

Fixed Income Clearing Corporation

Audited Financial Statements as of and for the Years Ended
December 31, 2017 and 2016, and Unaudited Condensed for the
Three Months Ended December 31, 2017 and 2016

FIXED INCOME CLEARING CORPORATION

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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	<u>21,509,792</u>	<u>23,561,440</u>
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	<u>19,092</u>	<u>16,166</u>
TOTAL ASSETS	<u>\$ 21,528,884</u>	<u>\$ 23,577,606</u>
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	<u>21,260,369</u>	<u>23,341,082</u>
OTHER NON-CURRENT LIABILITIES:		
Other non-current liabilities	14,906	6,525
Total liabilities	<u>21,275,275</u>	<u>23,347,607</u>
COMMITMENTS AND CONTINGENCIES (Note 7)		
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	<u>253,609</u>	<u>229,999</u>
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	<u>\$ 21,528,884</u>	<u>\$ 23,577,606</u>

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

FIXED INCOME CLEARING CORPORATION

STATEMENTS OF INCOME

(In thousands)	For the three months ended December 31, (Unaudited)		For the years ended December 31,	
	2017	2016	2017	2016
REVENUES:				
Clearing services	\$ 63,216	\$ 58,012	\$ 237,111	\$ 212,200
EXPENSES:				
Employee compensation and related benefits	18,741	21,356	75,789	78,769
Information technology	5,197	4,196	19,200	16,740
Professional and other services	21,618	16,555	83,023	67,574
Occupancy	1,562	1,561	5,563	6,083
Depreciation and amortization	1,962	2,178	8,418	12,082
General and administrative	1,167	990	3,465	3,581
Total expenses	50,247	46,836	195,458	184,829
Total operating income	12,969	11,176	41,653	27,371
NON-OPERATING INCOME (EXPENSE):				
Interest income	26,585	12,100	89,326	39,919
Refunds to Participants	(25,900)	(11,667)	(87,313)	(39,329)
Interest expense	—	(84)	—	(672)
Total non-operating income (expense)	685	349	2,013	(82)
Income before taxes	13,654	11,525	43,666	27,289
Provision for income taxes	7,566	4,758	20,056	11,441
Net income	\$ 6,088	\$ 6,767	\$ 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

<u>(In thousands)</u>	<u>Common Stock</u>	<u>Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Total Shareholder's Equity</u>
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	<u>\$ 10</u>	<u>\$ 86,617</u>	<u>\$ 166,982</u>	<u>\$ 253,609</u>

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	<u>38,157</u>	<u>(22,485)</u>
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	<u>(11,344)</u>	<u>69,154</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on loan payable to DTCC	—	(52,000)
Net cash provided by/(used in) financing activities	<u>—</u>	<u>(52,000)</u>
Net increase/(decrease) in Cash and cash equivalents	26,813	(5,331)
Cash and cash equivalents - Beginning of year	<u>210,109</u>	<u>215,440</u>
Cash and cash equivalents - End of year	<u>\$ 236,922</u>	<u>\$ 210,109</u>
SUPPLEMENTAL DISCLOSURES:		
Cash interest paid	<u>\$ —</u>	<u>\$ 737</u>
Cash income taxes paid to DTCC - net of refunds	<u>\$ 18,135</u>	<u>\$ 4,140</u>

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

FIXED INCOME CLEARING CORPORATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016, AND THE THREE MONTHS ENDED DECEMBER 31, 2017 AND 2016

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 ITPLLC (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). See Note 2 in FICC's Audited Financial Statements for the years ended December 31, 2017 and 2016, for additional information on the Company's summary of Significant Accounting Policies.

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.

FIXED INCOME CLEARING CORPORATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016, AND THE THREE MONTHS ENDED DECEMBER 31, 2017 AND 2016

3. ACCOUNTING AND REPORTING DEVELOPMENTS

Standard	Description	Impact on the financial statements or other significant matters
<i>Recently Issued Accounting Standards</i>		
Financial Instruments - Credit Losses <i>Issued June 2016</i>	<ul style="list-style-type: none">• 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.	<ul style="list-style-type: none">• 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 <i>Issued May 2014</i>	<ul style="list-style-type: none">• 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.	<ul style="list-style-type: none">• 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.

FIXED INCOME CLEARING CORPORATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016, AND THE THREE MONTHS ENDED DECEMBER 31, 2017 AND 2016

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	<u>\$ 16,073,743</u>	<u>\$ 5,178,874</u>	<u>\$ 21,252,617</u>	<u>\$ 15,911,727</u>	<u>\$ 7,422,130</u>	<u>\$ 23,333,857</u>

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	<u>\$ 16,073,743</u>	<u>\$ 5,178,874</u>	<u>\$ 21,252,617</u>	<u>\$ 15,911,727</u>	<u>\$ 7,422,130</u>	<u>\$ 23,333,857</u>

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	<u>\$ 8,840,868</u>	<u>\$ 9,685,414</u>

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 \$25,900,000 and \$11,667,000 for the three months ended December 31, 2017 and 2016, respectively, and \$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.

FIXED INCOME CLEARING CORPORATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016, AND THE THREE MONTHS ENDED DECEMBER 31, 2017 AND 2016

5. DEBT

During 2016, the Company repaid a loan from its parent, DTCC. Interest on the loan from parent was \$0 and \$84,000 for the three months ended December 31, 2017 and 2016, respectively, and \$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.

6. PENSION AND POSTRETIREMENT BENEFITS

Eligible DTCC 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. 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 \$442,000 and \$305,000 for the three months ended December 31, 2017 and 2016, respectively, and \$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.

7. 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.

FIXED INCOME CLEARING CORPORATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016, AND THE THREE MONTHS ENDED DECEMBER 31, 2017 AND 2016

8. 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.

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.

See Note 13 in FICC's Audited Financial Statements for the years ended December 31, 2017 and 2016 for additional information.

9. 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.