

MERRILL LYNCH, PIERCE, FENNER & SMITH
INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
AS OF JUNE 29, 2007
(UNAUDITED)

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Merrill Lynch, Pierce, Fenner & Smith Incorporated
Member, Securities Investor Protection Corporation (SIPC)

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New York, New York 10080

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CONSOLIDATED BALANCE SHEET AS OF JUNE 29, 2007 (UNAUDITED)

(Dollars in Millions, Except Per Share Amounts)

ASSETS		LIABILITIES AND STOCKHOLDER'S EQUITY	
<i>Cash and cash equivalents</i>	\$ 3,091	Liabilities	
<i>Cash and securities segregated for regulatory purposes or deposited with clearing organizations</i>	3,804	<i>Securities financing transactions</i>	
<i>Securities financing transactions</i>		Payables under repurchase agreements (includes \$1,451 measured at fair value in 2007 in accordance with SFAS No. 159)	\$ 74,549
Receivables under resale agreements (includes \$12,264 measured at fair value in 2007 in accordance with SFAS No. 159)	31,623	Payables under securities loaned transactions	8,346
Receivables under securities borrowed transactions	<u>95,343</u>		<u>82,895</u>
	<u>126,966</u>	<i>Payables to affiliated companies</i>	75,644
<i>Trading assets, at fair value (includes securities pledged as collateral that can be sold or repledged of \$2,212)</i>		<i>Trading liabilities, at fair value</i>	
Mortgages and asset-backed	14,653	Equities and convertible debentures	7,736
Equities and convertible debentures	9,632	Contractual agreements	3,757
Corporate debt and preferred stock	9,512	Corporate debt and preferred stock	2,984
Contractual agreements	4,492	U.S. Government and agencies	1,807
Municipals	2,626	Municipals and money markets	412
Money markets	2,235	Non-U.S. Governments and agencies	305
U.S. Government and agencies	1,155	Mortgages and asset-backed	<u>51</u>
Non-U.S. Governments and agencies	<u>378</u>		<u>17,052</u>
	<u>44,683</u>	<i>Obligations to return securities received as collateral</i>	6,782
<i>Securities received as collateral</i>	6,782	<i>Other payables</i>	
<i>Receivables from affiliated companies</i>	55,695	Brokers and dealers	31,187
<i>Other receivables</i>		Customers	30,983
Customers (net of allowance for doubtful accounts of \$20)	12,251	Compensation and benefits	4,010
Brokers and dealers	11,011	Interest and other	<u>6,700</u>
Interest and other	<u>4,947</u>		<u>72,880</u>
	<u>28,209</u>	Total	<u>255,253</u>
<i>Other investments</i>	1,828	<i>Subordinated borrowings</i>	12,850
<i>Equipment and facilities</i>		Stockholder's Equity	
(net of accumulated depreciation and amortization of \$3,636)	1,313	Common stock, par value \$1,000 per share; 1,200 shares authorized; 1,000 shares issued and outstanding	1
<i>Goodwill and other intangible assets</i>	523	Paid-in capital	4,377
<i>Other assets</i>	<u>663</u>	Accumulated other comprehensive loss, net of taxes	(7)
		Retained earnings	<u>1,083</u>
Total Assets	<u>\$ 273,557</u>	Total Stockholder's Equity	<u>5,454</u>
		Total Liabilities and Stockholder's Equity	<u>\$ 273,557</u>

See Notes to Consolidated Balance Sheet.

MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (UNAUDITED) AS OF JUNE 29, 2007 (Dollars in Millions, Except Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business—Merrill Lynch, Pierce, Fenner & Smith Incorporated (“MLPF&S”), together with its subsidiaries (the “Company”), provides investment, financing, and related services to individuals and institutions on a global basis. Services provided to clients include securities brokerage, trading, and underwriting; investment banking, strategic advisory services, including mergers and acquisitions, and other corporate finance activities; origination, brokerage, dealer and related activities in swaps, options, forwards, exchange-traded futures, other derivatives and foreign exchange products; securities clearance and settlement financing services and investment advisory and related record keeping services. The Company is a wholly owned subsidiary of Merrill Lynch & Co., Inc. (the “Parent”). The Company’s principal subsidiary is Merrill Lynch Professional Clearing Corp. (“MLPCC”).

Basis of Presentation—The Consolidated Balance Sheet includes the accounts of MLPF&S and its subsidiaries and is presented in accordance with accounting principles generally accepted in the United States of America, which include industry practices. Intercompany transactions and balances have been eliminated.

The Consolidated Balance Sheet is presented in U.S. dollars. The Company’s non-U.S. subsidiary has a functional currency (i.e., the currency in which activities are primarily conducted) of Singapore dollars. The non-U.S. subsidiary’s assets and liabilities are translated to U.S. dollars at June 29, 2007 exchange rates, while revenues and expenses are translated at average exchange rates during the six months ended June 29, 2007. Adjustments that result from translating amounts in the entity’s functional currency and related hedging, net of related tax effects, are reported in stockholder’s equity as a component of *Accumulated other comprehensive loss*. As of July 25, 2007, the Company’s non-U.S. subsidiary was transferred to an affiliate.

At June 29, 2007, approximately \$50,379 of assets, \$44,463 of liabilities and \$3,350 of subordinated borrowings were attributable to consolidated subsidiaries. The aggregate stockholder’s equity of these subsidiaries was \$2,566 at June 29, 2007.

Securitization Activities—In the normal course of business, the Company securitizes: commercial and residential mortgage loans and home equity loans and other types of financial assets. The Company may retain interests in the securitized financial assets through holding tranches of the securitization. In accordance with SFAS No. 140, the Company recognizes transfers of financial assets as sales, provided control has been relinquished. Control is considered to be relinquished when all of the following conditions have been met:

- a. The transferred assets have been legally isolated from the transferor even in bankruptcy or other receivership;

- b. The transferee has the right to pledge or exchange the assets it received or, if the entity is a QSPE (a passive entity with significantly limited permitted activities that is used as a securitization vehicle and is limited in the type of assets it may hold, the derivatives it can enter into and the level of discretion it may exercise through servicing activities), the beneficial interest holders have that right; and
- c. The transferor does not maintain effective control over the transferred assets (e.g. the ability to unilaterally cause the holder to return specific transferred assets).

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 certain repurchase and resale agreements. The impact of adopting SFAS No. 159 did not have a material effect on retained earnings.

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

Use of Estimates—In presenting the Consolidated Balance Sheet, management makes estimates regarding certain trading inventory valuations and investment securities, 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 the Parent, customer award liabilities, valuation of employee stock options, and other matters that affect the reported amounts and disclosure of contingencies. 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 Consolidated 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 trading derivatives are disclosed in Note 3.

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

Legal and Other Reserves—The Company has been named as a defendant in various legal actions, including arbitrations, class actions, and other litigation arising in connection with its

activities as a diversified financial services institution. The Company is also involved in investigations and/or proceedings by governmental and self-regulatory agencies. 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. Certain model inputs require management to exercise judgment. The expected life of the option is based on an analysis of an employee’s historical exercise behavior. The expected volatility is based on the Parent’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 Consolidated 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 entities to which the deferred tax assets are attributable as discussed in SFAS No. 109, *Accounting for Income Taxes*. See Note 12 to the Consolidated Balance Sheet for further discussion of income taxes.

Restricted Investments—The Company holds investments that may have quoted market prices but that are subject to restrictions (e.g., requires consent of the issuer or other investors to sell) that may limit the Company’s ability to realize the quoted market price. Restricted investments may be recorded in either trading assets or other investments. The Company estimates the fair value of these securities taking into account the restrictions, which may result in a fair value for a security that is less than its quoted market price.

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 maintains relationships with clients and therefore it is obligated by

rules mandated by its primary regulators, including the Securities and Exchange Commission (“SEC”) and the Commodities Futures Trading Commission (“CFTC”) in the United States, to segregate or set aside cash and/or qualified securities to satisfy these regulations, which have been promulgated to protect customer assets. In addition, the Company is a member of various clearing organizations at which it maintains cash and/or securities required for the conduct of its day-to-day clearance activities.

Securities Financing Transactions—The Company enters into repurchase and resale agreements and securities borrowed and loaned transactions to accommodate customers (also referred to as “matched-book” transactions), 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 the *Other Receivables and Payables—Customer Transactions* section for additional information.

Resale and repurchase agreements are accounted for as collateralized financing transactions and are recorded at their contractual amounts, plus accrued interest or at fair value under the fair value option election in SFAS No. 159. Resale and repurchase agreements recorded at fair value are generally valued based on pricing models that use inputs with observable levels of price transparency. 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.

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.

Securities borrowed and loaned transactions are recorded at the amount of cash collateral advanced or received. Securities borrowed transactions require the Company to provide the counterparty with collateral in the form of cash, letters of credit, or other securities. The Company receives collateral in the form of cash or other securities for securities loaned transactions. 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. Although substantially all securities borrowing and lending activities are transacted under master netting agreements, such receivables and payables with the same counterparty are not offset on the Consolidated Balance Sheet.

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.

Transactions where the Company acts as the lender in a securities lending agreement and receives securities that can be pledged or sold as collateral are recognized on the Consolidated Balance Sheet as an asset, representing the securities received (*Securities received as collateral*), and a

liability for the same amount, representing the obligation to return those securities (*Obligations to return securities received as collateral*).

Trading Assets and Liabilities—The Company’s trading activities consist primarily of securities brokerage, trading and underwriting; derivatives dealing and brokerage; and securities financing transactions. Trading assets and trading liabilities consist of cash instruments (such as securities) and derivative financial instruments 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, pricing models (utilizing indicators of general market conditions or other economic measurements), or management’s best estimates of amounts to be realized on settlement, assuming current market conditions and an orderly disposition over a reasonable period of time. As previously noted, 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 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 Consolidated 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 Consolidated 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 Consolidated Balance Sheet. Such transactions with affiliates are included in affiliated company balances.

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 amounts estimated to be received from or paid to a third party in settlement of these instruments. These derivatives are determined 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.

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 level of precision in the Consolidated Balance Sheet. 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 the Company to mark all positions consistently when only a subset of prices are directly observable. Values for nonexchange-traded 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, the Company continually refines its pricing models based on experience to correlate more closely to the market risk of these instruments.

Valuation adjustments are an integral component of the valuation process for financial instruments that are carried at fair value but not traded in active markets (i.e. those transactions that are categorized in Levels 2 and 3 of the SFAS No. 157 fair value hierarchy. See Note 4 to the Consolidated Balance Sheet for further information related to the SFAS No. 157 fair value hierarchy). These adjustments may be taken when either the sheer size of the trade or other specific features of the trade or particular market (such as counterparty credit quality, concentration or market liquidity) requires adjustment to the values derived from the pricing models, and other market participants would also consider such an adjustment in pricing the financial instrument. For trades that may have quoted market prices but are subject to sales restrictions, the Company estimates the fair value of these securities taking into account such restrictions, which may result in a fair value that is less than the quoted market price.

Other Receivables and Payables—Customer Transactions—Customer securities and commodities transactions are recorded on a settlement date basis. Receivables from and payables to customers include amounts due on cash and margin transactions, including futures contracts transacted on behalf of the Company’s customers. Securities owned by customers, including those that collateralize margin or other similar transactions, are not reflected on the Consolidated Balance Sheet.

Brokers and Dealers Receivables and Payables—Receivables from brokers and dealers primarily include amounts receivable for securities not delivered by the Company to a purchaser by the settlement date (“fails to deliver”), margin deposits, commissions and net receivables arising from unsettled trades. Payables to brokers and dealers primarily include amounts payable for securities not received by the Company from a seller by the settlement date (“fails to receive”), and net payables arising from unsettled trades. Broker and dealer receivables and payables also include amounts related to futures contracts transacted on behalf of customers.

Interest and Other Receivables and Payables—Interest and other receivables include interest receivable on corporate and government obligations, customer receivables, stock borrowed transactions, receivables from commissions and fees, dividends and income taxes. Interest and other payables include interest payable for corporate and government obligations, customer payables, stock loan transactions, reserves and income taxes.

Compensation and Benefits Payable—Compensation and benefits payable consist of salaries payable, financial advisor compensation, incentive and deferred compensation, payroll taxes, pension and other employee benefits.

Other Investments—As part of the Company’s investing activities, certain equity investments are held at fair value and are included in *Other investments*. The cost basis of each investment sold is specifically identified for purposes of computing realized gains and losses. Fair value of investments, including partnership interests, is estimated using a number of methods, including

earnings multiples, cash flow analyses, and review of underlying financial conditions and other market factors. Accordingly, the Company's current estimate of fair value and the ultimate realization on these investments may differ.

Equipment and Facilities—Equipment and facilities primarily consist of technology hardware and software, leasehold improvements, and owned facilities. Equipment and facilities are reported at historical cost, net of accumulated depreciation and amortization, except for land, which is reported at historical cost. The cost of certain facilities shared with affiliates is allocated to the Company by the Parent 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.

Qualifying costs incurred in the development of internal-use software are capitalized when costs exceed \$5 and amortized over the useful life of the developed software, generally not exceeding three years.

Goodwill and Other Intangibles— Goodwill represents the cost of acquired businesses in excess of fair value of the related net assets at acquisition. In accordance with SFAS No. 142, goodwill and 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. The Parent 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—Other assets consist primarily of prepaid pension expense related to plan contributions in excess of obligations, other prepaid expenses, deferred deal related expenses and other deferred charges.

Borrowing Activities—Funding is principally obtained through loans from the Parent (see Note 7) and repurchase agreements.

Stock Based Compensation—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") 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. 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. 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.

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.

Income Taxes—The results of operations of the Company and its wholly owned subsidiaries are 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. The Parent 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 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 period during which such changes are enacted. Deferred tax assets and liabilities are included in *Interest and other receivables* and *Interest 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 12 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 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 enters into repurchase and resale agreements and securities borrowed and loaned transactions to finance firm inventory positions, and obtain securities for settlement with other companies affiliated by common ownership. The Company also engages in trading activities such as providing securities brokerage, dealing, financing and underwriting services with affiliated companies.

The Company clears certain securities and commodities transactions through or for other affiliated companies on both a fully-disclosed and non-disclosed basis. Pursuant to agreements, the Company receives or pays a fee for such services.

The Company also has been engaged by an affiliate to provide services to asset management customers. Pursuant to an agreement, the Company receives a fee for such services.

Receivables from affiliated companies are composed of:

Receivables under resale agreements	\$ 31,131
Receivables under securities borrowed transactions	11,517
Trading assets	4,087
Uncollateralized, variable-rate term loans	3,081
Customers	1,719
Brokers and dealers	1,317
Other	2,843
	<u>\$ 55,695</u>

Payables to affiliated companies are composed of:

Payables under securities loaned transactions	\$ 28,769
Due to parent, net	15,404
Trading liabilities	9,481
Payables under repurchase agreements	9,084
Brokers and dealers	6,511
Customers	3,789
Uncollateralized, variable-rate term loans	2,014
Other	592
	<u>\$ 75,644</u>

The Company obtains financing from the Parent in the normal course of business. Amounts due to the Parent primarily include the following: \$12,979 of U.S. dollar-denominated, uncollateralized obligations at variable interest rates based on the 30-day commercial paper rate; and \$1,575 of collateralized, short-term borrowings outstanding under two revolving loan agreements with available commitments totaling \$1,800. Borrowings outstanding under these agreements, which mature 12 months following demand, are collateralized by fixed assets and securities.

3. TRADING ACTIVITIES

The Company's trading activities include providing securities brokerage, dealing, financing and underwriting services to both affiliated and third party clients. While trading activities are primarily generated by client order flow, the Company also takes selective 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 positions, along with the related hedging and financing. 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 and currency exchange rates, equity and commodity prices, credit spreads, or other risks. The level of market risk is influenced by the volatility and the liquidity in the markets in which financial instruments are traded.

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.

Interest rate agreements used by the Company include caps, collars, floors, basis swaps, leveraged swaps and options. Interest rate caps and floors provide the purchaser with protection against

rising and falling interest rates, respectively. Interest rate collars combine a cap and a floor, providing the purchaser with a predetermined interest rate range. Basis swaps are a type of interest rate swap agreement where variable rates are received and paid, but are based on different index rates. Leveraged swaps are another type of interest rate swap where changes in the variable rate are multiplied by a contractual leverage factor, such as four times three-month LIBOR (London Interbank Offered Rate). The Company's exposure to interest rate risk resulting from these leverage factors is typically hedged with other financial instruments.

Currency Risk—Currency risk arises from the possibility that fluctuations in foreign exchange rates will impact the value of financial instruments. Currency forwards and options are commonly used to manage currency risk. Currency swaps may also be used in situations where a long-dated forward market is not available or where the end-user needs a customized instrument to hedge a foreign currency cash flow stream. Typically, parties to a currency swap initially exchange principal amounts in two currencies, agreeing to exchange interest payments and to re-exchange the currencies at a future date and exchange rate.

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, a defined basket of stocks, or a stock index. Instruments typically used by the Company to manage equity price risk include equity options, warrants, total return swaps and baskets of equity securities. Equity options, for example, can require the writer to purchase or sell a specified stock or to make a cash payment based on changes in the market price of that stock, basket of stocks, or stock index.

Credit Spread Risk—Credit spread risk arises from the possibility that changes in credit spreads will affect the value of financial instruments. Credit spreads represent the credit risk premiums required by market participants for a given credit quality, i.e., the additional yield that a debt instrument, issued by an AA-rated entity, must produce over a risk-free alternative (e.g., U.S. Treasury instrument). Certain instruments are used by the Company to manage this type of risk. Swaps and options, for example, can be designed to mitigate losses due to changes in credit spreads, as well as the credit downgrade or default of the issuer. Credit risk resulting from default on counterparty obligations is discussed in the *Credit Risk* section.

Commodity Price Risk—The Company views its commodity contracts as financial instruments since they are generally settled in cash and not by delivery of the underlying commodity. Commodity price risk results from the possibility that the price of the underlying commodity may rise or fall.

Credit Risk—The Company is exposed to the risk of loss if an individual, counterparty or an 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. Credit risk arising from changes in credit spreads was previously discussed in the *Market Risk* section.

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

In the normal course of business, the Company executes, settles, and finances various 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 customers or 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 customers or counterparties. The Company seeks to control the risks associated with its customer margin activities by requiring 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 purchase the underlying security in the market and seek reimbursement for losses from the counterparty.

Concentrations of Credit Risk—The Company's exposure to credit risk, both default and credit spread, 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 net credit risk was with the U.S. Government and its agencies. Direct exposure, which primarily results from trading asset positions in instruments issued by the U.S. Government and its agencies and the related accrued interest receivable, amounted to \$1,182 at June 29, 2007. 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 only in the event of the counterparty's default. Securities issued by the U.S. Government and its agencies held as collateral for resale agreement and securities borrowed transactions at June 29, 2007 totaled \$27,563, of which \$25,552 was from affiliated companies.

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

In the normal course of business, the Company purchases, sells, underwrites, and makes markets in non-investment grade instruments. These activities expose the Company to a higher degree of credit risk than is associated with trading, investing in, and underwriting investment grade instruments and extending credit to investment grade counterparties. At June 29, 2007, the Company's aggregate exposure to credit risk associated with non-investment grade trading assets amounted to approximately \$7,615.

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. The table below presents fair values of the Company’s trading derivatives as of June 29, 2007:

	<u>Fair Value</u>	
	<u>Assets</u>	<u>Liabilities</u>
Swap agreements	\$ 2,346	\$ 4,129
Options	2,524	2,791
Warrants	38	2

The above amounts include trading derivative assets of \$416 and trading derivative liabilities of \$3,165 with affiliated companies.

The Company generally enters into International Swaps and Derivative Association, Inc. master agreements or their equivalent (“master netting agreements”) with each of its counterparties, whenever 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.

To reduce default risk, the Company requires collateral, principally U.S. Government and agency 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.

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	\$ 335	\$ 1,196	\$ -	\$ 1,531
Receivables under resale agreements	-	12,264	-	12,264
Trading assets, excluding contractual agreements	12,408	26,601	1,180	40,189
Contractual agreements	1,329	3,020	143	4,492
Investment securities	23	791	2	816
Other assets	5	-	-	5
Receivables from affiliated companies ⁽¹⁾	2,773	1,314	-	4,087
Liabilities:				
Payables under repurchase agreements	\$ -	\$ (1,451)	\$ -	\$ (1,451)
Trading liabilities, excluding contractual agreements	(9,468)	(3,826)	-	(13,294)
Contractual agreements	(1,221)	(2,493)	(43)	(3,757)
Payables to affiliated companies ⁽¹⁾	(6,137)	(3,344)	-	(9,481)

(1) Receivables from affiliated companies and payables to 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 agreements and payables under repurchase agreements, for which the fair value option has been elected, was not material to the Consolidated Balance Sheet.

5. SECURITIES FINANCING TRANSACTIONS

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

Under these agreements and transactions, the Company either receives or provides collateral, including U.S. Government and agencies, asset-backed securities, corporate debt, equity, and non-U.S. governments and agency 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 use these securities to secure repurchase agreements, enter into securities lending transactions 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 \$286,531, of which \$43,594 was received from affiliated companies. The fair value of securities received as collateral that had been sold or repledged was \$195,002, of which \$35,642 have been sold or repledged to affiliated companies. In addition, \$12,969 of securities received as collateral is segregated in a special reserve account as required by Rule 15c3-3 under the Securities Exchange Act of 1934.

The Company pledges certain 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 loaned or pledged to counterparties where those counterparties do not have the right to sell or repledge at June 29, 2007 are as follows:

Mortgage and asset-backed	\$ 10,149
Corporate debt and preferred stock	5,348
Equities and convertible debentures	3,992
U.S. Government and agencies	304
	<u>\$ 19,793</u>

6. SECURITIZATION TRANSACTIONS AND TRANSACTIONS WITH SPECIAL PURPOSE ENTITIES ("SPEs")

In the normal course of business, the Company securitizes commercial and residential mortgage loans and municipal bonds. SPEs, often referred to as Variable Interest Entities or VIEs, are often used when entering into or facilitating securitization transactions. The Company's involvement with SPEs used to securitize financial assets includes: structuring and/or establishing SPEs; selling assets to SPEs; underwriting, distributing, and making markets in securities issued by SPEs; engaging in derivative transactions with SPEs; owning notes or certificates issued by SPEs; and/or providing liquidity facilities and other guarantees to SPEs.

The Company securitized assets of \$113,702 for the six months ended June 29, 2007.

In certain instances, the Company retains interests in the senior tranche, subordinated tranche, and/or residual tranche of securities issued by SPEs created to securitize assets. The gain or loss on the sale of the assets is determined with reference to the previous carrying amount of the

financial assets transferred, which is allocated between the asset sold and the retained interests, if any, based on their relative fair value at the date of transfer.

Retained interests are recorded in the Consolidated Balance Sheet at fair value. To obtain fair values, observable market prices are used if available. Where observable market prices are unavailable, the Company generally estimates fair value initially and on an ongoing basis based on the present value or expected future cash flows using management's best estimates of credit losses, prepayment rates, forward yield curves, and discount rates, commensurate with the risks involved. Retained interests in securitized assets were approximately \$4,211 at June 29, 2007, which related to residential mortgage loan, commercial mortgage loan and other securitization transactions. The majority of retained interests consist of securities that have observable market prices. These retained interests are held as *Trading assets*.

In the case of residential mortgage loan, commercial mortgage loan and other securitizations, the investors and the securitization trust have no recourse to the Company's other assets for failure of mortgage holders to pay when due.

The following table presents information on retained interests held by the Company at June 29, 2007 arising from the Company's residential mortgage loan, commercial mortgage loan and other securitization transactions. The sensitivities of the current fair value of the retained interests to an immediate 10% and 20% adverse change in assumptions and parameters are also shown.

	Residential Mortgage Loans	Commercial Mortgage and Other Loans
Retained interest (fair value)	\$ 4,011	\$ 200
Weighted-average life (in years)	5.9	2.2
Range	0.1 - 29.6	1.7 - 9.7
Weighted-average credit losses (rate per annum)	0.0%	0.8%
Range	0.0 - 8.4%	0.0 - 3.5%
Impact on fair value of 10% adverse change	(\$2)	(\$4)
Impact on fair value of 20% adverse change	(\$4)	(\$7)
Weighted-average discount rate	6.9%	9.3%
Range	0.0 - 76.4%	5.9 - 15.0%
Impact on fair value of 10% adverse change	(\$129)	(\$4)
Impact on fair value of 20% adverse change	(\$228)	(\$9)
Weighted-average prepayment speed (CPR)	15.5%	38.2%
Range	0.0 - 50.0%	16.0 - 92.0%
Impact on fair value of 10% adverse change	(\$7)	(\$2)
Impact on fair value of 20% adverse change	(\$10)	(\$4)

CPR = Constant Prepayment Rate

The preceding table does not include the offsetting benefit of any financial instruments that the Company may utilize to hedge risks including credit, interest rate and prepayment risks that are

inherent in the retained interests. The Company employs hedging strategies that are structured to take into consideration the hypothetical stress scenarios above such that they would be effective in principally offsetting the Company's exposure to loss in the event these scenarios occur. In addition, the sensitivity analysis is hypothetical and should be used with caution. In particular, the effect of a variation in a particular assumption on the fair value of the retained interests is calculated independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities. Further, changes in fair value based on a 10% or 20% variation in an assumption or parameter generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the sensitivity analysis does not consider any hedging activity that the Company may take to mitigate the impact of any adverse changes in the key assumptions.

The weighted-average assumptions and parameters used initially to value retained interests relating to securitizations that were still held by the Company as of June 29, 2007 were as follows:

	<u>Residential Mortgage Loans</u>	<u>Commercial Mortgage and Other Loans</u>
Weighted-average life (in years)	5.9	2.8
Credit losses (rate per annum)	0.0 %	0.0 %
Weighted-average discount rate	6.5 %	3.8 %
Prepayment speed assumption (CPR)	15.6 %	17.2 %

CPR = Constant Prepayment Rate

The following table presents quantitative information about principal amounts outstanding and delinquencies of securitized financial assets as of June 29, 2007:

	<u>Residential Mortgage Loans</u>	<u>Commercial Mortgage and Other Loans</u>
Principal amount outstanding	\$ 98,130	\$ 19,803
Delinquencies	-	17

7. SUBORDINATED BORROWINGS

At June 29, 2007, subordinated borrowings and credit committed under agreements with the Parent consisted of the following:

	<u>Maturity</u>	<u>Amount Outstanding</u>	<u>Total Credit</u>
MLPF&S:			
Revolving Subordinated Loan	April 30, 2009	\$ 8,500	\$ 9,000
Cash Subordinated Loan	December 31, 2008	500	500
Cash Subordinated Loan	March 31, 2010	500	500
MLPCC:			
Revolving Subordinated Loan	April 30, 2009	2,850	3,850
Cash Subordinated Loan	April 30, 2010	500	500
		<u>\$ 12,850</u>	<u>\$ 14,350</u>

These borrowings, which have been approved for regulatory capital purposes for each respective company, are U.S. dollar-denominated obligations at variable interest rates based on one-month LIBOR.

8. STOCKHOLDER'S EQUITY

MLPF&S is authorized to issue 1,000 shares of \$25 par value preferred stock. At June 29, 2007, there were no preferred shares issued.

9. COMMITMENTS, CONTINGENCIES AND GUARANTEES

Litigation— The Company has been named as a defendant in various legal actions, including arbitrations, class actions, and other litigation arising in connection with its activities as a global diversified financial services institution.

Some of the legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or otherwise in financial distress. The Company is also involved in investigations and/or proceedings by governmental and self-regulatory agencies.

The Company believes it has strong defenses to, and where appropriate, will vigorously contest many of these matters. Given the number of these matters, some are likely to result in adverse judgments, penalties, injunctions, fines, or other relief. The Company may explore potential settlements before a case is taken through trial because of the uncertainty, risks and costs inherent in the litigation process. In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company will accrue a liability when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. In many lawsuits and arbitrations, including almost all of the 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. Subject to the foregoing, the Company continues to assess these cases and believes, based on information available to it, that the resolution of these matters will not have a material adverse effect on the financial condition of the Company as set forth in the Consolidated Balance Sheet.

The actions against the Company include, but are not limited to the following:

IPO Allocation Litigation

In re Initial Public Offering Antitrust Litigation: The Company was named as one of ten underwriter defendants in this consolidated antitrust class action filed in the United States District Court for the Southern District of New York. The complaint alleged that the defendants and unnamed co-conspirators violated the antitrust laws by conspiring to “require from customers consideration in addition to the underwriters’ discount for allocation of shares of initial public offerings of certain technology companies...and to inflate the aftermarket prices for such securities.” On June 18, 2007, the United States Supreme Court ruled in defendants’ favor and held that the claims in this case, all of which were brought under the antitrust laws, should have been dismissed because they were preempted by the federal securities laws.

In re Initial Public Offering Securities Litigation: The Company is named as one of the defendants in approximately 110 securities class action complaints filed in the United States District Court for the Southern District of New York alleging that dozens of underwriter defendants, including the Company, artificially inflated and maintained the stock prices of the relevant securities by creating an artificially high aftermarket demand for shares. On October 13, 2004, the district court, having previously denied defendants’ motion to dismiss, issued an order allowing certain of these cases to proceed against the underwriters as class actions. On December 5, 2006, the Second Circuit Court of Appeals reversed, holding that the district court erred in certifying these cases as class actions. On April 6, 2007, the Second Circuit denied plaintiffs’ petition for rehearing. The Second Circuit stated that its December 5, 2006 decision neither precluded the plaintiffs from seeking certification of a more modest class nor invited the district court to certify such a class.

IPO Underwriting Fee Litigation

In re Public Offering Fee Antitrust Litigation and In re Issuer Plaintiff Initial Public Offering Fee Antitrust Litigation: The Company is one of approximately two dozen defendants that have been named in purported class actions filed in the United States District Court for the Southern District of New York alleging that underwriters conspired to fix the “fee” paid to purchase certain initial public offering securities at 7% in violation of antitrust laws. These complaints have been filed by both investors and certain issuers in initial public offerings. On September 25, 2002, the court denied defendants’ motion to dismiss the issuer claims. On February 24, 2004, the court granted defendants’ motion to dismiss the investor claims for damages and penalties, and permitted the case to proceed only with regard to injunctive relief. On July 16, 2006, the Second Circuit Court of Appeals agreed to hear plaintiff’s appeal of the district court’s decision not to certify a broader class. The parties are awaiting a decision by the Second Circuit.

Enron Litigation

Newby v. Enron Corp, et al.: On April 8, 2002, the Company was added as a defendant in a consolidated class action filed in the United States District Court for the Southern District of Texas against 69 defendants purportedly on behalf of the purchasers of Enron's publicly traded equity and debt securities during the period October 19, 1998 through November 27, 2001. The complaint alleges, among other things, that the Company engaged in improper transactions in the fourth quarter of 1999 that helped Enron misrepresent its earnings and revenues in the fourth quarter of 1999. The complaint also alleges that the Company violated the securities laws in connection with its role as placement agent for and limited partner in an Enron-controlled partnership called LJM2. Plaintiff has argued that certain defendants, including the Company, can potentially be liable for all of the losses caused by the alleged misconduct involving Enron, regardless of whether they knew of or participated in that conduct. On March 19, 2007, the Fifth Circuit Court of Appeals reversed a district court's decision certifying the case as a class action. On April 5, 2007, plaintiffs filed a petition with the United States Supreme Court seeking review of the Fifth Circuit's decision. The Company filed an opposition to plaintiffs' petition on June 1, 2007. The Supreme Court has neither granted nor denied the petition. The Supreme Court did agree to review a decision in *Stoneridge Investment v. Scientific-Atlanta*, a case involving an issue similar to that decided by the Fifth Circuit in its March 19, 2007, decision. A decision by the Supreme Court in the *Stoneridge* case is expected to be issued by the end of June 2008.

Other Enron Litigation: Over a dozen other actions have been brought against the Company and other investment firms in connection with their Enron-related activities. There has been no adjudication of the merits of these claims.

Allegheny Energy Litigation

Merrill Lynch v. Allegheny Energy, Inc.: On September 24, 2002, the Company filed an action in the United States District Court for the Southern District of New York against Allegheny Energy, Inc. The complaint alleged that Allegheny owed the Company the final \$115 payment due in connection with Allegheny's purchase of the Company's energy trading business in 2001. The following day, Allegheny filed an action against the Company in the Supreme Court of the State of New York claiming misrepresentations in connection with the sale of the energy trading business to Allegheny. On July 18, 2005, following a bench trial, the court issued a decision holding that Allegheny is required to pay the Company \$115 plus interest and that Allegheny is not entitled to any recovery against the Company. On September 22, 2005, Allegheny appealed the court's July 18, 2005 decision awarding the Company \$115 plus interest on its claim and denying Allegheny any relief on its claim. The parties are awaiting a decision on that appeal.

Short-Sale Litigation

Electronic Trading Group, LLC v. Banc of America Securities LLC, et al.: On April 12, 2006, a purported class action was filed against eleven financial services firms, including the Company, in the United States District Court for the Southern District of New York. The case alleges that the defendants violated federal antitrust laws by charging unearned fees on short sales by their clients even when they failed to borrow and/or deliver stock in support of those short sales. The Company is vigorously defending itself against these charges.

Avenius v. Banc of America Securities LLC, et al: On June 22, 2006, 37 purchasers of securities of NovaStar Financial filed an action against eleven financial services firms, including the Company, in the California Superior Court in San Francisco. The case alleges that the defendants improperly depressed the price of NovaStar Financial shares by facilitating short sales that did not comply with regulatory requirements. On July 17, 2007, the Superior Court rejected defendants' argument that state law claims of facilitating improper short sales were preempted by the federal securities laws. The court did not rule on the substance of the underlying claims. The defendants, including the Company, are vigorously defending themselves against the claims.

Overstock.com, Inc. v. Morgan Stanley & Co., et al: On February 2, 2007, Overstock.com brought an action in the Superior Court of the State of California, County of San Francisco, against approximately a dozen investment banks, including the Company, alleging that they violated state law by improperly facilitating short sales of Overstock.com, which artificially depressed the price of its shares. On July 17, 2007, the Superior Court rejected defendants' argument that state law claims of facilitating improper short sales were preempted by the federal securities laws. The court did not rule on the substance of the underlying claims. The defendants, including the Company, are vigorously defending themselves against the claims.

Employment Litigation

McReynolds v. Merrill Lynch: On November 18, 2005, a purported class action was filed in the United States District Court for the Northern District of Illinois seeking to certify a class of current and former African American employees of the Company, as well as African Americans who applied for employment. Plaintiff alleges that the Company has engaged in a pattern and practice of discrimination against African Americans in violation of federal Civil Rights statutes. The Company is vigorously defending itself against these claims.

Bank Sweep Litigation

DeBlasio v. Merrill Lynch, et al: On January 12, 2007, a purported class action was brought against the Company and three other securities firms in the United States District Court for the Southern District of New York. A First Amended Complaint was filed on May 1, 2007, and a Second Amended Complaint was filed on June 11, 2007, each adding additional claims and defendants. The Second Amended Complaint alleges that the bank sweep programs violated state and federal law because their terms were not adequately disclosed to customers, because they allegedly tie products together in violation of antitrust laws, and because they breach various duties to customers. The Company is vigorously defending itself against these claims.

Leases— The Company has entered into various non-cancelable long-term lease agreements for premises and equipment that expire through 2024, including the World Financial Center Headquarters (“WFC”). The Company has also entered into various non-cancelable short-term equipment leases.

Future minimum rental commitments under non-cancelable leases with initial or remaining terms exceeding one year as of June 29, 2007 are presented below:

	<u>WFC</u>	<u>Other</u>	<u>Total</u>
2008	\$ 78	\$ 221	\$ 299
2009	78	214	292
2010	78	189	267
2011	79	156	235
2012	79	117	196
Thereafter	<u>98</u>	<u>276</u>	<u>374</u>
Total	<u>\$ 490</u>	<u>\$ 1,173</u>	<u>\$ 1,663</u>

The minimum rental commitments shown above have not been reduced by \$151 of minimum sublease rentals to be received in the future under non-cancelable subleases. The amounts in the above table do not include amounts related to lease renewal or purchase options or escalation clauses providing for increased rental payments based upon maintenance, utility and tax increases.

Other Commitments—In the normal course of business, the Company enters into commitments for underwriting transactions. Settlement of these transactions as of June 29, 2007 would not have had a material effect on the consolidated financial condition of the Company.

The Company also obtains letters of credit from issuing banks to satisfy various counterparty collateral requirements in lieu of depositing cash or securities collateral. Letters of credit aggregated \$23 at June 29, 2007.

The Company has entered into agreements with providers of market data, communications, and systems consulting services. At June 29, 2007, minimum fee commitments over the remaining life of these agreements aggregated \$216.

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*. 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 of interest rates, security prices, currency rates, commodity prices, 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 credit default swaps (contracts that require the Company to pay the counterparty the par value of a referenced security if that referenced security defaults). The Company does not monitor, for accounting purposes, whether its clients enter into these derivative contracts for speculative purposes or hedging purposes. Accordingly, the Company has disclosed below information about certain types of written options that can potentially be used by clients to protect against changes in an underlying security, regardless of how the contracts are used by the client.

For certain derivative contracts such as written interest rate caps and written currency options, the maximum payout could theoretically be unlimited, because, for example, the rise in interest rates

or changes in foreign exchange rates could theoretically be unlimited. In addition, the Company does not monitor its exposure to derivatives in this manner. As such, rather than including the maximum payout, the notional value of these contracts has been included to provide information about the magnitude of involvement with these types of contracts. However, it should be noted that the notional value is not a reliable indicator of the Company's exposure to these contracts.

The Company records all derivative transactions at fair value on its Consolidated Balance Sheet. As noted above, 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.

These guarantees and their expiration are summarized below:

<u>Type of Guarantee</u>	<u>Maximum Payout/ Notional</u>	<u>Less than 1 Year</u>	<u>1 - 3 Years</u>	<u>4 - 5 Years</u>	<u>Over 5 Years</u>	<u>Carrying Value</u>
Derivative contracts ⁽¹⁾	\$ 2,362	\$ 1,570	\$ 549	\$ 200	\$ 43	\$ 122
Standby letters of credit	35			33	2	
Performance guarantee ⁽²⁾	7	7				

(1) *As noted above, the notional value of derivative contracts is provided instead of the maximum payout amount, although the notional value should not be considered as a reliable indicator of the Company's exposure to these contracts.*

(2) *Relates to MLPCC guaranteeing on behalf of a client with a foreign stock exchange. This guarantee is secured by the assets of the client's accounts and has no expiration. No contingent liability is recorded since it 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, 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 arrangements.

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 customers with respect to securities transactions. If the customer fails to fulfill its obligation, the Company must fulfill the customer's obligation with the counterparty. The Company is secured by assets in the customer's account as well as any proceeds received from the securities transaction entered into by the Company on behalf of the customer. No contingent liability is carried on the Consolidated 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 trades submitted for or by such clients, with the applicable clearinghouse. The Company's liability under these arrangements is not quantifiable and could exceed any cash deposit made by a client. However, 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 Consolidated Balance Sheet for these transactions.

10. EMPLOYEE BENEFIT PLANS

The Company provides retirement and other postemployment benefits to its employees under plans sponsored by the Parent.

Defined Contribution Plans—The U.S. defined contribution plans consist of the Retirement Accumulation Plan (“RAP”) and the 401(K) Savings & Investment Plan (“401(K)”). These plans cover substantially all U.S. employees who have met service requirements.

Defined Benefit Pension Plans—The Parent 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.

Postretirement Benefits Other Than Pensions—The Company provides health and life insurance benefits to retired employees under Parent-sponsored plans that cover substantially all U.S. employees who have met age and service requirements. At June 29, 2007, neither the Company nor the Parent had funded these plans.

Postemployment Benefits—The Company provides certain postemployment benefits for employees on extended leave due to injury or illness and for terminated employees. Employees who are disabled due to non-work related illness or injury are entitled to disability income, medical coverage and life insurance. The Company also provides severance benefits to terminated employees.

Severance benefits may be provided to terminated employees under the terms of a severance pay plan. Although all full-time employees are eligible for severance benefits, no additional amounts were accrued as of June 29, 2007, since future severance costs are not estimable.

11. EMPLOYEE INCENTIVE PLANS

The Company participates in several compensation plans sponsored by the Parent which provide eligible employees with shares of the Parent's common stock or options to purchase such stock, and deferred cash compensation. These plans include the Long-Term Incentive Compensation Plans (“LTICP”), the Employee Stock Compensation Plan (“ESCP”), the Equity Capital Accumulation Plan (“ECAP”), the Employee Stock Purchase Plan (“ESPP”), the Financial Advisor Capital Accumulation Award Plan (“FACAAP”), and other deferred compensation plans and award programs.

LTICP, ESCP and ECAP—LTICP, ESCP and ECAP provide for grants of equity and equity-related instruments of the Parent to certain employees. LTIC Plans consist of the Long-Term Incentive Compensation Plan, a shareholder-approved plan used for grants to executive officers, and the Long-Term Incentive Compensation Plan for Managers and Producers, a broad-based plan which was approved by the Parent’s Board of Directors, but has not been shareholder approved. LTIC Plans provide for the issuance of Restricted Shares, Restricted Units, and Non-qualified Stock Options, as well as Incentive Stock Options, Performance Shares, Performance Units, Performance Options, Stock Appreciation Rights, and other securities of the Parent. ESCP, a broad-based plan approved by shareholders in 2003, provides for the issuance of Restricted Shares, Restricted Units, Nonqualified Stock Options and Stock Appreciation Rights. ECAP, a shareholder-approved plan, provides for the issuance of Restricted Shares, as well as Performance Shares. All plans under LTICP, ESCP and ECAP may be satisfied using either treasury or newly issued shares of the Parent. As of June 29, 2007, no instruments other than Restricted Shares, Restricted Units, Nonqualified Stock Options, Performance Options and Stock Appreciation Rights had been granted. Stock-settled Stock Appreciation Rights, which were first granted in 2004, were substantially all converted to Nonqualified Stock Options by December 31, 2004. The costs associated with these plans are allocated to the Company by the Parent.

Restricted Shares are shares of the Parent’s common stock carrying voting and dividend rights. A Restricted Unit is deemed equivalent in fair market value to one share of common stock. Substantially all awards are settled in shares of common stock. Recipients of Restricted Unit awards receive cash payments equivalent to dividends. Under these plans, such shares and units are restricted from sale, transfer, or assignment until the end of the restricted period. Such shares and units are subject to forfeiture during the vesting period, for grants under LTIC Plans, or the restricted period for grants under ECAP. Restricted share and unit grants made in 2003 through 2005 generally cliff vest in four years. Restricted share and unit grants made in 2006 generally step vest in four years.

In January 2006, Participation Units were granted from the Long-Term Incentive Compensation Plan under the Parent’s Managing Partners Incentive Program. The awards granted under this program are fully at risk, and the potential payout will vary depending on the Parent’s financial performance against pre-determined return on average common stockholders’ equity (“ROE”) targets. One-third of the Participation Units will convert into Restricted Shares on each of January 31, 2007, January 31, 2008 and January 31, 2009, subject to the satisfaction of minimum ROE targets determined for the most recently completed fiscal year. Participation Units will cease to be outstanding immediately following conversion. If the minimum target is not met, the Participation Units will expire without being converted.

The total fair value of Restricted Shares and Units granted to retirement-eligible employees, or for which service criteria were satisfied for the six months ended June 29, 2007, was \$318. The total fair value of Restricted Shares and Units vested at June 29, 2007 was \$879.

Nonqualified Stock Options granted under LTIC Plans in 1996 through 2000 generally became exercisable over five years; options granted in 2001 and 2002 became exercisable after approximately six months. Option and Stock Appreciation Right grants made after 2002 generally become exercisable over four years. The exercise price of these grants is equal to 100% of the fair market value (as defined in LTIC Plans) of a share of the Parent’s common stock on the date of grant. Options and Stock Appreciation Rights expire ten years after their grant date.

The total number of Stock Appreciation Rights that remained outstanding at June 29, 2007 was 6,404.

ESPP—The ESPP, which is approved by the Parent’s shareholders, allows eligible employees to invest from 1% to 10 % of their eligible compensation to purchase the Parent’s common stock, subject to legal limits. Purchases are made at a discount equal to 5% of the average high and low market price on the relevant investment date.

FACAAP—Under FACAAP, eligible employees in the Company’s Global Private Client group are granted awards generally based upon their prior year’s performance. Payment for an award is contingent upon continued employment for a period of time and is subject to forfeiture during that period. Awards granted in 2003 and thereafter are generally payable eight years from the date of grant in a fixed number of shares of the Parent’s common stock. For outstanding awards granted prior to 2003, payment is generally made ten years from the date of grant in a fixed number of shares of the Parent’s common stock unless the fair market value of such shares is less than a specified minimum value, in which case the minimum value is paid in cash.

Other Compensation Arrangements—The Company participates in Parent-sponsored deferred compensation plans in which employees who meet certain minimum compensation thresholds may participate on either a voluntary or mandatory basis. Contributions to the plans are made on a tax-deferred basis by participants. Participants’ returns on these contributions may be indexed to various Merrill Lynch mutual funds and other funds including certain Parent-sponsored investment vehicles that qualify as employee securities companies. The Company also participates in several Parent-sponsored, cash-based employee award programs, under which certain employees are eligible to receive future cash compensation, generally upon fulfillment of the service and vesting criteria for the particular program. At June 29, 2007, accrued liabilities for these plans and grants totaled \$1,705 and are recorded in *Compensation and benefits* liabilities.

When appropriate, the Company maintains various investments as an economic hedge of its liabilities to participants under these deferred compensation plans and award programs, including a derivative transaction with an affiliate. At June 29, 2007, the Company had such investments totaling \$619 in *Other investments* on the Consolidated Balance Sheet, and a derivative transaction with an affiliate effectively hedging an additional \$1,044 of the Company’s liabilities.

12. 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 \$113.

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount on 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 *Interest and other* receivables, are comprised of:

Deferred compensation	\$ 1,216
Restricted stock/Restricted units	788
Stock options	508
Depreciation	134
Employee benefits and pension	38
Valuation and other reserves ⁽¹⁾	(16)
Other, net	<u>448</u>
Net deferred tax asset	<u>\$ 3,116</u>

(1) Primarily related to *Trading assets, Litigation and Other Liabilities*

The valuation allowance at June 29, 2007 was less than \$2.

At June 29, 2007, the Company had state net operating loss carryforwards of approximately \$37, which are available to offset future taxable income, if any, for fiscal years ending in 2007 through 2025. The Company also had approximately \$71 of state tax credit carryforwards expiring in various years after 2007.

The Parent is under examination by 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 adopted FIN 48 effective the beginning of the first quarter of 2007 and recognized no change to beginning retained earnings and to the liability for unrecognized tax benefits. Unrecognized tax benefits are maintained on the books of the Parent, which at the date of adoption was not material.

The Parent regularly assesses the likelihood of additional assessments in each of the tax jurisdictions resulting from these examinations. Tax reserves have been established which the Parent believes to be adequate in relation to the potential for additional assessments. The Parent 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.

13. REGULATORY REQUIREMENTS

As a registered broker-dealer and futures commission merchant, MLPF&S is subject to the net capital requirements of Rule 15c3-1 (the "Rule") under the Securities Exchange Act of 1934 (the "Act") and capital requirements of the CFTC. Under the alternative method permitted by the Rule, the minimum required net capital, as defined, shall be the greater of 2% of aggregate debit items ("ADI") arising from customer transactions or \$500. At June 29, 2007, MLPF&S regulatory net

capital of \$4,090 was approximately 15.1% of ADI, and its regulatory net capital in excess of the minimum required was \$3,474. The CFTC also requires that minimum net capital should not be less than 8% of the total customer risk margin requirement plus 4% of the total non-customer risk margin requirement. At June 29, 2007, MLPF&S regulatory net capital of \$4,090 exceeded the CFTC minimum requirement of \$459 by \$3,631.

MLPCC, a fully-guaranteed subsidiary of MLPF&S, is subject to the regulatory requirements promulgated by the SEC or other regulatory and exchange authorities. Net capital and excess net capital at June 29, 2007, as defined by these regulatory authorities, is \$1,664 and \$1,591, respectively.

MLPF&S and MLPCC are also subject to the customer protection requirements of Rule 15c3-3 under the Act.

For the June 29, 2007 customer reserve computation, MLPF&S and MLPCC segregated in a special reserve account for the exclusive benefit of customers' qualified securities with a contract value of \$11,781 and \$0, respectively. Securities for both companies were obtained under resale agreements with an affiliate. Additionally, MLPF&S and MLPCC deposited \$926 and \$610, respectively, of cash into a money market deposit special reserve account for the exclusive benefit of customers.

MLPF&S and MLPCC are also required to perform a computation of reserve requirements for Proprietary Accounts of Introducing Brokers ("PAIB") pursuant to Rule 15c3-3 of the Act. For the June 29, 2007 PAIB reserve computation, MLPF&S and MLPCC segregated in a special reserve account for the exclusive benefit of PAIB securities with a contract value of \$605 and \$5,545, respectively. The securities for both companies were obtained under resale agreements with an affiliate.

As futures commission merchants, MLPF&S and MLPCC are 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 secured and held in separate accounts totaled \$9,694 and \$1,621 and exceeded requirements by \$1,636 and \$502 for MLPF&S and MLPCC, respectively.

14. SUBSEQUENT EVENTS

Subsequent to June 29, 2007, the Company incurred write-downs in certain asset backed securities including those related to the residential mortgage market. Such write-downs during this period did not result in any regulatory and capital deficiencies.

As of August 30, 2007, MLPF&S increased its total credit from the Parent by \$2,400 and its subordinated borrowings by \$2,200. As of August 23, 2007, MLPCC decreased its subordinated borrowings from the Parent by \$550.

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For additional information, the Company's 2006 annual audited report, filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934, is available for examination and photocopying at the Company's headquarters at World Financial Center, North Tower, 250 Vesey Street, New York, New York 10080 and the Northeast Regional Office of the Securities and Exchange Commission.

CODE: 100664RR-0306