Fixed Income Clearing Corporation

Financial Statements as of and for the Years Ended December 31, 2017 and 2016, and Report of Independent Registered Public Accounting Firm

FIXED INCOME CLEARING CORPORATION

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholder of the
Fixed Income Clearing Corporation
New York, NY

Opinion on the Financial Statements

We have audited the accompanying statements of financial condition of the Fixed Income Clearing Corporation (the "Company") as of December 31, 2017 and 2016, the related statements of income, changes in shareholder's equity, and cash flows, and the related footnotes (the "notes") for each of the two years in the period ended December 31, 2017 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2017, in conformity with the accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB 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, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting 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.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Deloitte & Touche LLP

February 27, 2018

We have served as the Company's auditor since 2009.

FIXED INCOME CLEARING CORPORATION

STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)	As of December 31, 2017	2016
ASSETS:		
CURRENT ASSETS:		
Cash and cash equivalents	$ 236,922	$ 210,109
Accounts receivable	11,490	14,342
Clearing Fund	21,252,617	23,333,857
Other Participants' assets	1,131	867
Other current assets	7,632	2,265
Total current assets	21,509,792	23,561,440
NON-CURRENT ASSETS:		
Premises and equipment - net of accumulated depreciation of $1,215 and $17,617 as of December 31, 2017 and 2016, respectively	701	723
Intangible assets - net of accumulated amortization of $70,840 and $111,504 as of December 31, 2017 and 2016, respectively	18,391	15,443
Total non-current assets	19,092	16,166
TOTAL ASSETS	$ 21,528,884	$ 23,577,606
LIABILITIES AND SHAREHOLDER'S EQUITY:		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 6,621	$ 4,218
Clearing Fund	21,252,617	23,333,857
Payable to Participants	1,131	867
Other current liabilities	—	2,140
Total current liabilities	21,260,369	23,341,082
OTHER NON-CURRENT LIABILITIES:		
Other non-current liabilities	14,906	6,525
Total liabilities	21,275,275	23,347,607
COMMITMENTS AND CONTINGENCIES (Note 12)		
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	166,982	143,372
Total shareholder's equity	253,609	229,999
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$ 21,528,884	$ 23,577,606

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

FIXED INCOME CLEARING CORPORATION
STATEMENTS OF INCOME

(In thousands)	For the years ended December 31, 2017	2016
REVENUES:		
Clearing services	$ 237,111	$ 212,200
EXPENSES:		
Employee compensation and related benefits	75,789	78,769
Information technology	19,200	16,740
Professional and other services	83,023	67,574
Occupancy	5,563	6,083
Depreciation and amortization	8,418	12,082
General and administrative	3,465	3,581
Total expenses	195,458	184,829
Total operating income	41,653	27,371
NON-OPERATING INCOME (EXPENSE):		
Interest income	89,326	39,919
Refunds to Participants	(87,313)	(39,329)
Interest expense	—	(672)
Total non-operating income (expense)	2,013	(82)
Income before taxes	43,666	27,289
Provision for income taxes	20,056	11,441
Net income	$ 23,610	$ 15,848

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

FIXED INCOME 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, 2016	$ 10	$ 86,617	$ 127,524	$ 214,151
Net income	—	—	15,848	15,848
BALANCE - December 31, 2016	10	86,617	143,372	229,999
Net income	—	—	23,610	23,610
BALANCE - December 31, 2017	$ 10	$ 86,617	$ 166,982	$ 253,609

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

FIXED INCOME CLEARING CORPORATION

STATEMENTS OF CASH FLOWS

(In thousands)	For the years ended December 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 23,610	$ 15,848
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:		
Depreciation and amortization	8,418	12,082
Discount on Investments in marketable securities	(21)	(30)
Deferred income taxes	1,807	(1,019)
Net change in:		
Accounts receivable	2,873	18,269
Other assets	(5,367)	3,530
Accounts payable and accrued expenses	2,403	2,354
Other liabilities	4,434	1,481
Clearing Fund deposits	—	(75,000)
Net cash provided by/(used in) operating activities	38,157	(22,485)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Maturities of Investments in marketable securities	75,000	100,000
Purchases of Investments in marketable securities	(75,000)	(25,000)
Purchases of Intangible assets	(11,344)	(5,846)
Net cash provided by/(used in) investing activities	(11,344)	69,154
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on loan payable to DTCC	—	(52,000)
Net cash provided by/(used in) financing activities	—	(52,000)
Net increase/(decrease) in Cash and cash equivalents	26,813	(5,331)
Cash and cash equivalents - Beginning of year	210,109	215,440
Cash and cash equivalents - End of year	$ 236,922	$ 210,109
SUPPLEMENTAL DISCLOSURES:		
Cash interest paid	$ —	$ 737
Cash income taxes paid to DTCC - net of refunds	$ 18,135	$ 4,140

The Notes to Financial Statements are an integral part of these 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 central counterparty (CCP) services to firms that participate in the U.S. government and mortgage-backed securities markets (collectively referred to as Participants). Services provided by FICC consist 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), DTCC ITP LLC (formerly known as Omgeo LLC), DTCC Deriv/SERV LLC, Business Entity Data, B.V. and DTCC Solutions LLC.

FICC is designated as a Systemically Important Financial Market Utility (SIFMU) by the U.S. Financial Stability Oversight Council pursuant to Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which subjects the Company to the SEC's standards for covered clearing agencies.

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). The Company reclassified prior period amounts related to Clearing Fund balances to conform to the current year presentation.

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 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.

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.

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 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. 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 FICC's rules.

Cash deposits and Investments in marketable securities. 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 FICC'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 included within Interest income in the accompanying Statements of Income, this interest is refunded to Participants and is included in Refunds to Participants 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 included within Interest income in the accompanying Statements of Income, this interest is refunded to Participants and is included in Refunds to Participants 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. The following table summarizes how the Company depreciates Premises and equipment:

Premises and equipment	Amortization Period	Amortization Method
Leasehold improvements	Shorter of useful life or remaining term of the lease	Straight-line
Furniture and equipment	5 to 7 years	Straight-line
Building and improvements	39 years	Straight-line

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 software costs expected to result in long-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.

Revenue recognition. The Company's revenue primarily consists of fees generated from clearing 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. The Company records a deferred income tax (benefit) provision when there are differences between assets and liabilities measured for financial reporting and for income tax return purposes. These temporary differences result in taxable or deductible amounts in future years and are measured using the tax rates and laws that will be in effect when such differences are expected to reverse. 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.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (Tax Reform Act) was signed into law making significant changes to the Internal Revenue Code. Changes include a Federal corporate tax rate decrease from 35% to 21% for tax years beginning after December 31, 2017. Concurrently, the SEC staff issued guidance on accounting for the tax effects of the Tax Reform Act, which provides a measurement period that should not extend beyond one year from the Tax Reform Act enactment date for companies to complete the accounting under U.S. GAAP tax accounting guidance. The SEC guidance requires companies to reflect the income tax effects of those aspects of the Tax Reform Act for which the accounting under U.S. GAAP tax accounting guidance is complete. To the extent that a company's accounting for certain income tax effects of the Tax Reform Act is incomplete, but it is able to determine a reasonable estimate, it must record and provisionally estimate the impact in its financial statements. The Company re-measured certain deferred tax assets and liabilities based on management's best estimates using information available at the financial statements date. The impact of the Tax Reform Act may differ from these provisional estimates due to, among other items, the issuance of additional regulatory guidance, further interpretations of the provisions of the Tax Reform Act, the state tax effect of adjustments made to federal temporary differences, and the filing of tax returns.

Expense allocations. Substantially all expenses are recorded at DTCC and are allocated to its subsidiaries, including FICC, based upon their estimated 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 expenses in the accompanying Statements of Income represent allocated costs including Employee compensation and related benefits, Information technology, Professional and other services, Occupancy, Depreciation and amortization and General and administrative.

3. ACCOUNTING AND REPORTING DEVELOPMENTS

Standard	Description	Impact on the financial statements or other significant matters
Recently Issued Accounting Standards		
Financial Instruments - Credit Losses *Issued June 2016*	• Replaces the current incurred loss approach for credit losses with an "expected loss" model for instruments measured at amortized cost. • Requires all lifetime credit losses for financial assets held at the reporting date to be estimated based on factors such as historical experience, current conditions and forecasts. • Requires entities to record allowances for available-for-sale debt securities.	• The required effective date is January 1, 2020. • The Company is evaluating the effect on its Financial Statements and related disclosures.
Revenue Recognition - Revenue from Contracts with Customers *Issued May 2014*	• Requires revenue from contracts with customers to be recognized upon transfer of control of a good or service in the amount of consideration expected to be received. • Changes the accounting for certain contract costs, including whether they may be offset against revenue in the accompanying Statements of Income, and requires additional disclosures about revenue and contract costs. • May be adopted using a full retrospective approach or a modified, cumulative effect approach wherein the guidance is applied only to existing contracts as of the day of initial application, and to new contracts transacted after that date.	• The required effective date is January 1, 2018. • The Company plans to adopt the revenue recognition guidance under the full retrospective transition approach in 2018. The Company's implementation efforts include the identification of revenue within the scope of the guidance and the evaluation of revenue contracts and related accounting policies. The Company does not anticipate changes to the recognition and timing of its revenues.

4. CLEARING FUND

Details for the Clearing Fund deposits as of December 31, 2017 and 2016 follow (in thousands):

	2017			2016		
	GS Division	MBS Division	Total	GS Division	MBS Division	Total
Required deposits	$ 10,664,173	$ 4,306,400	$ 14,970,573	$ 11,734,745	$ 6,553,783	$ 18,288,528
Excess deposits	5,409,570	872,474	6,282,044	4,176,982	868,347	5,045,329
Total	$ 16,073,743	$ 5,178,874	$ 21,252,617	$ 15,911,727	$ 7,422,130	$ 23,333,857

Details for the Clearing Fund deposits as of December 31, 2017 and 2016 follow (in thousands):

	2017			2016		
	GS Division	MBS Division	Total	GS Division	MBS Division	Total
Securities on deposit - at fair value	$ 10,257,951	$ 2,153,798	$ 12,411,749	$ 9,910,010	$ 3,738,433	$ 13,648,443
Cash deposits	5,815,792	3,000,076	$ 8,815,868	6,001,717	3,658,697	9,660,414
Investments in marketable securities	—	25,000	25,000	—	25,000	25,000
Total	$ 16,073,743	$ 5,178,874	$ 21,252,617	$ 15,911,727	$ 7,422,130	$ 23,333,857

Details for the Clearing Fund Cash deposits and investments in marketable securities as of December 31, 2017 and 2016 follow (in thousands):

	2017	2016
Bank deposits	$ 6,116,868	$ 6,441,414
Money market fund investments	2,139,000	2,669,000
Reverse repurchase agreements	560,000	550,000
U.S. Treasury bills	25,000	25,000
Total	$ 8,840,868	$ 9,685,414

Clearing Fund cash deposits and Investments in marketable securities. Cash deposits and investments in marketable securities of the Clearing Fund, may be applied to satisfy obligations of the depositing Participants, as provided in FICC’s rules.

Refunds to Participants. Interest income earned from the investment of Clearing Fund deposits is refunded to Participants and totaled $87,313,000 and $39,329,000 for the years ended December 31, 2017 and 2016, respectively. The amounts refunded are included in Refunds to Participants in the accompanying Statements of Income.

5. PREMISES AND EQUIPMENT

The cost, accumulated depreciation and net book value of Premises and equipment for the years ended December 31, 2017 and 2016 follow (in thousands):

	Furniture and equipment	Leasehold improvements	Buildings and improvements	Land	Total
Cost:					
As of January 1, 2016	$ 17,180	$ 72	$ 913	$ 175	$ 18,340
As of December 31, 2016	17,180	72	913	175	18,340
Disposals	(16,352)	(72)	—	—	(16,424)
As of December 31, 2017	$ 828	$ —	$ 913	$ 175	$ 1,916
Accumulated depreciation:					
As of January 1, 2016	$ 17,180	$ 72	$ 348	$ —	$ 17,600
Depreciation expense	—	—	17	—	17
As of December 31, 2016	17,180	72	365	—	17,617
Depreciation expense	—	—	22	—	22
Disposals	(16,352)	(72)	—	—	(16,424)
As of December 31, 2017	$ 828	$ —	$ 387	$ —	$ 1,215
Net book value:					
As of January 1, 2016	$ —	$ —	$ 565	$ 175	$ 740
As of December 31, 2016	$ —	$ —	$ 548	$ 175	$ 723
As of December 31, 2017	$ —	$ —	$ 526	$ 175	$ 701

6. INTANGIBLE ASSETS

The gross carrying value, accumulated amortization and net carrying value of capitalized software for the years ended December 31, 2017 and 2016 follow (in thousands):

	Capitalized Software
Gross carrying value:	
As of January 1, 2016	$ 121,101
Additions	5,846
As of December 31, 2016	126,947
Additions	11,344
Disposal	(49,060)
As of December 31, 2017	$ 89,231
Accumulated amortization:	
As of January 1, 2016	$ 99,439
Amortization expense	12,065
As of December 31, 2016	111,504
Amortization expense	8,396
Disposal	(49,060)
As of December 31, 2017	$ 70,840
Net carrying value:	
As of January 1, 2016	$ 21,662
As of December 31, 2016	$ 15,443
As of December 31, 2017	$ 18,391

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

2018	$ 7,195
2019	5,460
2020	4,188
2021	1,548
Total future estimated amortization	$ 18,391

7. DEBT

During 2016, the Company repaid a loan from its parent, DTCC. Interest on the loan from parent was $0 and $672,000 for the years ended December 31, 2017 and 2016, respectively. These amounts were included in Interest expense in the accompanying Statements of Income.

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, 2017 follow:

Moody's (1)			S&P		
Long-term	**Short-term**	**Outlook**	**Long-term**	**Short-term**	**Outlook**
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 the agency's Clearing Houses Rating Methodology.

8. 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.

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
Assets - Clearing Fund - Securities on deposit		
U.S. Treasury Securities U. S. Agency Issued Debt Securities (Non-Callable)	Obtained from pricing services engaged by the Company, and the Company receives one price for each security.	Level 1
U. S. Agency Issued Debt Securities (Callable) U.S. Agency Residential Mortgage-Backed Securities	Recent trades of similar securities.	Level 2
Liabilities - Clearing Fund - Securities on deposit		
U.S. Treasury Securities U. S. Agency Issued Debt Securities (Non-Callable)	Obtained from pricing services engaged by the Company, and the Company receives one price for each security.	Level 1
U. S. Agency Issued Debt Securities (Callable) U.S. Agency Residential Mortgage-Backed Securities	Recent trades of similar securities.	Level 2

Fair value measurements for those items measured on a recurring basis are summarized below as of December 31, 2017 and 2016 (in thousands):

	2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets - Clearing Fund				
Securities on deposit	$ 10,634,255	$ 1,777,494	$ —	$ 12,411,749
Liabilities - Clearing Fund				
Securities on deposit	$ 10,634,255	$ 1,777,494	$ —	$ 12,411,749

	2016			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets - Clearing Fund				
Securities on deposit	$ 11,998,929	$ 1,649,514	$ —	$ 13,648,443
Liabilities - Clearing Fund				
Securities on deposit	$ 11,998,929	$ 1,649,514	$ —	$ 13,648,443

There were no transfers between levels within the fair value hierarchy, nor were any amounts classified as Level 3 during the years ended December 31, 2017 and 2016.

Financial assets and liabilities measured at other than fair value. For financial assets 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
Assets - Current Assets - Clearing Fund		
Investments in marketable securities		
U.S. Treasury bills	Obtained from pricing services engaged by the Company, and the Company receives one price for each security.	Level 1

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, Accounts receivable, Clearing Fund - Cash deposits, Other Participants' assets, Accounts payable and Payable to Participants.

The tables below present the carrying values, fair values and fair value hierarchy levels of all financial instruments measured at other than fair value on the accompanying Statements of Financial Condition as of December 31, 2017 and 2016 (in thousands):

	2017				
	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 236,922	$ 236,922	$ 236,922	$ —	$ —
Accounts receivable	11,490	11,490	—	11,490	—
Clearing Fund:					
Cash deposits	8,815,868	8,815,868	8,255,868	560,000	—
Investments in marketable securities	25,000	24,920	24,920	—	—
Other Participants' assets	1,131	1,131	301	830	—
Total	$ 9,090,411	$ 9,090,331	$ 8,518,011	$ 572,320	$ —
Liabilities:					
Accounts payable and accrued expenses	$ 6,621	$ 6,621	$ —	$ 6,621	$ —
Clearing Fund:					
Cash deposits	8,840,868	8,840,868	8,840,868	—	—
Payable to Participants	1,131	1,131	1,131	—	—
Total	$ 8,848,620	$ 8,848,620	$ 8,841,999	$ 6,621	$ —

	2016				
	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 210,109	$ 210,109	$ 210,109	$ —	$ —
Accounts receivable	14,342	14,342	—	14,342	—
Clearing Fund:					
Cash deposits	9,660,414	9,660,414	9,110,414	550,000	—
Investments in marketable securities	25,000	24,829	24,829	—	—
Other Participants' assets	867	867	253	614	—
Total	$ 9,910,732	$ 9,910,561	$ 9,345,605	$ 564,956	$ —
Liabilities:					
Accounts payable and accrued expenses	$ 4,218	$ 4,218	$ —	$ 4,218	$ —
Clearing Fund:					
Cash deposits	9,685,414	9,685,243	9,685,243	—	—
Payable to Participants	867	867	867	—	—
Total	$ 9,690,499	$ 9,690,328	$ 9,686,110	$ 4,218	$ —

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.

There were no assets or liabilities measured at fair value on a non-recurring basis during the years ended December 31, 2017 and 2016.

9. PENSION AND POSTRETIREMENT BENEFITS

Eligible DTCC 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 DTCC 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 health care program, which provides benefits to eligible retired employees.

Cost allocation. DTCC allocates the cost of these plans to its subsidiaries based primarily upon the proportion of each subsidiary's salary cost relative to DTCC's total salary cost. The benefit plan costs allocated to FICC were $1,825,000 and $1,694,000 for the years ended December 31, 2017 and 2016, respectively. These costs are included in Employee compensation and related benefits in the accompanying Statements of Income.

10. INCOME TAXES

FICC is included in DTCC's consolidated Federal and various state tax returns. FICC also files other state tax returns on a separate company basis.

Details for the components of the Company's Provision (Benefit) for income taxes calculated on a separate company basis for the years ended December 31, 2017 and 2016 follow (in thousands):

	2017	2016
Current income tax/(benefit):		
Federal	$ 10,366	$ 9,352
State and local	2,200	2,788
Total current income tax/(benefit)	12,566	12,140
Deferred income tax/(benefit):		
Federal	822	(819)
State and local	6,668	120
Total deferred income tax/(benefit)	7,490	(699)
Provision for income taxes	$ 20,056	$ 11,441

Pursuant to a tax sharing agreement between DTCC and FICC, 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, 2017 and 2016, the Company paid income taxes to DTCC, net of refunds, of $18,135,000 and $4,140,000, respectively.

The Company re-measured certain deferred tax assets and liabilities in accordance with the Tax Reform Act based on management's best estimates using information available at the financial statements date. The re-measurement resulted in a tax benefit of $1,766,000, based on the reduced corporate tax rate per the Tax Reform Act and is subject to adjustment in 2018, based on further interpretations of the provisions of the Tax Reform Act.

The 2017 and 2016 effective tax rates differ from the 35% Federal statutory rate primarily due to state and local taxes, changes in unrecognized tax benefits, and the enactment of the Tax Reform Act. 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, 2017 and 2016 follow:

	2017	2016
U.S. statutory tax rate	35.0%	35.0%
State and local income taxes, net of Federal tax benefit	5.5	6.1
Change in unrecognized tax benefits	10.3	0.8
Enactment of the Tax Reform Act	(4.0)	—
Other	(0.9)	—
Effective tax rate	45.9%	41.9%

Details for the components of deferred tax assets and liabilities as of December 31, 2017 and 2016 follow (in thousands):

	2017	2016
Deferred tax assets:		
Accrued compensation and benefits	$ 326	$ 4,019
Depreciation	54	104
Deferred rent	939	1,474
Other	2,092	1,497
Total deferred tax assets	3,411	7,094
Deferred tax liabilities:		
Capitalized software	(6,512)	(8,388)
Total deferred tax liabilities	(6,512)	(8,388)
Net deferred tax liabilities	$ (3,101)	$ (1,294)

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, 2017 and 2016 follow (in thousands):

	2017	2016
Beginning balance at January 1,	$ 2,639	$ 2,639
Increases based on prior period tax positions	3,098	—
Decreases based on prior period tax positions	(75)	—
Decreases related to settlements with taxing authorities	(15)	—
Ending balance as of December 31,	$ 5,647	$ 2,639

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, 2017 and 2016, accrued interest related to unrecognized tax benefits recorded on the accompanying Statements of Financial Condition totaled $4,313,000 and $1,638,000, respectively.

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, 2017 follow:

	Tax Years	
Jurisdiction	**Under Examination**	**Subject to Examination**
U.S. Federal - Internal Revenue Service	-	2014 - 2016
New York State	2007 - 2014	2015 - 2016
New York City	2010 - 2014	2015 - 2016
State of Illinois	2012 - 2013	2014 - 2016

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.

11. TRANSACTIONS WITH RELATED PARTIES

In the ordinary course of the business, the Company enters into significant related party transactions with DTCC and its other subsidiaries.

Transactions with DTCC. FICC has an agreement with DTCC whereby DTCC pays for substantially all of the operational expenses of FICC. The related expenses are allocated to FICC based upon its estimated use of such goods or services. Further, the agreement provides that DTCC performs credit and quantitative risk services, and certain other services for FICC including administrative, internal audit, finance and legal services. In 2017 and 2016, the billing for these services was 108% and 105% of total allocated expenses, respectively, 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. From time-to-time, the Company funds purchases of long-term assets acquired by DTCC on its behalf.

Details for related party transactions for 2017 and 2016 follow (in thousands):

	Expenses For the years ended December 31,		Payables [2] As of December 31,	
Related party	**2017**	**2016**	**2017**	**2016**
DTCC [1]	$ 13,539	$ 8,171	$ 2,988	$ 1,314

(1) DTCC expenses relate to the 8% and 5% mark-up fee for services described above.
(2) Included in Accounts payable and accrued expenses on the accompanying Statements of Financial Condition.

12. 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.

13. GUARANTEES

FICC, through GSD and MBSD, provides CCP services, including clearing, settlement and risk management services. Acting as a CCP, FICC guarantees the settlement of trades in the event one or more of its Participants 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. FICC maintains separate Clearing Funds for each of GSD and MBSD.

GSD provides real-time trade matching, clearing, netting, risk management and settlement for trades in U.S. government debt including buy-sell transactions and repurchase agreement transactions. Securities processed by GSD include Treasury bills, bonds, notes, zero-coupon securities, government agency securities and inflation-indexed securities. The U.S. Government securities market is predominantly an over-the-counter market and most transactions are settled on trade date plus one day (T+1). Trades are guaranteed and novated upon comparison.

FICC's guarantee of GSD net settlement positions may result in a potential liability to FICC. Guaranteed positions that have not yet settled are margined and collateralized twice-daily through the Clearing Fund and marked-to-market twice-daily through the funds-only settlement process. In addition, a Participant may be subject to an additional amount referred to as the intraday supplemental required fund deposit, which, if applicable, may be collected on an intra-day basis through the Clearing Fund.

MBSD provides real-time trade matching, clearing, netting, risk management and settlement for trades in the U.S. mortgage-backed securities market. Specifically, MBSD processes to-be-announced transactions, specified pool trades and stipulated trades.

FICC's guarantee of MBSD transactions may result in potential liability to FICC. Guaranteed positions that have not yet settled are margined and collateralized daily through the Clearing Fund. The daily Clearing Fund includes a mark-to-market component that is calculated using guaranteed positions and prices as of prior end-of-day. In addition, a Participant may become subject to an intraday mark-to-market charge which, if applicable, may be collected on an intra-day basis through the Clearing Fund.

Details for each division's open positions for which a trade guarantee applied as of December 31, 2017 and 2016 follow (in billions):

Division	**2017**	**2016**
GSD	$ 1,039	$ 890
MBSD	312	304

There were no defaults by Participants to these obligations.

If a Participant defaults, such Participant's deposits to the applicable division's Clearing Fund is the first source of funds and collateral that FICC 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 from FICC's multilateral netting contract and limited cross-guaranty agreement with DTC, NSCC and Options Clearing Corporation (OCC). In accordance with this agreement, these clearing agencies have agreed to make payments to each other for any remaining unsatisfied obligations of a common defaulting Participant to the extent that these clearing agencies have excess resources belonging to the defaulting Participant. Each division would apply its own respective resources and determine its own liquidation results. In determining FICC's available net resources for purposes of the Cross-Guaranty Agreement, FICC would first offset the available net resources of GSD with those of MBSD.

In addition, with respect to GSD, FICC has entered into a cross-margining agreement with the Chicago Mercantile Exchange Inc. (CME). Under this agreement, FICC and CME would apply available amounts to each other under specified circumstances.

If there is still a deficit, FICC will satisfy this deficit by utilizing up to 25% of its retained earnings, or such greater amount of retained earnings to be determined by the Board of Directors. If a loss or liability remains, the division will divide such obligation between "Tier 1" Participants and "Tier 2" Participants. Tier 2 Participants will only be subject to such loss or liability to the extent they traded with the defaulting Participant. Tier 1 Participants will be allocated the loss or liability by assessing the required Clearing Fund deposit of each such Participant in the amount of up to $50,000, equally. If a loss or liability remains, Tier 1 Participants will be assessed ratably in accordance with the respective amounts of their required Clearing Fund deposit over the prior twelve months. GSD Participants who act as inter-dealer brokers are limited to a loss allocation of $5 million per event in respect of their inter-dealer broker activity.

14. OFF BALANCE SHEET AND CONCENTRATION OF CREDIT RISKS

As a CCP, FICC 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 primarily derived from clearing and settlement service operations. Customers are based in the United States and overseas 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 nonpayment 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 repos 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 and the 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 that 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, FICC has minimal credit risk related to these investments.

The Company is exposed to credit risk on a daily basis. This risk arises at FICC as it guarantees certain obligations of its Participants under specified circumstances. The Company manages and mitigates this risk by identifying, measuring and responding to these risks in order to protect the safety and soundness of the FICC 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; trade and netting trades continuously; marking unsettled trades to market; and utilizing a variety of advanced quantitative analytical methodologies, such as back and stress testing.

To become a Participant, an applicant must meet minimum eligibility criteria that are specified in the Company's rules. All applicants to be an FICC 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.

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, NSCC 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.

15. SUBSEQUENT EVENTS

The Company evaluated events and transactions occurring after December 31, 2017 through February 27, 2018, 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.