



DEUTSCHE BANK SECURITIES INC.
(An Indirect Wholly Owned Subsidiary of
Deutsche Bank AG)

Consolidated Statement of Financial Condition

December 31, 2012

(With Report of Independent Registered Public Accounting Firm Thereon)



KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholder
Deutsche Bank Securities Inc.:

We have audited the accompanying consolidated statement of financial condition of Deutsche Bank Securities Inc. and its subsidiaries, an indirect wholly owned subsidiary of Deutsche Bank AG, as of December 31, 2012, that is filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934 and Regulation 1.10 of the Commodity Exchange Act, and the related notes to the consolidated statement of financial condition (the financial statement).

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit 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 statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statement referred to above presents fairly in all material respects, the financial position of Deutsche Bank Securities Inc. and its subsidiaries as of December 31, 2012, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

February 28, 2013

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(In millions, except share data)

Assets	
Cash and cash equivalents	\$ 1,396
Cash and securities segregated for benefit of customers (includes securities at fair value of \$5,709)	10,170
Securities financing transactions:	
Securities purchased under agreements to resell (includes securities at fair value of \$37,631)	71,730
Securities borrowed (includes securities at fair value of \$26,492)	57,649
	<u>129,379</u>
Financial instruments owned, at fair value (includes securities pledged as collateral of \$60,740)	68,067
Receivables:	
Customers	988
Noncustomers	23,016
Brokers, dealers, and clearing organizations	2,132
	<u>26,136</u>
Property, plant, and equipment (net of accumulated depreciation of \$557)	623
Other assets (includes \$875 of securities received as collateral at fair value)	4,275
Total assets	<u>\$ 240,046</u>
Liabilities and Stockholder's Equity	
Securities financing transactions:	
Securities sold under agreements to repurchase (includes securities at fair value of \$53,687)	\$ 127,208
Securities loaned (includes securities at fair value of \$310)	42,907
	<u>170,115</u>
Payables:	
Customers	14,589
Noncustomers	529
Brokers, dealers, and clearing organizations	2,732
Other	6,597
	<u>24,447</u>
Financial instruments sold, but not yet purchased, at fair value	22,281
Other liabilities (includes \$875 of obligation to return securities as collateral at fair value)	4,496
Total liabilities	<u>221,339</u>
Commitments, contingencies and guarantees	
Subordinated liabilities	6,723
Stockholder's equity	11,984
Total liabilities and stockholder's equity	<u>\$ 240,046</u>

See accompanying notes to consolidated statement of financial condition.

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Notes to Consolidated Statement of Financial Condition
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(1) Organization

Deutsche Bank Securities Inc. (the Company) is a wholly owned subsidiary of DB U.S. Financial Markets Holding Corporation (the Parent), a wholly owned subsidiary of the Taunus Corporation (Taunus), which is a direct subsidiary of Deutsche Bank AG (the Bank), a German corporation. The Company is registered as a securities broker-dealer and investment advisor with the Securities and Exchange Commission (SEC), municipal advisor with the Municipal Securities Rulemaking Board (MSRB) and futures commission merchant (FCM) with the Commodities Futures Trading Commission (CFTC). The Company is a member of the Financial Industry Regulatory Authority (FINRA), the Securities Investor Protection Corporation (SIPC), the National Futures Association (NFA) and other self regulatory organizations.

In its capacity as a broker-dealer and FCM, the Company clears securities and derivatives products, respectively, for its customers, affiliates or itself on various exchanges of which the Company is a member. The Company provides trade execution services for a broad range of domestic and international clients and provides securities brokerage and investment advisory services to private clients and institutions. The Company provides a variety of capital raising, market making, and brokerage services for its government, financial institution, and corporate clients, including fixed income and equity sales and trading, emerging markets activities, equity market research and investment banking. The Company also executes trading and arbitrage strategies for its own account using debt, equity, and related derivative instruments and is a primary dealer in U.S. government securities.

The Company, like other securities firms, is directly affected by general economic and market conditions, including fluctuations in volume and price levels of securities, changes in interest rates, and demand for investment banking, securities brokerage, and other services, all of which have an impact on the Company's consolidated statement of financial condition as well as its liquidity.

(2) Significant Accounting Policies

(a) Basis of Presentation

The Company's consolidated statement of financial condition has been prepared in accordance with U.S. generally accepted accounting principles, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated statement of financial condition. The most important of these estimates and assumptions relate to fair value measurements and the provision for potential losses that may arise from litigation and regulatory proceedings and tax audits. Although these, and other, estimates and assumptions are based on the best available information, actual results could be different from these estimates.

The consolidated statement of financial condition includes the accounts of the Company and its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest. The Company's policy is to consolidate all entities in which it owns more than 50% of the outstanding voting stock unless it does not control the entity. The Company also consolidates any variable interest entities (VIEs) for which it is deemed to be the primary beneficiary. All material intercompany transactions and balances have been eliminated in consolidation.

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The consolidated statement of financial condition as of December 31, 2012 reflects \$1.6 billion of assets and liabilities attributable to the Company's subsidiaries as well as certain elimination and reclassification adjustments which are not reflected in the Company's unaudited statement of financial condition contained in Part II of SEC Form X-17A-5 which is prepared on an unconsolidated basis.

In the normal course of business, the Company's operations may include significant transactions conducted with affiliated entities. Such transactions are governed by contractual agreements between the Company and its affiliates.

At December 31, 2012, substantially all of the Company's assets and liabilities were carried at fair value or at amounts which approximate such values. Assets and liabilities recorded at fair value include cash equivalents, financial instruments owned, financial instruments sold, but not yet purchased and certain collateralized agreements and financings. Assets and liabilities recorded at contractual amounts that approximate fair value include certain collateralized agreements and financings, other receivables and payables and subordinated liabilities. The fair values of such items are not materially sensitive to shifts in market interest rates because of the limited term to maturity of many of these instruments and/or their variable interest rates.

(b) *Cash and Cash Equivalents*

The Company defines cash equivalents as short-term, highly liquid securities and interest-earning deposits with original maturities of three months or less, except for those used for trading purposes.

(c) *Cash and Securities Segregated for Benefit of Customers*

Cash and securities segregated for benefit of customers include cash and securities segregated in compliance with federal and other regulations and represent funds deposited by customers and funds accruing to customers as a result of trades or contracts. Also included are funds segregated and held in separate accounts in accordance with Section 4d(2), Regulation 30.7 and Regulation 190.01 of the Commodity Exchange Act.

(d) *Financial Instruments*

The financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value amounts are reflected in the consolidated statement of financial condition at fair value on a trade-date basis.

(e) *Other Financial Assets and Financial Liabilities at Fair Value*

In addition to financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value, the Company has elected to account for certain of its other financial assets and financial liabilities at fair value under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 825-10 (*Fair Value Option*). The primary reasons for electing the fair value option are to reflect economic events in earnings on a timely basis, to mitigate volatility in earnings from using different measurement attributes and to address simplification and

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cost-benefit considerations. Such financial assets and financial liabilities accounted for at fair value include certain collateralized agreements and financings and the debt related to consolidated VIEs.

(f) Fair Value Measurements

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Financial assets are marked to bid prices, and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs.

The fair value hierarchy under ASC 820 (*Fair Value Measurement and Disclosures*) prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Basis of Fair Value Measurement

- | | |
|---------|---|
| Level 1 | Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities |
| Level 2 | Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly |
| Level 3 | Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable |

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The Company defines active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalization for the instrument. The Company defines active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity.

Credit risk is an essential component of fair value. Cash products (e.g., bonds) and derivative instruments (particularly those with significant future projected cash flows) trade in the market at levels which reflect credit considerations. The Company manages its exposure to credit risk as it does other market risks and will price, economically hedge, facilitate and intermediate trades which involve credit risk.

In determining fair value, the Company separates its financial instruments owned, at fair value and its financial instruments sold, but not yet purchased, at fair value into two categories: cash instruments and derivative contracts.

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- *Cash Instruments* – the Company’s cash instruments are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include most U.S. government and sovereign obligations, active listed equities and certain money market securities. Such instruments are generally classified within Level 1 of the fair value hierarchy. Instruments classified within Level 1 of the fair value hierarchy are required to be carried at quoted market prices, even in situations where the Company holds a large position and a sale could reasonably impact the quoted price.

The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most government agency securities, most investment-grade corporate bonds, certain mortgage products and whole loans, certain bank and bridge loans, less liquid listed equities, state, municipal and provincial obligations, and certain money market securities. Such instruments are generally classified within Level 2 of the fair value hierarchy.

Certain cash instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. Such instruments include private equity and real estate fund investments, less liquid corporate debt securities and other debt obligations (including less liquid high-yield corporate bonds, distressed debt instruments and collateralized debt obligations (CDOs) backed by corporate obligations), certain securities (backed by either commercial or residential real estate). The transaction price is initially used as the best estimate of fair value. Accordingly, when a pricing model is used to value such an instrument, the model is adjusted so that the model value at inception equals the transaction price. This valuation is adjusted only when changes to inputs and assumptions are corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows.

For positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or nontransferability. Such adjustments are generally based on available market evidence where available. In the absence of such evidence, management’s best estimate is used.

Recent market conditions have increased the level of management judgment required to value cash trading instruments classified within Level 3 of the fair value hierarchy. In particular, management’s judgment is required to determine the appropriate risk-adjusted discount rate for cash trading instruments with little or no price transparency as a result of decreased volumes and lower levels of trading activity. In such situations, the Company’s valuation is adjusted to approximate rates which market participants would likely consider appropriate for relevant credit and liquidity risks. Due to the level of management judgment and estimate used

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in the valuation of cash instruments included within Level 3 of the fair value hierarchy, it is possible that other market participants could determine a materially different estimate of fair value for such instruments.

- *Derivative Contracts* – derivative contracts can be exchange-traded or over-the-counter (OTC). Exchange-traded derivatives typically fall within Level 1 or Level 2 of the fair value hierarchy depending on whether they are deemed to be actively traded or not. The Company generally values exchange-traded derivatives using models which calibrate to market-clearing levels and eliminate timing differences between the closing price of the exchange-traded derivatives and their underlying instruments. In such cases, exchange-traded derivatives are classified within Level 2 of the fair value hierarchy.

OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Where models are used, the selection of a particular model to value an OTC derivative depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. The Company generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment. OTC derivatives are classified within Level 2 of the fair value hierarchy when all of the significant inputs can be corroborated to market evidence.

Certain OTC derivatives trade in less liquid markets with limited pricing information, and the determination of fair value for these derivatives is inherently more difficult. Such instruments are classified within Level 3 of the fair value hierarchy. Where the Company does not have corroborating market evidence to support significant model inputs and cannot verify the model to market transactions, the transaction price is initially used as the best estimate of fair value. Accordingly, when a pricing model is used to value such an instrument, the model is adjusted so that the model value at inception equals the transaction price. The valuations of these less liquid OTC derivatives are typically based on Level 1 and/or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Subsequent to initial recognition, the Company updates the Level 1 and Level 2 inputs to reflect observable market changes, with resulting gains and losses reflected within Level 3. Level 3 inputs are only changed when corroborated by evidence such as similar market transactions, third-party pricing services and/or broker or dealer quotations, or other empirical market data. In circumstances where the Company cannot verify the model value to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

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When appropriate, valuations are adjusted for various factors such as liquidity, bid/offer spreads and credit considerations. Such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

(g) Collateralized Agreements and Financings

Collateralized agreements and financings consist of the following:

- *Resale and Repurchase Agreements* – securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are accounted for as collateralized financing transactions and are recorded at their contractual amounts, plus accrued interest. The Company's policy is to obtain possession of collateral with a market value equal to or in excess of the principal amount loaned under reverse repurchase agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is valued daily, and the Company may require counterparties to deposit additional collateral or return collateral pledged, when appropriate. Substantially all repurchase and reverse repurchase activities are transacted under master netting agreements that give the Company the right, in the event of default, to liquidate collateral held and offset receivables and payables with the same counterparty.

As noted above, certain resale and repurchase agreements are carried in the consolidated statement of financial condition at fair value. Resale and repurchase agreements are generally valued based on inputs with reasonable levels of price transparency and are classified within Level 2 of the fair value hierarchy.

Reverse repurchase and repurchase balances with common counterparties, along with their respective interest receivables and payables, are reported net by counterparty, when applicable, pursuant to the provisions of ASC 210-20 (*Offsetting*). At December 31, 2012, the Company's reverse repurchase and repurchase balances reflected \$33.3 billion of netting pursuant to ASC 210-20.

In accordance with ASC 860-30 (*Secured Borrowing and Collateral*), \$68.4 billion of U.S. government securities are pledged as collateral under repurchase agreements which the counterparty is permitted to sell or repledge. Additionally, \$94.5 billion of U.S. government and corporate securities have been pledged as collateral under agreements to repurchase for which the counterparty does not have the right to sell or repledge.

- *Securities Borrowed and Loaned* – securities borrowed and loaned transactions are recorded at the amount of cash collateral advanced or received. Securities borrowed transactions require the Company to provide the counterparty with collateral in the form of cash, letters of credit, or other securities. The Company receives collateral in the form of cash or other securities for securities loaned transactions. On a daily basis, the Company monitors the market value of securities borrowed or loaned against the collateral value and the Company may require counterparties to deposit additional collateral or return collateral pledged, when appropriate.

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As these arrangements generally can be terminated on demand, they exhibit little, if any, sensitivity to changes in interest rates. Certain securities borrowed and loaned transactions are recorded at fair value under the fair value option. These securities borrowed and loaned transactions are generally valued based on inputs with reasonable levels of price transparency and are classified within Level 2 of the fair value hierarchy.

Securities borrowed and securities loaned balances with common counterparties are reported net by counterparty, when applicable, pursuant to the provisions of ASC 210-20. At December 31, 2012, the Company's securities borrowed and securities loaned balances reflected \$10.8 billion of netting pursuant to ASC 210-20.

(h) *Receivables and Payables – Customers*

Receivables from and payables to customers include amounts due on cash and margin transactions. At December 31, 2012, margin receivables and margin payables with the same customer are netted on the consolidated statement of financial condition in the amount of \$4.6 billion. Securities owned by customers, including those that collateralize margin or similar transactions, are not reflected on the consolidated statement of financial condition.

(i) *Receivables and Payables – Noncustomers*

Receivables from and payables to noncustomers include amounts due on cash and margin transactions of banks and broker dealers trading for their own account through the Company. These amounts represent transactions made predominantly with affiliates. Securities owned by noncustomers, including those that collateralize margin or similar transactions, are not reflected on the consolidated statement of financial condition.

(j) *Payables – Other*

Other payables, consisting primarily of loans payable, are presented on the consolidated statement of financial condition at their outstanding unpaid principal balances. These loans are predominantly made with affiliates.

(k) *Foreign Currency Translation*

Assets and liabilities denominated in non-U.S. dollar currencies are translated into U.S. dollar equivalents using year-end spot foreign exchange rates.

(l) *Share-Based Compensation*

The Bank has a share ownership program granting certain employees of the Company special stock awards and incentives as part of their total compensation. The cost of employee services received in exchange for a share-based award is generally measured based on the grant-date fair value of the award in accordance with ASC 718 (*Share Based Payments*). Share-based employee awards that require future service are amortized over the relevant service period.

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(m) Exchange Memberships

Exchange memberships are recorded at cost, less impairment, and are included in other assets on the accompanying consolidated statement of financial condition.

(n) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of furniture, fixtures, equipment, and computer software is computed using the straight-line method over their estimated useful lives of three to seven years. Buildings are depreciated on a straight-line basis over their estimated useful lives of 27 years. Leasehold improvements are amortized on a straight-line basis over the terms of the leases or the estimated useful lives of the improvements, whichever is shorter.

(o) Income Taxes

The results of the Company are included in the consolidated U.S. federal income tax return, and certain combined and unitary state tax returns of Deutsche Bank AG New York Branch. In addition, the Company files tax returns in certain states on a stand-alone basis. Pursuant to a tax sharing agreement, income taxes are computed on a separate company basis and the Company is reimbursed on a current basis by Taunus for the value of any federal taxable losses of the Company.

The Company provides for income taxes on all transactions that have been recognized in the consolidated statement of financial condition in accordance with ASC 740, *(Income Taxes)*. Accordingly, deferred taxes are adjusted to reflect the tax rates at which future taxable amounts will likely be settled or realized. The effects of tax rate changes on future deferred tax liabilities and deferred tax assets, as well as other changes in income tax laws, are recognized in the period during which such changes are enacted. Deferred tax assets are recognized subject to management's judgment that realization is more likely than not. Deferred tax assets and liabilities are included in other assets and liabilities, respectively, on the consolidated statement of financial condition.

ASC 740 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, disclosure, and transition

(p) Variable Interest Entities

VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when an enterprise has a variable interest, or a combination of variable interests, that provides the enterprise with (i) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. The Company determines whether it is the primary beneficiary of a VIE by

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performing an analysis that principally considers: (i) the VIE's purpose and design, including the risks the VIE was designed to create and pass through to its variable interest holders, (ii) the VIE's capital structure, (iii) the terms between the VIE and its variable interest holders and other parties involved with the VIE, (iv) which variable interest holders have the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, (v) which variable interest holders have the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE and (vi) related party relationships. The Company reassesses its initial evaluation of an entity as a VIE upon the occurrence of certain reconsideration events. The Company reassesses its determination of whether the Company is the primary beneficiary of a VIE upon changes in facts and circumstances that could potentially alter the Company's assessment.

(q) Recent Accounting Developments

Reconsideration of Effective Control for Repurchase Agreements. In April 2011, the FASB issued Accounting Standards Update (ASU) 2011-03, "*Reconsideration of Effective Control for Repurchase Agreements*". ASU 2011-03 amends Accounting Standards Codification (ASC) Topic 860, Transfers and Servicing, by removing from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation related to that criterion. Other criteria applicable to the assessment of effective control are not changed. Those criteria indicate that the transferor is deemed to have maintained effective control over the financial assets transferred (and thus must account for the transaction as a secured borrowing), for agreements that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity if all of the following conditions are met: (1) the financial assets to be repurchased or redeemed are the same or substantially the same as those transferred, (2) the agreement is to repurchase or redeem them before maturity, at a fixed or determinable price, and (3) the agreement is entered into contemporaneously with or in contemplation of, the transfer. The guidance became effective for the first interim or annual period beginning on or after December 15, 2011 and did not have a material impact on the Company's financial condition.

Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRS. In May 2011, the FASB issued ASU 2011-04, "*Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRS*". ASU 2011-04 amends Accounting Standards Codification (ASC) Topic 820, (*Fair Value Measurements and Disclosures*). The amendments result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRS by changing the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include those that clarify the Board's intent about the application of existing fair measurement and disclosure requirements and those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. In addition, some changes in wording were necessary to ensure that U.S. GAAP and IFRS fair value measurements and disclosure requirements are described in the same way. The amendments clarify the Board's intent with regard to the application of the highest and best use and valuation premise

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concepts, and requirements for measuring fair value of those instruments, such as equity interests, issued as consideration for in a business combination. The amendments clarify that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized as Level 3 of the fair value hierarchy. The amendments permit an exception to the requirements for measuring fair value when an entity manages its financial instruments on the basis of its net risk exposures to permit a reporting entity to measure fair value of such assets and liabilities at the price that would be received to sell a net position for a particular risk or to transfer a net liability position in an orderly transaction between market participants at the measurement date. The amendments clarify that premiums or discounts related to the size rather than as a characteristic of the asset or liability are not permitted in a fair value measurement. The amendments also expand the qualitative disclosure requirements for financial instruments categorized within Level 3 of the fair value hierarchy, as well as requiring entities to disclose by level of the fair value hierarchy, those instruments that are not measured at fair value in the statement of financial position, but for which fair value is required to be disclosed. Additional disclosures are also required when a reporting entity's use of a nonfinancial asset differs from the asset's highest and best use when that asset is measured at fair value in the statement of financial position or when its fair value is disclosed on the basis of its highest and best use. For nonpublic companies, the guidance became effective for annual periods beginning after December 15, 2011. Adoption of this ASU did not have a material impact on the Company's financial condition.

Compensation – Retirement Benefits Multiemployer Plans (Subtopic 715-80). In September 2011, the FASB issued ASU 2011-09, “*Compensation – Retirement Benefits Multiemployer Plans (Subtopic 715-80)*”. ASU 2011-09 requires that employers provide additional quantitative and qualitative disclosures for multiemployer pension plans and other postretirement benefit plans. The amended disclosures provide users with more detailed information about an employer's involvement in multiemployer pension plans including the significant multiemployer plans in which an employer participates, the level of an employer's participation in the significant multiemployer plans, the financial health of the multiemployer plans, and the nature of the employer's commitments to the plan. For nonpublic entities this amendment became effective for fiscal years ending after December 15, 2012. Adoption of this amendment did not have a material impact on the Company's financial condition.

Disclosures about Offsetting Assets and Liabilities. In December 2011, the FASB issued ASU2011-11, “*Disclosures about Offsetting Assets and Liabilities – Balance Sheet (Topic 210)*”. ASU 2011-11 requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. ASU 2011-11 is the result of a joint project conducted by the FASB and the IASB to enhance disclosures and provide converged disclosures about financial instruments and derivative instruments that are either offset on the statement of financial position, or subject to an enforceable master netting arrangement or similar agreement, irrespective to whether they are offset on the statement of financial position. Entities are required to provide both net and gross information for assets and liabilities in order to enhance comparability between those entities that prepare their financial statements on the basis of US GAAP and those entities that prepare their financial

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statements on the basis of IFRS. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013 and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparable periods presented. Adoption of this ASU is not expected to have a material impact on the Company's financial condition.

Technical Corrections and Improvements. In October 2012, the FASB issued ASU 2012-04, "*Technical Corrections and Improvements*". ASU 2012-04, includes items raised to the Board through the Codification's feedback mechanism and are items that the Board concluded met the scope of its project to address feedback received from stakeholders on the Codification and to make other incremental improvements to US GAAP. In addition, this Update includes more substantive limited scope improvements that represent narrow and incremental improvement to U.S. GAAP and are not purely technical corrections. This Update also includes amendments that identify when the use of fair value should be linked to the definition of fair value in Topic 820, (*Fair Value Measurement*). The amendments in this Update that will not have transition guidance will be effective upon issuance for both public and nonpublic entities. For public entities, the amendments that are subject to transition guidance will be effective for fiscal periods beginning after December 15, 2012. For nonpublic entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2013. Adoption of this ASU is not expected to have a material impact on the Company's financial condition.

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(3) Fair Value Measurements

(a) Fair Value of Financial Instruments

The following table sets forth the Company's financial instruments owned, at fair value, including those pledged as collateral, and financial instruments sold, but not yet purchased, at fair value (in millions):

	Assets	Liabilities
U.S. Treasury securities	\$ 18,460	14,107
U.S. Government agency obligations (excluding MBS)	29,383	1,037
Other mortgage backed securities	4,760	28
Asset backed securities	1,413	9
Other structured financial products	8	—
Other debt securities	3,287	2,030
Equities	5,975	3,727
Derivatives:		
Interest rate contracts	752	593
Credit contracts	12	35
Equity contracts	2,370	584
Forward contracts	84	131
Commercial paper and money market funds	344	—
State and municipal bond obligations	1,219	—
Total	\$ 68,067	22,281

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(b) Recurring Fair Value Measurements

The following table sets forth by level within the fair value hierarchy financial instruments owned, at fair value, including those pledged as collateral, financial instruments sold, but not yet purchased, at fair value and other financial assets and financial liabilities accounted for at fair value on a recurring basis and under the fair value option as of December 31, 2012 (in millions). Refer to note 2 for further information on the fair value hierarchy. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Counter-party netting</u>	<u>Total</u>
Assets:					
Cash equivalents	\$ 209	—	—	—	209
Cash and securities segregated for benefit of customers	1,698	4,011	—	—	5,709
Securities financing transactions	—	108,251	—	(44,128)	64,123
Financial instruments owned:					
U.S. Treasury securities	18,096	364	—	—	18,460
U.S. Government agency obligations (excluding MBS)	—	29,253	130	—	29,383
Other mortgage backed securities	83	4,263	414	—	4,760
Asset backed securities	—	1,047	366	—	1,413
Other structured financial products	—	—	8	—	8
Other debt securities	—	3,190	97	—	3,287
Equities	5,904	53	18	—	5,975
Derivatives:					
Interest rate contracts	—	890	356	(494)	752
Credit contracts	—	11	1	—	12
Equity contracts	2,974	220	—	(824)	2,370
Forward contracts	—	84	—	—	84
Commercial paper and money market funds	6	338	—	—	344
State and municipal bond obligations	117	1,091	11	—	1,219
Total financial instruments owned	<u>27,180</u>	<u>40,804</u>	<u>1,401</u>	<u>(1,318)</u>	<u>68,067</u>
Securities received as collateral (included in other assets)	<u>—</u>	<u>875</u>	<u>—</u>	<u>—</u>	<u>875</u>
Total recurring fair value measurements	<u>\$ 29,087</u>	<u>153,941</u>	<u>1,401</u>	<u>(45,446)</u>	<u>138,983</u>

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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Counter-party netting</u>	<u>Total</u>
Liabilities:					
Securities financing transactions	\$ —	98,125	—	(44,128)	53,997
Financial instruments sold, not yet purchased:					
U.S. Treasury Securities	13,422	685	—	—	14,107
U.S. government agency obligations (excluding MBS)	3	1,034	—	—	1,037
Other mortgage backed securities	—	28	—	—	28
Asset backed securities	—	9	—	—	9
Other debt securities	792	1,231	7	—	2,030
Equities	3,698	29	—	—	3,727
Derivatives:					
Interest rate contracts	—	1,076	11	(494)	593
Credit contracts	—	28	7	—	35
Equity contracts	1,407	1	—	(824)	584
Forward contracts	—	131	—	—	131
Total financial instruments sold, not yet purchased	<u>19,322</u>	<u>4,252</u>	<u>25</u>	<u>(1,318)</u>	<u>22,281</u>
Obligation to return securities as collateral (included in other liabilities)	<u>—</u>	<u>875</u>	<u>—</u>	<u>—</u>	<u>875</u>
Total liabilities	<u>\$ 19,322</u>	<u>103,252</u>	<u>25</u>	<u>(45,446)</u>	<u>77,153</u>

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(c) Level 3 Financial Assets/Financial Liabilities

The table below presents the (1) valuation techniques and the nature of significant inputs generally used to determine the fair values of each type of level 3 financial asset/financial liabilities (in millions) and (2) the ranges of significant unobservable inputs used to value the Company's Level 3 financial asset/financial liabilities. These ranges represent the significant unobservable inputs that were used in the valuation of each type of financial assets/financial liabilities. The ranges of these inputs are not representative of the appropriate inputs to use when calculating the fair value of any one type of financial assets/financial liabilities. Accordingly, the ranges of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of the Company's Level 3 financial assets/financial liabilities.

	Level 3 at Dec 31, 2012		Valuation technique(s)	Significant unobservable input(s) (Level 3)	Range	
	Assets	Liabilities				
Financial instruments owned:						
U.S. Government agency obligations (excluding MBS)	\$ 130		Discounted cash flow Market comparables	Credit spread Price	3% 108%	12% 111%
Other mortgage backed securities	414		Discounted cash flow Discounted cash flow	Credit spread Correlation	1% 3%	20% 23%
Asset backed securities	366		Discounted cash flow	Credit spread	4%	19%
Other structured financial products	8		Discounted cash flow	Credit spread	0%	19%
Other debt securities	97	7	Market comparables Discounted cash flow Discounted cash flow	Price Credit spread Recovery	10% 3% 10%	15% 15% 50%
Equities	18		Market comparables	Price	0%	100%
Derivatives:						
Interest rate contracts	356	11	Discounted cash flow Discounted cash flow	Constant prepayment rate (%) Price	6% 6%	52% 82%
Credit contracts	1	7	Discounted cash flow	Credit spread	4%	11%
State and municipal bond obligations	11		Market comparables	Price	0%	99%
	\$ 1,401	\$ 25				

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The table below presents additional information about Level 3 assets and liabilities measured at fair value on a recurring basis (in millions). Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realized and unrealized gains and losses for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realized or unrealized gains and losses on hedging instruments that have been classified by the Company within the Level 1 and/or Level 2 categories. Additionally, both observable and unobservable inputs may be used to determine the fair value of positions that the Company has classified within the Level 3 category. As a result, the unrealized gains and losses for assets and liabilities within the Level 3 category presented in the tables below may include changes in fair value that were attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in unobservable long-dated volatilities) inputs.

	Beginning Balance	Realized Gains (Losses)	Unrealized Gains (losses)	Transfers into Level 3	Transfers out of Level 3	Purchases	Sales	Issuances	Settlements	Ending Balance
Assets:										
Financial instruments owned:										
US Government agency obligations(excluding MBS)	\$ 79	(21)	12	-	-	79	(19)	-	-	130
Other mortgage backed securities	796	15	58	-	-	442	(897)	-	-	414
Asset backed securities	144	23	7	41	-	306	(155)	-	-	366
Other structured financial products	-	-	-	-	-	15	-	-	(7)	8
Other debt securities	263	2	(24)	20	-	72	(236)	-	-	97
Equities	3	-	-	7	-	8	-	-	-	18
Derivatives:										
Interest rate contracts	460	11	(122)	-	-	140	(95)	-	(38)	356
Credit contracts	-	-	-	-	-	1	-	-	-	1
Equity contracts	10	-	-	-	-	-	-	-	(10)	-
Forward contracts	3	-	-	-	-	-	-	-	(3)	-
State and municipal bond obligations	118	(2)	(19)	-	(72)	6	(20)	-	-	11
Total financial instruments owned	\$ 1,876	28	(88)	68	(72)	1,069	(1,422)	-	(58)	1,401
Liabilities:										
Financial instruments sold, not yet purchased:										
Other debt securities	-	-	-	-	-	7	-	-	-	7
Derivatives:										
Interest rate contracts	8	-	-	-	-	-	-	(8)	11	11
Credit contracts	-	-	-	-	-	7	-	-	-	7
Forward contracts	3	-	-	-	-	-	-	-	(3)	-
Total financial instruments sold, not yet purchased:	\$ 11	-	-	-	-	14	-	(8)	8	25

There were no significant transfers between Level 1 and Level 2 of the fair value hierarchy during the year ended December 31, 2012.

(d) Financial Instruments Not Measured at Fair Value

Certain of the Company's financial assets and liabilities, such as various collateralized agreements and financings, are not measured at fair value on a recurring basis but nevertheless are recorded at amounts that approximate fair value due to their liquid or short-term nature.

(e) Derivative Activities

Derivative contracts are instruments, such as futures, forwards, swaps or option contracts that derive their value from underlying assets, indices, reference rates, or a combination of these factors. Derivative contracts may be privately negotiated contracts, which are often referred to as OTC derivatives, or they may be listed and traded on an exchange. Derivatives may involve future commitments to purchase or sell financial instruments, or to exchange currency or interest payment

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streams. The amounts exchanged are based on the specific terms of the contract with reference to specified rates, securities, currencies, or indices.

Substantially all of the Company's derivative transactions are entered into for trading purposes, to facilitate customer transactions, or as a means of risk management of firm inventory positions. Risk exposures are managed through diversification, by controlling position sizes and by establishing hedges in related securities or derivatives. The Company does not apply hedge accounting under ASC 815 (*Derivatives and Hedging*) to any of its derivative contracts.

The following table sets forth the fair value and the number of the Company's derivative contracts by major product type on a gross basis as of December 31, 2012. Gross fair values in the table below exclude the effects of both netting under enforceable netting agreements and netting of cash received or posted pursuant to credit support agreements, and therefore are not representative of the Company's exposure (in millions, except number of contracts):

<u>Derivative contract type</u>	<u>Derivative assets</u>	<u>Derivative liabilities</u>	<u>Notional amount</u>	<u>Number of contracts</u>
Interest rate contracts	\$ 1,246	1,087	3,498,825	3,458
Credit contracts	12	35	45,137	3,147
Equity contracts	3,194	1,408	200,506	9,622
Futures contracts	-	-	56,805	952
Forward contracts	84	131	940,800	39,811
Subtotal	4,536	2,661	<u>4,742,073</u>	<u>56,990</u>
Counterparty netting (1)	<u>(1,318)</u>	<u>(1,318)</u>		
Total fair value	<u>\$ 3,218</u>	<u>1,343</u>		

(1) Represents the netting of receivable balances with payable balances for the same counterparty pursuant to credit support agreements.

The Company generally enters into International Swaps and Derivative Association, Inc. master netting agreements or their equivalent with each of its counterparties, whenever possible. These master netting agreements provide protection in bankruptcy in certain circumstances and to further reduce default risk, the Company requires collateral, generally cash or securities in connection with its derivative transactions.

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Credit Derivatives – the Company enters into credit derivatives, principally through credit default swaps, under which it provides counterparties protection against the risk of default on a set of debt obligations issued by a specified reference entity or entities. A majority of the Company's counterparties are banks, broker-dealers, insurance and other financial institutions, and monoline insurers. The table below summarizes certain information regarding protection sold through credit default swaps and credit-linked notes as of December 31, 2012 (in millions):

Credit ratings of the reference obligation	Protection sold				Fair value asset (liability) (1)
	Maximum potential payout/notional				
	Years to maturity				
	Less than 1	1 – 5	Over 5	Total	
Single-name credit default swaps:					
AAA	\$ —	4	—	4	—
AA	—	11	17	28	(2)
A	—	1	—	1	—
BBB	—	11	57	68	(13)
Noninvestment grade	398	209	325	932	(117)
	<u>398</u>	<u>236</u>	<u>399</u>	<u>1,033</u>	<u>(132)</u>
Multi-name credit default swaps:					
Noninvestment grade	\$ 12	2,528	18,568	21,108	(3,647)
	<u>12</u>	<u>2,528</u>	<u>18,568</u>	<u>21,108</u>	<u>(3,647)</u>
Total return swaps:					
Noninvestment grade	2	—	—	2	2
	<u>2</u>	<u>—</u>	<u>—</u>	<u>2</u>	<u>2</u>
Total protection sold	\$ 412	2,764	18,967	22,143	(3,777)
	<u><u>412</u></u>	<u><u>2,764</u></u>	<u><u>18,967</u></u>	<u><u>22,143</u></u>	<u><u>(3,777)</u></u>

(1) Fair value amounts are shown on a gross basis prior to cash collateral or counterparty netting.

The maximum potential amounts of future payments under credit derivatives contracts are based on the notional value of credit derivatives. The Company believes that the maximum potential amount of future payments for credit protection sold does not represent the actual loss exposure based on historical experience. In addition, the maximum amount of future payments for credit protection sold has not been reduced for any cash collateral paid to counterparties. Payments under credit derivative contracts would be calculated after netting all derivative exposures with that counterparty in accordance with a related master netting agreement. Due to such netting processes, determining the amount of collateral that relates to credit exposures only is not possible.

Single-name and multi-name credit default swaps – A credit default swap protects the buyer against the loss of principal on a bond or loan in case of a default by the issuer. The protection buyer pays a periodic premium (typically quarterly) over the life of the contract and is protected for the period. The Company in turn will have to perform under a credit default swap if a credit event as defined under the contract occurs. Typical credit events include bankruptcy, dissolution, or insolvency of the referenced entity; failure to pay; the obligations of the referenced entity and restructuring of the

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obligations of the referenced entity. In order to provide an indication of the current payment status or performance risk of the credit default swaps, the external credit ratings, primarily Moody's credit ratings, of the underlying reference entity of the credit default swaps are disclosed.

Total return swaps – a total return swap transfers the risks relating to economic performance of a reference obligation from the protection buyer to the protection seller. Typically the protection buyer receives from the protection seller a floating rate of interest and protection against any reduction in fair value of the reference obligation, and in return the protection seller receives the cash flows associated with the reference obligation, plus any increase in the fair value of the reference obligation.

Purchased credit protection – for single-name and multi-name credit default swaps and total return swaps, the Company has purchased protection with a notional amount of \$23.0 billion, compared with a notional amount of \$22.1 billion of credit protection sold with identical underlying reference obligations. The purchase of credit protection does not represent the sole manner in which the Company risk manages its exposure to credit derivatives. The Company manages its exposure to these derivative contracts through a variety of risk mitigation strategies. Aggregate market risk limits have been established for credit derivatives, and market risk measures are routinely monitored against these limits. The Company may also recover amounts on the underlying reference obligation delivered to the Company under credit default swaps where credit protection was sold.

Credit-Risk Related Contingent Features in Derivatives

For the Company's OTC derivative contracts that are with related parties, there are no credit-risk-related contingent features in these contracts with provisions that require the Company to either settle immediately, or post additional collateral if its credit rating, or the credit rating of its affiliates, is downgraded.

(4) Securities Pledged as Collateral and Obligations to Return Collateral

The Company pledges firm-owned assets to collateralize repurchase agreements and other secured financings. Pledged securities that can be sold or re-pledged by the secured party are parenthetically disclosed in financial instruments owned, at fair value on the consolidated statement of financial condition.

In transactions where the Company acts as a lender in a securities lending agreement and receives securities that can be pledged or sold as collateral, it recognizes an asset on the consolidated statement of financial condition, representing the securities received, and a liability for the same amount, representing the obligation to return those securities. At December 31, 2012, included in other assets and other liabilities on the accompanying consolidated statement of financial condition was \$875.4 million resulting from these transactions.

At December 31, 2012, the Company has received collateral of \$114.1 billion and \$76.5 billion under agreements to resell and securities borrowed, respectively, of which \$100.6 billion and \$64.3 billion, respectively, has been re-pledged as collateral for repurchase transactions, securities lending transactions,

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to meet margin requirements at clearing organizations and to facilitate short sales of customers and noncustomers.

At December 31, 2012 in the normal course of business, the Company was in possession of collateral in the amount of \$63.1 billion and \$61.4 billion from customers and noncustomers, respectively, of which \$3.7 billion and \$35.2 billion, respectively, has been pledged for securities lending transactions, repurchase transactions and to facilitate short sales of customers and noncustomers.

(5) Securitization Activities and Variable Interest Entities

(a) Securitization Activities

The Company engages in securitization activities related to residential mortgage loans and other types of financial assets. The Company may act as an underwriter of the beneficial interests that are sold to investors. The Company derecognizes financial assets transferred in securitizations, provided it has relinquished control over such assets. Transferred assets are accounted for at fair value prior to securitization. The Company generally receives cash in exchange for transferred assets.

The Company may have retained interests in transferred financial assets. These retained interests are classified as financial instruments owned, at fair value in the consolidated statement of financial condition and are measured at fair value. The outstanding principal amount of the underlying collateral and fair value of retained interests transferred at December 31, 2012 were \$29.6 million and \$16.0 million respectively.

The following table sets forth the weighted average key economic assumptions used in measuring the fair value of the Company's retained interests and the sensitivity of this fair value to immediate adverse changes of 10% and 20% in those assumptions at December 31, 2012 (in thousands):

		Mortgage- backed
Fair value of retained interests	\$	<u>15,975</u>
Constant prepayment rate		1.00%
Impact of 10% adverse change	\$	(54)
Impact of 20% adverse change		(53)
Anticipated credit losses		8.00%
Impact of 10% adverse change	\$	(54)
Impact of 20% adverse change		(54)
Discount rate		22.49%
Impact of 10% adverse change	\$	(51)
Impact of 20% adverse change		(48)

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(b) Variable Interest Entities

The Company, in the ordinary course of business, creates or transacts with entities that are considered VIEs. The Company also purchases and sells variable interests in VIEs which primarily issue mortgage-backed and other asset backed securities in connection with its market making activities and making investments in VIEs that hold performing and nonperforming debt, equity and other assets. Substantially all of the consolidated assets of the VIE act as the collateral for the related consolidated liabilities.

The Company's variable interests in VIEs include senior and subordinated debt interests in mortgaged backed and asset backed securitization vehicles. The Company's exposure to the obligations of VIEs is generally limited to its interests in these entities. The Company has aggregated nonconsolidated VIEs based on the principal business activities. The following table sets forth (in millions) the carrying amounts of assets in nonconsolidated VIEs in which the Company holds variable interests and the Company's maximum exposure to loss excluding the benefit of offsetting financial instruments that are held to mitigate the risks associated with these variable interests. In accordance with ASC 860 (*Transfers and Servicing*) and ASC 810 (*Consolidations*), the following table includes nonconsolidated VIEs in which the Company holds variable interests (and to which the Company sold assets and has continuing involvement as of December 31, 2012) that were formerly considered QSPEs prior to the adoption of these standards.

	Fair value of variable interests held	Maximum exposure of debt interests
Residential mortgages	\$ 30	16
Commercial mortgages	2,648	2,648
Total	\$ 2,678	2,664

The Company's maximum exposure to loss presented in the preceding table does not reflect the benefit of offsetting financial instruments that are held to mitigate the risks associated with these variable interests.

The following table sets forth the carrying amount (in millions) and classification of the Company's assets and liabilities, excluding the benefit of offsetting financial instruments that are held to mitigate the risks associated with its variable interests, in consolidated VIEs. In accordance with ASC 810, the following table excludes VIEs in which the Company holds a majority of voting interest if the VIE meets the definition of a business as defined in ASC 805 and the VIE's assets can be used for purposes other than settlement of its obligations. The Company has aggregated consolidated VIEs based on principal business activity. Consolidated VIE assets and liabilities are presented after intercompany eliminations and include assets financed on a nonrecourse basis.

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		Asset backed securities
Assets:		
Financial instruments owned, at fair value	\$	303
Total assets	\$	303
Liabilities:		
Payables - other	\$	287
Total liabilities	\$	287

(6) Receivable from and Payable to Brokers, Dealers, and Clearing Organizations

Amounts receivable from and payable to brokers, dealers, and clearing organizations as of December 31, 2012 consist of the following (in millions):

	Receivable	Payable
Securities failed to deliver/receive	\$ 614	588
Payable to clearing broker	—	1,761
Receivable from clearing organizations	1,040	—
Other	478	383
	\$ 2,132	2,732

The Company clears certain of its proprietary and customer transactions through other broker-dealers on a fully disclosed basis. The amount payable to the clearing broker relates, in part, to the above-mentioned transactions and is collateralized by securities owned by the Company.

(7) Payables – Other

The Company maintains an uncommitted bank loan facility whereby it may borrow funds on an unsecured or secured basis from the Bank at various rates approximating the Federal Funds rate of interest. At December 31, 2012, all but \$1.7 billion of the Company's borrowings, aggregating \$6.6 billion, which are included in other payables in the accompanying consolidated statement of financial condition were with affiliates and were unsecured. At December 31, 2012, the weighted average interest rate on these borrowings was 1.29%. In addition, \$4.8 billion of the borrowings were overnight or short-term.

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(8) Other Assets and Other Liabilities

The significant components of the Company's other assets as of December 31, 2012 were as follows (in millions):

Deferred tax assets	\$	1,331
Securities received as collateral under ASC 860-30, at fair value		875
Receivables from affiliates		625
Accrued interest and dividends receivable		446
Investment in unconsolidated subsidiary		329
Syndicate receivables		269
Other		400
	\$	<u>4,275</u>

The significant components of the Company's other liabilities as of December 31, 2012 were as follows (in millions):

Accrued compensation and benefits	\$	1,607
Obligation to return securities received as collateral under ASC 860-30, at fair value		875
Accrued operating expenses		573
Payables to affiliates		459
Current income tax liability		289
Accrued interest and dividends payable		194
Other		499
	\$	<u>4,496</u>

(9) Related-Party Transactions

The Company is involved in significant financing and other transactions, and has significant related-party balances with certain of its affiliates. Related party financing transactions are also discussed in notes 5 and 15.

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(a) Related-Party Assets and Liabilities

The following table sets forth assets and liabilities with related parties as of December 31, 2012 (in millions):

Assets:

Cash and cash equivalents	\$	649
Cash and securities segregated for benefit of customers		1,328
Securities purchased under agreements to resell		34,683
Securities borrowed		9,260
Financial instruments owned, at fair value		467
Receivable from customers		193
Receivable from noncustomers		23,009
Receivable from brokers, dealers, and clearing organizations		334
Other assets		1,897
	\$	71,820

Liabilities:

Securities sold under agreements to repurchase	\$	41,293
Securities loaned		39,481
Payable to customers		901
Payable to noncustomers		400
Payable to brokers, dealers, and clearing organizations		286
Payables – other		4,892
Financial instruments sold, but not yet purchased, at fair value		306
Other liabilities		1,604
Subordinated liabilities		6,723
	\$	95,886

(10) Off Balance Sheet Risk and Concentrations of Credit Risk

(a) Market Risk

Market risk is the potential loss the Company may incur as a result of changes in the market value of a particular instrument. All financial instruments, including derivatives and short sales, are subject to market risk. The Company's exposure to market risk is determined by a number of factors, including the size, duration, composition, and diversification of positions held, the absolute and relative levels of interest rates and foreign currency exchange rates as well as market volatility and illiquidity. For instruments such as options and warrants, the time period during which the options or warrants may be exercised and the relationship between the current market price of the underlying instrument and the option's or warrant's contractual strike or exercise price also affects the level of market risk. A significant factor influencing the overall level of market risk to which the Company is exposed is its

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use of hedging techniques to mitigate such risk. The Company manages market risk by setting risk limits and monitoring the effectiveness of its hedging policies and strategies.

(b) Credit Risk

The Company acts as a dealer of securities in the global capital markets and, consequently, has credit risk for the timely repayment of principal and interest regarding its holdings of securities. Credit risk is measured by the loss the Company would record if its counterparties failed to perform pursuant to the terms of their contractual obligations and the value of collateral held, if any, was not adequate to cover such losses. Specifically, the Company's potential credit loss exposure for contractual commitments is equal to the market or fair value of contractual commitments that are in a net asset position less the effect of master netting agreements. The Company has established controls to monitor the creditworthiness of counterparties, as well as the quality of pledged collateral, and uses master netting agreements whenever possible to mitigate the Company's exposure to counterparty credit risk. The Company may require counterparties to submit additional collateral when deemed necessary. The Company also enters into collateralized financing agreements in which it extends short-term credit, primarily to major financial institutions. The Company controls the collateral pledged by the counterparties, which consists largely of securities issued by the U.S. government or its agencies.

The notional amounts of contractual commitments do not represent exposure to credit risk. Credit risk associated with futures contracts is limited since all transactions are guaranteed by the exchange on which they are traded and daily cash settlements by all counterparties are required for changes in the market value of open contracts. The Company's purchased exchange issued options also possess low credit risk due to guarantee of performance by the issuing exchange. Negotiated contractual commitments, such as forwards, and certain OTC options possess greater exposure to credit risk since cash settlement is not normally required on a daily basis, and therefore, counterparty credit quality and the value of pledged collateral are essential elements in controlling the Company's risk.

Concentrations of credit risk from financial instruments, including contractual commitments, exist when groups of issuers or counterparties have similar business characteristics or are engaged in like activities that would cause their ability to meet their contractual commitments to be adversely affected, in a similar manner, by changes in the economy or other market conditions. As a financial intermediary, the Company regularly transacts business with, and owns securities issued by, a broad range of governments, corporations, international organizations, central banks, and other financial institutions, which are economically and geographically diverse. The Company monitors credit risk on both an individual and group counterparty basis. The Company minimizes this risk through credit reviews, approvals, trading limits, and monitoring procedures.

(c) Operational and Support Risk

As a major intermediary in financial markets, the Company is directly exposed to market risk and credit risk which arise in the normal course of its business activities. Less direct, but of critical importance, are risks pertaining to operational and back-office support. This is particularly the case in a rapidly changing and increasingly global environment with increasing transaction volumes and

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an expansion in the number and complexity of products in the marketplace. Such risks include the following:

- i. Operational/settlement risk – the risk of financial and opportunity loss and legal liability attributable to operational problems such as inaccurate pricing of transactions, untimely trade execution, clearance and/or settlement, or the inability to process large volumes of transactions. The Company is subject to increased risks with respect to its trading activities in emerging markets securities, where clearance, settlement, and custodial activities continue to develop.
- ii. Technological risk – the risk of loss attributable to technological limitations or hardware failure that constrain the Company’s ability to gather, process, and communicate information efficiently and securely, without interruption, with customers, and in the markets where the Company participates. In addition, the Company must address the technological implications that will result from regulatory and market changes.
- iii. Legal/documentation risk – the risk of loss attributable to deficiencies in the documentation of transactions (such as trade confirmations) and customer relationships (such as master netting agreements) or errors that result in noncompliance with applicable legal and regulatory requirements.
- iv. Financial control risk – the risk of loss attributable to limitations in financial systems and controls; strong financial systems and controls ensure that assets are safeguarded, that transactions are executed in accordance with management’s authorization, and that financial information utilized by management and communicated to external parties, creditors, and regulators is free of material errors.

(11) Commitments and Contingencies

(a) Commitments

Underwriting Commitments – in the normal course of business, the Company enters into underwriting transactions. Commitments relating to such underwritings that were open at December 31, 2012, and were subsequently settled did not have a material effect on the consolidated statement of financial condition as of that date.

Letters of Credit – the Company has \$1.7 billion of uncommitted facilities with external banks permitting borrowing on an unsecured and secured basis. As of December 31, 2012, \$34.0 million of this facility was utilized for letters of credit posted as margin to clearing organizations and none was utilized for other operational purposes.

Forward Secured Financings – the Company had commitments to enter into forward secured financing transactions, including certain reverse repurchase agreements of \$7.9 billion and repurchase agreements of \$10.5 billion, respectively, as of December 31, 2012.

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Customer Margin Financing – the Company’s prime brokerage business enters into term margin agreements with selected customers covering the Company’s collateralized margin lending activities. Term margin agreements are formal conditional commitments between the Company and the customer whereby the Company agrees not to change the terms of its agreement without providing a specific notice period. At December 31, 2012, the Company did not have an obligation to its customers to fund incremental debit balances of their accounts above the current debit balance amounts.

Leases – the Company has entered into various noncancelable lease agreements for premises and equipment that expire through 2023. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges. Future minimum rental commitments under noncancelable leases with initial or remaining terms exceeding one year as of December 31, 2012 are presented below (in millions):

Year ending:		
2013	\$	16.0
2014		15.6
2015		10.4
2016		10.0
2017		8.3
2018 and thereafter		<u>30.4</u>
Total	\$	<u><u>90.7</u></u>

Other Commitments – other compensation related commitments of the Company totaled \$47.8 million as of December 31, 2012.

(b) Contingencies

The Company, together with various other brokers and dealers, corporations, and individuals, has been named as a defendant in various legal actions, including arbitrations, class actions, and other litigation arising in connection with the conduct of its business activities that allege violations of federal and state securities laws and claim substantial damages.

In accordance with ASC 450 (*Loss Contingencies*), the Company will accrue a liability when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. In many lawsuits and arbitrations, it is not possible to determine whether a liability has been incurred or to estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case no accrual is made until that time. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, the Company cannot determine the probability or estimate what the eventual loss or range of loss related to such matters will be. Subject to the foregoing, the Company continues to assess these cases and believes, based on information available to it, that the resolution of these matters will

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not have a material adverse effect on the financial condition of the Company. The actions against the Company as of December 31, 2012 include but are not limited to the following:

Tax-Related Litigation

The Bank, along with certain affiliates, including the Company, and current and/or former employees (collectively referred to as Deutsche Bank), have collectively been named as defendants in a number of legal proceedings brought by customers in various tax-oriented transactions. Deutsche Bank provided financial products and services to these customers, who were advised by various accounting, legal and financial advisory professionals. The customers claimed tax benefits as a result of these transactions, and the United States Internal Revenue Service (IRS) has rejected those claims. In these legal proceedings, the customers allege that the professional advisors, together with Deutsche Bank, improperly misled the customers into believing that the claimed tax benefits would be upheld by the IRS. The legal proceedings are pending in state and federal courts, and claims against Deutsche Bank are alleged under both U.S. state and federal law. 107 legal proceedings have been resolved and dismissed with prejudice with respect to Deutsche Bank. A number of other legal proceedings remain pending against Deutsche Bank and are currently at various pre-trial stages, including discovery. Deutsche Bank has received a number of unfiled claims as well, and has resolved certain of those unfiled claims, though others remain pending against Deutsche Bank. The Bank does not expect these pending legal proceedings and unfiled claims to have a significant effect on its financial position or profitability.

Mortgage-Related and Asset Backed Securities Matters

The Bank and its affiliates, including the Company (collectively referred to as Deutsche Bank), have received subpoenas and requests for information from certain regulators and government entities concerning its activities regarding the origination, purchase, securitization, sale and/or trading of mortgage loans, residential mortgage backed securities (RMBS), collateralized debt obligations, asset backed commercial paper and credit derivatives. Deutsche Bank is cooperating fully in response to those subpoenas and requests for information.

Deutsche Bank has been named as defendant in numerous civil litigations in various roles as issuer or underwriter in RMBS offerings and other asset-backed securities. These cases include purported class action suits, actions by individual purchasers of securities, and actions by insurance companies that guaranteed payments of principal and interest for particular tranches of securities offerings. Although the allegations vary by lawsuit, these cases generally allege that the RMBS offering documents contained material misrepresentations and omissions, including with regard to the underwriting standards pursuant to which the underlying mortgage loans were issued.

Deutsche Bank is a defendant in putative class actions relating to its role, along with other financial institutions, as underwriter of RMBS issued by various third-parties and their affiliates including Countrywide Financial Corporation, IndyMac MBS, Inc., Novastar Mortgage Corporation, and Residential Accredited Loans, Inc. These cases are in various stages up through discovery. On March

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29, 2012, the court dismissed with prejudice and without leave to replead the putative Novastar Mortgage Corporation class action, which the plaintiffs have appealed.

Deutsche Bank is a defendant in various non-class action lawsuits by alleged purchasers of, and counterparties involved in transactions relating to, RMBS, and their affiliates, including Allstate Insurance Company, Asset Management Fund, Bayerische Landesbank, Cambridge Place Investments Management Inc., the Federal Deposit Insurance Corporation (as conservator for Colonial Bank, Guaranty Bank, Franklin Bank S.S.B., Citizens National Bank and Strategic Capital Bank), the Federal Home Loan Bank of Boston, the Federal Home Loan Bank of San Francisco, the Federal Home Loan Bank of Seattle, the Federal Housing Finance Agency (as conservator for Fannie Mae and Freddie Mac), John Hancock Insurance Company, Landesbank Baden-Württemberg, Mass Mutual Life Insurance Company, Moneygram Payment Systems, Inc., Phoenix Light SF Limited (as purported assignee of claims of special purpose vehicles created and/or managed by WestLB AG), Royal Park Investments (as purported assignee of claims of special-purpose vehicle created to acquire certain assets of Fortis Bank), Sealink Funding Ltd. (as purported assignee of claims of special purpose vehicles created and/or managed by Sachsen Landesbank and its subsidiaries), Spencerview Asset Management Ltd., The Charles Schwab Corporation, The Union Central Life Insurance Company, The Western and Southern Life Insurance Co. and the West Virginia Investment Management Board. These civil litigations are in various stages up through discovery.

Deutsche Bank and several current or former employees were also named as defendants in a putative class action commenced on June 27, 2008, relating to two Deutsche Bank-issued RMBS offerings. Following a mediation, the parties agreed to settle the matter for \$13.0 million. On July 11, 2012, the settlement received final court approval.

On May 8, 2012, Deutsche Bank reached a settlement with Assured Guaranty Municipal Corporation (Assured) regarding pending and threatened litigations on certain RMBS issued and underwritten by Deutsche Bank that are covered by financial guaranty insurance provided by Assured. Pursuant to this settlement, the Company made a payment of \$20 million to settle one litigation.

On February 6, 2012, the United States District Court for the Southern District of New York issued an order dismissing claims brought by Dexia SA/NV and Teachers Insurance and Annuity Association of America, and their affiliates and on January 4, 2013, the court issued an opinion explaining the basis for the order. The court dismissed some of the claims with prejudice and granted the plaintiffs leave to replead other claims. The plaintiffs replead the claims dismissed without prejudice by filing a new complaint on February 4, 2013.

On July 16, 2012, the Fourth Judicial District for the State of Minnesota dismissed Deutsche Bank from a litigation brought by Moneygram Payment Systems, Inc. (Moneygram) relating to investments in RMBS, collateralized debt obligations and credit-linked notes. The court further denied Moneygram's motion for reconsideration, and Moneygram has filed an appeal. On January 11, 2013, Moneygram filed a summons with notice in New York State Supreme Court seeking to assert claims similar to those dismissed in Minnesota.

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On February 4, 2013, pursuant to the terms of a settlement agreement, Stichting Pensioenfonds ABP dismissed two lawsuits that had been filed against Deutsche Bank. The terms of the settlement are confidential.

On May 3, 2011, the United States Department of Justice (USDOJ) filed a civil action against Deutsche Bank and MortgageIT, Inc. in the United States District Court for the Southern District of New York. The USDOJ filed an amended complaint on August 22, 2011. The amended complaint, which asserts claims under the U.S. False Claims Act and common law, alleged that Deutsche Bank, DB Structured Products, Inc., MortgageIT, Inc. and the Company submitted false certifications to the Department of Housing and Urban Development's Federal Housing Administration (FHA) concerning MortgageIT, Inc.'s compliance with FHA requirements for quality controls and concerning whether individual loans qualified for FHA insurance. As set forth in the amended complaint, the FHA has paid \$368 million in insurance claims on mortgages that are allegedly subject to false certifications. The amended complaint sought recovery of treble damages and indemnification of future losses on loans insured by FHA, and as set forth in the filings, the USDOJ sought over \$1 billion in damages. On September 23, 2011, the defendants filed a motion to dismiss the amended complaint. Following a hearing on December 21, 2011, the court granted the USDOJ leave to file a second amended complaint. On May 10, 2012, Deutsche Bank settled this litigation with the USDOJ for \$202.3 million.

A number of other entities have threatened to assert claims against Deutsche Bank in connection with various RMBS offerings and other related products, and Deutsche Bank has entered into agreements with a number of these entities to toll the relevant statute of limitations. It is possible that these potential claims may have a material impact on Deutsche Bank. In addition, Deutsche Bank has entered into settlement agreements with some of these entities, the financial terms of which are confidential.

Auction Rate Securities

The Bank and the Company, including a division of the Company, have been named as defendants in 21 individual actions asserting various claims under the federal securities laws and state common law arising out of the sale of auction rate securities (ARS). Of those 21 actions, three are pending and 18 have been resolved and dismissed with prejudice. The Bank and the Company were the subjects of a putative class action, filed in the United States District Court for the Southern District of New York, asserting various claims under the federal securities laws on behalf of all persons or entities who purchased and continue to hold ARS offered for sale by the Bank and the Company between March 17, 2003 and February 13, 2008. In December 2010, the court dismissed the putative class action with prejudice. After initially filing a notice of appeal, the plaintiff voluntarily withdrew and dismissed the appeal in December 2011. The Bank was also named as a defendant, along with ten other financial institutions, in two putative class actions, filed in the United States District Court for the Southern District of New York, asserting violations of the antitrust laws. The putative class actions allege that the defendants conspired to artificially support and then, in February 2008,

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restrain the ARS market. On or about January 26, 2010, the court dismissed the two putative class actions. The plaintiffs have filed appeals of the dismissals.

Trust Preferred Securities

The Bank and certain of its affiliates and officers, including the Company, are the subject of a consolidated putative class action, filed in the United States District Court for the Southern District of New York, asserting claims under the federal securities laws on behalf of persons who purchased certain trust preferred securities issued by Deutsche Bank and its affiliates between October 2006 and May 2008. Claims are asserted under sections 11, 12(a)(2), and 15 of the Securities Act of 1933. An amended and consolidated class action complaint was filed on January 25, 2010. On August 19, 2011, the court granted in part and denied in part the defendants' motion to dismiss following which plaintiffs filed a second amended complaint, which did not include claims based on the October 2006 issuance of securities. On defendants' motion for reconsideration, the court on August 10, 2012 dismissed the second amended complaint with prejudice. Plaintiffs have sought reconsideration of that dismissal.

Aravali

The Company has been named as a respondent in 27 arbitrations seeking damages allegedly sustained from investments in the Aravali Fund (Aravali), a third-party hedge fund sold by the Company to retail clients. Aravali used a high degree of leverage in investing in municipal bonds to generate return and income, leverage that led to the collapse of the fund when the municipal bond market suffered a decline in the fall of 2008. All 27 of the arbitrations have concluded or have been resolved and have been dismissed with prejudice. One additional Aravali claim has been made although no arbitration has been filed to date in connection with this claim.

Themis

The Company has been named as a respondent in 16 arbitrations seeking damages for losses sustained through a put spread options investment strategy directed by an independent registered investment advisor, Themis Asset Strategies LLC (Themis), whose principal Derek Clark was a client advisor at the Company from 2002-2005. Claimants include direct clients of Themis, for whom the Company performed execution and custody services; customers of the Company, who participated in the trading program through the Company's referral program; and a non-customer whose trades were executed through the Company's options desk and delivered to another firm. The put spread options strategy experienced a severe decline during the market turmoil of October 2008, and the Company discontinued its referral arrangement with Themis in November 2008. Two of the arbitrations are pending and 14 have been resolved and dismissed with prejudice.

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MF Global Litigations

The Company, along with numerous other securities firms and individuals, has been named as a defendant in a consolidated class action lawsuit pending in the United States District Court for the Southern District of New York. The lawsuit is purportedly brought on behalf of investors in certain debt securities issued by MF Global Holdings Ltd. The Company is being sued as an underwriter for two of the three debt offerings that are the subject of the lawsuit. The lawsuit alleges material misstatements and omissions in a registration statement and prospectuses. A consolidated amended complaint has been filed, and a motion to dismiss by the underwriter defendants is pending.

SPhinX

The Bank, along with certain affiliates, including the Company (collectively Deutsche Bank), are the subjects of a litigation filed in the United States District Court for the Southern District of New York by the Joint Official Liquidators (JOLs) of the SPhinX family of hedge funds (SPhinX) arising from losses allegedly suffered by SPhinX when SPhinX assets were transferred from segregated accounts at Refco LLC to unprotected accounts at Refco Capital Markets, Ltd. According to the complaint, the JOLs filed the action to recover (i) \$263 million plus interest in damages suffered by SPhinX, (ii) the lost business enterprise value and deepening insolvency damages suffered by SPhinX's investment manager, PlusFunds Group, Inc., and (iii) damages suffered by a group of SPhinX investors that assigned claims to the JOLs. The complaint included claims for breach of fiduciary duty, fraud/misrepresentation, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, aiding and abetting conversion, breach of contract/breach of implied covenant of good faith and fair dealing, and declaratory relief on Deutsche Bank's indemnity claims against SPhinX. On November 1, 2011, the court dismissed all claims, except for the claim for aiding and abetting fraud and further limited that claim to losses suffered by SPhinX with respect to assets placed at Refco LLC. On December 26, 2012, the court issued an order granting Deutsche Bank's motion for summary judgment and dismissed the aiding and abetting fraud claim. As a result, all claims against Deutsche Bank have been dismissed. The dismissal becomes final when the court issues a written opinion explaining the rulings in the December 26, 2012 order.

Insurative v. DBSI

The Company and one of its former employees are named as defendants in a lawsuit brought by Insurative Premium Finance (Jersey) Limited (Insurative) in the United States District Court for the District of Massachusetts. The lawsuit asserts claims for fraudulent misrepresentation, tortious interference with advantageous business relations, unfair and deceptive acts or practices, promissory estoppel, breach of contract, breach of duty of good faith and negligent supervision, all arising from the former employee's alleged involvement in a fraudulent scheme involving the purchase of premium life insurance policies by clients of the Company. Insurative alleges that it was contracted to provide the financing for the life insurance policies and that it suffered lost profits when the clients terminated the financing arrangement. Insurative seeks \$38 million in alleged lost profits and treble damages. On December 18, 2012, the Magistrate Judge assigned to the case issued a report

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recommending that the District Court Judge grant the Company's motion to dismiss as to all claims except for unfair and deceptive acts or practices and negligent supervision. Insurative has filed objections to the Magistrate Judge's report.

(12) Obligations under Guarantees

The Company has obligations under certain guarantee arrangements, including contracts and indemnification agreements that contingently require a guarantor to make payments to the guaranteed party based on changes in an underlying measure (such as an interest or foreign exchange rate, security or commodity price, an index or the occurrence or nonoccurrence of a specified event) related to an asset, liability or equity security of a guaranteed party. Also included as guarantees are contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an agreement, as well as indirect guarantees of the indebtedness of others.

The Company enters into certain derivative contracts that meet the accounting definition of a guarantee under ASC 460 (*Guarantees*). Such derivative contracts include certain written options, contingent forward contracts and credit default swaps. Although the Company's derivative arrangements do not specifically identify whether the derivative counterparty retains the underlying asset, liability or equity security, the Company has disclosed information regarding all derivative contracts that could meet the accounting definition of a guarantee. In order to provide information regarding the maximum potential amount of future payments that the Company could be required to make under certain derivative contracts, the notional amount of the contracts has been disclosed.

The Company records all derivative contracts at fair value. Aggregate market risk limits have been established, and market risk measures are routinely monitored against these limits. The Company also manages its exposure to these derivative contracts through a variety of risk mitigation strategies, including, but not limited to, entering into offsetting economic hedge positions. The Company believes that the notional amounts of the derivative contracts generally overstate its exposure.

The Company also provides guarantees to securities clearing houses and exchanges. Under the standard membership agreement, members are required to guarantee the performance of other members. Under the agreements, if another member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet shortfalls. The Company's liability under these arrangements is not quantifiable and could exceed the cash and securities it has posted as collateral. However, the potential for the Company to be required to make payments under these arrangements is remote. Accordingly, no contingent liability is carried on the consolidated statement of financial condition for these transactions.

In connection with its prime brokerage business, the Company provides to counterparties guarantees of the performance of its prime brokerage clients. Under these arrangements, the Company stands ready to meet the obligations of its customers with respect to securities transactions. If the customer fails to fulfill its obligation, the Company must fulfill the customer's obligation with the counterparty. The Company is secured by assets in the customer's account as well as any proceeds received from the securities transaction entered into by the Company on behalf of the customer. No contingent liability is carried on the

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consolidated statement of financial condition as the Company believes that potential for loss under these arrangements is remote.

In connection with its securities clearing business, the Company performs securities execution, clearance and settlement services on behalf of other broker-dealer clients for whom it commits to settle, with the applicable clearinghouse, trades submitted for or by such clients; trades are submitted either individually, in groups or series or, if specific arrangements are made with a particular clearinghouse and client, all transactions with such clearing entity by such client. The Company's liability under these arrangements is not quantifiable and could exceed any cash deposit made by a client. However, the potential for the Company to be required to make unreimbursed payments under these arrangements is remote due to the contractual requirements associated with clients' activity and the regular review of clients' capital. Accordingly, no contingent liability is carried on the consolidated statement of financial condition for these transactions.

The Company utilizes Pershing LLC (Pershing), a nonaffiliated broker-dealer, as its clearing agent for general securities brokerage transactions. Pershing carries the cash and margin accounts for the Company's retail brokerage customers on a fully disclosed basis. The Company is responsible for the initial and any subsequent margin requirement for any transaction in the event a customer of the Company were to fail to fulfill its obligation to Pershing. The Company is secured by assets in the customer's account. Accordingly, no contingent liability is carried on the consolidated statement of financial condition for these transactions.

The table below summarizes certain information regarding the Company's credit default swap derivative contracts that meet the definition of a guarantee as of December 31, 2012 (in millions):

Type of guarantee	Maximum potential payout/ notional years to maturity			Total	Amount (asset/ liability)	Collateral/ recourse
	Less than 1	1 – 5	Over 5			
Notional amount of derivative contracts	\$ 410	2,764	18,967	22,141	(3,779)	—
Financial guarantees issued	—	1,641	—	1,641	1,641	—

(13) Retirement Plans

(a) Defined Benefit Pension Plan

Along with other affiliates of Deutsche Bank Americas Holding Corp. (DBAH), the Company participates in the DBAH Cash Account Pension Plan. The plan is a tax-qualified, noncontributory defined benefit cash account pension plan that covers substantially all employees who have completed one full year of service and were hired on or before December 31, 2004. An employee's pension account is credited each year with 6.5% of base pay plus bonus amounts up to 75% of base pay up to IRS limits. Accounts are also credited each year with an interest credit equivalent to the annual rate of interest of 30-year U.S. Treasury securities. The funding policy has been to contribute at least the amount required to satisfy the Employee Retirement Income Security Act of 1974 minimum funding requirements.

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The plan was closed to new participants effective December 31, 2004.

(b) *Defined Contribution Plan – Matched Savings Plan*

The Company participates, together with other affiliates of DBAH in a tax qualified 401(k) plan. Employees are able to contribute from 1-20% of their eligible compensation on a before-tax and/or after-tax basis, up to IRS limits. For employees hired before January 1, 2005, after a participant has completed six months of service the Company matches dollar for dollar up to 5% of eligible compensation, up to a maximum of \$4,000 per year.

Effective January 1, 2005, the plan was amended for employees hired on or after January 1, 2005. Participants who have completed six months of service receive a Company matching contribution of up to 4% of eligible compensation, up to the IRS annual compensation maximum. In addition, participants employed less than 10 years receive a Company fixed contribution equal to 4% of the first \$100,000 of eligible compensation. Participants employed 10 or more years receive a Company fixed contribution equal to 6% of the first \$100,000 of eligible compensation.

(c) *Share Based Compensation*

The Company participates in various share-based compensation plans of the Bank, including the DB Share Scheme and the Restricted Equity Units Plan, where the Bank grants employees of the Company deferred share awards which provide the right to receive common shares of the Bank at specified future dates. The vesting period of the awards is generally from one to five years. The Bank discontinued the Global Share Plan in 2010.

The Bank adopted guidance in accordance with ASC Topic 718 effective January 1, 2006. For transition purposes, the Bank elected the modified prospective application method. Under this application method, ASC Topic 718 applies to new awards and to awards modified, repurchased, or canceled after the required effective date. Awards are expensed on a straight-line basis over the vesting period, which is generally from three to five years.

The Bank enters into certain derivative contracts indexed to its common shares in order to hedge the overall cost associated with employee share-based compensation awards. These amounts have been reflected as an adjustment to the Company's paid-in capital in excess of par value in the accompanying consolidated statement of changes in stockholder's equity.

(d) *Cash Retention Plan*

The Company participates in cash retention plans of the Bank, including the DB Restricted Cash Plan and the DB Restricted Incentive Plan. As a rule of the DB Restricted Cash Plan the awards are only paid out to the employee if there is a non-terminated employment relationship between the employee and Deutsche Bank at the respective vesting date. The award consists of three tranches each amounting to one third of the original grant volume. The first two tranches vested in early 2010 and 2011, respectively and were paid out, net of any forfeiture during the course of 2009 and 2010 according to the terms and conditions of the plan. The remaining tranche vested in early 2012.

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The DB Restricted Incentive Plan consists of three tranches each amounting to one third of the grant volume. The tranches vest in early 2012, 2013 and 2014. Each tranche is expensed over its vesting period. In line with regulatory requirements this plan includes performance-indexed clawback rules for the most senior employees. Thus, there is the possibility that parts of the awards will be subject to forfeiture in the event of non-achievement of defined targets, breach of policy or financial impairment.

(14) Income Taxes

Significant components of the Company's deferred tax assets and liabilities as of December 31, 2012 were as follows (in millions):

Deferred tax assets:	
Deferred compensation	\$ 659
Deferred book gain	349
Depreciation	101
Litigation and other reserves	97
Pension and post retirement benefits	29
Investment in securities	67
Nondeductible interest expense	18
Other	11
	<hr/>
Gross deferred tax assets	1,331
Valuation allowance	—
	<hr/>
Deferred tax assets, net of valuation allowance	1,331
	<hr/>
Deferred tax liabilities:	
Accrued rental expense	(148)
	<hr/>
Gross deferred tax liabilities	(148)
	<hr/>
Net deferred tax assets	\$ 1,183
	<hr/> <hr/>

The Company believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets. The realization of the Company's net deferred tax assets are also impacted by the Bank's various strategic initiatives.

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In accordance with ASC 740, a reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2012	\$	74
Additions based on tax positions related to the current year		—
Additions for tax positions of prior years		3
Reductions for tax positions of prior years		(1)
Settlements		(12)
		<hr/>
Balance at December 31, 2012	\$	<u>64</u>

The effect of the unrecognized tax benefits of \$64 million, if recognized, would impact the effective tax rate of the Company.

The Company and its subsidiaries remain subject to income tax examinations in certain U.S. state and local jurisdictions for years after 2001, and the U.S. federal jurisdiction, for years after 2003.

Pursuant to ASC 718, excess tax benefits are recognized as additional paid-in capital in the period the benefit is realized. The write-off of a deferred tax asset related to a tax deficiency is first offset against any existing additional paid-in capital that resulted from previously realized excess tax benefits from previous awards accounted for in accordance with ASC 718. During 2012, a tax shortfall of \$12.0 million occurred, which was the result of the tax deduction being less than the cumulative book compensation cost. This is reflected as a decrease in stockholder's equity and the Company's pool of tax benefits (APIC pool).

(15) Subordinated Liabilities

The Company has an \$8.0 billion revolving note and cash subordination agreement with Deutsche Bank Trust Corp., an affiliated entity. The agreement has a maturity date of November 15, 2013 and at December 31, 2012, \$6.7 billion of the facility was outstanding, all of which is approved by FINRA and qualifies as regulatory capital for the purpose of computing net capital under the Uniform Net Capital Rule of the SEC. To the extent that the outstanding subordinated liabilities are required for the Company's continued compliance with its regulatory net capital requirements, the subordinated liabilities may not be repaid.

The Company's subordinated revolving note and cash subordination agreement requires the payment of interest at floating rates based on the London Interbank Offered Rate plus 30 basis points. At December 31, 2012, the interest rate on this facility was .61%. For the year ended December 31, 2012, the total interest expense incurred on the Company's subordinated liabilities was \$41.1 million. The Company must obtain the approval of FINRA prior to any additional subordinated borrowings or repayments.

(16) Regulatory Requirements

The Company is subject to the SEC's Uniform Net Capital Rule (15c3-1), which requires the maintenance of minimum net capital.

DEUTSCHE BANK SECURITIES INC.
(An Indirect Wholly Owned Subsidiary of
Deutsche Bank AG)

Notes to Consolidated Statement of Financial Condition
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The Company has elected to use the alternative method, permitted by the Rule, which requires that it maintain minimum net capital, as defined, equal to the greater of \$1.5 million, 2% of aggregate debit balances arising from customer transactions, as defined, or the CFTC minimum net capital requirement, as defined. Additionally, equity capital may not be withdrawn or cash dividends paid if resulting net capital would be less than 5% of aggregate debits. As of December 31, 2012, the Company had net capital of \$9.3 billion, which was 100.23% of aggregate debit balances, and \$8.7 billion in excess of required minimum net capital.

As a clearing broker and in accordance with SEC Rule 15c3-3, the Company computed a reserve requirement for the proprietary accounts of introducing broker-dealers (PAIB). As of December 31, 2012, securities aggregating \$1.3 million were segregated on behalf of introducing broker-dealers.

The Company is also subject to the SEC's Customer Protection Rule (15c3-3) which requires, under certain circumstances, that cash or securities be deposited into a special reserve bank account for the exclusive benefit of customers. As of December 31, 2012, the Company had \$3.9 billion of cash and \$1.3 billion of U.S. Government securities segregated in the special reserve bank account.

The Company, in accordance with the Commodity Exchange Act, is required to segregate and hold in separate accounts all monies, securities, and property received to margin and to guaranty or secure the trades or contracts of customers in regulated commodities. As of December 31, 2012, segregated funds exceeded such requirement by \$787.1 million. In addition, pursuant to Regulation 30.7 of the CFTC, the Company had secured funds held in separate accounts for foreign denominated positions that exceeded such requirements by \$360.0 million. Also, pursuant to Regulation 190.01 of the CFTC, the Company is required to compute a cleared swap customer requirement. As of December 31, 2012, the Company had excess funds in sequestration of \$119.6 million.