

**Credit Suisse Securities (USA) LLC and Subsidiaries**  
**(A wholly owned subsidiary of Credit Suisse (USA), Inc.)**  
**Unaudited Consolidated Statement of Financial Condition**  
**June 30, 2020**

**CREDIT SUISSE SECURITIES (USA) LLC AND SUBSIDIARIES**  
**(A wholly owned subsidiary of Credit Suisse (USA), Inc.)**  
**Consolidated Statement of Financial Condition**  
**June 30, 2020**  
**(In millions)**

**ASSETS**

Cash and cash equivalents.....	\$ 738
Collateralized short-term financings, of which \$9,583 is reported at fair value:	
Securities purchased under agreements to resell.....	24,172
Securities borrowed.....	23,826
Securities received as collateral, at fair value (\$1,827 of which was encumbered) .....	1,973
Financial instruments owned, at fair value (\$1,257 of which was encumbered):	
Debt instruments, of which \$8 is from consolidated VIEs .....	8,945
Equity instruments .....	5,118
Derivative contracts.....	377
Receivables:	
Customers .....	12,511
Brokers, dealers and others.....	6,349
Deferred tax asset.....	701
Goodwill.....	518
Other assets and deferred amounts, of which \$456 is reported at fair value and \$442 is from consolidated VIEs.....	3,069
Total assets .....	<u>\$ 88,297</u>

See accompanying notes to consolidated financial statements.

**CREDIT SUISSE SECURITIES (USA) LLC AND SUBSIDIARIES**  
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**Consolidated Statement of Financial Condition (Continued)**  
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**(In millions)**

**LIABILITIES AND MEMBER'S EQUITY**

Short-term borrowings.....	\$ 253
Collateralized short-term financings, of which \$11,042 is reported at fair value:	
Securities sold under agreements to repurchase .....	17,998
Securities loaned.....	3,977
Obligation to return securities received as collateral, at fair value.....	1,973
Financial instruments sold not yet purchased, at fair value:	
Debt instruments.....	3,049
Equity instruments.....	580
Derivative contracts.....	233
Payables:	
Customers .....	12,248
Brokers, dealers and others.....	3,188
Subordinated and other long-term borrowings, of which \$319 is reported at fair value and is from consolidated VIEs .....	28,194
Other liabilities, of which \$292 reported at fair value.....	3,808
Total liabilities .....	<u>75,501</u>
Member's equity:	
Member's contributions .....	13,920
Accumulated loss .....	(909)
Accumulated other comprehensive loss .....	(215)
Total member's equity .....	<u>12,796</u>
Total liabilities and member's equity.....	<u>\$ 88,297</u>

See accompanying notes to consolidated financial statements.

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**Notes to Consolidated Statement of Financial Condition**  
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## 1. Organization and Summary of Significant Accounting Policies

### The Company

Credit Suisse Securities (USA) LLC and Subsidiaries (the “Company”) is a wholly owned subsidiary of Credit Suisse (USA), Inc. (the “Parent Company” or “CS USA”) and an indirect wholly owned subsidiary of Credit Suisse Holdings (USA), Inc. (“CS Holdings”), whose ultimate parent is Credit Suisse Group AG (“CSG”).

The consolidated statement of financial condition include the accounts of the Company and its wholly owned subsidiary, Special Situations Holdings, Inc. – Westbridge, as well as all Variable Interest Entities (“VIEs”) where the Company is the primary beneficiary. See Note 8 for more information regarding the Company’s consolidation of VIEs.

The Company, as a U.S. registered broker-dealer, provides a variety of capital raising, market making, advisory and brokerage services for governments, financial institutions, corporate clients and affiliates. It is an underwriter, placement agent and dealer for money market instruments, commercial paper, mortgage and other asset-backed securities, as well as a range of debt, equity and other convertible securities of corporations and other issuers.

The accompanying consolidated statement of financial condition have been prepared from the separate records maintained by the Company and may not necessarily be indicative of the financial condition or the results of its operations that would have existed if the Company had been operated as an unaffiliated entity.

### Significant Accounting Policies

*Basis of financial information.* To prepare the consolidated statement of financial condition in accordance with accounting principles generally accepted in the United States of America (“US GAAP”), management is required to make estimates and assumptions, including but not limited to, the fair value measurements of certain financial assets and liabilities, the evaluation of variable interest entities, recognition of deferred tax assets, pension liabilities, and tax uncertainties, as well as various contingencies. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated statement of financial condition during the reporting period. While management evaluates its estimates and assumptions on an ongoing basis, actual results could differ materially from management’s estimates. Market conditions may increase the risk and complexity of the judgments applied in these estimates. All material intercompany balances and transactions have been eliminated.

*Cash and cash equivalents.* Cash and cash equivalents include all demand deposits held in banks, including demand deposits held at affiliate branches, and certain highly liquid investments with original maturities of 90 days or less, other than those held-for-sale in the ordinary course of business. Included in Cash and cash equivalents is cash segregated for regulatory purposes under the Commodity Exchange Act Sections 4d(2) and 4d(F).

*Collateralized short-term financings.* The Company enters into transactions involving securities sold under agreements to repurchase (“repurchase agreements”) and securities purchased under agreements to resell (“resale

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**1. Organization and Summary of Significant Accounting Policies (Continued)**

agreements”) and securities borrowed and securities loaned transactions as part of the Company’s matched book activities to accommodate clients, finance the Company’s trading inventory, obtain securities for settlement and earn interest spreads. Repurchase and resale agreements and securities loaned and securities borrowed transactions do not constitute economic sales and are therefore treated as collateralized financing, which are accounted for as financing transactions.

Certain repurchase agreements and resale agreements that primarily represent matched-book activities are fair value elected. The remaining repurchase agreements and resale agreements are carried at contract amounts that reflect the amounts at which the securities will be subsequently repurchased or resold. Interest on repurchase and resale agreements is accrued and is included in the consolidated statement of financial condition in receivables from and payables to brokers, dealers and others. The Company takes possession of the securities purchased under resale agreements and obtains additional collateral when the market value falls below the contract value. The Company nets certain repurchase agreements and resale agreements with the same counterparty in the consolidated statement of financial condition when all of the criteria under US GAAP have been met.

Certain securities loaned and securities borrowed transactions that represent matched-book activities are carried at fair value. The remaining securities borrowed and securities loaned transactions that are cash-collateralized are included in the consolidated statement of financial condition at amounts equal to the cash advanced or received. If securities received in a securities lending transaction as collateral may be sold or repledged, they are recorded at the fair value of the collateral received as securities received as collateral in the consolidated statement of financial condition and a corresponding obligation to return the security is recorded. For securities borrowing and lending transactions, the Company deposits or receives cash or securities collateral in an amount generally in excess of the market value of securities borrowed or lent. The Company monitors the fair value of securities borrowed and loaned on a daily basis with additional collateral obtained as necessary.

*Fair value measurement and option.* The fair value measurement guidance establishes a single authoritative definition of fair value and sets out a framework for measuring fair value. The fair value option creates an alternative measurement treatment for certain financial assets and financial liabilities. The fair value option can be elected at initial acquisition of the eligible item or at the date when the Company enters into an agreement which gives rise to an eligible item (e.g., a firm commitment). If not elected at initial recognition, the fair value option can be applied to an item upon certain triggering events that give rise to a new basis of accounting for that item. The application of the fair value option to a financial asset or a financial liability does not change its classification on the face of the consolidated statement of financial condition and the election is irrevocable. Changes in fair value resulting from the election are recorded in principal transactions-net in the consolidated statement of comprehensive income. A significant portion of the Company’s financial instruments are carried at fair value. See Note 2 for more information.

*Derivative contracts.* All derivative contracts are carried at fair value. The fair value amounts associated with derivative instruments are reported net by counterparty across

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**1. Organization and Summary of Significant Accounting Policies (Continued)**

products, provided a legally enforceable master netting agreement exists and such provisions are stated in the master netting agreement. The fair value amounts recognized for derivative instruments as well as the fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral, are reported net. See Note 2 and 5 for more information.

*Receivables from customers/Payables to customers.* Receivables from and payables to customers include amounts due on regular way securities transactions, margin transactions and futures. Securities owned by customers, including those that collateralize margin or similar transactions are held for clients on an agency or fiduciary capacity by the Company, are not assets of the Company and are not reflected in the consolidated statement of financial condition.

*Receivables from brokers, dealers and others/Payables to brokers, dealers and others.* Receivables from brokers, dealers and others include amounts receivable for securities not delivered by the Company to a purchaser by the settlement date (“fails to deliver”), omnibus receivables, receivables from clearing organizations, and other non-customer receivables, which are primarily amounts related to futures contracts. Payables to brokers, dealers and others include amounts payable for securities not received by the Company from a seller by the settlement date (“fails to receive”), payables to clearing organizations and other non-customer payables, which are primarily amounts related to futures contracts. In addition, the net receivable or payable arising from unsettled regular-way trades is included in receivables from brokers, dealers and others or payables to brokers, dealers and others.

*Goodwill and identifiable intangible assets.* Goodwill represents the amount by which the purchase price exceeds the fair value of the net tangible and intangible assets of an acquired company on the date of acquisition. Goodwill and indefinite-lived intangible assets are reviewed annually for impairment. Intangible assets that do not have indefinite lives, principally client relationships, are amortized over their useful lives and reviewed for impairment. Intangible assets are included in other assets and deferred amounts in the consolidated statement of financial condition. As of June 30, 2020, the Company had \$518 million of goodwill and \$12 million of indefinite-lived intangible assets.

*Other assets and deferred amounts.* Other assets and deferred amounts primarily includes capitalized software and office facilities, interest receivables, other receivables, and loans held-for-sale. Loans and securities that are held by VIEs, which were consolidated under US GAAP, are considered held-for-sale. The Company elects to record these VIE assets at fair value.

As of June 30, 2020, the Company had fixed assets of \$1.8 billion offset by \$1.1 billion of accumulated depreciation, of which capitalized software (net of accumulated depreciation) was \$642 million. The Company capitalizes costs relating to the acquisition, installation and development of software with a measurable economic benefit, but only if such costs are identifiable and can be reliably measured. The Company depreciates capitalized software costs on a straight-line basis over the estimated useful life of the software, generally not exceeding three years, taking into consideration the effects of obsolescence, technology, competition and other economic factors.

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**1. Organization and Summary of Significant Accounting Policies (Continued)**

*Allowance for credit losses.* The credit loss requirements apply to financial assets measured at amortized cost as well as off-balance sheet credit exposures, such as irrevocable loan commitments and similar instruments. The credit loss requirements are based on a forward-looking, lifetime CECL model by incorporating reasonable and supportable forecasts of future economic conditions available at the reporting date. The estimation and application of forward-looking information requires quantitative analysis and significant judgement. The CECL amounts are estimated over the contractual term of the financial assets taking into account the effect of prepayments. This requires considerable judgment over how changes in macroeconomic factors (MEFs) as well as changes in forward-looking borrower-specific characteristics will affect the CECL amounts.

The Company measures expected credit losses of financial assets on a collective (pool) basis when similar risk characteristics exist. For financial assets which do not share similar risk characteristics, expected credit losses are evaluated on an individual basis. The estimate of the component of the allowance for specifically identified credit losses on impaired loans is based on a periodic and detailed analysis of each loan in the portfolio considering collateral and counterparty risk. CECL amounts are probability-weighted estimates of potential credit losses based on historical frequency, current trends and conditions as well as forecasted MEFs, such as interest rates, gross domestic product (GDP) and unemployment rates.

An allowance for credit losses is deducted from the amortized cost basis of the financial asset. Provisions for off-balance sheet credit exposures are recognized as a provision in other liabilities in the consolidated balance sheets.

Write-off of a financial asset occurs when it is considered certain that there is no possibility of recovering the outstanding principal. If the amount of loss on write-off is greater than the accumulated allowance for credit losses, the difference results in an additional credit loss. The additional credit loss is first recognized as an addition to the allowance; the allowance is then applied against the gross carrying amount. Any repossessed collateral is initially measured at fair value. The subsequent measurement depends on the nature of the collateral. Any uncollectible accrued interest receivable is written off by reversing the related interest income.

Expected recoveries on financial assets previously written off or assessed/planned to be written off have to be reflected in the allowance for credit losses; for this purpose, the amount of expected recoveries cannot exceed the aggregate amounts previously written off or assessed/planned to be written off. Accordingly, expected recoveries from financial assets previously written off may result in an overall negative allowance for credit loss balance.

*Subordinated and other long-term borrowings.* The Company carries long-term borrowings of certain VIEs, principally residential mortgage-backed securities (“RMBS”) and commercial mortgage-backed securities (“CMBS”), which are consolidated under US GAAP at fair value. The Company carries its subordinated and long-term borrowings with affiliates on an accrual basis. Subordinated and other long-term borrowings with affiliates are with CS Holdings and CS USA. See Notes 2, 8 and 9 for more information.

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**1. Organization and Summary of Significant Accounting Policies (Continued)**

*Other liabilities.* Other liabilities primarily includes deferred compensation accruals, interest payables, intercompany payables, and legal reserves.

*Securitization.* The Company securitizes primarily RMBS and CMBS. Before recording a securitization as a sale, the Company must assess whether that transfer is accounted for as a sale of the assets. Transfers of assets may not meet sale requirements if the assets have not been legally isolated from the Company and/or if the Company's continuing involvement is deemed to give it effective control over the assets. If the transfer is not deemed a sale, it is instead accounted for as a secured borrowing, with the transferred assets as collateral. The Company may retain interests in these securitized assets in connection with its underwriting and market-making activities. Retained interests in securitized financial assets are included at fair value in financial instruments owned in the consolidated statement of financial condition. The fair values of retained interests are determined using either prices of comparable securities observed in the market, vendor prices or the present value of estimated future cash flow valuation techniques that incorporate assumptions that market participants customarily use in their estimates of values including prepayment speeds, credit losses and discount rates. See Note 9 for more information.

*Projected benefit obligation.* The Company uses the projected unit credit actuarial method to determine the present value of its projected benefit obligation ("PBO") and the current and past service costs or credits related to its defined benefit and other post-retirement benefit plans. The measurement date used to perform the actuarial valuation is December 31<sup>st</sup>. Certain key assumptions are used in performing the actuarial valuations. These assumptions must be made concerning the future events that will determine the amount and timing of the benefit payments and thus require significant judgment and estimates by the Company's management. Among others, assumptions have to be made with regard to discount rates, expected return on plan assets and salary increases. The assumed discount rates reflect the rates at which the pension benefits could be effectively settled. These rates are determined based on yields of high-quality corporate bonds currently available and are expected to be available during the period to maturity of the pension benefits. The expected long-term rate of return on plan assets is determined on a plan basis, taking into account asset allocation, historical rate of return, benchmark indices for similar-type pension plan assets, long-term expectations of future returns and investment strategy. Health care cost trend rates are determined by reviewing external data and the Company's own historical trends for health care costs. Salary increases are determined by reviewing external data and considering internal projections. The funded status of the Company's defined benefit post-retirement and pension plans is recognized in the consolidated statement of financial condition.

*Income taxes.* The Company is included in the consolidated federal income tax return filed by CS Holdings and certain state and local income tax returns filed by CS Holdings and CS USA. CS Holdings allocates federal income taxes to its subsidiaries on a modified separate company basis, and any state and local income taxes on a pro rata basis, pursuant to a tax sharing arrangement.

The Company uses the asset and liability method in providing for income taxes which requires that deferred income taxes be recorded and adjusted for the future tax consequences of events that have been recognized in the statement of financial condition or tax returns, based upon enacted tax laws and rates. Deferred tax assets are recognized subject to management's judgment that realization is more likely than not. The net federal, state and local deferred tax asset is included in deferred taxes in the consolidated statement of financial



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**1. Organization and Summary of Significant Accounting Policies (Continued)**

condition. The federal deferred tax asset related to net operating losses is effectively settled as part of the intercompany settlements. See Note 15 for more information.

The Company uses a two-step approach in recognizing and measuring its uncertain tax benefits whereby it is first determined if the tax position is more likely than not to be sustained under examination. If the tax position meets the more likely than not threshold, the position is then measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. For more information on the Company's accounting for uncertainty in income taxes, see Note 15.

**RECENTLY ADOPTED ACCOUNTING STANDARDS**

**ASC Topic 820 - Fair Value Measurement**

In August 2018, the FASB issued ASU 2018-13, "Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement" ("ASU 2018-13"), an update to ASC Topic 820 - Fair Value Measurement. The amendments in ASU 2018-13 removed, modified and added certain disclosure requirements in ASC Topic 820, Fair Value Measurement. ASU 2018-13 is effective for annual reporting periods beginning after December 15, 2019 and for the interim periods within those annual reporting periods. Early adoption was permitted, including in an interim period, for any eliminated or modified disclosure requirements. The Company early adopted the amendments for removing disclosures and the amendments for certain modifying disclosures upon issuance of ASU 2018-13. The Company adopted the remaining amendments on January 1, 2020. As these amendments related only to disclosures, there was no impact from the adoption of ASU 2018-13 on the Company's consolidated statement of financial condition.

**ASC Topic 326 - Financial Instruments - Credit Losses**

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"), creating ASC Topic 326 - Financial Instruments - Credit Losses. ASU 2016-13 is intended to improve financial reporting by requiring timelier recording of credit losses on financial assets measured at amortized cost basis including, but not limited to loans, net investments in leases and off-balance sheet credit exposures. ASU 2016-13 eliminated the probable initial recognition threshold under the current incurred loss methodology for recognizing credit losses. Instead, ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date over the remaining contractual life (considering the effect of prepayments) based on historical experience, current conditions, and reasonable and supportable forecasts. The Company has incorporated forward-looking information and macroeconomic factors into its credit loss estimates. ASU 2016-13 requires enhanced disclosures to help investors and other financial statement users to better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio.

In May 2019, the FASB issued ASU 2019-05, "Financial Instruments - Credit Losses" ("ASC 2019-05"), to provide targeted transition relief upon the adoption of ASU 2016-13. The amendment provided the option to irrevocably elect the fair value option on certain financial assets on transition. ASU 2016-13 and its subsequent amendments were effective for annual reporting periods beginning after December 15, 2019, including interim

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## **1. Organization and Summary of Significant Accounting Policies (Continued)**

periods within those annual reporting periods. The Company adopted ASU 2016-13 and its subsequent amendments on January 1, 2020, applying the modified retrospective approach, which did not have a material impact on the Company's consolidated statement of financial condition.

### **STANDARDS TO BE ADOPTED IN FUTURE PERIODS**

#### **ASC Topic 740 - Income Taxes**

In December 2019, the FASB issued ASU 2019-12, "Simplifying the Accounting for Income Taxes" ("ASU 2019-12"), an update to ASC Topic 740 - Income Taxes. The amendments in ASU 2019-12 eliminates certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the accounting for basis differences when there are changes in foreign ownership. In addition, ASU 2019-12 includes clarification and simplification of other aspects of the accounting for income taxes. The amendments are effective for annual reporting periods beginning after December 15, 2020 and for the interim periods within those annual reporting periods. Early adoption is permitted, including in an interim period. The Company is currently evaluating the impact of the adoption of ASU 2019-12 on the Company's consolidated statement of financial condition.

#### **ASC Topic 848 - Reference Rate Reform**

In March 2020, the FASB issued ASU 2020-04, "Facilitation of the Effects of Reference Rate Reform on Financial Reporting" ("ASU 2020-04"), creating ASC Topic 848 - Reference Rate Reform. The amendments in ASU 2020-04 provide optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. The amendments are elective and apply to contracts, hedging relationships and other transactions that reference the London Interbank Offered Rate ("LIBOR") or another reference rate expected to be discontinued because of reference rate reform. The Company may elect to apply the amendments as of March 12, 2020 through December 31, 2022. The Company is currently evaluating the impact of the adoption of ASU 2020-04 on the Company's consolidated statement of financial condition.

## **2. Fair Value of Financial Instruments**

### **Fair Value Measurement**

A significant portion of the Company's financial instruments are carried at fair value. Deterioration of the financial markets could significantly impact the fair value of these financial instruments and the Company's results of operations. The fair value of the majority of the Company's financial instruments is based on quoted prices in active markets or observable inputs. These instruments primarily include U.S. government securities, most investment grade corporate debt, certain high yield debt securities, exchange traded and certain over-the-counter ("OTC") derivative instruments, certain mortgage-backed and asset-backed securities, resale agreements

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## **2. Fair Value of Financial Instruments (Continued)**

and securities borrowed transactions, repurchase agreements and securities loaned transactions, listed equity securities, and loans held-for-sale.

In addition, the Company holds financial instruments for which no prices are available, and/or which have little or no observable inputs. For these instruments, the determination of fair value requires subjective assessment and judgment depending on liquidity, pricing assumptions, the current economic and competitive environment and the risks affecting the specific instrument. In such circumstances, valuation is determined based on management's own judgments about the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. These instruments primarily include certain investment-grade corporate debt securities, certain high-yield debt securities, distressed debt securities, certain equity securities, certain CDOs, certain mortgage-backed and asset-backed securities, and other liabilities.

The fair value of financial assets and liabilities is impacted by factors such as benchmark interest rates, prices of financial instruments issued by third parties, commodity prices and index prices or rates. In addition, valuation adjustments are an integral part of the valuation process when market prices are not indicative of the credit quality of a counterparty, and are applied to debt instruments.

### **Fair Value Hierarchy**

The levels of the fair value hierarchy are defined as follows:

*Level 1:* Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. This level of the fair value hierarchy provides the most reliable evidence of fair value and is used to measure fair value whenever available.

*Level 2:* Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. These inputs include: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is publicly available; (c) inputs other than quoted prices that are observable for the asset or liability or (d) inputs that are derived principally from or corroborated by observable market data by correlation or other means.

*Level 3:* Inputs that are unobservable for the asset or liability. These inputs reflect the Company's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). These inputs are developed based on the best information available in the circumstances, which include the Company's own data. The Company's own data used to develop unobservable inputs are adjusted if information indicates that market participants would use different assumptions.

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**2. Fair Value of Financial Instruments (Continued)**

**Quantitative Disclosures of Fair Values**

The following is a tabular presentation of fair value of assets and liabilities for instruments measured at fair value on a recurring basis.

June 30, 2020	Level 1	Level 2	Level 3	Total at fair value
(In millions)				
<b>Assets</b>				
Resale agreements and securities borrowed				
transactions.....	\$ —	\$ 9,583	\$ —	\$ 9,583
Securities received as collateral:				
Debt instruments.....	1,406	—	—	1,406
Equity instruments.....	563	4	—	567
Total securities received as collateral.....	1,969	4	—	1,973
Financial instruments owned:				
Debt instruments:				
US federal government.....	204	—	—	204
Commercial mortgage-backed securities (CMBS).....	—	2,024	46	2,070
Corporates.....	—	3,666	31	3,697
Foreign government.....	—	14	—	14
Other collateralized debt obligations (CDO).....	—	430	164	594
Residential mortgage-backed securities (RMBS).....	—	2,092	274	2,366
Total debt instruments.....	204	8,226	515	8,945
Equity instruments.....	4,909	127	82	5,118
Derivative contracts:				
Interest rate products.....	375	130	—	505
Foreign exchange products.....	—	13	—	13
Equity/index-related products.....	2	24	5	31
Credit products.....	—	49	67	116
Netting(1).....	—	—	—	(288)
Total derivative contracts.....	377	216	72	377
Other assets:				
Loans held-for-sale.....	—	55	387	442
Other.....	—	9	5	14
Total other assets.....	—	64	392	456
<b>Total assets at fair value.....</b>	<b>\$ 7,459</b>	<b>\$ 18,220</b>	<b>\$ 1,061</b>	<b>\$ 26,452</b>

(1) Derivative contracts are reported on a gross basis by level, with the total at fair value column including the impact of netting. The impact of netting represents an adjustment related to counterparty and cash collateral netting.

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**2. Fair Value of Financial Instruments (Continued)**

June 30, 2020	Level 1	Level 2	Level 3	Total at fair value
<b>Liabilities</b>	(In millions)			
Repurchase agreements and securities loaned transactions.....	\$ —	\$ 11,042	\$ —	\$ 11,042
Obligation to return securities received as collateral:				
Debt instruments.....	1,406	—	—	1,406
Equity instruments.....	563	4	—	567
Total obligation to return securities received as collateral.....	1,969	4	—	1,973
Financial instruments owned:				
Debt instruments:				
US federal government.....	288	—	—	288
Corporates.....	—	2,709	—	2,709
Foreign government.....	—	12	—	12
Residential mortgage-backed securities (RMBS).....	—	38	2	40
Total debt instruments.....	288	2,759	2	3,049
Equity instruments.....	579	—	1	580
Derivative contracts:				
Interest rate products.....	381	14	—	395
Foreign exchange products.....	—	21	—	21
Equity/index-related products.....	—	10	—	10
Credit products.....	—	45	26	71
Netting(1).....				(264)
Total derivative contracts.....	381	90	26	233
Subordinated and other long-term borrowings.....	—	56	263	319
Other liabilities.....	—	10	282	292
<b>Total liabilities at fair value.....</b>	<b>\$ 3,217</b>	<b>\$ 13,961</b>	<b>\$ 574</b>	<b>\$ 17,488</b>

(1) Derivative contracts are reported on a gross basis by level, with the total at fair value column including the impact of netting. The impact of netting represents an adjustment related to counterparty and cash collateral netting.

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## **2. Fair Value of Financial Instruments (Continued)**

### **Qualitative Disclosures of Valuation Techniques**

The following information on the valuation techniques and significant unobservable inputs of the various financial instruments, and the sensitivity of fair value measurements to changes in significant unobservable inputs, should be read in conjunction with the quantitative disclosures of valuation techniques table.

### **Repurchase agreement and resale agreement transactions and securities borrowed and securities loaned**

Securities purchased under resale agreements and securities sold under repurchase agreements are measured at fair value using discounted cash flow analysis. Future cash flows are discounted using observable market interest rate repurchase/resale curves for the applicable maturity and underlying collateral of the instruments. As such, both securities purchased under resale agreements and securities sold under repurchase agreements are included in level 2 of the fair value hierarchy. Securities borrowed and securities loaned are measured at fair value and are included in level 2 of the fair value hierarchy.

Securities purchased under resale agreements are usually fully collateralized or over collateralized by government securities, money market instruments, corporate bonds, or other debt instruments. In the event of counterparty default, the collateral service agreement provides the Company with the right to liquidate the collateral held.

### **Securities received as collateral and obligation to return securities received as collateral**

Securities received as collateral and obligation to return securities received as collateral are measured at fair value using the methods outlined below for “debt instruments” and “equity instruments.”

#### **Debt instruments**

##### **Corporates**

Corporate bonds are priced to reflect current market levels either through recent market transactions or broker or dealer quotes. Where a market price for the particular security is not directly available, valuations are obtained based on yields reflected by other instruments in the specific or similar entity’s capital structure and adjusting for differences in seniority and maturity, benchmarking to a comparable security where market data is available (taking into consideration differences in credit, liquidity and maturity), or through the application of cash flow modeling techniques utilizing observable inputs, such as current interest rate curves and observable CDS spreads. The significant unobservable input is market comparable price. Convertible bonds are generally valued using observable pricing sources. For a small number of convertible bonds no observable prices are available and valuation is determined using models, for which the key inputs include stock price, dividend rates, credit spreads, prepayment rates, discount rates, earnings before income tax, depreciation and amortization (“EBITDA”) multiples and equity market volatility.

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## **2. Fair Value of Financial Instruments (Continued)**

### **CMBS, RMBS and other CDO securities**

Fair values of RMBS, CMBS and other CDO may be available through quoted prices, which are often based on the prices at which similarly structured and collateralized securities trade between dealers and to and from customers. Generally, the fair values of RMBS, CMBS and other CDOs are valued using observable pricing sources. Fair values of RMBS, CMBS and other CDO for which there are no significant observable inputs are valued using price that is derived. Price may not be observable for fair value measurement purposes for many reasons, such as the length of time since the last executed transaction for the related security, usage of a price from a similar but not exact instrument, or usage of a price from an indicative quote. Fair values determined by price may include discounted cash flow models using the inputs prepayment rates, default rates, loss severity and discount rates.

For some structured debt securities, determination of fair value requires subjective assessment depending on liquidity, ownership concentration, and the current economic and competitive environment. Valuation is determined based on management's own assumptions about how market participants would price the asset. Collateralized debt, bonds and loan obligations are split into various structured tranches, and each tranche is valued based upon its individual rating and the underlying collateral supporting the structure. Values are derived by using valuation models based on either prices of comparable securities observed in the market or discounted cash flows.

### **Equity instruments**

The majority of the Company's positions in equity securities are traded on public stock exchanges, for which quoted prices are readily and regularly available. Fair values of preferred shares are determined by their yield and the subordination relative to the issuer's other credit obligations. Level 2 and level 3 equities include equity securities with restrictions that are not traded in active markets. Significant unobservable inputs may include price.

### **Derivative contracts**

Derivatives held for trading purposes include both OTC and exchange-traded derivatives. The fair values of exchange-traded derivatives measured using observable exchange prices are included in level 1 of the fair value hierarchy. For exchange-traded derivatives where the volume of trading is low, the observable exchange prices may not be considered executable at the reporting date. These derivatives are valued in the same manner as similar observable OTC derivatives and are included in level 2 of the fair value hierarchy. If the similar OTC derivative used for valuing the exchange-traded derivative is not observable, the exchange-traded derivative is included in level 3 of the fair value hierarchy. See Note 5 for more information.

The fair values of OTC derivatives are determined on the basis of industry standard models. The model uses various observable and unobservable inputs in order to determine fair value. The inputs include those characteristics of the derivative that have a bearing on the economics of the instrument. Where observable inputs (prices from exchanges, dealers, brokers or market consensus data providers) are not available, attempts are made to infer values from observable prices through model calibration (spot and forward rates, mean reversion,

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## **2. Fair Value of Financial Instruments (Continued)**

benchmark interest rate curves and volatility inputs for commonly traded option products). For inputs that cannot be derived from other sources, estimates from historical data may be made. OTC derivatives where the majority of the value is derived from market observable inputs are categorized as level 2 instruments, while those where the majority of the value is derived from unobservable inputs are categorized as level 3 of the fair value hierarchy.

### **Other assets**

The Company's other assets include loans held-for-sale held by VIE's that are used to back the securities issued by the VIEs. The fair value of loans held-for-sale from VIEs are determined based on the quoted prices for securitized bonds, where available, or on cash flow analyses for securitized bonds, when quoted prices are not available.

### **Subordinated and other long-term borrowings**

The Company's subordinated and other long-term borrowings include the long-term borrowings in VIEs that were consolidated. The fair value of long-term borrowings of consolidated VIEs is determined based on the quoted prices for securitized bonds, where available, or on cash flow analyses for securitized bonds, when quoted prices are not available. The significant unobservable input for subordinated and other long-term borrowings is price.

### **Other liabilities**

Included in other liabilities are Contingent Capital Awards ("CCAs") and other deferred compensation plans, which are measured at fair value using the discounted cash flow method. The value of the CCAs liabilities are based on CSG's referenced contingent convertible ("coco") instruments. The significant unobservable input is credit spread.

### **Sensitivity of fair value measurements to changes in significant unobservable inputs**

For level 3 assets with a significant unobservable input of price, prepayment rate and EBITDA multiple, in general, an increase in the significant unobservable input would increase the fair value. For level 3 assets with a significant unobservable input of default rate, discount rate, loss severity, and credit spread, in general, an increase in the significant unobservable input would decrease the fair value. An increase in the related significant unobservable input for level 3 liabilities would have the inverse impact on fair value.

### **Interrelationships between significant unobservable inputs**

There are no material interrelationships between the significant unobservable inputs for the financial instruments. As the significant unobservable inputs move independently, generally an increase or decrease in one significant unobservable input will have no material impact on the other significant unobservable inputs.



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## 2. Fair Value of Financial Instruments (Continued)

### Quantitative disclosures of valuation techniques

The following table provides a representative range of minimum and maximum values of each significant unobservable input for material level 3 assets and liabilities by the related valuation technique.

June 30, 2020 Assets	Fair Value (In millions)	Valuation Technique	Unobservable Input	Minimum Value	Maximum Value	Weighted Average
<b>Debt instruments:</b>						
Other CDOs	164	Discounted cash flow	Default rate, in %	0.5%	30.0%	7.0%
			Discount rate, in %	3.5%	39.4%	11.6%
			Loss severity, in %	15.0%	100.0%	55.8%
			Prepayment rate, in %	5.0%	20.0%	12.9%
Residential mortgage backed securities	274	Discounted cash flow	Default rate, in %	0.0%	12.0%	2.7%
			Discount rate, in %	0.8%	40.0%	8.8%
			Loss severity, in %	0.0%	100.0%	39.5%
			Prepayment rate, in %	0.0%	35.0%	9.1%
Equity instruments	82	Vendor price	Price, in actuals	0	35,399	695
Credit products	67	Option model	Volatility, in %	76.1%	97.9%	90.5%
Other assets: Loans held-for-sale	387	Market comparable	Price, in %	0.0%	99.0%	66.8%
<b>Liabilities</b>						
Long-term borrowings	263	Market comparable	Price, in %	0.0%	99.0%	34.3%
Other liabilities	282	Discounted cash flow	Credit spread, in bps	472	701	586

### Qualitative discussion of the ranges of significant unobservable inputs

The following sections provide further information about the ranges of significant unobservable inputs included in the table above. The level of aggregation and diversity within the financial instruments disclosed in the table above result in certain ranges of significant inputs being wide and unevenly distributed across asset and liability categories.

*Discount rate.* The discount rate is the rate of interest used to calculate the present value of the expected cash flows of a financial instrument. There are multiple factors that will impact the discount rate for any given financial instrument including the coupon on the instrument, the term and the underlying risk of the expected cash flows. For example, two instruments of similar term and expected cash flows may have significantly different discount rates because the coupons on the instruments are different.

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## 2. Fair Value of Financial Instruments (Continued)

*Default rate and loss severity.* For financial instruments backed by residential real estate or other assets, diversity within the portfolio is reflected in a wide range for loss severity due to varying levels of default. The lower end of the range represents high performing or government guaranteed collateral with a low probability of default or guaranteed timely payment of principal and interest while the higher end of the range relates to collateral with a greater risk of default.

*Prepayment rate.* Prepayment rates may vary from collateral pool to collateral pool, and are driven by a variety of collateral specific factors, including the type and location of the underlying borrower, the remaining tenor of the obligation and the level and type (e.g. fixed or floating) of interest rate being paid by the borrower.

*Price.* Bond equivalent price is a primary significant unobservable input for multiple products. Where market prices are not available for an instrument, benchmarking may be utilized to identify comparable issues (same industry and similar product mixes) while adjustments are considered for differences in deal terms and performance.

### Fair Value Option

The Company elected fair value for certain of its financial statement captions as follows:

*Collateralized short term financings:* The Company has elected to account for matched book repurchase and resale agreements and securities borrowed and securities loaned transactions at fair value.

*Other assets:* Included in other assets are the loans held-for-sale from VIEs that were consolidated. The Company has elected to account for these transactions at fair value.

*Subordinated and other long-term borrowings:* Subordinated and other long-term borrowings include long-term borrowings of VIEs that were consolidated. The Company has elected to account for these transactions at fair value. The fair value of long-term borrowings of consolidated VIEs is determined based on the quoted prices for securitized bonds, where available, or on cash flow analyses for securitized bonds when quoted prices are not available.

The fair value election was made for the above financial statement captions as these activities are managed on a fair value basis, thus fair value accounting for these instruments is deemed more appropriate for reporting purposes.

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**2. Fair Value of Financial Instruments (Continued)**

**Difference between the fair value and the aggregate unpaid principal balances**

June 30, 2020	<u>Of which at fair value</u>	<u>Aggregate unpaid principal</u>	<u>Difference between aggregate fair value and unpaid principal</u>
		(In millions)	
Resale agreements and securities-borrowed transactions .....	\$ 9,583	\$ 9,513	\$ 70
Other assets - Loans held-for-sale .....	442	541	(99)
Repurchase agreements and securities-lending transactions .....	11,042	11,042	—
Subordinated and other long-term borrowings	319	611	(292)

In the ordinary course of business, the Company receives collateral in connection with its resale agreements and securities borrowed transactions and pledges collateral received in connection with its repurchase agreements and securities lending transactions. As a result of the collateralized nature of these transactions, credit risk does not have an impact on fair value. For loans held-for-sale and subordinated and other long-term borrowings, the credit risk does not impact fair value because the debt holders of the consolidated VIEs have recourse to the assets in these consolidated VIEs and not to the Company.

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**2. Fair Value of Financial Instruments (Continued)**

**Leveling of assets and liabilities not at fair value where a fair value is disclosed**

The following table provides the carrying value and fair value of financial instruments which are not carried at fair value in the consolidated statement of financial condition. The disclosure excludes all non-financial instruments such as real estate, premises and equipment, equity method investments and pension and benefit obligations, along with receivables and payables with customers and brokers, dealers and others with an expected maturity of less than one year.

June 30, 2020	Carrying Value	Fair Value			Total
		Level 1	Level 2	Level 3	
<b>(In millions)</b>					
<b>Financial Assets</b>					
Cash and cash equivalents.....	\$ 738	\$ 738	\$ -	\$ -	\$ 738
Resale agreements and securities borrowed transactions.....	38,415	-	38,415	-	38,415
Other assets and deferred amounts.....	1,552	-	1,527	25	1,552
Total financial assets.....	<u>\$ 40,705</u>	<u>\$ 738</u>	<u>\$ 39,942</u>	<u>\$ 25</u>	<u>\$ 40,705</u>
<b>Financial Liabilities</b>					
Short-term borrowings (1).....	\$ 253	\$ 69	\$ 184	\$ -	\$ 253
Repurchase agreements and securities loaned transactions.....	10,933	-	10,933	-	10,933
Subordinated and other long-term borrowings...	27,875	-	30,272	-	30,272
Other liabilities.....	2,444	-	2,444	-	2,444
Total financial liabilities.....	<u>\$ 41,505</u>	<u>\$ 69</u>	<u>\$ 43,833</u>	<u>\$ -</u>	<u>\$ 43,902</u>

(1) Amounts in Level 1 relate to cash overdrafts.

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### 3. Related Party Transactions

In the ordinary course of business, the Company enters into significant financing and operating transactions with affiliated companies.

The following table sets forth the Company's related party assets and liabilities as of June 30, 2020:

#### ASSETS

	(In millions)
Cash and cash equivalents.....	\$ 197
Securities purchased under agreements to resell.....	21,183
Securities borrowed.....	14,391
Securities received as collateral.....	1,973
Debt instruments (included in Financial instruments owned).....	343
Receivables from customers.....	63
Receivables from brokers, dealers and others.....	2,035
Loans held to maturity (included in Other assets and deferred amounts).....	90
Net deferred tax asset.....	701
Taxes receivable (included in Other assets and deferred amounts).....	5
Intercompany receivables (included in Other assets and deferred amounts).....	542
Total assets.....	\$ 41,523

#### LIABILITIES

Short-term borrowings.....	\$ 202
Securities sold under agreements to repurchase.....	13,349
Securities loaned.....	2,544
Obligation to return securities received as collateral.....	1,973
Debt instruments (included in Financial instruments sold not yet purchased).....	77
Derivative contracts (included in Financial instruments sold not yet purchased).....	8
Payables to customers.....	683
Payables to brokers, dealers and others.....	1,651
Subordinated and other long-term borrowings.....	27,875
Taxes payable (included in Other liabilities).....	475
Intercompany payables (included in Other liabilities).....	513
Total liabilities.....	\$ 49,350

The Company has certain foreign affiliates holding customer securities pursuant to the applicable SEC rules.

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### 3. Related Party Transactions (Continued)

The Share Plan provides for the grant of equity-based awards to Company employees based on CSG shares pursuant to which employees of the Company may be granted shares or other equity-based awards as compensation for services performed. The Company purchases shares directly from CSG to satisfy these awards. For the six months ended June 30, 2020, the Company decreased its member's contribution by \$34 million, which consisted of accruals for share award obligations, the purchases of shares for delivery to employees including realized mark-to-market gains (losses) on these shares at delivery date and dividend equivalents.

The Company is included in the consolidated federal income tax return and combined state and local income tax returns filed by CS Holdings and CS USA. See Note 15 for more information.

### 4. Receivables from/Payables to Brokers, Dealers and Others

Amounts receivable from and payable to brokers, dealers and others as of June 30, 2020 consist of the following:

	<u>Receivables</u>	<u>Payables</u>
	(In millions)	
Unsettled regular way securities trades, net.....	\$ 13	\$ —
Fails to deliver/fails to receive .....	1,817	1,930
Omnibus receivables/payables .....	402	(1)
Receivables from/payables to clearing organizations .....	3,583	24
Other non-customer receivables/payables .....	528	1,235
Other.....	6	—
Total.....	<u>\$ 6,349</u>	<u>\$ 3,188</u>

The amounts receivable from/payable to clearing organizations primarily relate to unsettled trades and deposits from customers held at clearing organizations and are collateralized by securities owned by the Company.

### 5. Derivative Contracts

Derivatives are generally standard contracts transacted through regulated exchanges. The Company uses derivative contracts for trading, to provide products for clients and economic hedging purposes. Economic hedges arise when the Company enters into derivative contracts for its own risk management purposes, but the contracts entered into do not qualify for hedge accounting treatment. These derivatives include options, forwards, and futures. Derivative contracts are carried at fair value.

#### *Options*

The Company performs market making activities for option contracts specifically designed to meet customer needs or for economic hedging purposes. Most options do not expose the Company to credit risk

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## **5. Derivative Contracts (Continued)**

because they are primarily exchange traded options, except for credit options. During the contract period, the Company bears the risk of unfavorable changes in the value of the financial instruments underlying the options. To manage this market risk, the Company purchases or sells cash or derivative financial instruments on a proprietary basis. Such purchases and sales may include debt and equity securities, forward and futures contracts, swaps and options. With purchased options, the Company gets the right, for a fee, to buy or sell the underlying instrument at a fixed price on or before a specified date. The underlying instruments for these options include fixed income securities, equities and interest rate instruments or indices.

### *Forwards and Futures*

In the normal course of business, the Company's customer and trading activities include executing, settling and financing various securities and financial instrument transactions. To execute these transactions, the Company purchases and sells (including "short sales") securities, and purchases and sells forward contracts primarily related to U.S. government and agencies and mortgage-backed securities. In addition, the Company enters into futures contracts on equity-based indices and other financial instruments, as well as options on futures contracts. These contracts are typically settled through the Fixed Income Clearing Corporation ("FICC").

Because forward contracts are subject to the credit worthiness of the counterparty, the Company is exposed to credit risk. To mitigate this credit risk, the Company reviews the credit worthiness of specific counterparties, reviews credit limits, requires certain customers and counterparties to maintain margin collateral and adheres to internally established credit extension policies.

For futures contracts and options on futures contracts, the change in the market value is settled with a clearing broker or exchange in cash each day. As a result, the credit risk with the clearing broker is limited to the net positive change in the market value for a single day, which is recorded in receivables from brokers, dealers and others in the consolidated statement of financial condition.

### *Swaps*

The Company's swap agreements consist primarily of interest rate, equity, and credit default swaps. Interest rate swaps are contractual agreements to exchange interest rate payments based on agreed notional amounts and maturity. Equity swaps are contractual agreements to receive the appreciation or depreciation in value based on a specific strike price on an equity instrument in exchange for paying another rate, which is usually based on index or interest rate movements. Credit default swaps are contractual agreements in which one counterparty pays a periodic fee in return for a contingent payment by the other counterparty following a credit event of a reference entity. A credit event is commonly defined as bankruptcy, insolvency, receivership, material adverse restructuring of debt, or failure to meet payment obligations when due. Total return swaps are contractual agreements where one counterparty agrees to pay the other counterparty the total economics of a defined underlying asset, in return for receiving a stream of floating rate cash flows such as the London Interbank Offered Rate ("LIBOR"). Swaps are reported at fair value.

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**5. Derivative Contracts (Continued)****Fair value of derivative instruments**

The table below represents gross derivative fair values, segregated by type of contract. Notionals have also been provided as an indication of the volume of derivative activity within the Company.

	Notional amount	Positive replacement value	Negative replacement value
<b>June 30, 2020</b>	(In millions)		
Forwards .....	\$ 196,131	\$ 505	\$ 395
Futures .....	1,499	—	—
<b>Interest rate products</b> .....	197,630	505	395
Forwards .....	4,992	13	21
<b>Foreign exchange products</b> .....	4,992	13	21
Forwards .....	43	5	2
Futures .....	4,716	—	—
Options bought and sold (OTC) .....	1	—	—
Options bought and sold (exchange traded) .....	1,962	26	8
<b>Equity/index-related products</b> .....	6,722	31	10
Swaps sold .....	4,188	1	12
Swaps purchased .....	10,727	16	39
Swaptions purchased .....	8,175	99	—
Swaptions sold .....	2,000	—	20
<b>Credit products</b> .....	25,090	116	71
<b>Total gross derivative contracts</b> .....	\$ 234,434	\$ 665	\$ 497
Impact of counterparty netting (1) .....	—	(239)	(239)
Impact of cash collateral netting (1) .....	—	(49)	(25)
<b>Total derivative contracts (1)</b> .....	\$ 234,434	\$ 377	\$ 233

(1) Derivative contracts are reported on a net basis in the consolidated statement of financial condition. The impact of netting represents an adjustment for counterparty and cash collateral netting.



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## **5. Derivative Contracts (Continued)**

These financial instruments are included as derivative contracts in financial instruments owned/sold not yet purchased, respectively, in the consolidated statement of financial condition. Financial instruments related to futures contracts are included in receivables from brokers, dealers and others and payables to brokers, dealers and others, respectively, in the consolidated statement of financial condition.

### **Risk Management**

As a result of the Company's broad involvement in financial products and markets, its trading strategies are correspondingly diverse and exposures are generally spread across a diversified range of risk factors and locations. CSG uses a value at risk ("VaR") and economic capital limit structure to limit overall risk-taking. The level of risk is further restricted by a variety of specific limits, including controls over trading exposures. Also as part of its overall risk management, the Company holds a portfolio of economic hedges. Hedges are impacted by market movements, similar to other trading securities, and may result in gains or losses on the hedges which offset losses or gains on the portfolios they were designed to economically hedge. CSG specifically risk manages its trading positions with regards to market and credit risk. For market risk the Company uses tools capable of calculating comparable exposures across its many activities, as well as focused tools that can specifically model unique characteristics of certain instruments or portfolios. As the hedges are recorded at the CSG level, there would be no impact on the financial results of the Company.

The principal risk management measurement methodology for financial instruments owned accounted for at fair value is value at risk. To mitigate the credit risk on these products and to transfer the risk into the capital markets, securities and cash are held as collateral.

### **Credit derivatives**

Included in the table above 'Fair value of derivative instruments' are credit derivatives which are contractual agreements in which the buyer generally pays a periodic fee in exchange for a contingent payment following a credit event on the underlying referenced entity or asset. Credit derivatives are generally privately negotiated OTC contracts. Most credit derivatives are structured so that they specify the occurrence of an identifiable credit event, which can include bankruptcy, insolvency, receivership, material adverse restructuring of debt, or failure to meet payment obligations when due.

From time to time the Company enters into credit derivative contracts in the normal course of business by buying protection. The Company purchases protection to economically hedge various forms of credit exposure, for example, the economic hedging of other cash positions. These referenced instruments can form a single item or be combined on a portfolio or multiname basis.

The credit derivatives most commonly transacted by the Company are CDS and credit swaptions. CDSs are contractual agreements by which the buyer of the swap pays an upfront and/or a periodic fee in return for a contingent payment by the seller of the swap following a credit event of the referenced entity or asset. Credit swaptions are options with a specified maturity to buy or sell protection under a CDS on a specific referenced credit event.

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**5. Derivative Contracts (Continued)**

Credit protection sold is the maximum potential payout, which is based on the notional value of derivatives and represents the amount of future payments that the Company would be required to make as a result of credit risk-related events. The Company believes that the maximum potential payout is not representative of the actual loss exposure based on historical experience. In accordance with most credit derivative contracts, should a credit event (or settlement trigger) occur, the Company is usually liable for the difference between credit protection sold and the recourse it holds in the value of the underlying assets.

To reflect the quality of the credit risk of the underlying, the Company assigns an internally generated rating. Internal ratings are assigned by experienced credit analysts, based on expert judgment that incorporates analysis and evaluation of both quantitative and qualitative factors. The specific factors analyzed, and the relative importance of them, are dependent on the type of counterparty. The analysis emphasizes a forward looking approach, concentrating on economic trends and financial fundamentals, and making use of peer analysis, industry comparisons and other quantitative tools. External ratings and market information are also used in the analysis process where available.

As of June 30, 2020, 54% of the notional amount of credit protection purchased and 71% of the notional amount of credit protection sold by the Company was with third parties with the remainder from affiliates.

Credit protection purchased represents those instruments where the underlying reference instrument is identical to the reference instrument of the credit protection sold. The maximum potential payout amount of credit protection purchased for each individual identical underlying reference instrument may be greater or lower than the notional amount of protection sold. The Company also considers estimated recoveries that it would receive if the specified credit event occurred, including both the anticipated value of the underlying referenced asset that would, in most instances, be transferred to the Company and the impact of any purchased protection with an identical reference instrument.

In the normal course of business, the Company purchases protection to offset the risk of credit protection sold that may have similar, but not identical, reference instruments, and may use similar, but not identical products, which reduces the total credit derivative exposure. Other protection purchased is based on the notional value of the instruments. The Company purchases its protection from banks and broker dealers, other financial institutions and other counterparties.

The fair values of credit protection sold reflect payment risk, as the negative fair values increase when the potential payment under the derivative contracts becomes more probable.

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**5. Derivative Contracts (Continued)**

The Company's credit derivative exposure for the six months ended June 30, 2020 was as follows:

June 30, 2020	Credit Derivative Exposures				
	Credit protection sold	Credit protection purchased	Net Credit protection (sold)/ purchased	Other protection purchased	Fair value of credit protection sold
	(In millions)				
<b>Single name instruments</b>					
Investment grade .....	\$ (3)	\$ —	\$ (3)	\$ 14	\$ —
Non-investment grade.....	(135)	437	301	2,019	(8)
<b>Total single name instruments</b>	<b>\$ (138)</b>	<b>\$ 437</b>	<b>\$ 298</b>	<b>\$ 2,033</b>	<b>\$ (8)</b>
of which non-sovereign .....	(138)	437	298	2,033	(8)
<b>Multiname instruments</b>					
Investment grade .....	\$ (1,803)	\$ 4,324	\$ 2,521	\$ 4,225	\$ (6)
Non-investment grade.....	(4,247)	5,983	1,736	1,900	(17)
<b>Total multiname instruments</b>	<b>\$ (6,050)</b>	<b>\$ 10,307</b>	<b>\$ 4,257</b>	<b>\$ 6,125</b>	<b>\$ (23)</b>
of which non-sovereign .....	(6,050)	10,307	4,257	6,125	(23)
<b>Total instruments</b>	<b>(6,188)</b>	<b>10,744</b>	<b>4,555</b>	<b>8,158</b>	<b>(31)</b>

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**5. Derivative Contracts (Continued)**

The maturity and underlying risk gives an indication of the current status of the potential for performance under the derivative contracts.

The maximum potential amount of future payments that the Company would be required to make under the credit derivatives as a result of credit-risk-related events for which it has sold protection as of June 30, 2020 was as follows:

	Maximum Potential Payout by Maturity			
	Less than 1 year	1 - 5 years	Over 5 years	Total
	(in millions)			
Single name instruments .....	\$ 71	\$ 67	\$ —	\$ 138
Multiname instruments .....	2,000	4,050	—	6,050
<b>Total instruments</b>	<b>\$ 2,071</b>	<b>\$ 4,117</b>	<b>\$ —</b>	<b>\$ 6,188</b>

**6. Assets Assigned and Pledged**

The Company pledges assets mainly for repurchase agreements and other securities financing. Certain pledged assets may be encumbered, meaning they have the right to be sold or repledged. The encumbered assets are parenthetically disclosed on the consolidated statement of financial condition. The Company receives cash and securities in connection with resale agreements, securities borrowing and loans and margined broker loans.

A substantial portion of the collateral and securities received by the Company were sold or repledged in connection with repurchase agreements, securities sold not yet purchased, securities borrowing or loans, pledges to clearing organizations and segregation requirements under securities laws and regulations.

As part of the Company's financing and securities settlement activities, the Company uses securities as collateral to support various secured financing sources. If the counterparty does not meet its contractual obligation to return securities used as collateral, the Company may be exposed to the risk of reacquiring the securities at prevailing market prices to satisfy its obligations. The Company controls this risk by monitoring the market value of financial instruments pledged each day and by requiring collateral levels to be adjusted in the event of excess market exposure.

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**6. Assets Assigned and Pledged (Continued)**

The following table sets forth the assets pledged by the Company and the collateral received by the Company as of June 30, 2020:

	<u>June 30, 2020</u>
	<u>(In millions)</u>
Total assets pledged or assigned as collateral by the Company.....	\$ 10,650
of which was encumbered.....	5,400
Fair value of the collateral received by the Company with the right to sell or repledge.....	111,571
of which was sold or repledged.....	66,495

**7. Offsetting of Financial Assets and Financial Liabilities**

The disclosures set out in the tables below include derivatives, reverse repurchase and repurchase agreements, and securities lending and borrowing transactions that are offset in the Company's consolidated statement of financial condition; or are subject to an enforceable master netting agreement or similar agreement ("enforceable master netting agreements" or "enforceable MNA"), irrespective of whether they are offset in the Company's consolidated statement of financial condition. Similar agreements include derivative clearing agreements, global master repurchase agreements and global master securities lending agreements.

**Derivatives**

The Company primarily transacts its derivatives with exchanges ("exchange-traded derivatives") and central clearing counterparties ("OTC-cleared derivatives"), positive and negative replacement values and related cash collateral may be offset if the terms of the rules and regulations governing these exchanges and central clearing counterparties permit such netting and offset. Where no such agreements exist, fair values are recorded on a gross basis.

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**7. Offsetting of Financial Assets and Financial Liabilities (Continued)**

**Offsetting of derivatives**

The following table presents the gross amount of derivatives subject to enforceable master netting agreements by contract and transaction type, the amount of offsetting, the amount of derivatives not subject to enforceable master netting agreements and the net amount presented in the consolidated statement of financial condition.

	<b>Derivative assets</b>	<b>Derivative liabilities</b>
<b>As of June 30, 2020</b>	<b>(In millions)</b>	
OTC-cleared.....	\$ 313	\$ 149
OTC.....	25	52
<b>Interest rate products</b> .....	<b>338</b>	<b>201</b>
OTC.....	13	21
<b>Foreign exchange products</b> .....	<b>13</b>	<b>21</b>
Exchange-traded.....	26	8
<b>Equity/index-related products</b> .....	<b>26</b>	<b>8</b>
OTC.....	116	71
<b>Credit products</b> .....	<b>116</b>	<b>71</b>
OTC-cleared.....	313	149
OTC.....	154	144
Exchange-traded.....	26	8
<b>Total gross derivative contracts subject to enforceable MNA</b> .....	<b>493</b>	<b>301</b>
of which OTC-cleared.....	(127)	(122)
of which OTC.....	(154)	(135)
of which exchange-traded.....	(7)	(7)
<b>Offsetting</b> .....	<b>(288)</b>	<b>(264)</b>
of which OTC-cleared.....	186	27
of which OTC.....	—	9
of which exchange-traded.....	19	1
<b>Total net derivatives subject to enforceable MNA</b> .....	<b>205</b>	<b>37</b>
<b>Total derivatives not subject to enforceable MNA (1)</b> .....	<b>172</b>	<b>196</b>
<b>Total net derivatives presented in the consolidated statement of financial condition</b> .....	<b>\$ 377</b>	<b>\$ 233</b>

(1) Represents derivatives where a legal opinion supporting their enforceability of netting in the event of default or termination under the agreement is not in place.

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**7. Offsetting of Financial Assets and Financial Liabilities (Continued)**

**Reverse repurchase and repurchase agreements and securities lending and borrowing transactions**

Reverse repurchase and repurchase agreements are generally covered by global master repurchase agreements with netting terms similar to ISDA Master Agreements. In certain situations, for example in the event of default, all contracts under the agreements are terminated and are settled net in one single payment.

Transactions under such agreements are netted in the consolidated statement of financial condition if they are with the same counterparty, have the same maturity date, settle through the same clearing institution and are subject to the same master netting agreement. The amounts offset are measured on the same basis as the underlying transaction (i.e. on an accrual basis or fair value basis).

Securities lending and borrowing transactions are generally executed under global master securities lending agreements with netting terms similar to ISDA Master Agreements. In certain situations, for example in the event of default, all contracts under the agreement are terminated and are settled net in one single payment. Transactions under these agreements are netted in the consolidated statement of financial condition if they meet the same right of setoff criteria as for reverse repurchase and repurchase agreements. In general, most securities lending and borrowing transactions do not meet the criterion of having the same settlement date specified at inception of the transaction, and therefore they are not eligible for netting in the consolidated statement of financial condition. However, securities lending and borrowing transactions with explicit maturity dates may be eligible for netting in the consolidated statement of financial condition.

Reverse repurchase and repurchase agreements are collateralized principally by government securities, money market instruments and corporate bonds and have terms ranging from overnight to a longer or unspecified period of time. In the event of counterparty default, the reverse repurchase agreement or securities lending agreement provides the Company with the right to liquidate the collateral held. As is the case in the Company's normal course of business, substantially all of the collateral received that may be sold or repledged has been sold or repledged as of June 30, 2020. In certain circumstances, financial collateral received may be restricted during the term of the agreement (e.g., in tri-party arrangements).

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## 7. Offsetting of Financial Assets and Financial Liabilities

### Offsetting of securities purchased under resale agreements and securities borrowing transactions

The following table presents the gross amount of securities purchased under resale agreements and securities borrowing transactions subject to enforceable master netting agreements, the amount of offsetting, the amount of securities purchased under resale agreements and securities borrowing transactions not subject to enforceable master netting agreements and the net amount presented in the consolidated statement of financial condition.

June 30, 2020	Gross	Offsetting	Net
	(In millions)		
Securities purchased under resale agreements.....	\$ 28,256	\$ (5,505)	\$ 22,751
Securities borrowing transactions.....	19,437	(250)	19,187
<b>Total subject to enforceable MNA.....</b>	<b>47,693</b>	<b>(5,755)</b>	<b>41,938</b>
<b>Total not subject to enforceable MNA (1).....</b>	<b>6,060</b>	<b>-</b>	<b>6,060</b>
<b>Total (2).....</b>	<b>\$ 53,753</b>	<b>\$ (5,755)</b>	<b>\$ 47,998</b>

- (1) Represents securities purchased under resale agreements and securities borrowing transactions where a legal opinion supporting their enforceability of netting in the event of default or termination under the agreement is not in place.
- (2) \$9,583 million of the total net amount of securities purchased under resale agreements and securities borrowing transactions are reported at fair value.

### Offsetting of securities sold under repurchase agreements and securities lending transactions

The following table presents the gross amount of securities sold under repurchase agreements and securities lending transactions subject to enforceable master netting agreements, the amount of offsetting, the amount of securities sold under repurchase agreements and securities lending transactions not subject to master netting agreements and the net amount presented in the consolidated statement of financial condition.

June 30, 2020	Gross	Offsetting	Net
	(In millions)		
Securities sold under repurchase agreements.....	\$ 23,305	\$ (5,755)	\$ 17,550
Securities lending transactions.....	2,801		2,801
Obligation to return securities received as collateral, at fair value.....	1,973		1,973
<b>Total subject to enforceable MNA.....</b>	<b>28,079</b>	<b>(5,755)</b>	<b>22,324</b>
<b>Total not subject to enforceable MNA (1).....</b>	<b>1,624</b>	<b>-</b>	<b>1,624</b>
<b>Total.....</b>	<b>\$ 29,703</b>	<b>\$ (5,755)</b>	<b>\$ 23,948</b>
of which securities sold under repurchase agreements and securities lending transactions (2)	\$ 27,730	\$ (5,755)	\$ 21,975
of which obligation to return securities received as collateral, at fair value	1,973	-	1,973

- (1) Represents securities sold under repurchase agreements and securities lending transactions where a legal opinion supporting their enforceability of netting in the event of default or termination under the agreement is not in place.
- (2) \$11,042 million of the total net amount of securities sold under repurchase agreements and securities lending transactions are reported at fair value.



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## 7. Offsetting of Financial Assets and Financial Liabilities

### Amount not offset in the consolidated statement of financial condition

The following table presents the net amount presented in the consolidated statement of financial condition of financial assets and liabilities subject to enforceable master netting agreements and the gross amount of financial instruments and cash collateral not offset in the consolidated statement of financial condition. The table excludes derivatives, reverse repurchase and repurchase agreements and securities borrowing and lending transactions not subject to enforceable master netting agreements where a legal opinion supporting the enforceability of the master netting agreements is not in place.

	Net	Financial Instruments <sup>(1)</sup>	Cash collateral received/ pledged <sup>(1)</sup>	Net exposure
June 30, 2020	(In millions)			
<b>Financial assets subject to enforceable MNA</b>				
Derivative contracts .....	\$ 205	\$ 5	\$ —	\$ 200
Securities purchased under resale agreements .....	22,751	22,751	—	—
Securities borrowing transactions .....	19,187	19,088	—	99
<b>Total financial assets subject to enforceable MNA .....</b>	<b>\$ 42,143</b>	<b>\$ 41,844</b>	<b>\$ —</b>	<b>\$ 299</b>
<b>Financial liabilities subject to enforceable MNA</b>				
Derivative contracts .....	\$ 36	\$ —	\$ —	\$ 36
Securities sold under repurchase agreements .....	17,550	17,550	—	—
Securities lending transactions .....	2,801	2,646	—	155
Obligation to return securities received as collateral, at fair value...	1,973	1,973	—	—
<b>Total financial liabilities subject to enforceable MNA .....</b>	<b>\$ 22,360</b>	<b>\$ 22,169</b>	<b>\$ —</b>	<b>\$ 191</b>

(1) The total amount reported in financial instruments (recognized financial assets and financial liabilities and non-cash financial collateral) and cash collateral is limited to the amount of the related instruments presented in the consolidated statement of financial condition and therefore any over-collateralization of these positions is not included.

## 8. Transfers of Financial Assets and Variable Interest Entities

### Securitization Activities

In the normal course of business, the Company enters into transactions with, and makes use of, special purpose entities (“SPEs”). An SPE is an entity in the form of a trust or other legal structure designed to fulfill a specific limited need of the company that organized it and is generally structured to isolate the SPEs assets from creditors or other entities, including the Company. The principal uses of SPEs are to obtain liquidity by transferring certain Company financial assets and to create investment products for clients. SPEs typically qualify

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

as VIEs. At each balance sheet date, VIEs are reviewed for events that may trigger reassessment of the entities' classification.

The majority of the Company's securitization activities involve mortgages and mortgage-related securities and are predominantly transacted using SPEs. In a typical securitization, the SPE purchases assets financed by proceeds received from the SPE's issuance of debt instruments. These assets and liabilities are recorded on the balance sheet of the SPE and not reflected on the Company's consolidated statement of financial condition, unless either the Company sold the assets to the entity and the criteria under US GAAP for sale accounting was not met or the Company consolidates the SPE.

The Company purchases RMBS, CMBS, and other debt securities for the purpose of securitization and sells these securities to SPEs. These SPEs issue RMBS, CMBS and other CDOs that are collateralized by the assets transferred to the SPE and that pay a return based on the returns on those assets. Investors in these mortgage-backed securities typically have recourse to the assets in the SPEs unless a third-party guarantee has been received to further enhance the credit worthiness of the assets. The investors and the SPEs have no recourse to the Company's assets. The Company is an underwriter of, and makes a market in, these securities.

Re-securitizations comprised a portion of the Company's deal volume within its RMBS securitization business during the six months ended June 30, 2020. In these transactions, certificates from existing RMBS securitizations are pooled and transferred into separate securitization trusts, which then issue new certificates. Re-securitizations are carried out to meet specific investor needs.

Securitization transactions are assessed for appropriate accounting treatment of the assets transferred by the Company. The Company's and its clients' investing or financing needs determine the structure of each transaction, which in turn determines whether sale accounting and subsequent derecognition of the transferred assets applies. Certain transactions may be structured to include derivatives or other provisions that prevent sale accounting.

When the Company transfers assets into an SPE, it must assess whether that transfer is accounted for as a sale of the assets. Transfers of assets may not meet sale requirements if the assets have not been legally isolated from the Company and/or if the Company's continuing involvement is deemed to give it effective control over the assets. If the transfer is not deemed a sale, it is instead accounted for as a secured borrowing, with the transferred assets as collateral.

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

**Continuing involvement in transferred financial assets**

The Company may have continuing involvement in the financial assets that are transferred to an SPE, regardless of whether the transfer was accounted for as a sale or a secured borrowing, which may take several forms, including, but not limited to, recourse and guarantee arrangements and beneficial interests (i.e., the rights to receive all or portions of specified cash inflows received by an SPE, including, but not limited to, senior and subordinated shares of interest, principal, or other cash inflows to be “passed through” or “paid-through” and residual interests, whether in the form of debt or equity) as recorded on the Company’s consolidated statement of financial condition at fair value. The carrying value and maximum exposure as of June 30, 2020 resulting from agreements to provide support to SPEs is included in the section titled ‘Non-consolidated VIEs’.

The Company’s exposure resulting from continuing involvement in transferred financial assets is generally limited to its beneficial interests, typically held by the Company in the form of instruments issued by the respective SPEs that are senior, subordinated or residual tranches. These instruments are held by the Company in connection with underwriting or market-making activities and are included in financial instruments owned in the consolidated statement of financial condition at fair value. Any changes in the fair value of these beneficial interests are recognized in the consolidated statement of comprehensive income.

Investors usually have recourse to the assets in the SPE and often benefit from other credit enhancements. The SPE may also enter into a derivative contract in order to convert the yield of the underlying assets to match the needs of the SPE investors or to limit or change the credit risk of the SPE.

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

**Principal amounts outstanding and total assets of SPEs resulting from continuing involvement**

The following table provides the outstanding principal balance of assets to which the Company continues to be exposed/has continuing involvement with after the transfer of the financial assets to any SPE and the total assets of the SPE as of June 30, 2020, regardless of when the transfer of assets occurred.

	For the six months ended June 30, 2020		
	RMBS	CMBS	CDO
	(In millions)		
Principal amount outstanding (1) .....	\$ 19,997	\$ 10,185	\$ 528
Total assets of SPE .....	20,791	10,185	528

(1) Principal amount outstanding relates to assets transferred from the Company and does not include principal amounts for assets transferred from third parties.

The fair values of the assets or liabilities that result from any continuing involvement are determined using fair value estimation techniques, such as the present value of estimated future cash flows that incorporate assumptions that market participants customarily use in these valuation techniques. The fair value of the assets or liabilities that result from any continuing involvement does not include any benefits from financial instruments that the Company may utilize to economically hedge the inherent risks.

**Key economic assumptions used in measuring the fair value of beneficial interests at the time of transfer during the six months ended June 30, 2020**

	For the six months ended June 30, 2020	
	RMBS	CMBS
	(Dollars in millions)	
Fair value of assets.....	\$ 1,611	\$ 164
of which level 1 .....	—	—
of which level 2 .....	1,510	164
of which level 3 .....	101	—
Weighted-average life, in years.....	3.3	8.7
Prepayment speed assumption (rate per annum), in % .....	0% - 42.9%	0% - 15%
Cash flow discount rate (rate per annum), in % .....	0.7% - 24.8%	1.5% - 6.5%
Expected credit losses (rate per annum), in % .....	0% - 22.9%	0%

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

The table below provides the sensitivity analysis of key economic assumptions used in measuring the fair value of beneficial interests held in SPEs as of June 30, 2020:

	As of June 30, 2020	
	RMBS	CMBS
	(Dollars in millions)	
Fair value of assets and liabilities.....\$	1,943	\$ 234
of which non-investment grade.....\$	180	\$ —
Weighted-average life, in years.....	3.4	7.4
Prepayment speed assumption (rate per annum), in % .....	0% - 46.4%	0% - 15%
Impact on fair value from 10% adverse change .....	(56)	\$ (1)
Impact on fair value from 20% adverse change .....	(106)	\$ (3)
Cash flow discount rate (rate per annum), in % .....	0.6% - 42%	1.3% - 22.4%
Impact on fair value from 10% adverse change .....	(25)	\$ (4)
Impact on fair value from 20% adverse change .....	(47)	\$ (7)
Expected credit losses (rate per annum), in % .....	0.0% - 22.9%	0.0%
Impact on fair value from 10% adverse change .....	(23)	\$ (3)
Impact on fair value from 20% adverse change .....	(44)	\$ (6)

These sensitivities are hypothetical and do not reflect economic hedging activities. Changes in fair value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the beneficial interests is calculated without changing any other assumption. In practice, changes in one assumption may result in changes in other assumptions (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

**Securities sold under repurchase agreements and lending transactions accounted for as secured borrowings**

For securities sold under repurchase agreements and securities lending transactions accounted for as secured borrowings, US GAAP requires the disclosure of the collateral pledged and the associated risks to which a transferor continues to be exposed after the transfer. This provides an understanding of the nature and risks of short-term collateralized financing obtained through these types of transactions.

Securities sold under repurchase agreements and securities lending transactions represent collateralized financing transactions used to earn net interest income, increase liquidity or facilitate trading activities. These transactions are collateralized principally by government debt securities, corporate debt securities, asset backed securities, equity securities and other collateral and have terms ranging from overnight to a longer or unspecified period of time.

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

In the event of the Company's default or a decline in fair value of collateral pledged, the repurchase agreement or security lending transaction provides the counterparty with the right to liquidate the collateral held or request additional collateral.

The following tables provide the gross obligation relating to securities sold under repurchase agreements, securities lending transactions and obligation to return securities received as collateral by the class of collateral pledged and by remaining contractual maturity as of June 30, 2020.

**Securities sold under repurchase agreements, securities lending transactions and obligation to return securities received as collateral – by class of collateral pledged**

	<b>June 30, 2020</b>
	<b>(In millions)</b>
Government debt securities .....	\$ 17,254
Corporate debt securities .....	3,068
Asset-backed securities .....	2,404
Equity securities .....	827
Other .....	200
<b>Securities sold under repurchase agreements</b> .....	<b>23,753</b>
Government debt securities .....	1
Corporate debt securities .....	339
Equity securities .....	3,631
Other .....	6
<b>Securities lending transactions</b> .....	<b>3,977</b>
Government debt securities .....	1,406
Equity securities .....	567
<b>Obligation to return securities received as collateral, at fair value</b> .....	<b>1,973</b>
<b>Total</b> .....	<b>\$ 29,703</b>

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

**Securities sold under repurchase agreements, securities lending transactions and obligation to return securities received as collateral – by remaining contractual maturity**

As of June 30, 2020	On demand <sup>(1)</sup>	Remaining contractual maturities			Total
		Up to 30 days <sup>(2)</sup>	30 to 90 days	More than 90 days	
Securities sold under repurchase agreements .....	\$ 3,917	\$ 13,805	\$ 2,805	\$ 3,226	\$ 23,753
Securities lending transactions .....	1,792	9	226	1,950	3,977
Obligation to return securities received .....					
as collateral, at fair value.....	1,973				1,973
Total .....	\$ 7,682	\$ 13,814	\$ 3,031	\$ 5,176	\$ 29,703

(1) Includes contracts with no contractual maturity that may contain termination arrangements subject to a notice period.

(2) Includes overnight transactions.

Refer to “Note 7 – Offsetting of financial assets and financial liabilities” for a reconciliation of gross amounts of securities sold under repurchase agreements, securities lending transactions and obligation to return securities received as collateral to the net amounts disclosed in the consolidated statement of financial condition.

**Variable Interest Entities**

As a normal part of its business, the Company engages in various transactions that include entities which are considered VIEs and are broadly grouped into two primary categories: CDOs and financial intermediation. VIEs are SPEs that typically either lack sufficient equity to finance their activities without additional subordinated financial support or are structured such that the holders of the voting rights do not substantively participate in the gains and losses of the entity. VIEs may be sponsored by the Company, unrelated third parties or clients. Such entities are required to be assessed for consolidation, requiring the primary beneficiary to consolidate the VIE. The assessment requires an entity to determine whether it has the power to direct the activities that most significantly affect the economics of the VIE and has potentially significant benefits or losses in the VIE. In addition, determination of the primary beneficiary must be re-evaluated on an on-going basis.

Application of the accounting requirements for consolidation of VIEs may require the exercise of significant management judgment. In the event consolidation of a VIE is required, the exposure to the Company is limited to that portion of the VIE’s assets attributable to any beneficial interest held by the Company prior to any risk management activities to economically hedge the Company’s net exposure. Any interests held in the VIE by third parties, even though consolidated by the Company, will not typically impact its results of operations.

Transactions with VIEs are generally executed to facilitate securitization activities or to meet specific client needs, such as providing liquidity or investing opportunities, and, as part of these activities, the Company may hold interests in the VIEs. Securitization-related transactions with VIEs involve selling or purchasing assets.

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

Typically, the VIE's assets are restricted in nature in that they are held primarily to satisfy the obligations of the entity.

As a consequence of these activities, the Company holds variable interests in VIEs. Such variable interests consist of financial instruments issued by VIEs and which are held by the Company. In general, investors in consolidated VIEs do not have recourse to the Company in the event of a default, except where a guarantee was provided to the investors.

The total assets of consolidated and non-consolidated VIEs for which the Company has involvement represent the total assets of the VIEs even though the Company's involvement may be significantly less due to interests held by third-party investors. The asset balances for unconsolidated VIEs where the Company has involvement represent the most current information available to the Company regarding the remaining principal balance of cash assets owned. In most cases, the asset balances represent an amortized cost basis without regard to impairments in fair value, unless fair value information is readily available.

The Company's maximum exposure to loss is different from the carrying value of the assets of the VIE. This maximum exposure to loss consists of the carrying value of the Company's variable interests held as financial instruments owned and the notional amount of guarantees to VIEs, rather than the amount of total assets of the VIEs. The maximum exposure to loss does not reflect the Company's risk management activities, including effects from financial instruments that the Company may utilize to economically hedge the risks inherent in these VIEs. The economic risks associated with VIE exposures held by the Company, together with all relevant risk mitigation initiatives, are included in the Company's risk management framework.

Except as described below, the Company has not provided financial or other support to consolidated or non-consolidated VIEs that it was not contractually required to provide.

**Collateralized Debt Obligations**

The Company engages in CDO transactions to meet client and investor needs, earn fees and sell financial assets. The Company may act as underwriter or placement agent and may warehouse assets prior to the closing of a transaction. As part of its structured finance business, the Company purchases loans and other debt obligations from and on behalf of clients for the purpose of securitization. The loans and other debt obligations are sold to VIEs, which in turn issue CDOs to fund the purchase of assets such as investment grade and high yield corporate debt instruments.

Typically, the collateral manager in a managed CDO is deemed to be the entity that has the power to direct the activities that most affect the economics of the entity. In a static CDO this power role is more difficult to analyze and may be the sponsor of the entity or the credit default swap ("CDS") counterparty. CDOs provide credit risk exposure to a portfolio of asset-backed securities ("ABS") (cash CDOs) or a reference portfolio of securities (synthetic CDOs). Cash CDO transactions hold actual securities whereas synthetic CDO transactions use CDS to exchange the underlying credit risk instead of using cash assets. The CDO entities may have actively managed (open) portfolios or static (closed) portfolios.



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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

The beneficial interests issued by these VIEs are payable solely from the cash flows of the related collateral, and third-party creditors of these VIEs do not have recourse to the Company in the event of default.

The Company's exposure in these CDO transactions is typically limited to interests retained in connection with its underwriting or market-making activities. Unless the Company has been deemed to have power over the entity and its interests in the entity are potentially significant, the Company is not the primary beneficiary of the vehicle and does not consolidate the entity. The Company's maximum exposure to loss does not include any effects from financial instruments used to economically hedge the risks of the VIEs.

**Financial Intermediation**

The Company has involvement with VIEs in its role as a financial intermediary on behalf of clients. The Company considers the likelihood of incurring a loss equal to the maximum exposure to be remote because of the Company's risk mitigation efforts, including, but not limited to, economic hedging strategies and collateral arrangements. The Company's economic risks associated with consolidated and non-consolidated VIE exposures arising from financial intermediation, together with all relevant risk mitigation initiatives, are included in the Company's risk management framework.

*Securizations*

In its financial intermediation activities, the Company acts as underwriter and market maker to VIEs related to certain securitization transactions. The Company believes its maximum loss exposure is generally equal to the carrying value of the beneficial interest held. The Company's maximum exposure to loss does not include any effects from financial instruments used to economically hedge the risks of the VIEs.

Typically, the servicer of the assets in the VIE will be deemed to have the power that most significantly affects the economics of the entity. When a servicer or its related party also has an economic interest that has the potential to absorb a significant portion of the gains and/or losses, it will be deemed the primary beneficiary and consolidate the vehicle. The Company typically consolidates securitization vehicles when it has holdings stemming from its role as underwriter and an affiliate is the servicer.

The Company may have relationships with such VIEs as a result of other business activities. The maximum exposure to loss consists of the fair value of instruments which are held by the Company.

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

**Consolidated VIEs**

Where the Company is considered the primary beneficiary, the table below provides the carrying amount of the assets and liabilities of the consolidated VIEs.

**Consolidated VIEs where the Company is the primary beneficiary**

June 30, 2020	<b>Financial Intermediation Securitization</b>
	<b>(In millions)</b>
<b>Assets</b>	
Debt instruments.....	\$ 8
Other assets.....	442
<b>Total assets</b> .....	<b>450</b>
<b>Liabilities</b>	
Subordinated and other long-term borrowings.....	319
<b>Total liabilities</b> .....	<b>\$ 319</b>

The assets and liabilities in the table above are presented net of intercompany eliminations.

**Non-consolidated VIEs**

The non-consolidated VIE tables provide the carrying amounts and classification of the assets of variable interests recorded in the consolidated statement of financial condition, maximum exposure to loss and total assets of the non-consolidated VIEs.

Maximum exposure to loss represents the variable interests of non-consolidated VIEs that are held by the Company (for example, direct holdings in vehicles, loans and other receivables), as well as notional amounts of guarantees and off-balance sheet commitments which are variable interests that have been extended to non-consolidated VIEs. Such amounts, particularly notional amounts of derivatives and guarantees, do not represent the anticipated losses in connection with these transactions as they do not take into consideration the effect of collateral, recoveries or the probability of loss. In addition, they exclude the effect of offsetting financial instruments that are held to mitigate these risks and have not been reduced by unrealized losses previously recorded by the Company in connection with guarantees or derivatives.

Non-consolidated VIE assets are VIEs with which the Company has variable interests. These amounts are typically unrelated to the exposure the Company has with the entity and thus are not amounts that are considered for risk management purposes.

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**8. Transfers of Financial Assets and Variable Interest Entities (Continued)**

June 30, 2020	Financial Intermediation			
	CDOs	Securitizations	Other	Total
(In millions)				
Financial instruments owned.....	\$ —	\$ 793	\$ 7	\$ 800
Other assets .....	8	81	—	89
Total variable interest assets .....	8	874	7	889
Guarantee .....	—	20	—	
Maximum exposure to loss .....	8	894	7	909
Non-consolidated VIE assets.....	\$ 778	\$ 130,002	\$ 1,250	\$ 132,030

**9. Borrowings**

Short-term borrowings are generally funding obligations with interest approximating the Federal Funds rate, LIBOR or other money market indices and an incremental spread. Such borrowings are generally used to facilitate the securities settlement process, finance financial instruments owned and finance securities purchased by customers on margin. As of June 30, 2020, the Company had \$253 million in short-term borrowings, which predominately includes short-term borrowings from affiliates and has a weighted average interest rate of 2.8%. As of June 30, 2020, there were no short-term borrowings secured by Company-owned securities.

As of June 30, 2020, the Company's outstanding subordinated and long-term borrowings were as follows:

	(In millions)
Subordinated debt agreement, 3 month LIBOR plus 205 bps, due in 2032 (1).....	\$ 2,500
Subordinated debt agreement, 3 month LIBOR plus 210 bps, due in 2033 (1).....	2,500
Equity subordinated debt, 3 month LIBOR plus 210 bps, due in 2034 (1) .....	2,500
Other long-term borrowings 0.0%-10.7%, due various dates through 2059 (2).....	319
Long-term borrowings from affiliate 1.3%-2.5%, due various dates through 2027 .....	20,375
Total subordinated and other long-term borrowings.....	\$ 28,194

(1) The weighted average effective interest rate for these subordinated borrowings as of June 30, 2020 was 2.7%.

(2) Other long-term borrowings represent the long-term borrowings in those VIEs consolidated under US GAAP.

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**9. Borrowings (Continued)**

The following table sets forth scheduled maturities of all long-term borrowings as of June 30, 2020:

	<u>(In millions)</u>
2021.....	\$ 5,375
2023.....	2,000
2024.....	4,000
Thereafter.....	16,819
Total .....	<u>\$ 28,194</u>

The subordinated borrowings under these subordinated agreements qualify as regulatory capital and the agreements include all statutory restrictions specified by the Uniform Net Capital Rule 15c3-1, under the Securities Exchange Act of 1934 (“the Exchange Act”), including restrictive covenants relating to additional subordinated borrowings and to minimum levels of net capital, as defined, and consolidated member’s equity.

**10. Guarantees and Commitments**

From time to time the Company enters into guarantee contracts as guarantor. US GAAP requires disclosure by a guarantor of its maximum potential payment obligations under certain of its guarantees to the extent that it is possible to estimate them. The carrying value represents the higher of the initial fair value (generally the related fee received or receivable) less cumulative amortization and the Company's current best estimate of payments that will be required under existing guarantee arrangements.

The guarantees may require the Company to make payments to the guaranteed party based on changes related to an asset, a liability or an equity security of the guaranteed party. The Company may also be contingently required to make payments to the guaranteed party based on another entity’s failure to perform under an agreement, or the Company may have an indirect guarantee of the indebtedness of others, even though the payment to the guaranteed party may not be based on changes related to an asset, liability or equity security of the guaranteed party.

In addition, US GAAP covers certain indemnification agreements that contingently require the Company to make payments to the indemnified party based on changes related to an asset, liability or equity security of the indemnified party, such as an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law.

**Other Guarantees**

The Company has certain guarantees for which its maximum contingent liability cannot be quantified.

As of June 30, 2020, the Company had \$20 million in guarantees due in less than one year related to a supplemental indemnity.

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## 10. Guarantees and Commitments (Continued)

### *Exchange and Clearinghouse Memberships*

The Company is a member of numerous securities exchanges and clearinghouses, and may, as a result of its membership arrangements, be required to perform if another member defaults.

As a member of the Fixed Income Clearing Corp ("FICC"), the Company is required to provide additional liquidity resources under a program called the Capped Contingency Liquidity Facility ("CCLF"). In the event of a default of a netting member of FICC, the Company would be required to enter into a resale agreement providing cash to FICC and receiving securities as collateral. Each member's commitment amount is periodically recalculated by FICC and communicated to the member firm. At June 30, 2020, the Company's maximum commitment was \$1.3 billion, of which none has been utilized.

For the remaining membership agreements, the Company has determined that it is not possible to estimate the maximum amount of these obligations and believes that any potential requirement to make payments under these arrangements is remote.

### **Other Commitments**

The following table sets forth the Company's commitments, including the current portion as of June 30, 2020:

	Commitment Expiration Per Period				Total commitments
	Less than 1 year	1-3 years	4-5 years	Over 5 years	
	(In millions)				
Unfunded lending commitments.....	\$ —	\$ —	\$ —	\$ 1,293	\$ 1,293
Total commitments .....	\$ —	\$ —	\$ —	\$ 1,293	\$ 1,293

(1) Represents commitments to enter into securities purchased under agreements to resell and agreements to borrow securities.

## 11. Concentrations of Credit Risk

As a securities broker and dealer, the Company is engaged in various securities trading and brokerage activities servicing a diverse group of domestic and foreign corporations, governments and institutional and individual investors. A substantial portion of the Company's transactions are executed with and on behalf of institutional investors, including other brokers and dealers, commercial banks, U.S. agencies, mutual funds, hedge funds and other financial institutions. These transactions are generally collateralized. Credit risk is the potential for loss resulting from the default by a counterparty of its obligations. Exposure to credit risk is generated by securities and currency settlements, contracting derivatives and forward transactions with customers and dealers, and the holding of bonds in inventory. The Company uses various means to manage its credit risk. The

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### **11. Concentrations of Credit Risk (Continued)**

creditworthiness of all counterparties is analyzed at the outset of a credit relationship with the Company. These counterparties are subsequently reviewed on a periodic basis. The Company sets a maximum exposure limit for each counterparty, as well as for groups of counterparties. Furthermore, the Company enters into master netting agreements when feasible and demands collateral from certain counterparties or for certain types of credit transactions. The Company deals with a broad range of counterparties across different industries however there is a high volume of transactions with financial services companies such as brokers and dealers, commercial banks, clearing houses, exchanges and investment funds. As a result the Company has credit concentration with respect to these counterparties. Provisions of the Dodd-Frank Act have led to increased trading activity through clearing houses, central agents or exchanges, which has increased our concentration of risk with respect to these entities.

The Company's customer securities activities are transacted either in cash or on a margin basis, in which the Company extends credit to the customer. The Company seeks to control the risks associated with its customer activities by requiring customers to maintain margin collateral to comply with various regulatory and internal guidelines. The Company monitors required margin levels each day and requires customers to deposit additional collateral, or reduce positions, when necessary.

### **12. Net Capital Requirements**

The Company is a registered broker-dealer and registered futures commission merchant and, accordingly, is subject to the minimum net capital requirements of the Securities and Exchange Commission ("SEC"), the Commodities Futures Trading Commission ("CFTC") and the Financial Industry Regulatory Authority ("FINRA"). Under the alternative method permitted by SEC Rule 15c3-1, the required net capital may not be less than 2% of aggregate debit balances arising from customer transactions. Under CFTC Regulation 1.17, the required minimum net capital requirement is 8% of the total risk margin requirement (as defined) for all positions carried in customer and non-customer accounts. FINRA may require a member firm to reduce its business if net capital is less than 4% of such aggregate debit items and may prohibit a firm from expanding its business if net capital is less than 5% of such aggregate debit items. As of June 30, 2020, the Company's net capital of approximately \$10.4 billion which was in excess of the CFTC's minimum requirement by approximately \$8.4 billion.

### **13. Cash and Securities Segregated Under Federal and Other Regulations**

As a registered broker-dealer, the Company is subject to the customer protection requirements of SEC Rule 15c3-3. The Company did not have any U.S. Treasury securities or cash as of June 30, 2020, subject to segregation in a special reserve bank account exclusively for the benefit of customers as required by rule 15c3-3.

The Company is also required to perform a computation of reserve requirements for Proprietary Accounts of Broker Dealers ("PAB") pursuant to SEC Rule 15c3-3. The Company did not have any U.S. Treasury securities or cash as of June 30, 2020, subject to segregation in a special reserve bank account to meet the PAB requirement.

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**13. Cash and Securities Segregated Under Federal and Other Regulations (Continued)**

As a futures commission merchant, the Company is required to perform computations of the requirements of Section 4d(2) and Regulation 30.7 under the Commodity Exchange Act. As of June 30, 2020, \$9.9 billion of cash and \$3.7 billion of securities aggregating \$13.6 billion were segregated in separate accounts exclusively for the benefit of customers.

As a futures commission merchant, the Company is required to perform computations of the requirements of Section 4d(F) under the Commodity Exchange Act. As of June 30, 2020, \$10.6 billion of cash and \$4.3 billion of securities aggregating \$14.9 billion were segregated in separate accounts exclusively for the benefit of cleared swaps customers.

**14. Employee Benefit Plans**

The Company provides retirement and post-retirement benefits to its U.S. and certain non-U.S. employees through participation in a defined benefit pension plan, a defined contribution savings and retirement plan and other plans. The Company records the liability for its defined benefit pension plan, defined contribution savings and retirement plan and other plans within other liabilities in the consolidated statement of financial condition.

**Pension Plans**

The Company participates in a non-contributory defined benefit pension plan (the “Qualified Plan”) available to individuals employed before January 1, 2000. Effective January 1, 2004, compensation and credited service for benefit purposes were frozen for certain participants. Employees who no longer accrue benefits in the Qualified Plan participate in a savings and retirement plan similar to employees hired on or after January 1, 2000.

CSG applies sponsor accounting for accounting and reporting for defined benefit pension plans. The Company and other CSG entities participate in and contribute to the same plan and the assets held by the plan are not restricted or segregated and can be used to provide benefits to employees of any of the participating CSG entities. The Company has been designated to be the sponsor of the plan and records all liabilities and expenses and allocates a portion of the expenses to affiliates for employees outside the Company.

Contributions to the Qualified Plan are made as required by the Internal Revenue Code and applicable law but not in excess of the amounts deductible by the Company for income tax purposes. The Company made no special contributions to the Qualified Plan during the six months ended June 30, 2020, and does not expect to contribute to the Qualified Plan during 2020.

The Company also provides a non-contributory, non-qualified, unfunded plan (the “Supplemental Plan”), which provides benefits to certain senior employees and Qualified Plan participants whose benefits may be limited by tax regulations. Benefits under these pension plans are based on years of service and employee compensation. The Company made payments of approximately \$8 million to the Supplemental Plan and other post retirement plans during the six months ended June 30, 2020, and expects to pay a total of \$8 million to the Plan during 2020.

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## 15. Income Taxes

The Company is included in the consolidated federal income tax return filed by CS Holdings and certain state and local income tax returns filed by CS Holdings and CS USA. CS Holdings allocates federal income taxes to its subsidiaries on a modified separate company basis, and any state and local income taxes on a pro rata basis, pursuant to a tax sharing arrangement. Tax benefits related to carryforwards are recorded only to the extent they could be used currently or in the future to reduce consolidated federal or state and local income tax expense.

As of June 30, 2020, there was \$1.3 million of unrecognized tax benefit recorded. There was no change in the Company's unrecognized tax benefit during the year ended December 31, 2020. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$1.3 million.

When accruals of interest and penalties related to unrecognized tax benefits are applicable, the Company recognizes interest and penalties through current income tax expense. No material interest and penalties have been accrued as of June 30, 2020.

The Company is currently subject to ongoing tax audits and inquiries with the tax authorities in a number of jurisdictions. Although the timing of the completion of these audits is uncertain, it is reasonably possible that some of these audits and inquiries will be resolved within the next twelve months. The Company is currently subject to examination by the Internal Revenue Service for the tax years 2010 and forward, New York State for the tax years 2006 and forward, and New York City for the tax years 2009 and forward. The Company does not anticipate any material changes to its financial statements due to audit settlements.



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**15. Income Taxes (Continued)**

Deferred tax assets and deferred tax liabilities are generated by the following temporary differences:

	<b>(In millions)</b>
Deferred tax assets:	
Financial instruments.....	\$ 30
Other liabilities and accrued expenses.....	553
Compensation and benefits.....	248
Pension.....	60
Total deferred tax assets.....	891
Deferred tax liabilities:	
Financial instruments.....	3
Other liabilities and accrued expenses.....	187
Total deferred tax liabilities.....	190
Net deferred tax asset.....	\$ 701

As of June 30, 2020, the net federal state and local deferred tax asset of \$701 million is included in deferred tax assets in the consolidated statement of financial position.

Based on anticipated future taxable income, the Company has not recorded a valuation allowance for the remaining net Federal deferred tax assets on timing items of \$570 million, or its net state and local deferred tax assets of \$131 million, as management believes that the net federal, state and local deferred tax assets as of June 30, 2020 are more likely than not to be realized. However, if estimates of future taxable income are reduced, the amount of the net federal, state and local deferred tax asset considered realizable could be reduced.

Effective January 1, 2018, U.S. tax reform introduced the base erosion and anti-abuse tax ("BEAT"). The BEAT is broadly levied on U.S. tax deductions created by base erosion payments by a US taxpayer, e.g., for interest and services, to its non-US affiliated companies. The BEAT is payable to the extent that the tax calculation based on modified taxable income exceeds the tax based on ordinary federal taxable income with adjustments. After analysis of the final BEAT regulations issued by the US Department of Treasury in December 2019, management has concluded that CS Holdings is subject to the BEAT. CS Holdings allocated the BEAT liability to its subsidiaries based on the subsidiary's relative contribution of base erosion payments to the BEAT. As such, the Company was allocated \$4 million in BEAT liability as of June 30, 2020. In addition, US tax reform introduced interest expense limitation provisions which resulted in the deferral of interest expense deductions. As of June 30, 2020, CS Holdings has booked no deferred tax asset associated with the deferred interest. Valuation allowance on deferral of interest expense has been removed due to the CARES Act.

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## 16. Legal Proceedings

The Company is involved in a number of judicial, regulatory and arbitration proceedings concerning matters arising in connection with the conduct of its businesses, including those disclosed below. Some of these proceedings have been brought on behalf of various classes of claimants and seek damages of material and/or indeterminate amounts.

The Company accrues loss contingency litigation provisions and takes a charge to income in connection with certain proceedings when losses, additional losses or ranges of loss are probable and reasonably estimable. The Company also accrues litigation provisions for the estimated fees and expenses of external lawyers and other service providers in relation to such proceedings, including in cases for which it has not accrued a loss contingency provision. The Company accrues these fee and expense litigation provisions and takes a charge to income in connection therewith when such fees and expenses are probable and reasonably estimable. The Company reviews its legal proceedings each quarter to determine the adequacy of its litigation provisions and may increase or release provisions based on management's judgment and the advice of counsel. The establishment of additional provisions or releases of litigation provisions may be necessary in the future as developments in such proceedings warrant.

It is inherently difficult to determine whether a loss is probable or even reasonably possible or to estimate the amount of any loss or loss range for many of the Company's legal proceedings. Estimates, by their nature, are based on judgment and currently available information and involve a variety of factors, including, but not limited to, the type and nature of the proceeding, the progress of the matter, the advice of counsel, the Company's defenses and its experience in similar matters, as well as its assessment of matters, including settlements, involving other defendants in similar or related cases or proceedings. Factual and legal determinations, many of which are complex, must be made before a loss, additional losses or ranges of loss can be reasonably estimated for any proceeding.

Most matters pending against the Company seek damages of an indeterminate amount. While certain matters specify the damages claimed, such claimed amount may not represent the Company's reasonably possible losses. For certain of the proceedings discussed below the Company has disclosed the amount of damages claimed and certain other quantifiable information that is publicly available.

The Company's aggregate litigation provisions include estimates of losses, additional losses or ranges of loss for proceedings for which such losses are probable and can be reasonably estimated. The Company does not believe that it can estimate an aggregate range of reasonably possible losses for certain of its proceedings because of their complexity, the novelty of some of the claims, the early stage of the proceedings, the limited amount of discovery that has occurred and/or other factors. The Company's estimate of the aggregate range of reasonably possible losses that are not covered by existing provisions for the proceedings discussed in the Credit Suisse Securities (USA) LLC December 31, 2019 Consolidated Statement of Financial Condition for which the Company believes an estimate is possible is zero to \$0.9 billion.

After taking into account its litigation provisions, the Company believes, based on currently available information and advice of counsel, that the results of its legal proceedings, in the aggregate, will not have a material adverse effect on the Company's financial condition. However, in light of the inherent uncertainties of such proceedings, including those brought by regulators or other governmental authorities, the ultimate cost to

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**16. Legal Proceedings (Continued)**

the Company of resolving such proceedings may exceed current litigation provisions and any excess may be material to its operating results for any particular period, depending, in part, upon the operating results for such period.

**17. Subsequent Events**

The Company has evaluated the potential for subsequent events from June 30, 2020 through the date of issuance of the financial statements on August 31, 2020 and determined that there were no other material events or transactions that would require recognition or disclosure in the consolidated financial statements.