



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

Consolidated Statement of Financial Condition

June 30, 2017

Unaudited

**DEUTSCHE BANK SECURITIES INC.**

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## Unaudited Consolidated Statement of Financial Condition

June 30, 2017

(In millions, except share data)

**Assets**

Cash and cash equivalents (includes cash equivalents at fair value of \$56)	\$	1,276
Cash and securities segregated for benefit of customers (includes securities at fair value of \$2,956)		4,709
Collateralized agreements and financings:		
Securities purchased under agreements to resell (includes \$13,374 at fair value)		47,402
Securities borrowed (includes \$24,870 at fair value)		67,883
		<u>115,285</u>
Financial instruments owned, at fair value (includes securities pledged as collateral of \$16,805)		22,330
Receivables:		
Customers		1,888
Noncustomers		151
Brokers, dealers, and clearing organizations		2,073
		<u>4,112</u>
Premises and equipment (net of accumulated depreciation of \$573)		509
Other assets (includes \$13 of securities received as collateral at fair value)		1,978
		<u>150,199</u>
Total assets	\$	<u>150,199</u>

**Liabilities and Stockholder's Equity**

Collateralized agreements and financings:		
Securities sold under agreements to repurchase (includes \$36,638 at fair value)	\$	64,746
Securities loaned (includes \$1,194 at fair value)		23,954
		<u>88,700</u>
Payables:		
Customers		8,839
Noncustomers		13,056
Brokers, dealers, and clearing organizations		1,629
Loans		3,693
		<u>27,217</u>
Financial instruments sold, but not yet purchased, at fair value		15,268
Other liabilities (includes \$13 of obligation to return securities as collateral at fair value)		1,645
		<u>132,830</u>
Total liabilities		<u>132,830</u>
Commitments, contingencies and guarantees		-
Subordinated liabilities		<u>6,723</u>
Stockholder's equity:		
Common stock, par value \$1.00 per share. 2,000 shares authorized, issued, and outstanding		-
Additional paid-in capital		14,597
Accumulated deficit		(3,951)
		<u>10,646</u>
Total stockholder's equity		<u>10,646</u>
Total liabilities and stockholder's equity	\$	<u>150,199</u>

See accompanying 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 DB USA Corporation (DBUSA), which is a direct, wholly owned subsidiary of Deutsche Bank AG (the Bank), a German corporation. DBUSA is designated the intermediate holding company (IHC) established to comply with certain requirements mandated, supervised and regulated by the Board of Governors of the Federal Reserve System (FRB).

The Company is registered as a securities broker-dealer and investment advisor with the Securities and Exchange Commission (SEC), 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. As an indirect subsidiary of DBUSA, the Company is indirectly subject to the regulatory oversight of the FRB.

In its capacity as a broker-dealer and FCM, the Company clears securities and derivatives products 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 is also 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 have been prepared in accordance with U.S. generally accepted accounting principles (US GAAP), which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies 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 include 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

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voting stock unless it does not control the entity. All material intercompany transactions and balances have been eliminated in consolidation.

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 June 30, 2017, 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 highly liquid securities and interest-earning deposits with original maturities of three months or less. Due to the short term nature of these instruments, the carrying value approximates fair value.

**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 SEC's Customer Protection Rule 15c3-3 (SEC Rule 15c3-3) 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 4(d)(f) of the Commodity Exchange Act (CEA).

**d) *Financial Instruments***

Proprietary financial instruments including securities, options, futures and other derivative transactions, are reported on the consolidated statement of financial condition at fair value on a trade-date basis.

Amounts receivable and payable relating to proprietary transactions that have not reached their contractual settlement are reflected net on the consolidated statement of financial condition.

**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 the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 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 cost-benefit considerations. Such financial assets and financial liabilities accounted for at fair value include certain

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collateralized agreements and financings and the debt related to consolidated variable interest entities (VIEs), if any.

*f) Fair Value Measurements*

The fair value of financial instruments 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. Generally, financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. See note 3 for further information about fair value measurements.

*g) Collateralized Agreements and Financings*

Collateralized agreements and financings consist of the following:

***Reverse Repurchase and Repurchase Agreements*** – securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are recorded at their contractual amounts. The Company's policy is to obtain possession or control 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 reverse repurchase and repurchase agreements are carried on the consolidated statement of financial condition at fair value under the fair value option. Reverse repurchase and repurchase agreements are generally valued based on inputs with reasonable levels of price transparency and are generally classified within Level 2 of the fair value hierarchy. Fair value is derived from valuation techniques by discounting future cash flows using the appropriate risk-adjusted discount rate. The credit risk-adjusted discount rate includes the consideration of the collateral received or pledged in the transaction. Where the risk-adjusted discount rate is not observable or readily available (primarily for long-dated repurchase agreements), a proxy discount rate may be used in the valuation.

***Securities Borrowed and Loaned*** – cash securities borrowed and loaned transactions are recorded at the amount of cash collateral advanced or received. Non-cash securities loaned transactions are recorded at the fair value of collateral received within other assets and other liabilities on the consolidated statement of financial condition. Collateral received or pledged for non-cash securities borrowed transactions are not recorded on the consolidated statement of financial condition. 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.

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

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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. Fair value is derived from valuation techniques by discounting future cash flows using the appropriate risk-adjusted discount rate. The credit risk-adjusted discount rate includes the consideration of the collateral received or pledged in the transaction. Where the risk-adjusted discount rate is not observable or readily available, a proxy discount rate may be used in the valuation.

***h) Receivables and Payables – Customers***

Receivables from and payables to customers include amounts due on cash and margin transactions. Securities owned by customers, including those that collateralize margin or similar transactions, are not reflected on the consolidated statement of financial condition. However, in the event of fails to deliver securities to or receive securities from the customer, the Company records corresponding receivables from customers or payables to customers, respectively, on a settlement-date basis on the consolidated statement of financial condition.

At June 30, 2017, margin receivables and margin payables with the same customer, where the Company has determined the right of offset exists, are netted on the consolidated statement of financial condition in the amount of \$15.5 billion.

***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. At June 30, 2017, margin receivables and margin payables with the same noncustomer, where the Company has determined the right of offset exists, are netted on the consolidated statement of financial condition in the amount of \$65.2 million. 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 – Loans***

Loans payable are presented on the consolidated statement of financial condition at their outstanding unpaid principal balances. These loans are predominantly transacted with affiliates.

***k) Foreign Currency Translation***

Assets and liabilities denominated in non-U.S. dollar currencies are translated into U.S. dollar equivalents using period-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 Topic 718 “*Share Based Payments*”.

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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) Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of furniture, fixtures and equipment and amortization of computer software are 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 remaining useful lives of 25 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 on the consolidated U.S. federal income tax return, and certain combined and unitary state tax returns of Deutsche Bank AG New York Branch (DBNY). 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 modified separate company basis and the Company is reimbursed on a current basis by an affiliate of DBNY for the benefit generated from any federal, New York State and New York City tax losses and temporary differences of the Company. The Company will be reimbursed by the affiliate for any subsequent adjustment which results in an increase of such tax benefit (for example, by means of an amended return, claim for refund or following the conclusion of an audit by a taxing authority). In the event of any subsequent adjustment which results in a permanent reduction of the tax benefit that was previously reimbursed by the affiliate (for example, as a result of a disallowance by a tax authority of the tax benefits supporting the deferred tax asset or a reduction in tax rates), the Company is not obligated to repay the affiliate. Rather, the affiliate is entitled to receive future tax benefits from the Company, if any, up to the amount of the loss in tax benefit, free of reimbursement payments to the Company.

The Company provides for income taxes on all transactions that have been recognized on the consolidated statement of financial condition in accordance with ASC Topic 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 other liabilities, respectively, on the consolidated statement of financial condition.

ASC Topic 740 provides guidance on the accounting for uncertainty in income taxes 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. ASC Topic 740 also provides guidance on de-recognition, classification, interest and penalties, disclosure, and transition.

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*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 in a VIE, known as the primary beneficiary, consolidates the VIE.

*q) Related Party Transactions*

The Company has related party transactions with certain of its subsidiaries and affiliates. These transactions include collateralized financing transactions, prime brokerage services, derivatives clearing, trading management services, advisory services, charges for operational support and the borrowing and lending of funds. These transactions are primarily short-term in nature and are entered into in the ordinary course of business.

*r) Recent Accounting Developments*

**Revenues (Topic 606) from Contracts with Customers.** In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, "*Revenue Recognition from Contracts with Customers*". The ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The ASU's core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU will replace most of the existing revenue recognition guidance under US GAAP. ASU 2014-09, as amended by ASU 2015-14, ASU 2016-08, ASU 2016-10 and ASU 2016-12, is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods under a modified retrospective approach or retrospectively to all periods presented. The Company is in the process of finalizing its implementation of this ASU and no significant implementation matter has yet been identified.

**Leases (ASC 842).** In February 2016, the FASB issued ASU 2016-02, "*Leases*". The ASU requires that, at lease inception, a lessee recognize on the statement of financial condition a right-of-use asset, representing the right to use the underlying asset for the lease term, and a lease liability, representing the liability to make lease payments. The ASU also requires that for finance leases, a lessee recognize interest expense on the lease liability, separately from the amortization of the right-of-use asset on the statement of operations, while for operating leases, such amounts should be recognized as a combined expense on the statement of operations. In addition, the ASU requires expanded disclosures about the nature and terms of lease agreements. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those reporting periods under a modified retrospective approach. Early adoption is permitted. The Company is currently assessing the impact of this ASU and no significant implementation matter has yet been identified.

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**Premium Amortization on Purchased Callable Debt Securities (Topic 310).** In March 2017, the FASB issued ASU 2017-08, “*Receivables – Nonrefundable Fees and Other Costs*”. The ASU requires the premium on purchased callable debt securities to be amortized to the earliest call date. ASU 2017-08 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those reporting periods under a modified retrospective approach. Early adoption is permitted. The adoption of this ASU is not expected to have a material impact on the Company’s financial condition

**Scope of Modification Accounting (Topic 718).** In May 2017, the FASB issued ASU 2017-09, “*Compensation—Stock Compensation*”. The ASU requires an entity account for the effects of a modification of a share-based payment award unless all the following are met: 1) The fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; 2) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; 3) The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. ASU 2017-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods under a prospective approach. Early adoption is permitted. The adoption of this ASU is not expected to have a material impact on the Company’s financial condition.

**3) Fair Value Measurements**

ASC 820 (Fair Value Measurement and Disclosures) defines fair value, establishes a consistent framework for measuring fair value and requires disclosures about fair value measurements. The standard also prioritizes the inputs to valuation techniques used to measure fair value based on whether such inputs are observable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company’s market assumptions. The fair value 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 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are 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. Thus, an item may be classified as Level 3 even though there may be some significant inputs that are readily observable.

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The hierarchy requires the use of observable market data when available. The Company considers relevant and observable market prices in its valuation where possible. 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.

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 and facilitate trades which involve credit risk.

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.

Financial 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. 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 possibly impact the quoted price. Certain financial instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. Level 3 valuations are generally based on pending transactions, subsequent financing of issuer or comparable issuer and/or pricing models that generally includes at least one significant unobservable input involving management assumption such as property type differences, cash flows, performance, and other input.

The transaction price is typically used as the initial 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 is calibrated to the transaction price. This valuation is adjusted 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 non-transferability. Such adjustments are generally based on available market evidence where available. In the absence of such evidence, management's best estimate is used.

Management judgment is required to value financial 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 financial 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 in the valuation of financial 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.

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The following are the different types of the Company's financial instruments and their related classification in the fair value hierarchy:

**U.S. Treasury securities**

U.S. Treasury bills, notes and bonds are classified as Level 1 of the fair value hierarchy and are valued based on quoted market prices in active markets. Treasury strips are generally categorized as Level 2 of the fair value hierarchy as they are typically valued based on pricing sources with reasonable level of price transparency or derived from a treasury curve.

**U.S. Government agency obligations**

U.S. Government agency obligations comprise three main categories consisting of agency-issued debt, agency mortgage pass-through securities, and agency collateralized mortgage obligations (CMOs). Actively traded and quoted U.S. government agency obligations are generally categorized in Level 1 of the fair value hierarchy while less actively traded US government agency obligations, whereby the fair values are based upon model-derived prices, quoted market prices, and trade data for identical or comparable securities, are generally categorized as Level 2 of the fair value hierarchy. While agency-issued debt can be either Level 1 or Level 2 depending upon how they are valued (i.e., quoted prices versus model derived), agency mortgage pass through securities and agency CMOs, are valued based on broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency and are generally categorized as Level 2.

**Other mortgage-backed securities (MBS)**

Private label MBS are valued based on price or spread data obtained from observed transactions. When position-specific external price data are not observable, the fair value determination may require benchmarking to similar instruments and/or analyzing expected credit losses, default, and recovery rates. In evaluating the fair value of each security, the Company considers security collateral-specific attributes including payment priority, credit enhancement levels, type of collateral, delinquency rates, and loss severity. Market standard models may be deployed to perform the valuation.

Private label MBS are generally categorized in Level 2 of the fair value hierarchy. If external prices or significant spread inputs are unobservable, then valuation techniques such as cash flow analysis are used. If the comparability assessment involves significant subjectivity related to property type differences, cash flows, performance, and other inputs, then the securities are categorized in Level 3 of the fair value hierarchy.

**Asset-backed securities (ABS)**

ABS include, but are not limited to; securities backed by auto loans, student loans, and credit card receivables and are generally categorized within Level 2 of the fair value hierarchy. Valuations were determined using the Company's own trading activities for identical or similar instruments. If external prices or significant spread inputs are unobservable, then valuation techniques such as cash flow analysis are used. If the comparability assessment involves significant subjectivity related to property type

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differences, cash flows, performance, and other inputs, then the securities are categorized in Level 3 of the fair value hierarchy.

**Other debt securities**

Other debt securities consist mainly of corporate bonds (including High Yield bonds). Corporate bonds that are measured primarily based on pricing data from observed market transactions of comparable size adjusted for bond or credit default swap spreads are generally classified as Level 2. If pricing or spread data is not available, valuation techniques (i.e., cash flow models) with unobservable inputs are used and the securities are classified as Level 3.

**Equities**

Exchange-traded equity securities are generally valued based on quoted prices from the exchange and are categorized as Level 1. Exchange-traded funds are classified as Level 1 if valuation is based upon prices from exchanges and Level 2 if valuation is based upon the fund's net asset value.

Non-exchange traded equity securities (i.e., private equity) are measured primarily using prices observed through market comparables such as volatility and price and are categorized within Level 3 of the fair value hierarchy.

**Money market funds**

Money market funds are generally valued based on quoted prices. Those prices obtained from active markets would be classified as Level 1. Remaining positions that are quoted in less active markets or are model based with observable market inputs are generally classified as Level 2. These instruments are reported as cash equivalents on the consolidated statement of financial condition.

**State and municipal bond obligations**

State and municipal bonds are generally valued based on the independent prices obtained from third party evaluated services. Where prices of recently executed market transactions of similar securities and of comparable size are easily observed, those are taken into consideration for arriving at the fair value. When independent prices are available for state and municipal bonds, these are categorized as Level 2 of the fair value hierarchy. If independent prices are not available, these are categorized as Level 3.

**Derivatives**

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 generally classified within Level 1 of the fair value hierarchy.

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The Company defines an active market based on liquidity of the product. Level 1 is comprised of listed options within equity contracts that are within a range of 80% to 120% of the strike price coupled with an expiration date of less than six months.

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 of observability. However, forward settling contracts such as to be announced securities are categorized within Level 1 as these contracts are observable through significant daily trading volumes.

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 of observability 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 is based on 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.

**a) *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 June 30, 2017 (in millions). Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Gross Amount</u>	<u>Counterparty Netting</u>	<u>Total</u>
<b>Assets:</b>						
Cash equivalents	\$ 56	-	-	56	-	56
Securities segregated for benefit of customers	564	2,392	-	2,956	-	2,956
Collateralized agreements and financings	-	58,778	-	58,778	(20,534)	38,244
<b>Financial instruments owned:</b>						
<b>Cash instruments:</b>						
U.S. Treasury securities	9,324	2,566	-	11,890	-	11,890
U.S. Government agency obligations	-	1,168	-	1,168	-	1,168
Other mortgage-backed securities	-	965	65	1,030	-	1,030
Asset-backed securities	-	854	71	925	-	925
Other debt securities	-	2,331	37	2,368	-	2,368
Equities	3,640	24	23	3,687	-	3,687
State and municipal bond obligations	-	388	45	433	-	433
Total cash instruments	<u>12,964</u>	<u>8,296</u>	<u>241</u>	<u>21,501</u>	<u>-</u>	<u>21,501</u>
<b>Derivatives:</b>						
Interest rate contracts	-	75	-	75	-	-
Credit contracts	-	40	-	40	-	-
Equity contracts	757	602	1	1,360	-	-
Other contracts	85	13	-	98	-	-
Total derivatives	<u>842</u>	<u>730</u>	<u>1</u>	<u>1,573</u>	<u>(744)</u>	<u>829</u>
Total financial instruments owned	<u>13,806</u>	<u>9,026</u>	<u>242</u>	<u>23,074</u>	<u>(744)</u>	<u>22,330</u>
<b>Securities received as collateral</b>						
(included in other assets)	-	13	-	13	-	13
Total recurring fair value measurements \$	<u>14,426</u>	<u>70,209</u>	<u>242</u>	<u>84,877</u>	<u>(21,278)</u>	<u>63,599</u>

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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Gross Amount</u>	<u>Counterparty Netting</u>	<u>Total</u>
Liabilities:						
Collateralized agreements and financings	\$ -	58,091	275	58,366	(20,534)	37,832
Financial instruments sold, not yet purchased:						
Cash instruments:						
U.S. Treasury Securities	9,720	295	-	10,015	-	10,015
U.S. Government agency obligations	-	28	-	28	-	28
Other debt securities	-	1,222	5	1,227	-	1,227
Equities	3,296	-	-	3,296	-	3,296
Total cash instruments	<u>13,016</u>	<u>1,545</u>	<u>5</u>	<u>14,566</u>	<u>-</u>	<u>14,566</u>
Derivatives:						
Interest rate contracts	-	-	-	-	-	-
Credit contracts	-	18	-	18	-	-
Equity contracts	445	886	-	1,331	-	-
Other contracts	86	11	-	97	-	-
Total derivatives	<u>531</u>	<u>915</u>	<u>-</u>	<u>1,446</u>	<u>(744)</u>	<u>702</u>
Total financial instruments sold, not yet purchased	<u>13,547</u>	<u>2,460</u>	<u>5</u>	<u>16,012</u>	<u>(744)</u>	<u>15,268</u>
Obligation to return securities as collateral (included in other liabilities)	-	13	-	13	-	13
Total recurring fair value measurements	<u>\$ 13,547</u>	<u>60,564</u>	<u>280</u>	<u>74,391</u>	<u>(21,278)</u>	<u>53,113</u>

There were no material transfers between Level 1 and Level 2 nor were there any material transfers in or out of Level 3 during the six months ended June 30, 2017.

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**b) 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 liability (in millions) and (2) the ranges of significant unobservable inputs used to value the Company's Level 3 financial assets/financial liabilities. The range of values shown below represents the highest and lowest inputs used to value the significant exposures within Level 3.

	<u>Level 3 at June 30, 2017</u>		<u>Valuation technique(s)</u>	<u>Significant unobservable input(s) (Level 3)</u>	<u>Range</u>	
	<u>Assets</u>	<u>Liabilities</u>				
Collateralized agreements and financings	\$ -	275	Discounted cash flow	Repurchase agreement rate (bps*)	168	198
Financial instruments owned and financial instruments sold, but not yet purchased:						
Cash instruments						
Other mortgage-backed securities	\$ 65	-	Discounted cash flow Price based	Credit spread (bps*) Price	144	1500 0 101
Asset-backed securities	71	-	Discounted cash flow Discounted cash flow Price based	Credit spread (bps*) Yield (%) Price	341	1500 10% 17% 0 27
Other debt securities	37	5	Discounted cash flow Price based	Credit spread (bps*) Price	116	305 0 102
Equities	23	-	Price based	Price	0	24
State and municipal bond obligations	45	-	Price based	Price	95	112
Total cash instruments	\$ <u>241</u>	<u>5</u>				
Derivatives						
Equity contracts	1	-	Market comparables	Stock Volatility (%)	2%	45%
Total derivatives	\$ <u>1</u>	<u>-</u>				
	\$ <u>242</u>	<u>280</u>				

\* basis points

The repurchase agreement rate is the annualized rate derived from transactions where two parties agree to buy or sell at pre-determined present and future prices.

Credit spread is relevant for fixed income and credit instruments with the ranges for the credit spread input varying across instruments.

The price input is a significant unobservable input for certain fixed income instruments. For these instruments, the price input is based on a par value of 100 and the fair value is determined using pricing data for comparable instruments. Securities that have embedded features and/or high coupons may be priced higher than par. The price input is also a significant unobservable input for certain equity securities with the range of inputs varying depending upon the type, number of shares, and other factors.

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The yield comprises a benchmark reference index depending on the asset being assessed, and a credit spread that reflects the credit quality of the exposure.

Stock volatility is a variable in option pricing formulas showing the extent to which the return of the underlying asset will fluctuate between the balance sheet date and the option's expiration date.

**c) *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.

The fair value represents management's best estimate of fair value based on a number of assumptions. The carrying value of short-term financial instruments not accounted for at fair value, as well as receivables and payables arising in the ordinary course of business, approximates fair value because of the relatively short period of time between their origination and expected realization. For longer term interest-bearing payables such as subordinated liabilities, the Company uses carrying value as a best estimate of fair value given that the interest rates on such debt resets to market rates at regular and frequent intervals.

The following table provides the carrying value and fair value of financial instruments which are not carried at fair value (in millions). The table excludes all non-financial instruments such as premises and equipment, tax assets and liabilities, and estimated accruals and provisions.

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	<u>Carrying Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Estimated Fair Value</u>
Assets:					
Cash	\$ 1,220	1,220	—	—	1,220
Cash and securities segregated for benefit of customers	1,753	276	1,477	—	1,753
Collateralized agreements and financings (1)	77,041	—	77,041	—	77,041
Receivables:					
Customers	1,888	—	1,888	—	1,888
Noncustomers	151	—	151	—	151
Brokers, dealers, and clearing organizations	2,073	—	2,073	—	2,073
Other assets	1,820	13	1,807	—	1,820
Liabilities:					
Collateralized agreements and financings (1)	\$ 50,868	—	50,868	—	50,868
Payables:					
Customers	8,839	—	8,839	—	8,839
Noncustomers	13,056	—	13,056	—	13,056
Brokers, dealers, and clearing organizations	1,629	—	1,629	—	1,629
Loans	3,693	—	2,534	1,159	3,693
Other liabilities	299	—	299	—	299
Subordinated liabilities	6,723	—	6,723	—	6,723

(1) - Includes netting under ASC 210-20 of \$8.9 billion

**d) Fair Value Option**

The Company elected the fair value option for certain portfolios of collateralized agreements and financings. The election was made as the particular portfolios are risk-managed and reported for internal purposes on a mark-to-market basis. The portfolios are priced to related market interest rates according to the collateral type and duration of the contract. The net present value is calculated daily and is based on changes in certain market curves and spreads.

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**4) Derivative Activities**

**a) Fair Value, Notional and Offsetting of Derivative Instruments**

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. All exchange-traded derivatives are cleared through central counterparties (CCPs), though the Company also uses CCP services for certain OTC derivative contracts. Derivatives may involve future commitments to purchase or sell financial instruments, or to exchange currency or interest payment 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 Topic 815, "Derivatives and Hedging", to any of its derivative contracts.

The following table sets forth the fair value and notional amount of the Company's derivative contracts by major product type as of June 30, 2017 (in millions):

<u>Derivative contract type</u>	<u>Derivative assets</u>	<u>Derivative liabilities</u>	<u>Notional amount</u>		
			<u>Exchange-traded</u>	<u>OTC</u>	<u>Total</u>
Interest rate contracts	\$ 75	-	4,534	724	5,258
Credit contracts	40	18	-	3,888	3,888
Equity contracts	1,360	1,331	101,310	-	101,310
Other contracts	98	97	-	12,996	12,996
<b>Total gross fair value/notional amount of derivatives</b>	<b>1,573</b>	<b>1,446</b>	<b>105,844</b>	<b>17,608</b>	<b>123,452</b>
Less: Counterparty netting (1)	(744)	(744)			
<b>Subtotal</b>	<b>829</b>	<b>702</b>			
Less: Securities collateral received/pledged	(616)	(587)			
Less: Cash collateral received/pledged	(6)	-			
<b>Net derivative assets/liabilities</b>	<b>\$ 207</b>	<b>115</b>			

(1) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default and where certain other criteria are met in accordance with applicable offsetting accounting guidance.

While the notional amounts disclosed above give an indication of the volume of the Company's derivative activity, the notional amount is not exchanged but rather used as a reference to calculate payments for most derivative transactions.

The Company generally enters into International Swaps and Derivative Association, Inc. (ISDA) 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

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derivative transactions. Total net derivative assets and liabilities are adjusted on an aggregate basis to take into consideration the effects of legally enforceable master netting agreements and have been reduced by the cash collateral received or paid.

The net derivative assets reflected above are subject to credit risk which arises from the failure of a counterparty to perform according to the terms of the contract.

**b) *Credit Derivatives***

The Company enters into credit derivatives primarily to facilitate client transactions and to manage credit risk exposures. The Company enters into credit derivatives, principally through credit default swaps (CDS) and total return swaps (TRS) with affiliate banks.

***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 obligations of the referenced entity. The ratings of the credit derivatives portfolio presented in the below table are based on the assigned external ratings of the referenced asset utilizing the lower of Moody's and S&P's published ratings as of June 30, 2017. Investment-grade ratings are considered to be 'Baa/BBB' and above, while anything below is considered non-investment grade.

***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.

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The following table summarizes certain information regarding protection sold through CDS and TRS as of June 30, 2017 (in millions).

Credit ratings of the reference obligation	Protection sold				Fair value asset/(liability) (1)
	Maximum potential payout/notional				
	Years to Maturity			Total	
<1 Year	1 to 5 Years	>5 Years			
Multi-name credit default swaps					
Investment grade	\$ -	190	1,115	1,305	(6)
	-	190	1,115	1,305	(6)
Total return swaps					
Investment grade	\$ 347	-	-	347	(1)
	347	-	-	347	(1)
Total protection sold	\$ 347	190	1,115	1,652	(7)

(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 practical.

The Company manages its exposure to these derivative contracts through a variety of risk mitigation strategies. For example, in certain instances, the Company may purchase credit protection derivatives with identical underlying referenced names to offset its exposure. The notional amount of credit protection sold for which the Company purchased credit protection with identical underlying referenced positions was \$1.6 billion at June 30, 2017. The purchase of credit protection does not represent the sole manner in which the Company risk manages its exposure to credit derivatives. 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. The Company's OTC credit derivative contracts are with related parties and 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.

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**5) Securities Pledged as Collateral and Obligations to Return Collateral**

The Company enters into reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions to, among other things, acquire securities to cover short positions and settle other securities obligations, to accommodate customers' needs and to finance its inventory positions.

**a) *Trading Assets Pledged***

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.

**b) *Collateral Received***

At June 30, 2017, the total fair value received as collateral where the Company is permitted to sell or re-pledge was \$78.5 billion and \$71.0 billion under agreements to resell and securities borrowed, respectively, of which \$71.2 billion and \$65.4 billion, respectively, has been sold or re-pledged as collateral for repurchase transactions, securities lending transactions, to meet margin requirements at clearing organizations and to facilitate short sales of customers, noncustomers and the Company.

In transactions where the Company acts as a lender in a securities lending agreement and receives securities that can be re-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 June 30, 2017, included in other assets and other liabilities on the accompanying consolidated statement of financial condition was \$13.5 million resulting from these transactions. Collateral received under non-cash securities borrowed transactions includes collateral of \$3.0 billion that is not reflected on the consolidated statement of financial condition.

**c) *Other***

The Company also engages in margin lending to clients that allows the client to borrow against the value of qualifying securities and is included within customer and noncustomer receivables on the consolidated statement of financial condition. Client receivables generated from margin lending activities are collateralized by client-owned securities held by the Company including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. The Company monitors required margin levels and established credit limits daily and, pursuant to such guidelines, requires clients to deposit additional collateral, or reduce positions, when necessary. At June 30, 2017, the Company was in possession of collateral in the amount of \$58.6 billion and \$20.5 billion from customers and noncustomers, respectively, of which \$15.6 billion and \$11.3 billion, respectively, has been sold or re-pledged.

**d) *Offsetting***

Reverse repurchase and repurchase balances with the same counterparties are reported net by counterparty, when applicable, pursuant to the provisions of ASC Subtopic 210-20, "*Offsetting*", with

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the respective interest receivables and payables also being reported net by counterparty. At June 30, 2017, the Company's reverse repurchase and repurchase balances reflected approximately \$29.0 billion of netting pursuant to ASC Subtopic 210-20.

Securities borrowed and securities loaned balances with the same counterparties are reported net by counterparty, pursuant to the provisions of ASC 210-20. At June 30, 2017, the Company's securities borrowed and securities loaned balances reflected approximately \$451.4 million of netting pursuant to ASC Subtopic 210-20.

The following table presents information about the offsetting of these instruments and related collateral amounts (in millions). For information related to offsetting of derivatives, see note 4.

	<u>Gross Amounts</u>	<u>Amounts Offset on the Statement of Financial Condition (1)</u>	<u>Net Amounts Presented on the Statement of Financial Condition</u>	<u>Collateral Received or Pledged (2)</u>	<u>Net Amount (3)</u>
<b>Assets</b>					
Collateralized agreements and financings					
Securities purchased under					
agreements to resell	\$ 76,380	(28,978)	47,402	(47,402)	-
Securities borrowed	<u>68,334</u>	<u>(451)</u>	<u>67,883</u>	<u>(65,967)</u>	<u>1,916</u>
<b>Total</b>	<u>\$ 144,714</u>	<u>(29,429)</u>	<u>115,285</u>	<u>(113,369)</u>	<u>1,916</u>
<b>Liabilities</b>					
Collateralized agreements and financings					
Securities sold under					
agreements to repurchase	\$ 93,724	(28,978)	64,746	(64,746)	-
Securities loaned	<u>24,405</u>	<u>(451)</u>	<u>23,954</u>	<u>(23,654)</u>	<u>300</u>
<b>Total</b>	<u>\$ 118,129</u>	<u>(29,429)</u>	<u>88,700</u>	<u>(88,400)</u>	<u>300</u>

- (1) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default and where certain other criteria are met in accordance with applicable offsetting accounting guidance. There are no amounts which were eligible for netting pursuant to ASC Subtopic 210-20 that the Company did not net.
- (2) Securities collateral is reflected at its fair value, but has been limited to the net exposure on the consolidated statement of financial condition in order to exclude any over-collateralization. These amounts do not reflect any cash collateral.
- (3) Includes amounts subject to enforceable master netting agreements that have not met the requirements for offsetting in accordance with applicable accounting guidance but are eligible for offsetting to the extent an event of default has occurred.

The Net Amount presented in the preceding table is not intended to represent the Company's actual exposure to credit risk as a variety of credit risk strategies are employed in addition to offsetting and collateral arrangements.

In accordance with ASC Subtopic 860-30, "Secured Borrowing and Collateral", \$53.7 billion of predominantly U.S. government securities are pledged as collateral under repurchase agreements which

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the counterparty is permitted to sell or re-pledge. Additionally, \$40.7 billion of predominantly U.S. government securities have been pledged as collateral under agreements to repurchase for which the counterparty does not have the right to sell or re-pledge.

In accordance with ASU Subtopic Topic 860-10, “*Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*”, the following table sets forth a disaggregation of the gross obligation of collateralized financings by type of collateral with the remaining maturities of such financings (in millions).

	Remaining Contractual Maturity of the Agreements				Total
	Overnight and Continuous	Up to 30 days	30-90 days	Greater than 90 days	
Securities sold under agreements to repurchase					
US Treasury and agency securities	\$ 65,057	8,780	1,081	2,339	77,257
State and municipal securities	4,619	37	-	-	4,656
Asset-backed securities	568	-	-	-	568
Other debt securities	2,526	95	-	-	2,621
Equity securities	-	400	5,470	2,450	8,320
Other mortgage-backed securities	246	-	-	-	246
Other	56	-	-	-	56
<b>Total</b>	<b>73,072</b>	<b>9,312</b>	<b>6,551</b>	<b>4,789</b>	<b>93,724</b>
Securities loaned					
US Treasury and agency securities	1,924	-	-	-	1,924
Other debt securities	1,048	-	-	-	1,048
Equity securities	21,416	-	-	-	21,416
Other	17	-	-	-	17
<b>Total</b>	<b>24,405</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>24,405</b>
<b>Total collateralized financings</b>	<b>\$ 97,477</b>	<b>9,312</b>	<b>6,551</b>	<b>4,789</b>	<b>118,129</b>

**6) Variable Interest Entities**

In connection with its underwriting and market making activities, the Company purchases and sells variable interests in VIEs that comprise primarily MBS and ABS issued by third party-sponsored VIEs. In addition, the Company may also underwrite and hold securities issued by VIEs that are created by an affiliate of the Company in connection with the affiliate’s securitization activities.

**a) VIE Consolidation Analysis**

The Company consolidates VIEs for which it is the primary beneficiary. The Company determines whether it is the primary beneficiary of a VIE by 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 continuously reassesses its initial evaluation of an entity as a VIE to

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determine whether the preliminary conclusion has changed. 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.

**b) *Nonconsolidated VIEs***

The Company's variable interests in VIEs include debt securities and other financial instruments issued by third party-sponsored VIEs of which the Company determined it is not the primary beneficiary. Therefore, the Company is not required to consolidate these VIEs. The Company's exposure to loss as a result of its involvement is generally limited to its interests in these VIEs. The following table sets forth (in millions) the carrying amounts of variable interests held in nonconsolidated VIEs and the Company's maximum exposure to loss.

	<b>Fair value of variable interests held</b>	<b>Maximum exposure of debt interests</b>
Other mortgage-backed securities	\$ 991	991
Asset-backed securities	925	925
Other debt securities	47	47
	\$ 1,963	1,963

The carrying values of variable interests in nonconsolidated VIEs in the preceding table are included in financial instruments owned, at fair value, on the consolidated statement of financial condition. The Company's maximum exposure to loss presented in the preceding table does not reflect the effect of economic hedges that are held to mitigate the risks associated with these variable interests. In addition, the Company has not provided any other support to the VIEs during the year that was not previously contractually required.

**c) *Consolidated VIEs***

As of June 30, 2017, the Company did not consolidate any VIEs as the Company was not the primary beneficiary of any VIE.

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**7) Receivable from and Payable to Brokers, Dealers, and Clearing Organizations**

Amounts receivable from and payable to brokers, dealers, and clearing organizations as of June 30, 2017 consist of the following (in millions):

	<b>Receivable</b>	<b>Payable</b>
Securities failed to deliver/receive	\$ 649	782
Receivable from/payable to clearing organizations	1,341	656
Other	83	191
	\$ 2,073	1,629

Receivable from clearing organizations includes cash deposits to satisfy various collateral and margin requirements. Payable to clearing organizations includes unsettled transactions on a net basis.

Other includes cash collateral paid or received from initial and variation margin related to uncleared OTC derivative transactions where the Company acts on a principal basis.

**8) Payables – Loans**

The Company has access to funding wherein it may borrow cash at rates equivalent to comparable market prices directly from the Bank or indirectly through DBUSA.

At June 30, 2017, \$2.5 billion of the Company's total borrowings of \$3.7 billion, which are included in payables-loans in the accompanying consolidated statement of financial condition, are with affiliates and are unsecured. \$1.5 billion of the borrowings are overnight or short-term. At June 30, 2017, the weighted average interest rate on these borrowings is 2.63%.

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**9) Other Assets and Other Liabilities**

The significant components of the Company's other assets and other liabilities as of June 30, 2017 are as follows (in millions):

Other Assets:

Investment in unconsolidated affiliate	\$	360
Accrued interest and dividends receivable		255
Current income tax receivable		68
Receivables from affiliates		464
Syndicate receivables		104
Employee deferred compensation plan assets		94
Deferred tax assets, net		37
Other		596
		<hr/>
	\$	<u>1,978</u>

Other Liabilities:

Accrued compensation and benefits	\$	676
Accrued operating expenses		458
Accrued interest and dividends payable		172
Payables to affiliates		126
Current income tax liability		27
Other		186
		<hr/>
	\$	<u>1,645</u>

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**10) Related-Party Transactions**

The Company is involved in financing and other transactions, and has significant related-party balances with certain of its affiliates. Related party financing transactions are also discussed in notes 8 and 16.

*a) Related-Party Assets and Liabilities*

The following table sets forth assets and liabilities with related parties as of June 30, 2017 (in millions):

Assets:

Cash and cash equivalents	\$	1,010
Cash and securities segregated for benefit of customers		136
Securities purchased under agreements to resell		36,385
Securities borrowed		21,541
Financial instruments owned, at fair value		176
Receivable from customers		58
Receivable from noncustomers		150
Receivable from brokers, dealers, and clearing organizations		242
Other assets		918
	\$	<u><u>60,616</u></u>

Liabilities:

Securities sold under agreements to repurchase	\$	15,006
Securities loaned		21,199
Payable to customers		998
Payable to noncustomers		13,048
Payable to brokers, dealers, and clearing organizations		265
Payables - loans		2,534
Financial instruments sold, but not yet purchased, at fair value		63
Other liabilities		294
Subordinated liabilities		6,723
	\$	<u><u>60,130</u></u>

**11) Risk Factors**

*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 are subject to market risk arising from changes in interest rates, credit spreads, foreign exchange rates, equity prices and commodity prices. The Company's exposure to market risk is determined by a number of factors, including the size, duration, composition and diversification of positions held; absolute and relative market rates; as well as volatilities and liquidity. 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 exercise price also affects the level of

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market risk. The Company manages market risk through a market risk management framework, policies, limits, management information systems and reporting. A significant factor influencing the overall level of market risk to which the Company is exposed is its use of hedging techniques to mitigate such risk. As an independent risk function, Market Risk Management (MRM) implements the framework to systemically identify, assess, monitor and report the Company's market risk and to support effective management and mitigation. In this capacity, MRM works closely with risk takers in the business units and other control and support groups to ensure that the business units optimize the risk/reward relationship and do not expose the Company to unacceptable losses outside of the Company's risk appetite.

**b) Credit Risk**

The Company acts as a futures commission merchant and a dealer of securities in the global capital markets, and consequently, incurs counterparty credit risk. 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.

For derivative products, credit risk exposure is measured based on mark-to-market values instead of the notional amounts which are not representative of the associated credit risk. The credit risk associated with exchange-traded futures & options (F&O) contracts and cleared OTC positions is largely mitigated as they are cleared by a central clearing counterparty (CCP). Exchange traded F&O require the daily settlement of changes in mark-to-market values, while the changes in mark-to-market values of cleared OTC positions are met with variation margin on a daily basis. For both exchange traded F&O exposures and cleared OTC exposures, initial margin posted to the CCP is a potential source of credit risk. Uncleared or bilaterally settled derivative transactions are negotiated contractual commitments possessing greater exposure to counterparty credit risk unless they are subject to regulation-mandated margin requirements for non-centrally cleared derivatives that require the posting of initial margin by the client in addition to any variation margin.

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 obligations 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

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individual and group counterparty basis. The Company minimizes this risk through credit reviews, approvals, limits, as well as monitoring reports and procedures.

**c) *Operational Risk***

The Company is exposed to operational risk arising from errors, inadvertent or intentional, made in the execution, confirmation or settlement of transactions or from transactions not being properly recorded, evaluated or accounted. In addition, on a daily basis, the Company is highly dependent on its ability to process a larger number of transactions, some increasingly complex, across numerous and diverse markets and currencies. Management relies heavily on its financial, accounting, and other data processing systems, some of which include manual processing components. If any of these processes or systems do not operate properly, are disabled, or are compromised due to intentional or inadvertent human error, the Company could be subjected to financial loss, disruption to the Company's businesses or clients, regulatory action, or reputational damage.

The Company is also dependent on its employees to conduct the Company's business in accordance with applicable laws, regulations and generally accepted business standards. Employee misconduct, which includes but is not limited to selling products that are not suitable for a particular customer, fraud and unauthorized trading, could result in a material impact to the Company in the form of regulatory action, reputational damage, or client attrition impacting the Company's financial position.

The Company operates in a legal and regulatory environment that exposes it to significant litigation risks. Failure to properly manage litigation or regulatory matters or properly interpret and apply applicable law, regulation, or rules may substantially and adversely affect the Company's planned results of operations, financial condition, and reputation.

The Company faces operational risk related to a substantial dependence on information technology (IT) and infrastructure. Operational instability, malfunction or outage of the Company's IT systems or IT infrastructure could materially impact the Company's ability to perform core business functions and secure information assets, resulting in financial losses, additional costs for repairing systems, reputational damage, customer dissatisfaction or potential regulatory and litigation exposure. The Company's operational systems are subject to an increasing risk of cyber-attacks and other internet crime, which could result in material losses of client or customer information, damage the Company's reputation and lead to regulatory penalties and financial losses. Among the operational risks the Company faces are the risk of security breaches of the Company's computer systems due to unauthorized access to networks or resources, the introduction of computer viruses or malware, or forms of cyber-attack or internet crime. Such breaches could threaten the confidentiality of the Company's clients' data and the integrity of the Company's systems.

While contingency plans are in place, the Company's ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports its businesses and the communities in which they are located. This may include a disruption due to terrorist activities, disease pandemics, as well as disruptions involving electrical, communications, transportation or other services used by the Company or counterparts with whom the Company conducts business.

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The size of the Company's clearing operations exposes the Company to a heightened risk of material losses should these operations fail to function properly. The Company has large clearing and settlement businesses and an increasingly complex and interconnected IT landscape. These give rise to the risk that the Company, the Company's customers or third parties could lose substantial sums if the Company's systems fail to operate properly for even short periods. This could harm the Company's reputation and cause customers to take their business elsewhere, which could materially harm the Company's revenues and profits.

**12) Commitments and Contingencies**

**a) Commitments**

Underwriting Commitments – in the normal course of business, the Company enters into underwriting transactions. There were no commitments relating to such underwritings open at June 30, 2017.

Letters of Credit – the Company has an available letter of credit facility issued by a third-party bank of \$250.0 million which the Company provides to counterparties in lieu of securities or cash to satisfy various collateral and margin deposit requirements. As of June 30, 2017, \$75.0 million of this facility was utilized.

Forward Secured Financings – the Company had commitments to enter into forward secured financing transactions, including certain reverse repurchase agreements of \$16.5 billion and repurchase agreements of \$7.6 billion as of June 30, 2017.

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 June 30, 2017, 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 non-cancelable lease agreements for premises and equipment that expire through 2024. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges. Future minimum rental commitments under non-cancelable leases with initial or remaining terms exceeding one year as of June 30, 2017 are as follows (in millions):

Period ending:		
2018	\$	9.1
2019		8.9
2020		8.9
2021		8.1
2022		7.0
2023 and thereafter		11.0
Total	\$	<u>53.0</u>

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The minimum rental commitments shown above have not been reduced by approximately \$7.9 million of sublease rental income to be received in 2017 and thereafter under non-cancelable subleases.

Other Commitments – Guaranteed employee bonuses totaled less than a million as of June 30, 2017.

**b) Contingencies**

The Company operates in a legal and regulatory environment that exposes it to significant legal risks. As a result, the Company is involved in litigation, arbitration and regulatory proceedings in the ordinary course of business that 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, regulatory proceedings 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 matter is close to resolution, in which event 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 matters and believes, based on information available to it, that the resolution of these matters will not have a material adverse effect on the financial condition of the Company.

For the Company’s significant matters where an estimate can be made, the Company currently estimates that, as of June 30, 2017, the aggregate future loss, which is considered to be reasonably possible, is approximately \$255.0 million.

This figure includes contingent liabilities on matters where the Company’s potential liability is joint and several and where the Company expects any such liability to be paid by a third party.

This estimated possible loss, as well as any provisions taken, is based upon currently available information and is subject to significant judgment and a variety of assumptions, variables and known and unknown uncertainties. These uncertainties may include inaccuracies in or incompleteness of the information available to the Company, particularly at the preliminary stages of matters, and assumptions by the Company as to future rulings of courts or other tribunals or the likely actions or positions taken by regulators or adversaries may prove incorrect. Moreover, estimates of possible loss for these matters are often not amenable to the use of statistical or other quantitative analytical tools frequently used in making judgments and estimates, and are subject to even greater degrees of uncertainty than in many other areas where the Company must exercise judgment and make estimates.

The matters for which the Company determines that the possibility of a future loss is more than remote will change from time to time, as will the matters as to which an estimate can be made and the estimated possible loss for such matters. Actual results may prove to be significantly higher or lower than the estimate of possible loss in those matters where such an estimate was made. In addition, loss may be incurred in matters with respect to which the Company believed the likelihood of loss was remote. In particular, the estimated aggregate possible loss does not represent the Company’s potential maximum loss exposure for those matters.

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The Company may settle litigation or regulatory proceedings or investigations prior to a final judgment or determination of liability. It may do so for a number of reasons, including to avoid the cost, management efforts or negative business, regulatory or reputational consequences of continuing to contest liability, even when the Company believes it has valid defenses to liability. It may also do so when the potential consequences of failing to prevail would be disproportionate to the costs of settlement. Furthermore, the Company may, for similar reasons, reimburse counterparties for their losses even in situations where it does not believe that it is legally compelled to do so.

The actions against the Company as of June 30, 2017 include, but are not limited to, the following (listed in alphabetical order):

**Corporate Securities Matters**

The Company regularly acts in the capacity of underwriter and sales agent for debt and equity securities of corporate issuers and is from time to time named as defendant in litigation commenced by investors relating to those securities.

The Company, along with numerous other financial institutions, has been named as a defendant in a putative consolidated class action lawsuit pending in the United States District Court for the District of New Jersey (the U.S. District Court proceeding) relating to alleged misstatements and omissions in the offering documents issued by Valeant Pharmaceuticals International, Inc. (Valeant) in connection with Valeant's issuance of senior notes in January 2015 and March 2015 (the Note Offerings), as well as Valeant's secondary offering of common stock in March 2015 (the Stock Offering). The Company acted as one of several initial purchasers of the Note Offerings and as one of several underwriters of the Stock Offering. Jointly with the other bank defendants, the Company filed a motion to dismiss the Consolidated Complaint on September 13, 2016. On April 28, 2017, the court partially granted and partially denied the motion to dismiss the US action. The Company, along with the other financial institutions referred to above, has also been named as a defendant in a putative class action lawsuit pending in the Superior Court of Quebec relating to issues similar to those alleged in the U.S. District Court proceeding. On August 29, 2017, the Quebec Court authorized the plaintiffs to pursue their claims by way of class action. In connection with its role as an initial purchaser in the Note Offerings and an underwriter in the Stock Offering, the Company received a customary indemnification agreement from Valeant as issuer.

The Company, along with numerous other underwriters of various securities offerings by SunEdison, Inc. and its majority-owned affiliate TerraForm Global, Inc., is named in 11 putative securities class and individual actions filed beginning in October 2015 in state and federal courts. The complaints all allege violations of the federal securities laws and several of the individual actions also variously assert claims under state securities laws and for common law negligent misrepresentation with respect to various offerings by SunEdison or TerraForm. The actions have been transferred for pre-trial proceedings to a multi-district litigation (MDL) pending in the Southern District of New York. Defendants filed motions to dismiss in the class actions, which are pending. Motions to dismiss that were pending in three of the individual actions have been withdrawn without prejudice to refile them after the court rules on the motions to dismiss filed in the class actions. The underwriters, including the Company, received customary indemnification in connection with the offerings, but the

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availability of indemnification could be repudiated by SunEdison, which filed for bankruptcy protection on April 21, 2016 in the U.S. Bankruptcy Court for the Southern District of New York.

**Interbank Offered Rates**

The Company is, along with various other financial institutions, a defendant in multiple actions alleging that it conspired to manipulate U.S. Dollar LIBOR that have been coordinated as part of a multidistrict litigation (the U.S. Dollar LIBOR MDL) in the Southern District of New York. On December 20, 2016, the district court in the U.S. Dollar LIBOR MDL issued a ruling dismissing certain antitrust claims while allowing others to proceed. The district court's ruling indicated that antitrust claims brought against the Company by plaintiff Salix Capital US Inc., on its own behalf and as assignee of the FrontPoint Funds, could proceed, and that claims brought against the Company by plaintiffs Principal Funds, Inc. and related companies remained dismissed. On February 2, 2017, the court entered an order holding that claims against affiliates of LIBOR panel banks should be dismissed, and directed that the parties meet and confer to identify the particular entities to be dismissed as a result of this holding.

Also coordinated as part of the U.S. Dollar LIBOR MDL is a putative class action brought by plaintiffs who allegedly traded exchange-listed Eurodollar futures and options (the exchange-based plaintiffs) and claim that defendants coordinated to make artificial USD LIBOR submissions. As is relevant to DBUSA, on April 15, 2016, the court denied the exchange-based plaintiffs leave to add the Company as a defendant, on the basis that their proposed claims were untimely. On July 13, 2017, the Bank, the Company, and DB Group Services (UK) Limited entered into an agreement with plaintiffs to settle this action. The settlement agreement is subject to further documentation and approval by the court.

On April 23, 2015, the Bank entered into separate settlements with the DOJ, the CFTC, the U.K. Financial Conduct Authority, and the New York State Department of Financial Services to resolve investigations into misconduct concerning the setting of certain interbank offered rates. The Company is not a named party to the settlements; however, the settlements may have an impact on the Company's ability to defend against the litigations. The Bank is also subject to ongoing investigations in relation to the setting of interbank offered rates, including an inquiry by a working group of U.S. state attorneys general. The Bank is cooperating with these investigations.

**Interest Rate Swaps (IR Swaps) Market**

On October 5, 2016, the CFTC issued a subpoena to the Bank and its affiliates, including the Company, seeking documents and information concerning the trading and clearing of IR Swaps. The Bank is cooperating fully in response to the subpoena and requests for information.

The Bank and the Company are defendants, along with numerous other IR Swaps dealer banks as well as TradeWeb and ICAP, in a multi-district civil class action filed in the United States District Court for the Southern District of New York. The class action plaintiffs are consumers of IR Swaps. Competitor trading platforms TeraExchange and Javelin have also filed individual lawsuits. All of the cases have been consolidated for pretrial purposes. Plaintiffs filed second consolidated amended complaints on December 9, 2016 alleging that the banks conspired with TradeWeb and ICAP to prevent the establishment of exchange-traded IR Swaps. On July 28, 2017, defendants' motions to dismiss the

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second consolidated amended complaints were granted in part and denied in part. The cases will now proceed to discovery.

**Life Settlements Investigation**

On May 2, 2017, the United States Attorney's Office for the Southern District of New York (USAO) notified the Bank that the USAO has closed its investigation of the Bank's historical life settlements business, which included the origination and purchase of investments in life insurance assets during the 2005 to 2008 period. As is customary, the USAO further informed the Bank that the USAO may reopen its investigation if it obtains additional information or evidence.

**Mortgage-Related and Asset-Backed Securities Matters and Investigation**

*Regulatory and Governmental Matters.* The Company, along with certain affiliates (collectively referred to in these paragraphs as Deutsche Bank), have received subpoenas and requests for information from certain law enforcement, regulators and government entities, including members of the Residential Mortgage-Backed Securities Working Group of the U.S. Financial Fraud Enforcement Task Force, concerning its activities regarding the origination, purchase, securitization, sale, valuation and/or trading of mortgage loans, residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralized debt obligations (CDOs), other ABS and credit derivatives. Deutsche Bank is cooperating fully in response to those subpoenas and requests for information. On January 17, 2017, Deutsche Bank executed a settlement with the DOJ to resolve potential claims related to its RMBS business conducted from 2005 to 2007. Under the settlement, Deutsche Bank paid a civil monetary penalty of \$3.1 billion and is obligated to provide \$4.1 billion in consumer relief.

In September 2016, Deutsche Bank received administrative subpoenas from the Maryland Attorney General (Maryland AG) seeking information concerning Deutsche Bank's RMBS and CDO businesses from 2002-2009. On June 1, 2017, Deutsche Bank and the Maryland AG executed a settlement to resolve the matter for \$15 million in cash and \$80 million in consumer relief to be allocated from the overall \$4.1 billion consumer relief obligation agreed to as part of Deutsche Bank's settlement with the DOJ.

*Issuer and Underwriter Civil Litigation.* Deutsche Bank has been named as defendant in numerous civil litigations brought by private parties in connection with its various roles, including issuer or underwriter, in offerings of RMBS and other ABS. These cases, described below, allege that the offering documents contained material misrepresentations and omissions, including with regard to the underwriting standards pursuant to which the underlying mortgage loans were issued, or assert that various representations or warranties relating to the loans were breached at the time of origination.

Deutsche Bank is a defendant in a putative class action relating to its role as underwriter of six RMBS issued by Novastar Mortgage Corporation. No specific damages are alleged in the complaint. On March 8, 2017, the parties executed a settlement agreement to resolve this matter. On May 9, 2017, the court issued an order preliminarily approving the settlement and scheduling a final approval hearing for September 13, 2017. On August 30, 2017, The Federal Housing Finance Agency and The Federal

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Home Loan Mortgage Corporation objected to the settlement, and defendants responded to their objection on September 6, 2017.

Deutsche Bank is a defendant in three actions related to RMBS offerings brought by the Federal Deposit Insurance Company (FDIC) as receiver for: (a) Colonial Bank (alleging no less than \$189 million in damages in the aggregate against all defendants), (b) Guaranty Bank (alleging no less than \$901 million in damages in the aggregate against all defendants), and (c) Citizens National Bank and Strategic Capital Bank (alleging no less than \$66 million in damages in the aggregate against all defendants). These actions were previously dismissed on statute of repose grounds, but reinstated by the respective appellate courts. All three matters are ongoing.

Deutsche Bank reached a settlement to resolve claims brought by the Federal Home Loan Bank of San Francisco on two resecuritizations of RMBS certificates for an amount not material to the Bank. Following this settlement and two other previous partial settlements of claims, the Company remained a defendant with respect to one RMBS offering, for which the Company, as an underwriter, was provided contractual indemnification. On January 23, 2017, a settlement agreement was executed to resolve the claims relating to that RMBS offering. On March 27, 2017, plaintiff filed a notice of dismissal of its remaining claims.

Deutsche Bank is a defendant in an action brought by Royal Park Investments (as purported assignee of claims of a special-purpose vehicle created to acquire certain assets of Fortis Bank) alleging common law claims related to the purchase of RMBS. On April 12, 2017, the court dismissed Royal Park's claim. On May 12, 2017, Royal Park filed a notice to appeal the dismissal.

In the actions against Deutsche Bank solely as an underwriter of other issuers' RMBS offerings, Deutsche Bank has contractual rights to indemnification from the issuers, but those indemnity rights may in whole or in part prove effectively unenforceable where the issuers are now, or may in the future be, in bankruptcy or otherwise defunct.

**Precious Metals Investigations and Litigations**

The Bank has received inquiries from certain regulatory and law enforcement authorities, including requests for information and documents, pertaining to investigations of precious metals trading and related conduct. The Bank is cooperating with these investigations, and engaging with relevant authorities, as appropriate. Relatedly, the Bank has been conducting its own internal review of the Bank's historic participation in the precious metals benchmarks and other aspects of its precious metals trading and precious metals business.

The Bank is a defendant in two consolidated class action lawsuits pending in the U.S. District Court for the Southern District of New York. The suits allege violations of U.S. antitrust law, the U.S. Commodity Exchange Act and related state law arising out of the alleged manipulation of gold and silver prices through participation in the Gold and Silver Fixes (Gold Action and Silver Action), but do not specify the damages sought. The Bank has reached agreements to settle both actions. On November 23, 2016, the court issued an order preliminarily approving settlement in the Silver action, on December 9, 2016, the court issued an order preliminarily approving settlement in the Gold Action. The settlements remain subject to final court approval.

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In addition, the Bank is a defendant in Canadian class action proceedings in the provinces of Ontario and Quebec concerning gold and silver. Each of the proceedings seeks damages for alleged violations of the Canadian Competition Act and other causes of action.

**Sovereign, Supranational and Agency Bonds (SSA) Investigations and Litigations**

The Bank has received inquiries from certain regulatory and law enforcement authorities, including requests for information and documents, pertaining to SSA bond trading. The Bank is cooperating with these investigations.

The Bank is a defendant in several putative class action complaints filed in the U.S. District Court for the Southern District of New York alleging violations of U.S. antitrust law and common law related to alleged manipulation of the secondary trading market for SSA bonds. The Bank has reached an agreement to settle the actions. The settlement is subject to court approval.

**STS Partners Fund, LP and Burgess Creek Master Fund Ltd.**

On October 22, 2014, plaintiffs STS Partners Fund, LP and Burgess Creek Master Fund Ltd. commenced an action in New York State Supreme Court against the Company and another affiliate of the Bank, as well as Wells Fargo Bank, N.A. (Wells Fargo), seeking \$15 million of alleged damages plus punitive damages and costs and fees in connection with the termination of a re-securitization of RMBS. Plaintiffs allege that defendants improperly terminated the re-securitization and that plaintiffs, who owned certain interest-only certificates in the re-securitization, were injured as a consequence.

The Company filed a motion to dismiss the complaint on January 16, 2015. On June 24, 2016, the court granted the motion to dismiss all claims against the Company. On December 29, 2016, plaintiffs filed an appeal to the First Department. On April 27, 2017, the First Department affirmed the dismissal of claims against the Company. On July 18, 2017, the First Department denied plaintiffs' motion for reargument or leave to appeal to the New York Court of Appeals. On August 28, 2017, plaintiffs filed a motion for leave to appeal in the New York Court of Appeals. Wells Fargo remains a party to the action.

**Tax-Related Litigation**

The Bank, along with certain affiliates, including the Company, and current and/or former employees (collectively referred to in this section as Deutsche Bank), have collectively been named as defendants in a number of legal proceedings brought by customers in various tax-oriented transactions that the Bank participated in between 1999 and 2002 and that are generally the subject of a non-prosecution agreement the Bank entered into with the U.S. Department of Justice in 2010. 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 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. Numerous legal proceedings have been resolved and dismissed with

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prejudice with respect to Deutsche Bank. A number of other legal proceedings have been filed and remain pending against Deutsche Bank and are currently at various pre-trial stages, including discovery. Deutsche Bank has received and resolved a number of unfiled claims as well.

**Trust Preferred Securities**

The Bank and certain of its affiliates and former 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 the Bank and its affiliates between October 2006 and May 2008. The court has dismissed all claims related to four of the six offerings, and narrowed claims as to the November 2007 and February 2008 Offerings. Plaintiffs have moved for class action certification. The court stayed all proceedings pending a decision by the Supreme Court of the United States in *California Public Employees' Retirement System v. ANZ Securities* in which the Supreme Court had granted a petition for writ of certiorari from *In re Lehman Brothers Securities and ERISA Litigation*, 655 Fed. Appx. 13 (2d Cir. July 8, 2016), to consider whether the filing of a putative class action serves to toll the three-year period of repose in Section 13 of the Securities Act with respect to the claims of putative class members. This related to claims relating to the February 2008 Offering. On June 26, 2017, the Supreme Court issued its opinion, holding that the three year provision in Section 13 is a statute of repose and is not subject to equitable tolling. By Order dated July 20, 2017, the court invited Defendants to move to dismiss the February 2008 Offering. Briefing on the motion will be fully submitted by September 28, 2017, and the court has scheduled a conference for October 16, 2017.

**US Treasury Securities Investigations and Litigations**

The Bank has received inquiries from certain regulatory and law enforcement authorities, including requests for information and documents, pertaining to U.S. Treasuries auctions, trading, and related market activity. The Bank is cooperating with these investigations.

The Bank is a defendant in several putative class actions alleging violations of U.S. antitrust law, the U.S. Commodity Exchange Act and common law related to the alleged manipulation of the U.S. Treasury securities market. These cases have been consolidated in the Southern District of New York and are in their early stages. The court has appointed Lead Counsel for the plaintiffs, and ordered that plaintiffs must file a Consolidated Amended Complaint by September 22, 2017 and defendants must file a motion to dismiss by October 23, 2017.

**13) 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 covered 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.

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The Company enters into certain derivative contracts that meet the accounting definition of a guarantee under ASC Topic 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 and derivatives 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 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), an unaffiliated broker-dealer, as its clearing agent for general securities brokerage transactions. Pershing carries the cash and margin accounts for the Company's

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retail brokerage customers, within its Private Client businesses, 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 following table summarizes certain information regarding the Company's credit derivative contracts and financial guarantees issued as of June 30, 2017 (in millions):

Type of guarantee	Maximum potential payout/ notional years to maturity			Total	Carrying Amount of asset/ (liability)	Collateral/ recourse
	Less than 1	1 – 5	Over 5			
Notional amount of derivative contracts	\$ 347	190	1,115	1,652	(7)	-
Financial guarantees issued	-	345	-	345	-	-

**14) Employee Benefit and Compensation 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 salary plus bonus amounts up to 75% of base salary up to limits established by the IRS. 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 Security Act of 1974 minimum funding requirements.

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 allowed to contribute up to 40% 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

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\$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 the Deutsche Bank Equity Plan and the Global Share Purchase 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 six months to four and a half years.

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.

The Bank enters into call options, indexed to its common shares in order to hedge the overall cost associated with employee share-based compensation awards. For the period ended June 30, 2017, the Company was allocated a gain of approximately \$29.7 million related to its portion of the overall net gain realized by the Bank that was attributable to share-based awards granted to the Company's employees. These amounts have been reflected as an adjustment to the Company's paid-in capital in excess of par value.

**d) *Cash Retention Plan***

The Company participates in the DB Restricted Incentive Plan, a cash retention plan of the Bank, under which Restrictive Incentive Awards (RIA) are granted as deferred cash compensation. The RIA consists of four tranches each amounting to one quarter of the grant volume. It is subject to a four-year pro-rata vesting period during which time specific forfeiture conditions apply. In line with regulatory requirements this plan includes performance-indexed clawback rules. 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.

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**15) Income Taxes**

Significant components of the Company's deferred tax assets and liabilities as of June 30, 2017 were as follows (in millions):

Deferred tax assets:	
Deferred book gain	\$ 434
Deferred compensation	219
Depreciation	117
Litigation and other reserves	57
Investment in securities	23
Pension and post retirement benefits	13
State and local tax net operating losses	13
Nondeductible interest expense	5
Charitable contribution carryforward	1
Other	18
	<hr/>
Gross deferred tax assets	900
Valuation allowance	(6)
	<hr/>
Deferred tax assets, net of valuation allowance	894
Deferred tax liabilities:	
Accrued rental expense	(259)
	<hr/>
Gross deferred tax liabilities	(259)
Net deferred tax assets before settlement	635
Settlement	(598)
	<hr/>
Net deferred tax assets after settlement	\$ <u>37</u>

In 2013, the Company executed an addendum to the tax sharing agreement whereby it will be reimbursed by an affiliate of DBNY for the deferred tax assets associated with its temporary differences, tax credits, and net operating losses. Under the same agreement, the Company would also pay the affiliate for the reversals of previously reimbursed temporary differences. As of December 31, 2016, the Company's cumulative reimbursement for the temporary differences, net operating losses, and credits was \$710.8 million. During 2017, the Company reduced its deferred tax settlement by \$93.7 million as a result of previously reimbursed deferred tax assets that reversed in 2017. Therefore, the cumulative reimbursement for the temporary differences, net operating losses, and credits as of June 30, 2017 is \$617.1 million. Included within this cumulative reimbursement are state and local net operating losses (net of Federal impact) of \$18.7 million that have since been transferred to an affiliate of DBNY as of June 30, 2017.

The state and local tax net operating losses generated by the Company are primarily related to New York State and New Jersey. At June 30, 2017, the Company had generated New York State and New Jersey net operating loss carryforwards of \$116.0 million and \$896.2 million, respectively. The net operating loss carryforwards will expire in 2034 for New York State and 2033 for New Jersey. The deferred tax assets related to the state and local net operating losses (net of federal impact) in these jurisdictions are \$5.7 million and \$3.0 million, respectively.

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The Company utilizes a modified separate company method for its separate company income tax computation. As such, the taxable income of the consolidated tax group of which the Company is a member is considered in evaluating whether deferred tax assets are expected to be realized. The Company believes it is more likely than not that the results of future operations, taking into account the impact of the Bank's various strategic initiatives, will generate sufficient taxable income to realize the net deferred tax assets.

The Company applies ASC Topic 740 as it applies to accounting for uncertainty in income taxes. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in millions):

Balance at January 1, 2017	\$ 29
Additions for tax positions of prior years	-
Reductions for tax positions of prior years	-
Settlements	-
	<hr/>
Balance at June 30, 2017	\$ <u>29</u>

The effect of the unrecognized tax benefits of \$19.0 million, net of federal tax benefit, if recognized, would impact the effective tax rate of the Company.

As of June 30, 2017, the consolidated group of which the Company is a member, is under examination by the IRS for 2012 through 2014. New York City is under examination for tax years 2012 through 2014. New York State is under examination for years 2010 through 2012.

Pursuant to ASC Topic 718, excess tax benefits are recognized as additional paid-in capital in the period the benefit was realized. The write-off of a deferred tax asset related to a tax deficiency is also recognized in the income statement as a tax expense in accordance with ASC Topic 718. During 2017, a tax shortfall of \$4.3 million occurred, which was a result of the tax deduction being less than the cumulative book compensation cost. This is reflected as an increase to tax expense and a decrease in stockholder's equity and the Company's retained earnings.

Tax refunds receivable due from New York State at June 30, 2017 are \$67.6 million. Tax refunds receivable due from New York City at June 30, 2017 are \$41.0 million. Tax refunds receivable due from other state tax authorities at June 30, 2017 are \$7.3 million. Tax payable due to Deutsche Bank New York Branch affiliates at June 30, 2017 is \$48.2 million. This amount is comprised of Federal payable of \$39.8 million, New York State payable of \$3.1 million, New York City payable of \$3.9 million and other states payable of \$1.4 million.

**16) Subordinated Liabilities**

The Company has a subordinated loan agreement with its Parent under which it borrowed \$6.7 billion. This subordination agreement, which has a maturity date of September 25, 2018, has been approved by FINRA and qualifies as regulatory capital for the purpose of computing net capital under SEC's Uniform Net Capital Rule 15c3-1 (SEC Rule 15c3-1). To the extent that the outstanding subordinated liability is required for the Company's continued compliance with its net capital requirements, the subordinated liability may not be repaid.

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The subordinated loan agreement requires the payment of interest at floating rates based on the London Interbank Offered Rate plus 85 basis points. At June 30, 2017, the interest rate on this loan was 2.15%. The Company must obtain the approval of FINRA prior to any additional subordinated borrowings or repayments.

**17) Regulatory Requirements**

*SEC Uniform Net Capital Rule*

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

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 securities 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 June 30, 2017, the Company had net capital of \$12.6 billion, which was 40.27% of aggregate debit balances, and \$12.0 billion in excess of required minimum net capital.

*SEC Customer Protection Rule*

The Company is also subject to the SEC 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 June 30, 2017, the Company had \$2.9 million of cash and \$2.4 billion of U.S. Government securities segregated in the special reserve bank account.

As a clearing broker and in accordance with SEC Rule 15c3-3, the Company computed a reserve requirement for the proprietary accounts of broker dealers (PAB). As of June 30, 2017, the Company had \$1.3 million of U.S. Government securities segregated in a special reserve bank account for such requirement.

*Commodity Exchange Act - Regulated Commodities and Cleared OTC Derivatives*

The Company, in accordance with the CEA, 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 and cleared OTC derivatives. As of June 30, 2017, for customers trading on U.S. commodity exchanges pursuant to Section 4d(2) of the CEA, segregated funds exceeded such requirement by \$200.9 million.

As of June 30, 2017, for customers trading on commodity exchanges located outside of the U.S., pursuant to Regulation 30.7 of the CEA, the Company held funds in separate accounts that exceeded such requirement by \$185.5 million.

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As of June 30, 2017, the Company had ceased its Interest Rate Swap and Credit Default Swap cleared OTC derivatives activities, however, for customers' residual cleared swaps balances, pursuant to Section 4d(f) of the CEA, segregated funds exceeded such requirement by \$24.7 million.

As of June 30, 2017, the amounts required to be segregated and the amounts in segregation for dealer options contracts pursuant to Regulation 32.6 of the CEA were both zero.

**18) Subsequent Events**

The Company has evaluated whether events or transactions have occurred after June 30, 2017 that would require recognition or disclosure on the consolidated statement of financial condition through September 13, 2017, which is the date the consolidated statement of financial condition was available to be issued. With the exception of the matters disclosed in note 12, no such events or transactions required recognition or disclosure on the consolidated statement of financial condition as of June 30, 2017.