# Fixed Income Clearing Corporation

Unaudited Condensed Financial Statements
as of March 31, 2016 and December 31, 2015 and for the
three months ended March 31, 2016 and 2015

# FIXED INCOME CLEARING CORPORATION

## TABLE OF CONTENTS


| | Page |
|---|---|
| UNAUDITED CONDENSED FINANCIAL STATEMENTS AS OF MARCH 31, 2016 AND DECEMBER 31, 2015 AND FOR THE THREE MONTHS ENDED MARCH 31, 2016 AND 2015: | |
| Unaudited Condensed Statements of Financial Condition | 1 |
| Unaudited Condensed Statements of Income | 2 |
| Unaudited Condensed Statements of Changes in Shareholder's Equity | 3 |
| Unaudited Condensed Statements of Cash Flows | 4 |
| Notes to the Unaudited Condensed Financial Statements | 5-10 |

# FIXED INCOME CLEARING CORPORATION

## UNAUDITED CONDENSED STATEMENTS OF FINANCIAL CONDITION
**(In thousands, except for share data)**

| | March 31, 2016 (unaudited) | December 31, 2015 (audited) |
|---|---|---|
| **ASSETS:** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 202,403 | $ 215,440 |
| Accounts receivable | 50,718 | 32,581 |
| Clearing Fund: | | |
| Cash deposits | 8,578,191 | 7,878,557 |
| Investments in marketable securities | 100,000 | 100,000 |
| Other deposits, at fair value | 8,848,018 | 7,537,070 |
| Other Participants' assets | 901 | 2,783 |
| Other current assets | 5,307 | 5,795 |
| Total current assets | 17,785,538 | 15,772,226 |
| NON-CURRENT ASSETS: | | |
| Premises and equipment - net of accumulated depreciation of $17,605 and $17,600 on March 31, 2016 and December 31, 2015, respectively | 735 | 740 |
| Intangible assets - net of accumulated amortization of $103,290 and $99,439 on March 31, 2016 December 31, 2015, respectively | 19,328 | 21,662 |
| Total non-current assets | 20,063 | 22,402 |
| TOTAL ASSETS | $ 17,805,601 | $ 15,794,628 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY:** | | |
| CURRENT LIABILITIES: | | |
| Loan payable to DTCC | $ 52,000 | $ 52,000 |
| Accounts payable | 2,981 | 1,864 |
| Clearing Fund: | | |
| Cash deposits | 8,678,191 | 7,978,557 |
| Other deposits, at fair value | 8,848,018 | 7,537,070 |
| Payable to Participants | 901 | 2,783 |
| Other current liabilities | 3 | - |
| Total current liabilities | 17,582,094 | 15,572,274 |
| NON-CURRENT LIABILITIES: | | |
| Other non-current liabilities | 8,378 | 8,203 |
| Total non-current liabilities | 8,378 | 8,203 |
| Total liabilities | 17,590,472 | 15,580,477 |
| COMMITMENTS AND CONTINGENCIES (Note 9) | | |
| SHAREHOLDER'S EQUITY: | | |
| Common stock, $0.50 par value - 105,000 shares authorized, 20,400 shares issued and outstanding | 10 | 10 |
| Paid-in capital | 86,617 | 86,617 |
| Retained earnings | 128,502 | 127,524 |
| Total shareholder's equity | 215,129 | 214,151 |
| TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY | $ 17,805,601 | $ 15,794,628 |

The Notes to the Unaudited Condensed Financial Statements are an integral part of these statements.

# FIXED INCOME CLEARING CORPORATION

## UNAUDITED CONDENSED STATEMENTS OF INCOME
**(In thousands)**

| | For the three months ended March, 31 2016 | 2015 |
|---|---|---|
| REVENUES: | | |
| Clearing services | $ 48,016 | $ 43,286 |
| EXPENSES: | | |
| Employee compensation and related benefits | 18,515 | 18,491 |
| Information technology | 3,756 | 2,795 |
| Professional and other services | 16,766 | 13,063 |
| Occupancy | 2,435 | 989 |
| Depreciation and amortization | 3,856 | 4,324 |
| Other general and administrative, net | 1,394 | 693 |
| Total expenses | 46,722 | 40,355 |
| Total operating income | 1,294 | 2,931 |
| NON-OPERATING INCOME: | | |
| Interest income | 7,578 | 2,087 |
| Refunds to Participants | (6,801) | (1,676) |
| Interest expense | (234) | (2) |
| Total non-operating income | 543 | 409 |
| Income before taxes | 1,837 | 3,340 |
| Provision for income taxes | 859 | 1,383 |
| Net income | $ 978 | $ 1,957 |

The Notes to the Unaudited Condensed Financial Statements are an integral part of these statements.

# FIXED INCOME CLEARING CORPORATION

## UNAUDITED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY
**(In thousands)**

| | Common Stock | Paid-In Capital | Retained Earnings | Total Shareholder's Equity |
|---|---|---|---|---|
| BALANCE - December 31, 2014 (audited) | $ 10 | $ 26,617 | $ 126,854 | $ 153,481 |
| Capital contribution from DTCC | - | 60,000 | - | 60,000 |
| Net income | - | - | 670 | 670 |
| BALANCE - December 31, 2015 (audited) | $ 10 | $ 86,617 | $ 127,524 | $ 214,151 |
| Net income | - | - | 978 | 978 |
| BALANCE - March 31, 2016 (unaudited) | $ 10 | $ 86,617 | $ 128,502 | $ 215,129 |

The Notes to the Unaudited Condensed Financial Statements are an integral part of these statements.

# FIXED INCOME CLEARING CORPORATION

## UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS
**(In thousands)**

| | For the three months ended March 31, 2016 | 2015 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 978 | $ 1,957 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 3,856 | 4,324 |
| Net premium amortized on investments in marketable securities | 61 | (86) |
| Deferred income taxes | 296 | (384) |
| Changes in operating assets and liabilities: | | |
| Increase in Accounts receivable | (18,198) | (22,169) |
| Decrease in Other assets | 488 | - |
| Increase (decrease) in Accounts payable | 1,117 | (1,612) |
| (Decrease) increase in Other liabilities | (118) | 2,898 |
| Net cash used in operating activities | (11,520) | (15,072) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Maturities of Investments in marketable securities | - | 200,000 |
| Purchases of Investments in marketable securities | - | (200,000) |
| Purchases of software | (1,517) | (1,889) |
| Net cash used in investing activities | (1,517) | (1,889) |
| Net decrease in cash and cash equivalents | (13,037) | (16,961) |
| Cash and cash equivalents - Beginning of period | 215,440 | 107,026 |
| Cash and cash equivalents - End of period | $ 202,403 | $ 90,065 |
| SUPPLEMENTAL DISCLOSURES: | | |
| Cash interest paid | $ 219 | $ - |

The Notes to the Unaudited Condensed Financial Statements are an integral part of these statements.

# FIXED INCOME CLEARING CORPORATION

## NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

### 1. BUSINESS AND OWNERSHIP

Fixed Income Clearing Corporation (FICC or the Company), a clearing agency registered with the U.S. Securities and Exchange Commission (SEC), provides various services to members of the government and mortgage-backed securities markets (Participants), consisting principally of automated real-time trade comparison, netting, settlement, trade confirmation, risk management and electronic pool notification. FICC has two Divisions, the Government Securities Division (GSD) and the Mortgage-Backed-Securities Division (MBSD).

FICC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (DTCC). Other subsidiaries of DTCC include The Depository Trust Company (DTC), National Securities Clearing Corporation (NSCC), Omgeo LLC, DTCC Deriv/SERV LLC, DTCC Solutions LLC, Business Entity Data, B.V. and Avox Limited.

### 2. BASIS OF PRESENTATION AND USE OF ESTIMATES

**Basis of presentation.** The accompanying Unaudited Condensed Financial Statements are prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP). The Unaudited Condensed Financial Statements reflect all adjustments of a normal recurring nature that are in the opinion of management, necessary for the fair presentation of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year. The Unaudited Condensed Financial Statements should be read in conjunction with FICC's Audited Financial Statements for the years ended December 31, 2015 and 2014 which is located on the Company's website *http://www.dtcc.com/legal/financial-statements.*

**Use of estimates.** The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Unaudited Condensed Financial Statements. Management makes estimates regarding the collectability of receivables, the outcome of litigation, the realization of deferred taxes, unrecognized tax benefits (UTBs), fair value measurements and other matters that affect the reported amounts. Estimates, by their nature, are based on judgment and available information; therefore, actual results could differ materially from those estimates.

### 3. ACCOUNTING AND REPORTING DEVELOPMENTS

**Recently Issued Accounting Standards.**

*FASB ASC Topic 606, Revenue from Contracts with Customers.* In March 2016, the FASB issued Accounting Standard Update (ASU) No. 2016-08 – Principal versus Agent Considerations. This ASU amends the principal versus agent implementation guidance with regard to determination of the appropriate unit of account under the new revenue standard, ASU No. 2014-09. The standard also provides guidance for applying the indicators of whether an entity is a principal or agent in accordance with the control principle. The new standard is effective for the Company on January 1, 2019, but may be adopted for not public businesses as of January 1, 2018. Early adoption is not permitted. The standard permits the use of the cumulative effect transition method. The Company is evaluating the impact this ASU will have on its Unaudited Condensed Financial Statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

*FASB ASC Topic 825, Recognition and Measurement of Financial Assets and Financial Liabilities.* In January 2016, the FASB issued ASU No. 2016-01 – Recognition and Measurement of Financial Assets and Financial Liabilities. This ASU requires equity investments (aside from those measured under the equity method investment or consolidation) to be measured at fair value, with changes to fair value recognized in net income. Additionally, the impairment assessment of equity method investments that do not possess readily determinable fair values will be simplified by requiring a qualitative assessment to identify impairments. If the qualitative assessment results suggest an impairment, the entity will measure the investment at fair value and the disclosure of fair value of financial instruments at amortized cost is no longer required. An entity will be required to present separately the financial assets and financial liabilities by measurement category and form of financial asset and financial liability on the balance sheet or notes to the financial statements. The ASU seeks to make targeted improvements to U.S. GAAP in order to enhance and simplify the reporting model of financial instruments. The new standard will be effective for the Company (non public businesses) on January 1, 2018. Early adoption is not permitted. The standard permits the use of the cumulative effect transition method. The Company is evaluating the impact this ASU will have on its Unaudited Condensed Financial Statements and related disclosures. The Company has not yet selected a transition method, nor has it determined the effect of the standard on its ongoing financial reporting.

*FASB ASC Topic 606, Revenue from Contracts with Customers.* In August 2015, the FASB issued ASU No. 2015-14 - Revenue from Contracts with Customers – Deferral of Effective Date. This ASU defers the effective date of ASU No. 2014-09 which requires an entity to recognize the amount of revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer. The amount of revenue recognized is the amount allocated to the satisfied performance obligation. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2019. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the impact this ASU will have on its Unaudited Condensed Financial Statements and its related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

**Recently Adopted Accounting Standards.**

*FASB ASC Topic 740, Income Taxes*. In November 2015, the FASB issued ASU No. 2015-17, as part of the initiative to reduce complexity in accounting standards, in which cost and complexity can be reduced while maintaining the information presented in the financial statements. In order to simplify the presentation of deferred income taxes, the update requires deferred tax assets and liabilities to be presented as noncurrent deferred tax assets or noncurrent deferred tax liabilities in a classified statement of financial position. This update aligns the presentation of deferred tax assets and liabilities with International Financial Reporting Standards. The Company early adopted this standard prospectively and reclassified all of its deferred tax liabilities to noncurrent deferred tax liabilities on its Unaudited Condensed Statement of Financial Condition as of December 31, 2015. The adoption did not have an impact to the Company's Unaudited Condensed Statements of Income or Cash Flows. This standard was not retrospectively applied and prior periods were not adjusted.

*FASB ASC Topic 740, Income Taxes.* In July 2013, the FASB issued ASU No. 2013-11, requiring public and private entities to present unrecognized tax benefits as a decrease in a net operating loss, similar tax loss or tax credit carry forward if certain criteria are met. The determination of whether a deferred tax asset is available is based on the unrecognized tax benefit and the deferred tax asset that exists at the reporting date and presumes disallowance of the tax position at the reporting date. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. The amendment was adopted effective January 1, 2015. The adoption of this guidance did not have an impact on FICC's Unaudited Condensed Statements of Financial Condition, Income or Cash Flows.

## 4. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following on March 31, 2016 and December 31, 2015 (in thousands):

| | 2016 | 2015 |
|---|---|---|
| Clearing and transaction fees due from Participants | $ 16,697 | $ 14,002 |
| Other receivables | 34,021 | 18,579 |
| **Total** | $ 50,718 | $ 32,581 |

There was no allowance for doubtful accounts as of March 31, 2016 and December 31, 2015.

## 5. CLEARING FUND

The rules of FICC require Participants to maintain deposits related to their respective activities based on calculated requirements. The deposits are available to secure Participants' obligations and certain liabilities of the Company. All deposits of cash and securities are recorded in Clearing Fund on the accompanying Unaudited Condensed Statements of Financial Condition.

A summary of the required and excess deposits held at March 31, 2016 and December 31, 2015 were as follows (in thousands):

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | GS Division | MBS Division | Total | GS Division | MBS Division | Total |
| Required deposits | $ 8,648,140 | $ 4,565,142 | $ 13,213,282 | $ 8,076,283 | $ 3,893,878 | $ 11,970,161 |
| Excess deposits | 3,618,561 | 694,366 | 4,312,927 | 2,795,034 | 750,432 | 3,545,466 |
| **Total deposits** | $ 12,266,701 | $ 5,259,508 | $ 17,526,209 | $ 10,871,317 | $ 4,644,310 | $ 15,515,627 |

A summary of the total deposits held at March 31, 2016 and December 31, 2015, including the excess of the calculated requirements were as follows (in thousands):

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | GS Division | MBS Division | Total | GS Division | MBS Division | Total |
| Cash deposits | $ 5,217,825 | $ 3,360,366 | $ 8,578,191 | $ 4,850,476 | $ 3,028,081 | $ 7,878,557 |
| Investments in marketable securities | - | 100,000 | 100,000 | - | 100,000 | 100,000 |
| U.S. Treasury and Agency securities, at fair value | 7,048,876 | 1,799,142 | 8,848,018 | 6,020,841 | 1,516,229 | 7,537,070 |
| **Total deposits** | $ 12,266,701 | $ 5,259,508 | $ 17,526,209 | $ 10,871,317 | $ 4,644,310 | $ 15,515,627 |

*Cash Deposits and Investments in marketable securities.* Cash deposits and investments in marketable securities of the Clearing Fund, which may be applied to satisfy obligations of the depositing Participants, as provided in FICC's rules, as of March 31, 2016 and December 31, 2015, were invested as follows (in thousands):

| | 2016 | 2015 |
|---|---|---|
| Reverse repurchase agreements | $ 1,000,000 | $ 1,465,000 |
| Money market fund investments | 1,788,000 | 4,793,000 |
| Bank deposits | 5,790,191 | 1,620,557 |
| U.S. Treasury bills | 100,000 | 100,000 |
| **Total** | $ 8,678,191 | $ 7,978,557 |

**Refunds to Participants.** The total amounts of Interest income the Company earned from the investment of cash deposits in the Clearing Fund were $6,801,000 and $1,676,000 for the three months ended March 31, 2016 and 2015, respectively, and reflected in the accompanying Unaudited Condensed Statements of Income.

## 6. DEBT

The Company's borrowings as of March 31, 2016 and December 31, 2015, consisted of the following (in thousands):

| | 2016 | 2015 |
|---|---|---|
| Loan payable to DTCC | $ 52,000 | $ 52,000 |

On May 1, 2015, the Company received a loan from DTCC, its parent, in the amount of $55 million, the outstanding balance of which was subsequently reduced to $52 million as of December 31, 2015 and remained outstanding as of March 31, 2016. The loan is interest bearing and structured as a demand loan, having no fixed term. The proceeds of the loan supplement the Company's liquid financial resources pursuant to the SEC's proposed standards for covered clearing agencies. The amount of the loan may vary over time, depending upon the Company's regulatory capital requirements and its general funding needs.

Total Interest expense included in the accompanying Unaudited Condensed Statements of Income for the three months ended March 31, 2016 and 2015 was $231,000 and $0, respectively.
The following table summarizes the interest rate, term and maturity of the loan payable as of March 31, 2016 and December 31, 2015 (in thousands):

| | | | | Outstanding Balance | |
|---|---|---|---|---|---|
| | **Rate** | **Issue Date** | **Maturity** | **2016** | **2015** |
| Loan payble to DTCC | LIBOR+ 1.30% | 5/1/2015 | On demand | $ 52,000 | $ 52,000 |

## 7. PENSION AND POST RETIREMENT BENEFITS

Eligible employees participate in DTCC's trusteed non-contributory defined benefit pension plan, supplemental executive retirement plan and benefit restoration plan, which provide for certain benefits upon retirement. Eligible employees also participate in DTCC's life insurance program, which provides for the payment of death benefits to beneficiaries of eligible retired employees, and DTCC's healthcare program, which provides benefits to eligible retired employees.

**Cost allocation.** DTCC allocates the cost of these plans to participating subsidiaries based primarily upon the proportion of each subsidiary's allocated salary cost to the aggregate salary cost of DTCC and its subsidiaries. For the three months ended March 31, 2016 and 2015, the benefit plan costs allocated to FICC were $609,000 and $1,137,000, respectively. These costs are included in Employee compensation and related benefits in the Company's accompanying Unaudited Condensed Statements of Income.

## 8. SHAREHOLDER'S EQUITY

**Common Stock.** FICC has 105,000 authorized shares of common stock with a par value of $0.50 per share. As of March 31, 2016 and December 31, 2015, 20,400 shares of common stock were issued and outstanding.

On May 1, 2015, the Company received a capital contribution from DTCC, its parent, in the amount of $60 million. The proceeds of the capital contribution supplement the Company's capital and liquid financial resources pursuant to the SEC's proposed standards for covered clearing agencies.

## 9. COMMITMENTS AND CONTINGENCIES

**Litigation.** The Company is involved in legal proceedings and litigation arising in the ordinary course of business. In the opinion of management, the outcome of such proceedings and litigation is not expected to have a material effect on the Company's Unaudited Condensed Financial Position, Income, or Cash Flows.

## 10. GUARANTEES

Through its GS and MBS divisions, FICC provides central counterparty (CCP) services, which includes clearing, settlement and risk management services. In its capacity as a CCP, FICC guarantees the settlement of trades in the event a Participant defaults. A Participant default is defined in each division's rules. In its guarantor role, FICC has equal claims to and from Participants on opposite sides of netted transactions. To cover its guarantee risk, FICC uses risk-based margining to collect cash and securities collateral through its Clearing Fund.

The following table summarizes, by FICC division, guaranteed positions at March 31, 2016 and December 31, 2015 (in billions):

| | 2016 | 2015 |
|---|---|---|
| GSD | $ 856 | $ 829 |
| MBSD | 314 | 245 |

There were no defaults by Participants to these obligations.

For additional information, refer to Note. 16 in FICC's Audited Financial Statements for the years ended December 31, 2015 and 2014.

## 11. OTHER MATTERS

**Lehman Brothers Inc.** On September 19, 2008, a Trustee was appointed, under the Securities Investor Protection Act (SIPA), to administer and liquidate the business of Lehman Brothers Inc. (LBI). As part of the liquidation of LBI, certain of its assets were sold to Barclays Capital Inc. (Barclays). These assets did not include the accounts that LBI maintained at NSCC, FICC and DTC.

As a result, the Trustee, Barclays, and DTCC, on behalf and for the benefit of NSCC, FICC and DTC (collectively, the "Clearing Agency Subsidiaries"), entered into an agreement that provided for the Clearing Agency Subsidiaries to wind down their respective LBI accounts, including the close out of pending transactions and the use of the proceeds in accordance with their respective rules and procedures, in the same manner in which they close out positions of Participants for whom they cease to act. On September 24, 2008, the Clearing Agency Subsidiaries formally ceased to act for LBI.

In addition, Barclays agreed to guaranty, indemnify, and hold harmless DTCC, each of NSCC, FICC and DTC, and their officers, directors, employees, owners, agents, and representatives against any and all losses, claims, damages, expenses (including legal fees) or liabilities that any of them may incur as a result of winding down and closing out the respective accounts. The guaranty is limited to a $250,000,000 cash deposit (the "Cash Deposit") it provided for that purpose.

Any losses will first be satisfied from the Cash Deposit. If there are losses in excess of the Cash Deposit, they will be satisfied in accordance with the rules and procedures of NSCC, FICC and DTC, respectively, (including through application of LBI's Clearing or Participants Fund deposits and any Clearing Agency cross guaranty agreements). If any portion of such funds remains after the close out of the LBI Accounts and satisfaction of all obligations of NSCC, FICC and DTC, they will be remitted to the Trustee. The Cash Deposit is held at DTCC to facilitate its investment pending application against losses or its turnover to the Trustee.

With respect to LBI, DTCC and its subsidiaries held the following deposits/balances at March 31, 2016 and December 31, 2015:

| | 2016 | 2015 |
|---|---|---|
| Segregated cash | $ 3,301,827 | $ 3,301,827 |
| Participants and Clearing Funds | 1,160,135 | 1,160,135 |
| Matured money market investment accounts | 31,133,201 | 31,133,201 |
| **Total** | $ 35,595,163 | $ 35,595,163 |

As of March 31, 2016, DTCC had delivered to the Trustee of the LBI estate $5,154,013,000 in cash as well as Clearing Fund securities valued at $159,479,000.

Management does not expect there will be any losses attributable to the liquidation of the LBI accounts to be assessed against retained earnings or Participants.

## 12. SUBSEQUENT EVENTS

The Company evaluated events and transactions occurring after March 31, 2016 through April 29, 2016, for potential recognition or disclosure in these Unaudited Condensed Financial Statements. No events or transactions occurred during such period that would require recognition or disclosure in these Unaudited Condensed financial statements.