100,000
Total Liabilities	177,407,347
Stockholder's Equity:	
Common stock, $100 par value - 1,000 shares authorized; issued and outstanding	100
Paid-in capital	699,200
Retained earnings	248,992
Total	948,292
Total Liabilities and Stockholder's Equity	$178,355,639

(Dollars in Thousands)

1. Summary of Significant Accounting Policies

Description of Business - Merrill Lynch Government Securities Inc. ("MLGSI") is a wholly-owned subsidiary of Merrill Lynch & Co. Inc. ("ML&Co." or the "Parent") and is a primary dealer in obligations issued or guaranteed by the U.S. Government and regularly makes a market in securities issued by Federal agencies and other government-sponsored entities, such as, among others, Government National Mortgage Association, Fannie Mae and Freddie Mac. MLGSI deals in mortgage-backed pass-through instruments issued by certain of these entities and also in related futures, options, and forward contracts for its own account, to hedge its own risk, and to facilitate customers' transactions. As a primary dealer, MLGSI acts as a counterparty to the Federal Reserve Bank of New York ("FRBNY") in the conduct of open market operations and regularly reports positions and activities to the FRBNY. An integral part of MLGSI's business involves entering into repurchase agreements, reverse-repurchase agreements and securities borrowed transactions. MLGSI's wholly-owned subsidiary, Merrill Lynch Money Markets Inc., provides a full range of origination, trading, and marketing services for money market instruments, such as commercial paper, banker's acceptances, and certificates of deposit.

Basis of Presentation - The Consolidated Balance Sheet includes the accounts of Merrill Lynch Government Securities Inc. and its subsidiary (collectively, the "Company") and is presented in accordance with accounting principles generally accepted in the United States of America, which includes industry practices. Intercompany balances and transactions have been eliminated.

Use of Estimates - In presenting the Consolidated Balance Sheet, management makes estimates regarding certain trading inventory valuations, the outcome of litigation, certain costs allocated by the Parent, the realization of deferred tax assets, and other matters that affect the reported amounts and disclosure of contingencies in the Consolidated Balance Sheet. Estimates, by their nature, are based on judgment and available information. Actual results could differ from those estimates and could have a material impact on the Consolidated Balance Sheet. It is possible that such changes could occur in the near term.

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

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, other than those used for trading purposes.

Cash and Securities Segregated for Regulatory Purposes or Deposited with Clearing Organizations - 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.

Securities Financing Transactions - The Company enters into repurchase and resale agreements and securities borrowed transactions to accommodate customers (also referred to as "matched-book" transactions), and earn residual interest rate spreads, obtain securities for settlement and finance inventory positions.

Repurchase and 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 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 Consolidated Balance Sheet.

The Company may use securities received as collateral for resale agreements to satisfy certain regulatory requirements. At June 29, 2007, the Company has pledged $741,289 in securities obtained through resale agreements to satisfy regulatory requirements.

Securities borrowed transactions are recorded at the amount of cash collateral advanced. Securities borrowed transactions require the Company to provide the counterparty with collateral in the form of cash, letters of credit, or other securities. On a daily basis, the Company monitors the market value of securities borrowed 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 Consolidated Balance Sheet.

Interest rate swaps may be used to modify the interest rate characteristics of long-term resale and repurchase agreements. See the Derivatives section for additional information on the accounting policy for derivatives.

Trading Assets and Liabilities - The Company's trading activities consist primarily of securities trading, derivatives dealing and securities financing transactions. Trading assets and trading liabilities consist of cash instruments (such as securities) and derivative instruments used for trading purposes or for managing risk exposures in other trading inventory. See the Derivatives section for additional information on the accounting policy for derivatives.

Trading securities 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 securities are based on quoted market prices, pricing models (utilizing indicators of general market conditions or 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 trading assets and liabilities requires significant management judgment.

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 based on a notional or contractual amount (i.e., interest rate swaps) or to purchase or sell other financial instruments at specified terms on a specified date (i.e., options to buy or sell securities). Derivatives entered into by the Company include options on U.S. Treasury and mortgage-backed securities, interest rate swaps, and forward purchase and sale agreements on to-be-announced ("TBA") mortgage securities.

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 and hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the Consolidated Balance Sheet and measure those instruments at fair value. The fair value of all derivatives is recorded on a net-by-counterparty basis on the Consolidated Balance Sheet where management believes a legal right of setoff exists under an enforceable netting agreement.

The accounting for changes in fair value of a derivative instrument depends on its intended use and if it is designated and qualifies as an accounting hedging instrument.

The Company enters into derivatives to facilitate client transactions, for proprietary trading and financing purposes, and to manage its risk exposures arising from trading assets and liabilities. Derivatives entered into for these purposes are recognized at fair value on the Consolidated Balance Sheet as trading assets and liabilities in Contractual agreements.

Derivatives entered into in a non-trading capacity are designated, on the date they are entered into, as a hedge of the fair value of a recognized asset or liability. Changes in the fair value of a derivative that is designated and qualified as a fair value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk, are recorded in the current period. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Company also formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives are highly effective in offsetting changes in fair value of hedged items. The Company assesses effectiveness on a prospective basis by comparing the expected change in the price of the hedge instrument to the expected change in the value of the hedged item under an interest rate shock scenario. In addition, the Company assesses effectiveness on a retrospective basis using the dollar-offset ratio approach. If it is determined that a derivative is not highly effective as a hedge, the Company discontinues hedge accounting. Hedge effectiveness is assumed for those derivatives whose terms match the terms of the asset or liability being hedged and that otherwise meet the conditions of SFAS No. 133 “long-haul method.”

Valuation of Derivatives - Fair values for certain exchange-traded derivatives, principally futures and certain options, are based on quoted market prices. 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 the Company’s credit ratings as appropriate. Obtaining the fair value for OTC derivative contracts requires the use of management judgment and estimates.

Risk Management of Derivatives - The derivative activity of the Company is subject to the overall risk management policies and procedures of ML&Co. In the course of conducting its business operations, the Company is exposed to a variety of risks. These risks include market, credit, and other risks that are material and require comprehensive controls and management. (See Note 4 for further information on market and credit risks). The responsibility and accountability for these risks remain primarily with the Company. The ML&Co. risk management group ensures that these risks are properly identified, monitored, and managed. The Company has clearly defined risk tolerance levels that are regularly reviewed by the ML&Co. risk management group to ensure consistency with the Company’s business strategy, capital structure, and current and anticipated market conditions.

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”), commissions, and net receivables arising from unsettled trades. Payables to brokers and dealers 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. Brokers and dealers receivables and payables also include amounts related to futures contracts.

Interest and Other Receivables and Payables - Interest and other receivables include interest receivable on government obligations, customer or other receivables, and securities-borrowed transactions. Also included are receivables from income taxes, underwriting and advisory fees, commissions and fees, and other receivables. Interest and other payables include interest payable for short-term and long-term borrowings, payables for employee compensation and benefits, income taxes, non-trading derivatives, other reserves, and other payables.

Borrowing Activities - Funding is principally obtained through loans from the Parent (see Note 8) and repurchase agreements.

Income Taxes - The results of operations of the Company and its wholly-owned subsidiary are included in the consolidated U.S. federal income tax return, and certain combined and unitary state tax returns of the Parent. 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. The Parent is under examination by the Internal Revenue Service (the "IRS") and states in which it 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. 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 2007. New York State and City audits for the years 1997-2001 were also completed in 2006 and did not have a material impact on the Company.

The Company provides for income taxes on all transactions that have been recognized in the Consolidated 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 current period. Deferred tax assets and liabilities are included under Affiliates in other receivables and other payables, respectively, on the Consolidated Balance Sheet. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. See Note 9 to the Consolidated Balance Sheet for further information.

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.

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.

New Accounting Pronouncements - On February 15, 2007, the Financial Accounting Standard 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 early adopted SFAS No. 159 in the first quarter of fiscal 2007.

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 early adopted SFAS No. 157 in the first quarter of fiscal 2007 and the adoption did not have a material impact on the Consolidated Balance Sheet.

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. The Company adopted FIN 48 in the first quarter of 2007.

During the first quarter of 2006, the Parent 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"). 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. The Parent 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. The Company participates in the Parent's stock-based compensation plans and is affected by the Parent's adoption of SFAS No. 123R. Thus, for the Parent, 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. The Company is allocated its portion of expenses related to SFAS No. 123R awards.

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, the Parent 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.

In addition, beginning with performance year 2006, for which the Parent expects to grant stock awards in early 2007, the Company will accrue the expense for future awards granted to retirement-eligible employees over the award performance year instead of recognizing the entire expense related to the award on the grant date. Compensation expense for all future stock awards granted to employees not eligible for retirement with respect to those awards will be recognized over the applicable vesting period.

SFAS No. 123R also requires expected forfeitures of share-based compensation awards for non-retirement-eligible employees to be included in determining compensation expense. Prior to the adoption of SFAS No. 123R, any benefits of employee forfeitures of such awards were recorded as a reduction of compensation expense when the employee left the Company and forfeited the award. In the first quarter of 2006, the Company recorded a benefit based on expected forfeitures which was not material to the results of operations for the quarter.

The adoption of SFAS No. 123R, combined with other business and competitive considerations, prompted the Parent to undertake a comprehensive review of its stock-based incentive compensation awards, including vesting schedules and retirement eligibility requirements, examining their impact to the Parent, the Company and its employees. Upon the completion of this review, the Management Development and Compensation Committee of the Parent's Board of Directors determined that to fulfill the objective of retaining high quality personnel, future stock grants should contain more stringent retirement provisions. These provisions include a combination of increased age and length of service requirements. While the stock awards of employees who retire continue to vest, retired employees are subject to continued compliance with the strict non-compete provisions of those awards. To facilitate transition to the more stringent future requirements, the terms of most outstanding stock awards previously granted to employees, including certain executive officers, were modified, effective March 31, 2006, to permit employees to be immediately eligible for retirement with respect to those earlier awards. While the Parent modified the retirement-related provisions of the previous stock awards, the vesting and non-compete provisions for those awards remain in force.

Since the provisions of SFAS No. 123R apply to awards modified in 2006, these modifications required the Company to record additional one-time compensation expense in the first quarter of 2006 for the remaining unamortized amount of all awards to employees who had not previously been retirement-eligible under the original provisions of those awards.

2. Related Party Transactions

The Company participates with affiliated companies in the sale of certain securities to third parties. The Company earns a service fee from such sales. In addition, the Company makes payments to affiliated companies for certain services provided in the execution and settlement of securities transactions, pursuant to various service fee agreements. The charge for these services is based primarily on the volume of transactions processed.

The Company enters into derivative transactions with affiliates. The Company also borrows funds from and lends funds to affiliated companies for securities financing purposes. Interest charged on these transactions is based on prevailing interest rates during the year. In addition, the Company has a subordinated borrowing from ML&Co.

Affiliate-related balances included in the Consolidated Balance Sheet follow:

Assets:	
Receivables under resale agreements	$13,237,315
Cash and securities deposited with clearing organizations	54,762
Trading assets - Contractual agreements	125,378
Other receivables	218,802
TOTAL	$13,636,257
Liabilities:	
Payables under repurchase agreements	$53,355,288
Trading liabilities - Contractual agreements	529
Subordinated borrowing	2,100,000
Other payables	762,011
TOTAL	$56,217,828

3. 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's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of June 29, 2007.

	As of June 29, 2007 Fair Value			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Receivables under resale agreements		10,379		10,379
Trading assets, excluding contractual agreements	16,359	659	-	17,018
Contractual agreements	947	66	-	1,013
Liabilities:				
Payables under repurchase agreements		(6,494)		(6,494)
Trading liabilities, excluding contractual agreements	(7,654)	-	-	(7,654)
Contractual agreements	(1,104)	(86)	-	(1,190)

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 agreements and payables under repurchase agreements, for which the fair value option has been elected, was not material to the Consolidated Balance Sheet.

4. Trading Activities

The Company's trading activities primarily consist of providing securities brokerage, derivatives dealing and financing to both affiliates and third party clients. While trading activities are primarily generated by client order flow, the Company also takes proprietary positions based on expectations of future market movements and conditions. The Company's trading strategies rely on the integrated management of its client-driven and proprietary transactions, along with the hedging and financing of these positions.

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 the Parent.

***Market Risk* -** Market risk is the potential change in an instrument's value caused by fluctuations in interest rates or other market factors. 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 and price 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 principal market risks affecting the Company's financial instruments are interest rate risk and, with respect to mortgage-backed securities, prepayment risk. The following discussion describes these types of market risks faced by the Company.

***Interest Rate Risk* -** Interest rate risk arises from the possibility that changes in interest rates will affect the value of the Company's financial instruments. Interest rate swap agreements, futures, and U.S. Treasury securities and options 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.

***Prepayment Risk* -** Prepayment risk, which is related to interest rate risk, arises from the possibility that the rate of principal repayment on mortgages will fluctuate, affecting the value of mortgage-backed securities.

***Credit Risk* -** The Company is exposed to risk of loss if an individual, counterparty, or issuer fails to perform its obligations under contractual terms and the collateral held, if any, is deemed worthless ("default risk"). Both cash instruments and derivatives expose the Company to default risk. The Company has established policies and procedures for mitigating credit risk on principal transactions, including reviewing and establishing limits for credit exposure, maintaining qualifying collateral, and continually assessing the creditworthiness of counterparties.

In the normal course of business, the Company executes, settles, and finances various client or counterparty securities 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 counterparties 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 other counterparties. The Company seeks to control default risk by requiring counterparties 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 purchased, 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 purchase the underlying security in the market and seek reimbursement for losses from the counterparty.

The Company uses resale and repurchase agreements to finance securities and securities borrowed transactions, to facilitate settlement processes, and to meet customer needs. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. Government and agencies securities, mortgage-backed securities, or money market instruments. When providing collateral for these transactions, the Company delivers its own securities as well as securities owned by counterparties collateralizing resale agreements and other obligations.

Concentrations of Credit Risk - The Company's exposure to credit risk, associated with its trading and other activities, is measured on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. Concentrations of credit risk can be affected by changes in political, industry, or economic factors. To reduce the potential for risk concentration, credit limits are established and monitored in light of changing counterparty 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. This concentration consists of both direct and indirect exposures. Direct exposure, which primarily results from trading asset positions in instruments issued by the U.S. Government and its agencies, excluding mortgage-backed securities, amounted to $8,787,868 including interest. The Company's indirect exposure results from maintaining U.S. Government and agencies securities as collateral, primarily for resale agreements and securities borrowed transactions. 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 in the event of the counterparty's default. Securities issued by the U.S. Government or its agencies held as collateral for resale agreements and securities borrowed transactions at June 29, 2007 totaled $144,742,422.

The Company's most significant industry credit concentrations are with financial institutions and municipalities. Financial institutions include other brokers and dealers, commercial banks, finance companies, investment companies, and insurance companies. This concentration arises in the normal course of the Company's trading and financing activities.

Trading Derivatives - The Company's trading derivatives (contractual agreements) consist of derivatives provided to customers and derivatives entered into for proprietary trading strategies or risk management purposes.

Default risk is limited to the current cost of replacing derivative contracts in a gain position. Default risk exposure varies by type of derivative. Swap agreements and forward contracts are generally OTC-transacted and thus are exposed to default risk to the extent of their replacement cost. Since futures contracts are exchange-traded and usually require daily cash settlement, the related risk of loss is generally limited to a one-day net positive change in market value. Option contracts can be exchange-traded or OTC-transacted. Purchased options have default risk to the extent of their replacement cost. Written options represent a potential obligation to counterparties and typically do not subject the Company to default risk.

To reduce default risk, the Company requires collateral, principally U.S. Government and agencies securities, on certain derivative transactions. From an economic standpoint, the Company evaluates default risk exposures net of related collateral. In addition to obtaining collateral, the Company attempts to mitigate default risk on derivatives by entering into transactions with provisions that enable the Company to terminate or reset the terms of the derivative contract.

The Company generally enters into International Swaps and Derivative Association, Inc. master agreements or their equivalent ("master netting agreements") with each of its counterparties, as soon as possible. Master netting agreements provide protection in bankruptcy in certain circumstances and, in some cases, enable receivables and payables with the same counterparty to be offset on the Consolidated Balance Sheet, providing for a more meaningful balance sheet presentation of credit exposure.

5. Securities Financing Transactions

The Company enters into securities financing transactions to finance trading inventory positions, obtain securities for settlement, meet customer needs, and earn residual interest rate spreads.

The Company receives collateral in connection with resale agreements and securities borrowed transactions. Under many agreements, the Company is permitted to sell or repledge these securities held as collateral and use these securities to secure repurchase agreements or 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 $315,307,620, of which $13,237,315 was received from affiliated companies. The fair value of these securities that had been sold or repledged was $308,932,720, of which $53,355,291 have been sold or repledged to affiliated companies.

The Company pledges firm-owned assets, which are included in Trading assets, to collateralize repurchase agreements and other secured financings. Pledged securities that can be sold or repledged by the secured party are disclosed parenthetically in Trading assets on the Consolidated Balance Sheet.

The carrying value and classification of securities owned by the Company that have been pledged to counterparties where those counterparties do not have the right to sell or repledge as of June 29, 2007, are as follows:

U.S. Government and agencies	$ 6,213,604
Mortgage-backed	7,642,369
Money markets	250,038
TOTAL	$14,106,011

6. Commitments and Contingencies

Litigation - As of June 29, 2007, ML&Co. and/or certain of its subsidiaries, including the Company, have been named as parties in various actions, some of which involve claims for substantial amounts. Although the Company cannot predict what the eventual loss or range of loss related to such matters will be, the Company believes, based on information available, that the resolution of these actions will not have a material adverse effect on the financial condition of the Company, as set forth in the Consolidated Balance Sheet.

Other Commitments - In the normal course of business, the Company enters into when-issued and delayed delivery transactions. Settlement of these transactions as of June 29, 2007, would not have a material effect on the consolidated financial position of the Company.

In connection with its financing activities, the Company had commitments to enter into resale agreements at June 29, 2007 of $5,894,511.

The Company obtains standby letters of credit from issuing banks to satisfy various collateral requirements in lieu of the Company depositing collateral of securities or cash. There were no outstanding letters of credit at June 29, 2007.

Guarantees - The Company enters into certain derivative contracts that meet the accounting definition of a guarantee under FASB Interpretation No. 45 ("FIN 45"), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others – an Interpretation of FASB Statements No. 5, 57 and 107, and Rescission of FASB Interpretation No. 34,* which includes derivative contracts that contingently require a guarantor to make payment to a guaranteed party based on changes in an underlying, such as changes in interest rates or the value of a security. The Company 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. The Company economically hedges its exposure to these contracts by entering into a variety of offsetting derivative contracts and security positions. See the Derivatives section of Note 1 for further discussion of risk management of derivatives.

Guarantees under FIN 45 entered into by the Company consist of written put options on U.S. Treasury and mortgage-backed securities. The maximum payout under these options at June 29, 2007 was $13,610,900; the carrying value at that date was $51,526. These guarantees expire in less than one year.

In addition to the guarantees described above, the Company also provides guarantees to securities clearing houses 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, the potential for the Company to be required to make payments under these arrangements is remote. Accordingly, no liability is carried on the Consolidated Balance Sheet for these transactions.

7. Employee Benefit Plans

The Company participates in various benefit and incentive plans sponsored by ML&Co.

The defined contribution plans consist of the Retirement Accumulation Plan, the 401(k) Savings and Investment Plan and the incentive plan consists of the Employee Stock Ownership Plan. These plans are available to substantially all U.S. employees who have met service requirements.

8. Subordinated Borrowing

At June 29, 2007, the Company's subordinated borrowing amount outstanding with ML&Co. totaled $2,100,000. The subordinated borrowing agreement matures on October 15, 2007.

This borrowing is approved for regulatory capital purposes and accrues interest based on prevailing interest rates.

9. Income Taxes

The Company is included in the consolidated U.S. federal income tax return, and certain combined and unitary state tax returns of the Parent. The Parent 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. At June 29, 2007, the Company had a current tax payable to the Parent of $22,429.

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 Consolidated 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 Receivables, are comprised of:

Deferred Tax Assets:

Restricted stock	$11,799
Stock options	3,950
Reserves	1,774
Depreciation	(1,563)
Other	(6,791)
Net deferred tax asset	$ 9,169

The Parent is under examination by the IRS and states in which it 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. 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 2007. New York State and City audits for the years 1997-2001 were also completed in 2006 and did not have a material impact on the Company.

10. Stockholder's Equity

The Company is authorized to issue 1,000 shares of $100 par value common stock. At June 29, 2007, 1,000 shares were issued and outstanding.

11. Regulatory Requirements

As a primary U.S. Government securities dealer, the Company is subject to the financial responsibility requirements of Section 402.2 of the Regulations under Section 15C of the Securities Exchange Act of 1934 (the "Act"). The Act provides that the ratio of liquid capital to total haircuts (as defined) shall be maintained in excess of 1.2 to 1. At June 29, 2007, the Company's liquid capital, total haircuts, and ratio of liquid capital to total haircuts were $2,395,913, $872,415 and 2.75 to 1, respectively.

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Merrill Lynch

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For additional information, the Company's 2006 annual audit report, including comments from our auditor on a material inadequacy relating to certain unreconciled items, has been filed pursuant to Section 405.2 of Rule 15C under the Securities Exchange Act of 1934, and is available for examination and photocopying at the Company's headquarters at 4 World Financial Center, 250 Vesey Street, New York, New York, 10080 and the Northeast regional Office of the Securities and Exchange Commission.