

National Securities Clearing Corporation

Financial Statements as of and for the Years Ended
December 31, 2016 and 2015, and Report of Independent
Registered Public Accounting Firm

NATIONAL SECURITIES CLEARING CORPORATION
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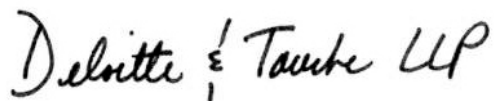
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholder of the
National Securities Clearing Corporation
New York, NY

We have audited the accompanying statements of financial condition of the National Securities Clearing Corporation (the "Company") as of December 31, 2016 and 2015, and the related statements of income, changes in shareholder's equity, and cash flows for each of the two years in the period ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Securities Clearing Corporation as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.



February 28, 2017

NATIONAL SECURITIES CLEARING CORPORATION

STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)	As of December 31,	
	2016	2015
ASSETS:		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,767,668	\$ 1,320,379
Reverse repurchase agreements	100,000	—
Investments in marketable securities	—	7,400
Participants' segregated cash	15,886	26,581
Accounts receivable	32,284	79,679
Clearing Fund:		
Cash deposits	4,157,717	3,847,082
Securities on deposit - at fair value	242,239	290,388
Other Participants' assets	665	265
Other current assets	12,091	1,322
Total current assets	<u>7,328,550</u>	<u>5,573,096</u>
NON-CURRENT ASSETS:		
Premises and equipment - net of accumulated depreciation of \$53,631 and \$54,632 as of December 31, 2016 and 2015, respectively	19,722	24,221
Intangible assets - net of accumulated amortization of \$138,274 and \$119,129 as of December 31, 2016 and 2015, respectively	32,907	33,418
Total non-current assets	<u>52,629</u>	<u>57,639</u>
TOTAL ASSETS	<u>\$ 7,381,179</u>	<u>\$ 5,630,735</u>
LIABILITIES AND SHAREHOLDER'S EQUITY:		
CURRENT LIABILITIES:		
Commercial paper - net of unamortized discount of \$1,669 and \$435 as of December 31, 2016 and 2015, respectively	\$ 2,554,020	\$ 1,007,124
Loan payable to DTCC	—	99,000
Accounts payable	2,578	170
Payable to Participants	16,551	26,846
Clearing Fund:		
Cash deposits	4,157,717	3,847,082
Securities on deposit - at fair value	242,239	290,388
Total current liabilities	<u>6,973,105</u>	<u>5,270,610</u>
OTHER NON-CURRENT LIABILITIES:		
Other non-current liabilities	10,117	6,875
Total liabilities	<u>6,983,222</u>	<u>5,277,485</u>
COMMITMENTS AND CONTINGENCIES (Note 16)		
SHAREHOLDER'S EQUITY:		
Common stock, \$0.50 par value - 30,000 shares authorized; 20,000 shares issued and outstanding	10	10
Paid-in capital	69,442	69,442
Retained earnings	328,505	283,798
Total shareholder's equity	<u>397,957</u>	<u>353,250</u>
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	<u>\$ 7,381,179</u>	<u>\$ 5,630,735</u>

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

NATIONAL SECURITIES CLEARING CORPORATION

STATEMENTS OF INCOME

<u>(In thousands)</u>	For the years ended December 31,	
	2016	2015
REVENUES:		
Clearing services	\$ 270,512	\$ 263,536
Wealth management services	104,954	103,001
Other	3,477	1,270
Total revenues	<u>378,943</u>	<u>367,807</u>
EXPENSES:		
Employee compensation and related benefits	122,860	129,479
Information technology	34,298	29,984
Professional and other services	104,367	110,472
Occupancy	9,340	10,082
Depreciation and amortization	24,010	23,156
Other general and administrative	7,031	7,942
Total expenses	<u>301,906</u>	<u>311,115</u>
Total operating income	<u>77,037</u>	<u>56,692</u>
NON-OPERATING INCOME (EXPENSE):		
Interest income	11,325	1,176
Interest expense	(12,671)	(1,257)
Total non-operating expense	<u>(1,346)</u>	<u>(81)</u>
Income before taxes	75,691	56,611
Provision for income taxes	30,984	23,908
Net income	<u>\$ 44,707</u>	<u>\$ 32,703</u>

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

NATIONAL SECURITIES CLEARING CORPORATION

STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY

(In thousands)	Common Stock	Paid-In Capital	Retained Earnings	Total Shareholder's Equity
BALANCE - January 1, 2015	\$ 10	\$ 34,442	\$ 251,095	\$ 285,547
Capital contribution from DTCC	—	35,000	—	35,000
Net income	—	—	32,703	32,703
BALANCE - December 31, 2015	10	69,442	283,798	353,250
Net income	—	—	44,707	44,707
BALANCE - December 31, 2016	<u>\$ 10</u>	<u>\$ 69,442</u>	<u>\$ 328,505</u>	<u>\$ 397,957</u>

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

NATIONAL SECURITIES CLEARING CORPORATION

STATEMENTS OF CASH FLOWS

<u>(In thousands)</u>	For the years ended December 31,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 44,707	\$ 32,703
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	24,010	23,156
Impairment on Intangible assets	—	476
Deferred income taxes	2,884	1,101
Changes in operating assets and liabilities:		
Decrease (increase) in Accounts receivable	47,395	(47,311)
Increase in Other assets	(10,769)	(1,322)
Increase in Other Participants' assets	(400)	(71)
Increase (decrease) in Accounts payable	2,408	(1,208)
Increase (decrease) in Other liabilities	358	(3,090)
Decrease in Payable to Participants	(10,295)	(15,357)
Net cash provided by (used in) operating activities	<u>100,298</u>	<u>(10,923)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Reverse repurchase agreements	(100,000)	—
Purchases of Investments in marketable securities	—	(7,400)
Maturities of Investments in marketable securities	7,400	—
Decrease in Participants' segregated cash	10,695	15,428
Purchases of Intangible assets	(18,634)	(15,340)
Purchases of Premises and equipment	(366)	—
Net cash used in investing activities	<u>(100,905)</u>	<u>(7,312)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in Commercial paper, net	1,546,896	1,007,124
Proceeds received on Loan payable to DTCC	—	100,000
Repayments on Loan payable to DTCC	(99,000)	(1,000)
Capital contribution from DTCC	—	35,000
Net cash provided by financing activities	<u>1,447,896</u>	<u>1,141,124</u>
Net increase in Cash and cash equivalents	1,447,289	1,122,889
Cash and cash equivalents - Beginning of year	<u>1,320,379</u>	<u>197,490</u>
Cash and cash equivalents - End of year	<u>\$ 2,767,668</u>	<u>\$ 1,320,379</u>
SUPPLEMENTAL DISCLOSURES:		
Cash interest paid	<u>\$ 10,441</u>	<u>\$ 761</u>
Cash income taxes paid to DTCC - net of refunds	<u>\$ 28,440</u>	<u>\$ 27,323</u>

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

1. BUSINESS AND OWNERSHIP

National Securities Clearing Corporation (NSCC or the Company), a clearing agency registered with the U.S. Securities and Exchange Commission (SEC) and provides central counterparty (CCP) services to firms of the financial community (collectively referred to as Participants), consisting principally of securities trade capture, clearance, netting, settlement and risk management services.

On October 28, 2016, Crestside Facilities Corporation, a wholly-owned subsidiary of NSCC, was dissolved. As a result of the dissolution, NSCC is no longer a consolidated company under U.S. GAAP.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation. The accompanying Financial Statements are prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP).

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 Financial Statements. Management makes estimates regarding, among other things, the collectability of receivables, the outcome of litigation, the realization of deferred taxes, unrecognized tax benefits, 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.

Cash and cash equivalents. All highly liquid investments purchased with an original maturity of three months or less at the date of acquisition are classified as Cash and cash equivalents. Cash equivalents consist primarily of highly liquid investments in deposits held in banks.

Reverse repurchase agreements. The Company receives collateral in connection with reverse repurchase agreement transactions. Reverse repurchase agreements provide for delivery of cash in exchange for securities having a fair value that is at least 102% of the amount of the agreements. Securities purchased under reverse repurchase agreements are typically U.S. Treasury and agency securities. Reverse repurchase agreements are recorded at the contract amounts. Interest earned on these investments is included within Interest income in the accompanying Statements of Income.

Investments in marketable securities. All of the marketable securities are classified as held-to-maturity and are recorded at amortized cost. The Company intends and has the ability to hold all held-to-maturity securities to maturity. The Company does not intend to reclassify any amount of held-to-maturity investments to available-for-sale or trading investments.

The Company performs a periodic review of its investment portfolio for impairment. A debt security is considered impaired if its fair value is less than its carrying value. Any unrealized loss deemed other-than-temporary is included in current period earnings. The decline in fair value is determined to be other-than-temporary impairment if (a) the Company has the intent to sell the impaired debt security, or (b) it is more likely than not that the Company will be required to sell the security before recovery of the amortized cost in which case the carrying value is adjusted, or (c) the Company does not expect to recover the entire amortized cost basis. The Company does not intend to sell those securities and it is not more likely than not that the Company will have to sell.

Participants' segregated cash. NSCC receives cash from Participants for the exclusive benefit of the Participants' customers in compliance with SEC rule 15c3-3 (customer protection).

Fair value measurements. The Company may be required or permitted to measure and disclose certain assets and liabilities using fair value measurements. Fair value is defined as the price 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. The Company uses a three-level classification hierarchy of fair value measurements that establishes the quality of inputs used to measure fair value. The fair value of financial instruments is determined using various techniques that involve some level of estimation and judgment, the degree of which is dependent on the price transparency and the complexity of the instruments.

Accounts receivable. Accounts receivable are stated at cost, net of an allowance for doubtful accounts. The Company establishes an allowance for estimated losses resulting from uncollectibility. The Company determines the need for an allowance based on a variety of factors, including the length of time receivables are past due, macroeconomic conditions, historical experience and the financial condition of customers and other debtors.

Clearing Fund. The rules of NSCC 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. Margin deposits and Participant contributions are maintained within the Clearing Fund on the accompanying Statements of Financial Condition due to the benefits and risks of ownership incurred by the Company. Deposits and contributions may be in the form of cash and cash equivalents and securities. These deposits may be applied to satisfy obligations of the depositing Participant, other Participants, or the Company as provided in NSCC's rules.

Cash deposits. Deposits and contributions received in the form of cash may be invested in bank deposits, reverse repurchase agreements, money market funds and direct obligations of the U.S. Government. Reverse repurchase agreements provide for NSCC's delivery of cash in exchange for securities having a fair value that is at least 102% of the amount of the agreements. Securities purchased under reverse repurchase agreements are typically U.S. Treasury and agency securities. Reverse repurchase agreements are recorded at the contract amounts. All interest earned on these investments is accrued and refunded to Participants within Interest income in the accompanying Statements of Income.

Securities on deposit - at fair value. Securities may include U.S. Treasury securities, U.S. agency debt securities and U.S. agency residential mortgage-backed securities. All interest earned on these investments is accrued and refunded to Participants within Interest income in the accompanying Statements of Income.

Premises and equipment. Premises and equipment are stated at cost, net of accumulated depreciation. Routine maintenance, repairs and replacement costs are expensed as incurred and improvements that extend the useful life of the assets are capitalized. When equipment is sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in the accompanying Statements of Income. Premises and equipment are reviewed for impairment whenever events or changes in circumstances indicate the related carrying amount may not be recoverable.

Leasehold improvements are amortized using the straight-line method over their useful lives or the remaining term of the related lease, whichever is shorter. Furniture and equipment are depreciated over estimated useful lives ranging from five to seven years, using the straight-line method. Building and improvements are primarily amortized over 39 years using the straight-line method. Depreciation expense for leasehold improvements, furniture and equipment, and buildings and improvements is included in Depreciation and amortization in the accompanying Statements of Income.

Intangible assets. Intangible assets represent capitalized software. The Company capitalizes eligible costs associated with the acquisition or development of internal-use software projects that provide new or significantly improved functionality. The Company capitalizes projects expected to result in longer-term operational benefits, such as replacement systems or new applications that result in significantly increased operational efficiencies or functionality. All other costs incurred in connection with an internal-use software project are expensed as incurred.

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate the related carrying amount may not be recoverable. Intangible assets are amortized over estimated useful lives ranging from three to five years using the straight-line method.

NATIONAL SECURITIES CLEARING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

Commercial paper. NSCC issues Commercial paper under a \$5 billion Commercial paper program. The proceeds from the issuance of the Commercial paper constitute liquid resources of NSCC that, together with other liquid resources of the Company, will enable NSCC to effect the settlement of its payment obligations in the event of the default of any of its Participants in accordance with NSCC's rules and procedures. Pending use by NSCC of the proceeds of the Commercial paper issuance for this purpose, the funds raised are invested in highly liquid short-term instruments in accordance with NSCC's investment policy.

Revenue recognition. The Company's revenue primarily consists of fees generated from clearing services and wealth management services. Revenue is generally recognized as services are rendered and is billed on a monthly basis.

Income taxes. The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amount and tax bases of assets and liabilities. Valuation allowances are recognized if, based on the weight of available evidence, it is more likely than not that some portion of the deferred tax asset will not be realized. Deferred tax assets and liabilities are reported net in non-current assets or liabilities on the accompanying Statements of Financial Condition. It is the Company's policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by the tax authorities.

Expense allocations. Substantially all expenses are recorded at DTCC and are allocated to its subsidiaries, including NSCC, based upon their use of such goods or services as determined by various allocation factors including direct expenses, level of support provided and utilization of technology resources. Accordingly, the expense classifications in the accompanying Statements of Income represent allocated expenses including Employee compensation and related benefits, Information technology, Professional and other services, Occupancy, Depreciation and amortization, and Other general and administrative.

Reclassification. In the fourth quarter of 2016, the Company reclassified \$1,270,000 from Settlement and asset services in the December 31, 2015 Statement of Income to Other revenues to conform to the current period presentation.

NATIONAL SECURITIES CLEARING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

3. ACCOUNTING AND REPORTING DEVELOPMENTS

Standard	Description	Date of Issuance/ Adoption	Impact on the financial statements or other significant matters
<i>Recently Issued Accounting Standards</i>			
ASU No. 2016-18, <i>FASB ASC Topic 230, Statement of Cash Flows</i>	The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. The amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows.	November 2016/ January 1, 2018 Early adoption is permitted	The Company is evaluating the effect on its Statement of Cash Flows and related disclosures.
ASU No. 2016-15, <i>FASB ASC Topic 230, Statement of Cash Flows</i>	The amendments in this update address eight specific cash flow issues with the objective of reducing the existing diversity in treatment. The cash flow issues addressed include: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; separately identifiable cash flows and application of the predominance principle. The amendments provide guidance for each of the eight issues, where current guidance is either unclear or does not specify treatment, thereby reducing the current and potential future diversity in practice.	August 2016/ January 1, 2018 Early adoption is permitted.	The Company is evaluating the impact on its Statement of Cash Flows and related disclosures.
ASU No. 2016-13, <i>FASB ASC Topic 326, Financial Instruments - Credit Losses</i>	The standard replaces the current incurred loss approach for credit losses with an "expected loss" model for instruments measured at amortized cost. All lifetime credit losses for financial assets held at the reporting date will be required to be estimated based on factors such as historical experience, current conditions and forecasts. Additionally, the standard requires entities to record allowances for available-for-sale debt securities.	June 2016/ January 1, 2020 Early adoption is permitted for fiscal years beginning after December 15, 2018.	The Company is evaluating the effect on its Financial Statements and related disclosures.

NATIONAL SECURITIES CLEARING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

Standard	Description	Date of Issuance/ Adoption	Impact on the financial statements or other significant matters
<i>Recently Issued Accounting Standards (Continued)</i>			
ASU No. 2016-01, <i>FASB ASC Topic 825, Recognition and Measurement of Financial Assets and Financial Liabilities</i>	The standard requires the fair value measurement of unconsolidated equity investments, except those accounted for under the equity method. Entities will be required to measure these investments at the end of each reporting period and recognize the changes in fair value in net income. Entities will no longer be able to recognize unrealized gains and losses on equity securities classified as available-for-sale in other comprehensive income.	January 2016/ January 1, 2018 Early adoption is permitted.	The Company is evaluating the effect on its Financial Statements and related disclosures.
ASU No. 2014-09, <i>FASB ASC Topic 606 Revenue from Contracts with Customers</i> ASU No. 2016-08, <i>Principal versus Agent Considerations (Reporting Revenue Gross versus Net)</i> ASU No. 2016-10, <i>Identifying Performance Obligations and Licensing</i> ASU No. 2016-12, <i>Narrow-Scope Improvements and Practical Expedients</i>	The standards outline a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. Additionally, the ASU expands the disclosure requirements for revenue recognition.	May 2014/ January 1, 2018 Early adoption is permitted.	The Company is evaluating the updated revenue recognition guidance collectively, including the alternative methods of adoption. On a preliminary basis, the Company does not anticipate a material change to the timing and pattern of revenue recognition, although the analysis used to determine the timing and pattern of revenue recognition will differ. The Company anticipates the primary impact of the adoption on its Financial Statements will be the additional required disclosures around revenue recognition in the notes to its financial statements. The Company's preliminary assessment is subject to change.

NATIONAL SECURITIES CLEARING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

Standard	Description	Date of Issuance/ Adoption	Impact on the financial statements or other significant matters
<i>Recently Adopted Accounting Standards</i>			
ASU No. 2015-17, <i>FASB ASC Topic 740, Income Taxes</i>	The update required 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 aligned the presentation of deferred tax assets and liabilities with International Financial Reporting Standards.	November 2015/ December 31, 2015	The Company early adopted this standard prospectively and reclassified all of its deferred tax liabilities to noncurrent deferred tax liabilities on its Statement of Financial Condition as of December 31, 2015. The adoption did not have a material impact to its Statements of Income, Cash Flows or related disclosures. This standard was not retrospectively applied and prior periods were not adjusted.

4. PARTICIPANTS' SEGREGATED CASH, OTHER PARTICIPANTS' ASSETS AND PAYABLE TO PARTICIPANTS

Details for Participants' segregated cash, Other Participants' assets and Payable to Participants as of December 31, 2016 and 2015 follow (in thousands):

	2016	2015
Assets:		
Participants' segregated cash	\$ 15,886	\$ 26,581
Other Participants' assets	665	265
Total	<u>\$ 16,551</u>	<u>\$ 26,846</u>
Liabilities:		
Payable to Participants	\$ 16,551	\$ 26,846
Total	<u>\$ 16,551</u>	<u>\$ 26,846</u>

Segregated cash received from Participants to facilitate their compliance with SEC customer protection rules, and cash received from Participants to collateralize their short positions. Unclaimed balances are remitted to the appropriate authority when required by abandoned property laws.

5. ACCOUNTS RECEIVABLE

Details for Accounts receivable as of December 31, 2016 and 2015 follow (in thousands):

	2016	2015
Clearing and transaction fees due from Participants	\$ 32,284	\$ 32,653
Due from related parties ⁽¹⁾	—	47,026
Total	<u>\$ 32,284</u>	<u>\$ 79,679</u>

There were no allowances for doubtful accounts as of December 31, 2016 and 2015.

(1) See Note 15 for additional information.

NATIONAL SECURITIES CLEARING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

6. CLEARING FUND

Details for the Clearing Fund deposits as of December 31, 2016 and 2015 follow (in thousands):

	2016	2015
Required deposits	\$ 3,580,823	\$ 3,164,627
Excess deposits	819,133	972,843
Total	<u>\$ 4,399,956</u>	<u>\$ 4,137,470</u>

Details for the total deposits as of December 31, 2016 and 2015 follow (in thousands):

	2016	2015
Cash deposits	\$ 4,157,717	\$ 3,847,082
Securities on deposit - at fair value	242,239	290,388
Total	<u>\$ 4,399,956</u>	<u>\$ 4,137,470</u>

Details for the Clearing Fund cash deposits as of December 31, 2016 and 2015 follow (in thousands):

	2016	2015
Bank deposits	\$ 3,170,717	\$ 850,082
Money market fund investments	737,000	2,382,000
Reverse repurchase agreements	250,000	615,000
Total	<u>\$ 4,157,717</u>	<u>\$ 3,847,082</u>

Clearing Fund cash deposits. Clearing Fund cash deposits to the Clearing Fund may be applied to satisfy obligations of the depositing Participants as provided in NSCC's rules.

Refunds to Participants. Interest income earned from the investment of Clearing Fund deposits is refunded to Participants and totaled \$26,715,000 and \$6,559,000 for the years ended December 31, 2016 and 2015, respectively. The amounts refunded are netted within Interest income in the accompanying Statements of Income.

NATIONAL SECURITIES CLEARING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

7. PREMISES AND EQUIPMENT

The cost, accumulated depreciation and net book value of Premises and equipment for the years ended December 31, 2016 and 2015 follow (in thousands):

	Furniture and equipment	Leasehold improvements	Capital Leases	Buildings and improvements	Land	Total
Cost:						
As of January 1, 2015	\$ 58,342	\$ 10,514	\$ 5,556	\$ 17,971	\$ 1,540	\$ 93,923
Disposals	(4,737)	(8,685)	—	(1,648)	—	(15,070)
As of December 31, 2015	53,605	1,829	5,556	16,323	1,540	78,853
Additions	366	—	—	—	—	366
Disposals	(310)	—	(5,556)	—	—	(5,866)
As of December 31, 2016	<u>\$ 53,661</u>	<u>\$ 1,829</u>	<u>\$ —</u>	<u>\$ 16,323</u>	<u>\$ 1,540</u>	<u>\$ 73,353</u>
Accumulated Depreciation:						
As of January 1, 2015	\$ 44,456	\$ 10,514	\$ 5,556	\$ 4,447	\$ —	\$ 64,973
Depreciation expense	3,677	—	—	1,052	—	4,729
Disposals	(4,737)	(8,685)	—	(1,648)	—	(15,070)
As of December 31, 2015	43,396	1,829	5,556	3,851	—	54,632
Depreciation expense	4,672	—	—	193	—	4,865
Disposals	(310)	—	(5,556)	—	—	(5,866)
As of December 31, 2016	<u>\$ 47,758</u>	<u>\$ 1,829</u>	<u>\$ —</u>	<u>\$ 4,044</u>	<u>\$ —</u>	<u>\$ 53,631</u>
Net book value:						
As of January 1, 2015	<u>\$ 13,886</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 13,524</u>	<u>\$ 1,540</u>	<u>\$ 28,950</u>
As of December 31, 2015	<u>\$ 10,209</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 12,472</u>	<u>\$ 1,540</u>	<u>\$ 24,221</u>
As of December 31, 2016	<u>\$ 5,903</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 12,279</u>	<u>\$ 1,540</u>	<u>\$ 19,722</u>

NATIONAL SECURITIES CLEARING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

8. INTANGIBLE ASSETS

The gross carrying value, accumulated amortization, and net carrying value of capitalized software for the years ended December 31, 2016 and 2015 follow (in thousands):

	Capitalized Software
Gross carrying value:	
As of January 1, 2015	\$ 139,570
Additions	15,340
Impairment	(2,363)
As of December 31, 2015	<u>152,547</u>
Additions	18,634
As of December 31, 2016	<u><u>\$ 171,181</u></u>
Accumulated amortization:	
As of January 1, 2015	\$ 102,589
Amortization expense	18,427
Write-offs	(1,887)
As of December 31, 2015	<u>119,129</u>
Amortization expense	19,145
As of December 31, 2016	<u><u>\$ 138,274</u></u>
Net carrying value:	
As of January 1, 2015	<u>\$ 36,981</u>
As of December 31, 2015	<u>\$ 33,418</u>
As of December 31, 2016	<u><u>\$ 32,907</u></u>

The Company recognized impairment charges of \$0 and \$476,000 for the years ended December 31, 2016 and 2015, respectively, that were determined to have no realizable value. The impairment charges are included within Other general and administrative in the accompanying Statements of Income.

Details for estimated amortization expense for each of the next four years follow (in thousands):

2017	\$ 15,253
2018	10,719
2019	5,077
2020	1,858
Total future estimated amortization	<u><u>\$ 32,907</u></u>

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9. COMMERCIAL PAPER

Details for Commercial paper as of December 31, 2016 and 2015 follow (in thousands):

	<u>2016</u>	<u>2015</u>
Commercial paper - net of unamortized discount of \$1,669 and \$435 as of December 31, 2016 and 2015, respectively	\$ 2,554,020	\$ 1,007,124
Weighted-average interest rates	0.75%	0.40%

Interest expense on Commercial paper included in the accompanying Statements of Income was \$11,433,000 and \$232,000 for the years ended December 31, 2016 and 2015, respectively.

Details for the cash flows associated with the issuance and maturities of Commercial paper for the years ended December 31, 2016 and 2015 follow (in thousands):

	<u>2016</u>	<u>2015</u>
Maturities less than 90 days:		
Proceeds from Commercial paper less than 90 days, net	\$ 830,061	\$ 972,156
Maturities greater than 90 days:		
Proceeds from Commercial paper	1,681,596	34,968
Repayments of Commercial paper	(964,761)	—
Proceeds from Commercial paper greater than 90 days, net	<u>716,835</u>	<u>34,968</u>
Total proceeds from Commercial paper, net	<u>\$ 1,546,896</u>	<u>\$ 1,007,124</u>

10. DEBT

Details for the Loan payable to DTCC including the interest rate, term and maturity as of December 31, 2016 and 2015 follow (in thousands):

	<u>Rate</u>	<u>Issue Date</u>	<u>Maturity</u>	<u>Outstanding Balance</u>	
				<u>2016</u>	<u>2015</u>
Loan payable to DTCC	LIBOR+1.30%	5/1/2015	On demand	\$ —	\$ 99,000

Loan payable to DTCC. The proceeds of the loan supplemented the Company's liquid financial resources pursuant to the SEC's standards for covered clearing agencies. The loan was fully repaid as of December 31, 2016. Interest on the loan, which is included in Interest expense in the accompanying Statements of Income was \$1,238,000 and \$1,010,000 for the years ended December 31, 2016 and 2015, respectively.

Line of credit. The Company maintains a line of credit to support settlement. Details for the terms of the outstanding line of credit as of December 31, 2016 and 2015 follow:

	<u>2016</u>	<u>2015</u>
Committed Amount	\$10.9 billion	\$12.1 billion
Number of Participants / Lenders	31/37	31/38
Borrowing Rate	The greater of the federal funds offered rate, adjusted LIBOR, or lenders' cost of funds, on the day of borrowing, plus 1.40%.	

There were no borrowings under the line of credit as of December 31, 2016 and 2015.

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Details for debt covenants related to the line of credit as of December 31, 2016 and 2015 follow:

	2016	2015
Minimum Net Worth	\$125 million	\$100 million
Minimum Clearing Fund deposits	1 billion	1 billion

As of December 31, 2016 and 2015, the Company was in compliance with its debt covenants.

Credit Ratings. The Company is rated by Moody's Investors Service, Inc. (Moody's) and S&P Global Inc. (S&P). Details for senior debt ratings and ratings outlooks for the Company as of December 31, 2016 follow:

Moody's ⁽¹⁾			S&P		
Long-term	Short-term	Outlook	Long-term ⁽²⁾	Short-term	Outlook ⁽²⁾
Aaa	P-1	Stable	AA+	A-1+	Stable

- (1) Moody's categorizes the long-term issuer ratings of the Company as a clearing counterparty rating (CCR) under their new Clearing Houses Rating Methodology introduced in January 2016.
- (2) On May 17, 2016, S&P placed the AA+ long-term issuer credit rating of NSCC on CreditWatch with negative implications. Subsequently, on September 20, 2016, NSCC's long-term rating was affirmed by S&P and its ratings outlook was changed to stable.

11. FAIR VALUE MEASUREMENTS

Valuation hierarchy

U.S. GAAP provides for a three-level valuation hierarchy based on the transparency of inputs to the valuation of an asset or liability as of the measurement date. Details for the descriptions of the three levels follow:

- Level 1 — Inputs to the valuation methodology are unadjusted quoted market prices for identical assets or liabilities in active markets as of the valuation date.
- Level 2 — Inputs to the valuation methodology are quoted market prices for similar assets and liabilities in active markets; quoted market prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 — Inputs to the valuation methodology are unobservable and reflect the Company's own assumptions about the estimates market participants would use pricing the asset or liability based on the best information available in the circumstances (e.g., internally derived assumptions surrounding timing and amount of expected cash flows).

A financial asset or liability's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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Financial assets and liabilities measured at fair value on a recurring basis. For financial assets and liabilities measured at fair value on a recurring basis the Company applies the following valuation techniques to measure fair value:

Product/ Instrument	Valuation Methodology	Classification in the valuation hierarchy
<u>Assets - Clearing Fund - Securities on deposit</u>		
U.S. Treasury Securities	Obtained from pricing services engaged by the Company, and the Company receives one price for each security. The fair values provided by the pricing services are estimated using pricing models, where the inputs to those models are based on observable market inputs or recent trades of similar securities.	Level 1
U. S. Agency Issued Debt Securities	Obtained from pricing services engaged by the Company, and the Company receives one price for each security. The fair values provided by the pricing services are estimated using pricing models, where the inputs to those models are based on observable market inputs or recent trades of similar securities.	Level 1
<u>Liabilities - Clearing Fund - Securities on deposit</u>		
U.S. Treasury Securities	Obtained from pricing services engaged by the Company, and the Company receives one price for each security. The fair values provided by the pricing services are estimated using pricing models, where the inputs to those models are based on observable market inputs or recent trades of similar securities.	Level 1
U. S. Agency Issued Debt Securities	Obtained from pricing services engaged by the Company, and the Company receives one price for each security. The fair values provided by the pricing services are estimated using pricing models, where the inputs to those models are based on observable market inputs or recent trades of similar securities.	Level 1

Fair value measurements for those items measured on a recurring basis are summarized below as of December 31, 2016 and 2015 (in thousands):

	2016			
	Level 1	Level 2	Level 3	Total
Assets - Clearing Fund				
Securities on deposit	\$ 242,239	\$ —	\$ —	\$ 242,239
Liabilities - Clearing Fund				
Securities on deposit	\$ 242,239	\$ —	\$ —	\$ 242,239
	2015			
	Level 1	Level 2	Level 3	Total
Assets - Clearing Fund				
Securities on deposit	\$ 290,388	\$ —	\$ —	\$ 290,388
Liabilities - Clearing Fund				
Securities on deposit	\$ 290,388	\$ —	\$ —	\$ 290,388

There were no transfers between levels within the fair value hierarchy, nor were any amounts classified as Level 3 for the years ended December 31, 2016 and 2015.

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Financial assets and liabilities measured at other than fair value. For financial assets and liabilities that are not required to be carried at fair value on a recurring basis the Company applies the following valuation techniques to measure fair value:

Product/ Instrument	Valuation Methodology	Classification in the valuation hierarchy
<u>Assets - Current Assets</u>		
<u>Investments in marketable securities</u>		
U.S. Treasury bills	Obtained from pricing services engaged by the Company, and the Company receives one price for each security. The fair values provided by the pricing services are estimated using pricing models, where the inputs to those models are based on observable market inputs or recent trades of similar securities.	Level 1
<u>Liabilities - Current Liabilities</u>		
Loan payable to DTCC	Discounted cash flows using current market rates for similar instruments of the same remaining maturity or quoted prices for the same of similar issues	Level 2

Financial assets and liabilities whose carrying value approximates fair value. The carrying values of certain assets and liabilities approximate their fair values because they are short-term in duration, have no defined maturity, or have market-based interest rates. These instruments include Cash and cash equivalents, Reverse repurchase agreements, Participants' segregated cash, Accounts receivable, Clearing Fund - Cash deposits, Commercial paper, Other Participants' assets, Accounts payable and Payable to Participants.

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The tables below present the carrying values, fair values and fair value hierarchy levels of certain financial instruments measured at other than fair value on the accompanying Statements of Financial Condition as of December 31, 2016 and 2015 (in thousands):

	2016				
	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	\$ 2,767,668	\$ 2,767,668	\$ 2,767,668	\$ —	\$ —
Reverse repurchase agreements ⁽¹⁾	100,000	100,000	—	100,000	—
Participants' segregated cash	15,886	15,886	15,886	—	—
Accounts receivable	32,284	32,284	—	32,284	—
Clearing Fund Cash deposits	4,157,717	4,157,717	3,907,717	250,000	—
Other Participants' assets	665	665	231	434	—
Total	\$ 7,074,220	\$ 7,074,220	\$ 6,691,502	\$ 382,718	\$ —
Liabilities:					
Commercial paper	\$ 2,554,020	\$ 2,554,020	\$ —	\$ 2,554,020	\$ —
Accounts payable	2,578	2,578	—	2,578	—
Payable to Participants	16,551	16,551	16,551	—	—
Clearing Fund Cash deposits	4,157,717	4,157,717	4,157,717	—	—
Total	\$ 6,730,866	\$ 6,730,866	\$ 4,174,268	\$ 2,556,598	\$ —

(1) The fair value of securities received as collateral under reverse repurchase agreements was \$102 million as of December 31, 2016.

	2015				
	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	\$ 1,320,379	\$ 1,320,379	\$ 1,320,379	\$ —	\$ —
Investments in marketable securities	7,400	7,400	7,400	—	—
Participants' segregated cash	26,581	26,581	26,581	—	—
Accounts receivable	79,679	79,679	—	79,679	—
Clearing Fund Cash deposits	3,847,082	3,847,082	3,232,082	615,000	—
Other Participants' assets	265	265	232	33	—
Total	\$ 5,281,386	\$ 5,281,386	\$ 4,586,674	\$ 694,712	\$ —
Liabilities:					
Commercial paper	\$ 1,007,124	\$ 1,007,124	\$ —	\$ 1,007,124	\$ —
Loan payable to DTCC	99,000	99,000	—	99,000	—
Accounts Payable	170	170	—	170	—
Payable to Participants	26,846	26,846	26,846	—	—
Clearing Fund Cash deposits	3,847,082	3,847,082	3,847,082	—	—
Total	\$ 4,980,222	\$ 4,980,222	\$ 3,873,928	\$ 1,106,294	\$ —

Financial assets measured at fair value on a non-recurring basis. Certain assets are subject to measurement at fair value on a non-recurring basis. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if determined to be impaired. Fair value is based on discounted cash flow analyses or comparing values of similar instruments. Discounted cash flow analyses are dependent upon various factors including estimated future cash flows, interest rate yield curves and volatility of inputs.

Fair value on the aforementioned capitalized software impairment, disclosed in Note 8, was based on discounted cash flows using Level 3 inputs under the fair value guidance. The cash flows are those expected to be generated by the market participants, discounted at the risk-free rate of interest. The impairment charges are included in the accompanying Statements of Income.

12. PENSION AND POSTRETIREMENT BENEFITS

DTCC eligible employees participate in DTCC’s trustee non-contributory defined benefit pension plan, supplemental executive retirement plan and benefit restoration plan, which provide for certain benefits upon retirement. DTCC 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. The benefit plan costs allocated to NSCC were \$2,793,000 and \$3,631,000 for the years ended December 31, 2016 and 2015, respectively. These costs are included in Employee compensation and related benefits in the accompanying Statements of Income.

13. INCOME TAXES

NSCC is included in DTCC’s consolidated Federal and combined and unitary state tax returns. NSCC files other state tax returns on a separate company basis.

Details for the components of the Company’s income tax provision calculated on a separate company basis for the years ended December 31, 2016 and 2015 follow (in thousands):

	<u>2016</u>	<u>2015</u>
Current income tax:		
Federal	\$ 21,860	\$ 16,201
State and local	5,763	5,928
Total current income tax	<u>27,623</u>	<u>22,129</u>
Deferred income tax:		
Federal	2,210	1,218
State and local	1,151	561
Total deferred income tax	<u>3,361</u>	<u>1,779</u>
Provision for income taxes	<u>\$ 30,984</u>	<u>\$ 23,908</u>

Pursuant to a tax sharing agreement between DTCC and NSCC, the Company is liable for its allocable share of Federal, state and local tax liabilities that are paid by DTCC. For the years ended December 31, 2016 and 2015, the Company paid income taxes to DTCC, net of refunds, of \$28,440,000 and \$27,323,000, respectively.

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The 2016 and 2015 effective tax rates differ from the 35% Federal statutory rate primarily due to state and local taxes and changes in unrecognized tax benefits.

Details for the reconciliation of the U.S. Federal statutory tax rate to the Company's effective tax rate on Income before taxes for the years ended December 31, 2016 and 2015 follow:

	<u>2016</u>	<u>2015</u>
U.S. statutory tax rate	35.0%	35.0%
State and local income taxes, net of Federal tax benefit	5.9	5.6
Change in unrecognized tax benefits	0.4	0.8
Other	(0.4)	0.8
Effective tax rate	<u>40.9%</u>	<u>42.2%</u>

Details for the components of deferred tax assets and (liabilities) as of December 31, 2016 and 2015 follow (in thousands):

	<u>2016</u>	<u>2015</u>
<u>Deferred tax assets:</u>		
Accrued compensation	\$ 838	\$ 1,323
Accrued employee benefits	6,902	9,528
Deferred rent	2,679	1,287
Other	2,231	2,065
Total deferred tax assets	<u>\$ 12,650</u>	<u>\$ 14,203</u>
<u>Deferred tax liabilities:</u>		
Depreciation	\$ (2,089)	\$ (1,992)
Software	(14,296)	(13,062)
Total deferred tax liabilities	<u>\$ (16,385)</u>	<u>\$ (15,054)</u>
Net deferred tax liabilities	<u>\$ (3,735)</u>	<u>\$ (851)</u>

The deferred tax assets are expected to be fully realized and, accordingly, no valuation allowance was established.

Details for unrecognized tax benefits as of December 31, 2016 and 2015 follow (in thousands):

	<u>2016</u>	<u>2015</u>
Beginning balance at January 1,	\$ 4,100	\$ 3,878
Increases to prior period tax positions	—	222
Ending balance as of December 31,	<u>\$ 4,100</u>	<u>\$ 4,100</u>

The Company classifies interest and penalties related to unrecognized tax benefits, if incurred, in Provision for income taxes in its accompanying Statements of Income. As of December 31, 2016 and 2015, accrued interest related to unrecognized tax benefits recorded on the accompanying Statements of Financial Condition totaled \$2,276,000 and \$1,799,000, respectively.

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The Company is subject to U.S. Federal income tax as well as income tax in various state and local jurisdictions.

Details for the periods currently under examination and remaining subject to examination by jurisdiction as of December 31, 2016 follow:

Jurisdiction	Tax Years	
	Under Examination	Subject to Examination
U.S. Federal - Internal Revenue Service ("IRS")	2009 - 2012 ⁽¹⁾	2013 - 2015
New York State	2007 - 2011	2012 - 2015
New York City	2010 - 2011	2013 - 2015
State of Florida	2010 - 2013	2014 - 2015
State of Illinois	2012 - 2013	2014 - 2015

(1) The IRS concluded its review of the Federal income tax returns for 2009 through 2012; however, it is pending the closing agreements from the IRS.

For the current ongoing audits related to open tax years, the Company estimates it is possible the balance of unrecognized tax benefits could decrease in the next twelve months as a result of the effective settlement of these audits, which might involve the payment of additional taxes, the adjustment of certain deferred taxes and/or the recognition of tax benefits. It is also possible new issues might be raised by tax authorities which might necessitate increases to the balance of unrecognized tax benefits. As the Company is unable to predict the timing of conclusion of these audits, the Company is unable to estimate the amount of changes to the balance of unrecognized tax benefits at this time. However, the Company believes it has adequately provided for its financial exposure for all open tax years by tax jurisdiction.

14. SHAREHOLDER’S EQUITY

On May 1, 2015, the Company received a capital contribution from DTCC in the amount of \$35 million. The proceeds of the capital contribution supplement the Company’s capital and liquid financial resources pursuant to the SEC’s standards for covered clearing agencies.

15. TRANSACTIONS WITH RELATED PARTIES

In the ordinary course of the business, the Company enters into related party transactions with DTCC and its other subsidiaries. From time-to-time, the Company funds purchases of long-term assets acquired by DTCC on its behalf.

Transactions with DTCC. NSCC has an agreement with DTCC whereby DTCC pays for substantially all of the operational expenses of NSCC. The related expenses are allocated to NSCC based upon its use of such goods or services. Further, the agreement provides that DTCC performs credit and quantitative risk services, and certain other services for NSCC including administrative, internal audit, finance and legal services. In 2016 and 2015, the billing for these services was 108% of total allocated expenses, excluding charges passed through to Participants and capitalized software costs. The fee, representing the amount over actual cost, is included in Professional and other services in the accompanying Statements of Income.

Transactions with DTCC Solutions LLC. DTCC Solutions LLC performs validation services on behalf of NSCC in connection with NSCC’s corporate action data information and are billed at cost. Expenses under this agreement are included in Professional and other services in the accompanying Statements of Income.

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Details for related party transactions with DTCC and DTCC Solutions LLC for 2016 and 2015 follow (in thousands):

	Expenses		Payables / (Receivables) ⁽²⁾	
	For the years ended December 31,		As of December 31,	
	2016	2015	2016	2015
DTCC ⁽¹⁾	\$ 20,647	\$ 22,750	\$ 1,969	\$ (47,827)
DTCC Solutions LLC	1,697	1,581	148	801
Total	<u>\$ 22,344</u>	<u>\$ 24,331</u>	<u>\$ 2,117</u>	<u>\$ (47,026)</u>

(1) DTCC expenses relate to the 8% billing for services described above.

(2) Included in Accounts payable and Accounts receivable, respectively, on the accompanying Statements of Financial Condition.

16. 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 accompanying Statements of Financial Condition, Income or Cash Flows.

17. GUARANTEES

NSCC provides CCP services, including clearing, settlement and risk management services. Acting as a CCP, NSCC guarantees the settlement of trades in the event one or more of its Participants defaults. A Participant default is defined in NSCC's rules. In its guarantor role, NSCC has equal claims to and from Participants on opposite sides of netted transactions. To cover its guarantee risk, NSCC uses risk-based margining to collect cash and securities collateral through its Clearing Fund.

NSCC is the leading provider of clearance, netting, risk management and settlement for virtually all U.S. broker-to-broker trades involving equities, corporate and municipal debt, exchange traded funds and unit investment trusts. Through its Continuous Net Settlement (CNS) system, NSCC is interposed between Participants in securities clearance and settlement. CNS transactions are generally guaranteed as of the later of midnight of trade date plus one day (T+1) or midnight of the day the transactions are reported to the Participants as compared/recorded. Since NSCC stands between the Participants delivering and receiving CNS trades, the failure of Participants to deliver securities to NSCC on settlement date, and the corresponding failure of NSCC to redeliver the securities, results in open positions. Open CNS positions are marked-to-market daily. Such marks are debited from or credited to the involved Participants through the settlement process.

Details for certain NSCC's open positions for which a trade guarantee applied as of December 31, 2016 and 2015 follow (in billions):

	2016	2015
NSCC	\$ 168	\$ 157

There were no defaults by Participants to these obligations.

If a Participant defaults, such Participant's deposits to the Clearing Fund, including Eligible Clearing Fund Securities pledged, is the first source of funds and collateral that NSCC would use to cover any losses that may result from the close-out and liquidation of the defaulting Participant's positions. This includes any amounts that may be available to NSCC under applicable agreements with other registered clearing agencies that relate to the guaranty by one or more clearing agency parties of certain obligations of a defaulting Participant to other clearing agency parties. This may include (1) the netting contract and limited cross-guaranty between NSCC and DTC relating to collateralization across the NSCC-DTC interface, and (2) the accord between Options Clearing Corporation (OCC) and NSCC. NSCC has also entered into a multilateral netting contract and limited cross-guaranty agreement with DTC, FICC and OCC.

If there is still a deficit, NSCC will apply at least 25% of its retained earnings to cover the loss. NSCC would satisfy any remaining deficiency by utilizing the Clearing Fund and assessing its non-defaulting Members as provided for in its Rules. The process, in general, allocates any remaining liabilities pro rata among the Members of NSCC who were non-defaulting Members on the date of default, based upon the Member's usage of the service to which the loss relates.

18. OFF BALANCE SHEET AND CONCENTRATION OF CREDIT RISKS

As a CCP, NSCC is exposed to significant credit risk to third-parties including its customer base, which extends to companies within the global financial services industry. Credit risk represents the potential for loss due to the default or deterioration in credit quality of a Participant. The Company's exposure to credit risk comes mostly from clearing and settlement service operations. Customers are based in the United States and include participating brokers, dealers, banks, mutual fund companies, insurance carriers and other financial intermediaries. Credit risk also comes from financial assets, which consist principally of cash and cash equivalents, investments, accounts receivable and the Clearing Fund.

Concentrations of credit risk may arise due to large connected individual exposures and significant exposures to groups of Participants whose likelihood of default is driven by common underlying factors including economic conditions affecting the securities industry and debt-issuing countries.

Cash and cash equivalents. The Company maintains cash and cash equivalents with various financial institutions. These financial institutions are located in various geographical regions, and the Company's policy is designed to limit exposure with any one financial institution. As part of its credit and risk management processes, the Company performs periodic evaluations of the relative credit standing of the financial institutions with whom it places funds. The Company generally makes deposits with financial institutions having a credit rating of at least BBB+/Baa1 or better from recognized rating agencies and that are approved via its internal credit review process. The Company also monitors the condition of the financial institutions with whom it places funds on an ongoing basis to identify any significant change in a financial institution's condition. If such a change takes place, the amounts deposited in such financial institutions may be adjusted.

Marketable securities. In addition to making investments in reverse repurchase agreements, money market funds and bank deposits, the Company also makes direct investments in U.S. Treasury securities. Credit risk related to marketable securities involves the risk of nonperformance by the counterparty, which could result in a material loss. To mitigate the risk of credit loss, the Company only makes investments in debt obligations of the U.S. government or those U.S. government agencies guaranteed by the U.S. government.

Accounts receivable. Credit risk related to accounts receivable involves the risk of non-payment by the counterparty. Credit risk is diversified due to the large number of Participants comprising the Company's customer base. The Company also performs ongoing credit evaluations of the financial conditions of its customers and evaluates the delinquency status of the receivables.

Clearing Fund. In addition to risk management policies described above for cash and cash equivalents, when Participants provide cash deposits to the Clearing Fund, the Company may invest the cash in reverse repurchase agreements (reverse repos). The Company bears credit risk related to reverse repurchase agreements only to the extent cash advanced to the counterparty exceeds the value of collateral received. Securities purchased under reverse repos are generally U.S. Treasury and Agency securities having minimal credit risk due to low probability of U.S. government default, coupled with the highly liquid nature of these securities. Reverse repos are collateralized; collateral must have a market value greater than or equal to 102% of the cash invested. Additionally, reverse repos are typically placed with financial institutions with a credit rating of BBB+/Baa1 or better from recognized rating agencies and are approved via the Company's credit review process. To avoid concentration of credit risk exposures, the Company sets credit limits for each counterparty.

Clearing Fund cash deposits may also be invested in money market mutual funds under Rule 2a-7 of the Investment Company Act of 1940 having a credit rating of AAA/Aaa from recognized rating agencies. Since the Company invests in highly rated money market mutual funds and cash is returned daily, NSCC has minimal credit risk related to these investments.

The Company is exposed to credit risk on a daily basis. This risk arises at NSCC as it guarantees certain obligations of its Participants under specified circumstances. The Company provides risk management/mitigation by identifying, measuring and responding to these risks in order to protect the safety and soundness of the NSCC clearing and settlement system. Various tools are utilized to mitigate these risks including, but not limited to: setting capital adequacy standards; assessing new applicants; performing continuous monitoring of Participants' financial condition; reviewing Participants' daily trading activity and determining appropriate collateral requirements; maintaining the Clearing Fund; continuous trade netting; marking unsettled trades to market; and utilizing a variety of advanced quantitative analytical methodologies, such as back and stress testing.

In order to become a Participant, an applicant must meet minimum eligibility criteria which are specified in the Company's rules. All applicants to be a NSCC Participant must provide the Company with certain financial and operational information. This information is reviewed to ensure the applicant has sufficient financial resources to make anticipated contributions to the Clearing Fund and to meet its obligations to the Company. The credit quality of the Participant is evaluated at the time of application and monitored on an ongoing basis to determine if the Participant continues to be financially stable and able to meet the financial requirements of membership. As part of its review, the Company utilizes an internal credit risk-rating matrix to risk rate its Participants. The resulting rating determines the level of financial review to be performed on each Participant and may impact their Clearing Fund requirements.

The Company collects Clearing Fund deposits from its Participants using a risk-based margin methodology. The risk-based methodology enables the Company to identify the risks posed by a Participant's unsettled portfolio and to quickly adjust and collect additional deposits as needed to cover those risks. At multiple times during the day, Clearing Fund requirements are calculated for each Participant based on their then-current unsettled and pending transactions. Security pricing is updated on an intraday basis and additional charges may be collected to cover significant price movements from those Participants with a significant exposure in the identified security. The Company monitors Participants' overall trading activities throughout the trading day to determine whether exposures exist that would require special actions to increase their Clearing Fund deposits.

The Company regularly performs back and stress testing of the quality and accuracy of its risk management systems to ensure the adequacy of Clearing Fund requirements and to respond to other risk factors that the tests may reveal.

NSCC maintains a committed, secured line of credit to support potential liquidity needs in the event of a Participant default.

The Company also limits its exposure to potential losses from default by Participants through its multilateral netting contract and limited cross-guaranty agreements with DTC, FICC and OCC. These arrangements are designed to provide a mechanism for the sharing of excess net resources of a common defaulting Participant held at one clearing agency to cover losses incurred at another clearing agency. NSCC and OCC also have an agreement providing for payments to each other relating to the settlement of certain option exercises and assignments in the event of a mutual Participant's failure. Further, NSCC has a netting contract and limited cross-guaranty agreement with DTC, which includes certain arrangements so that securities delivered by DTC to NSCC to cover CNS system allocations are fully collateralized.

19. 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 (collectively, the "Clearing Agency Subsidiaries").

As a result, the Trustee, Barclays and DTCC, on behalf and for the benefit of NSCC, FICC and DTC 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.

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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 million cash deposit (the “Cash Deposit”) 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.

Details for the deposits/balances held by DTCC and its subsidiaries as of December 31, 2016 and 2015 follow (in thousands):

	2016	2015
Segregated cash	\$ 1,173	\$ 3,302
Participants/Clearing and Settlement Funds	25	1,160
Matured money market investment accounts	1,000	31,133
Total	<u>\$ 2,198</u>	<u>\$ 35,595</u>

As of December 31, 2016, DTCC had delivered to the Trustee of the LBI estate \$5,186,330,000 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.

Severance. For the years ended December 31, 2016 and 2015, severance allocated by DTCC to NSCC were \$3,701,000 and \$1,003,000, respectively, that is included within Employee compensation and related benefits in the accompanying Statements of Income.

20. SUBSEQUENT EVENTS

The Company evaluated events and transactions occurring after December 31, 2016 through February 28, 2017, for potential recognition or disclosure in these accompanying Financial Statements. No events or transactions occurred during such period that would require recognition or disclosure in these accompanying Financial Statements.