

MarketAxess Corporation

(A wholly-owned subsidiary of
MarketAxess Holdings Inc.)

**Financial Statements and
Supplementary Schedules
December 31, 2016**

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

**ANNUAL AUDITED REPORT
FORM X-17A-5
PART III**

OMB APPROVAL	
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FACING PAGE

**Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder**

REPORT FOR THE PERIOD BEGINNING 1/1/2016 AND ENDING 12/31/2016
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

299 Park Avenue, 10th Fl

(No. and Street)

New York

NY

10171

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

CHRISTOPHER GEROSA

212-813-6343

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

PricewaterhouseCoopers LLP

(Name - if individual, state last, first, middle name)

300 Madison Ave

New York

NY

10017

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:



Certified Public Accountant



Public Accountant



Accountant not resident in United States or any of its possessions.

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*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

OATH OR AFFIRMATION

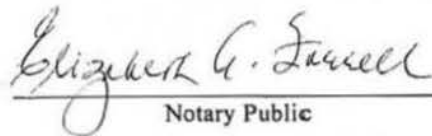
I, Antonio L. Delise, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of MarketAxess Corporation, as of December 31, 20 16, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:



Signature

ELIZABETH A. FARRELL
Notary Public, State of New York
No. 01FA6147437
Qualified in New York County
Commission Expires June 5, 2018

Title



Notary Public

This report ** contains (check all applicable boxes):

- ☒ (a) Facing Page.
- ☒ (b) Statement of Financial Condition.
- ☒ (c) Statement of Income (Loss).
- ☒ (d) Statement of Changes in Financial Condition.
- ☒ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
- ☐ (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- ☒ (g) Computation of Net Capital.
- ☐ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☐ (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
- ☐ (j) A Reconciliation, including appropriate explanation of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☐ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☒ (l) An Oath or Affirmation.
- ☐ (m) A copy of the SIPC Supplemental Report.
- ☒ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

**For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).

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(A wholly-owned subsidiary of MarketAxess Holdings Inc.)
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December 31, 2016

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Report of Independent Registered Public Accounting Firm

To the Board of Directors of MarketAxess Corporation:

In our opinion, the accompanying statement of financial condition and the related statements of operations, changes in shareholder's equity and cash flows present fairly, in all material respects, the financial position of MarketAxess Corporation as of December 31, 2016, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying Supplementary Schedule I is supplemental information required by Rule 17a-5 under the Securities and Exchange Act of 1934. The supplemental information is the responsibility of the Company's management. The supplemental information has been subjected to audit procedures performed in conjunction with the audit of the Company's financial statements. Our audit procedures included determining whether the supplemental information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information. In forming our opinion on the supplemental information, we evaluated whether the supplemental information, including its form and content, is presented in conformity with Rule 17a-5 under the Securities and Exchange Act of 1934. In our opinion, the information contained in Supplementary Schedule I is fairly stated, in all material respects, in relation to the financial statements as a whole.

PricewaterhouseCoopers LLP

February 21, 2017

MarketAxess Corporation
(A wholly owned subsidiary of MarketAxess Holdings Inc.)
Statement of Financial Condition
Year Ended December 31, 2016

Assets

Cash and cash equivalents	\$ 42,858,280
Deposit with clearing broker	500,000
Investments, at fair value	74,653,542
Accounts receivable, including accounts receivable from affiliates of \$6,782,754 net of allowance of \$64,613	49,347,874
Equipment, net of accumulated depreciation of \$21,662,573	7,636,687
Software development costs, net of accumulated amortization of \$49,120,391	12,864,814
Prepaid expenses and other assets	4,524,077
Deferred tax assets, net	1,273,833
Total assets	\$ 193,659,107

Liabilities and Shareholder's Equity

Liabilities

Accrued employee compensation	\$ 22,504,549
Deferred revenue	1,700,173
Accounts payable and other liabilities, including accounts payable to affiliates of \$12,488,355	17,632,574
Total liabilities	41,837,296

Shareholder's Equity

Common stock, \$0.01 par value, 1,000 shares authorized, issued and outstanding	10
Additional paid-in-capital	83,383,830
Retained earnings	68,437,971
Total shareholder's equity	151,821,811
Total liabilities and shareholder's equity	\$ 193,659,107

The accompanying notes are an integral part of these financial statements.

MarketAxess Corporation
(A wholly owned subsidiary of MarketAxess Holdings Inc.)
Statement of Operations
Year Ended December 31, 2016

Revenues

Commissions	\$ 300,212,121
Information services	8,456,376
Investment income	925,987
Other, including \$1,361,800 from affiliates	2,503,051
Total revenues	312,097,535

Expenses

Employee compensation and benefits	53,311,088
Service agreement fees to affiliates	25,210,184
Technology and communications	16,169,472
Depreciation and amortization	12,730,060
General and administrative	7,980,800
Professional and consulting fees	7,596,109
Marketing and advertising	6,053,094
Occupancy	1,904,168
Total expenses	130,954,975

Income before provision for income taxes **181,142,560**

Provision for income taxes	67,247,251
Net Income	\$ 113,895,309

The accompanying notes are an integral part of these financial statements.

MarketAxess Corporation

(A wholly-owned subsidiary of MarketAxess Holdings Inc.)

Statement of Changes in Shareholder's Equity

Year Ended December 31, 2016

	<u>Common</u>	<u>Stock</u>	<u>Additional</u>	<u>Retained</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Earnings</u>	<u>Shareholder's</u>
			<u>Capital</u>		<u>Equity</u>
Balance, December 31, 2015	1,000	\$ 10	\$80,088,989	\$ 54,542,662	\$ 134,631,661
Dividends paid to MarketAxess Holdings Inc.	—	—	—	(100,000,000)	(100,000,000)
Excess tax benefits from stock-based compensation	—	—	3,294,841	—	3,294,841
Net income	—	—	—	113,895,309	113,895,309
Balance, December 31, 2016	<u>1,000</u>	<u>\$ 10</u>	<u>\$83,383,830</u>	<u>\$ 68,437,971</u>	<u>\$ 151,821,811</u>

The accompanying notes are an integral part of these financial statements.

MarketAxess Corporation
(A wholly-owned subsidiary of MarketAxess Holdings Inc.)
Statement of Cash Flows
Year Ended December 31, 2016

Cash flows from operating activities

Net income	\$ 113,895,309
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	12,730,060
Deferred tax assets, net	(28,532)
Provision for bad debts	143,508
Changes in operating assets and liabilities:	
(Increase) in accounts receivable	(14,140,964)
(Increase) in prepaid expenses and other assets	(1,525,466)
(Increase) in investments, at fair value	(74,653,542)
Increase in accrued employee compensation	4,156,893
Increase in deferred revenue	285,331
(Decrease) in accounts payable and other liabilities	(183,372)
Net cash provided by operating activities	40,679,225

Cash flows from investing activities

Purchases of equipment	(5,416,716)
Capitalization of software development costs	(9,284,454)
Net cash (used in) investing activities	(14,701,170)

Cash flows from financing activities

Securities sold under agreements to resell with MarketAxess Holdings Inc.	4,223,410
Dividends paid to MarketAxess Holdings Inc.	(100,000,000)
Excess tax benefits from stock-based compensation	3,294,841
Net cash (used in) financing activities	(92,481,749)
Net (decrease) in cash and cash equivalents	(66,503,694)

Cash and cash equivalents

Beginning of year	109,361,974
End of year	\$ 42,858,280

Supplemental cash flow information

Cash paid during the year for income taxes	\$ 617,000
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The accompanying notes are an integral part of these financial statements.

MarketAxess Corporation
(A wholly-owned subsidiary of MarketAxess Holdings Inc.)
Notes to Financial Statements
December 31, 2016

1. Organization and Principal Business Activity

MarketAxess Corporation ("the Company") was incorporated in the State of Delaware on September 12, 1997, and operates a leading electronic trading platform that enables fixed-income market participants to efficiently trade corporate bonds and other types of fixed-income instruments. The Company's multi-dealer trading platform allows its institutional investor clients to simultaneously request competing executable bids or offers from multiple broker-dealer clients and execute trades with the broker-dealer of their choice from among those that choose to respond. The Company's trading platform provides access to global liquidity in U.S. high-grade corporate bonds, emerging markets and high-yield bonds, European bonds, U.S. agency bonds, municipal bonds, credit default swaps and other fixed-income securities. The Company also executes certain bond transactions between and among institutional investor and broker-dealer clients on a matched principal basis by serving as counterparty to both the buyer and the seller in trades which then settle through a third-party clearing broker. The Company provides fixed-income market data, analytics and compliance tools to assist clients with trading decisions. The Company is a wholly-owned subsidiary of MarketAxess Holdings Inc. (the "Parent"), which is a publicly traded enterprise listed on the NASDAQ Global Select Market under the symbol MKTX.

The Company is a broker-dealer registered with the U.S. Securities and Exchange Commission ("SEC") and is a member of the Financial Industry Regulatory Authority ("FINRA").

2. Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents includes cash and money market instruments that are primarily maintained at one major global bank. Given this concentration, the Company is exposed to certain credit risk in relation to its deposits at this bank. The Company defines cash equivalents as short-term interest-bearing investments with maturities at the time of purchase of three months or less.

Investments, at Fair Value

Trading investments are recorded in the Statement of Financial Condition on the trade date and primarily include investment grade corporate debt securities. Investments are carried at fair value, with realized and unrealized gains or losses included in other revenues in the Statement of Operations.

Fair Value Measurements

Fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." A three-tiered hierarchy for determining fair value has been established that prioritizes inputs to valuation techniques used in fair value calculations. The three levels of inputs are defined as Level 1 (unadjusted quoted prices for identical assets or liabilities in active markets), Level 2 (inputs that are observable in the marketplace other than those inputs classified in Level 1) and Level 3 (inputs that are unobservable in the marketplace). The Company's financial assets and liabilities measured at fair value on a recurring basis consist of its money market funds and trading securities. These financial instruments are short-term in nature and the carrying amount is reported on the Statement of Financial Condition at approximate fair value.

Securities Purchased Under Agreements to Resell

Through February 2016, the Company had reverse repurchase agreements with its Parent. The reverse repurchase agreements were accounted for as collateralized financing transactions and were recorded at their contractual amounts plus accrued interest. These agreements were collateralized by corporate bonds with varying maturities through February 2016.

MarketAxess Corporation

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Notes to Financial Statements

December 31, 2016

Allowance for Doubtful Accounts

All accounts receivable have contractual maturities of less than one year and are derived from trading-related fees and commissions and revenues from products and services. The Company continually monitors collections and payments from its customers and maintains an allowance for doubtful accounts. The allowance for doubtful accounts is based upon the historical collection experience and specific collection issues that have been identified. Additions to the allowance for doubtful accounts are charged to bad debt expense, which is included in general and administrative expenses in the Company's Statement of Operations.

Deposit with Clearing Broker

The deposit with a clearing broker consists of cash on deposit with a third-party clearing broker with whom the Company maintains a securities clearing agreement.

Depreciation

Equipment is carried at cost less accumulated depreciation. The Company uses the straight-line method of depreciation over three or five years.

Software Development Costs and Amortization

The Company capitalizes certain costs associated with the development of internal use software, including among other items, employee compensation and related benefits and third party consulting costs, at the point at which the conceptual formulation, design and testing of possible software project alternatives have been completed. Once the product is ready for its intended use, such costs are amortized on a straight-line basis over three years. The Company reviews the amounts capitalized for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable.

Revenue Recognition

The majority of the Company's revenues are derived from commissions for trades executed on its platform and distribution fees that are billed to its broker-dealer clients on a monthly basis. The Company also derives revenues from information services, investment income and other income.

Commission revenue. Commissions are generally calculated as a percentage of the notional dollar volume of bonds traded on the platform and vary based on the type, size, yield and maturity of the bond traded. Under the Company's transaction fee plans, bonds that are more actively traded or that have shorter maturities are generally charged lower commissions, while bonds that are less actively traded or that have longer maturities generally command higher commissions. For trades that the Company executes between and among institutional investor and broker-dealer clients on a matched principal basis by serving as counterparty to both the buyer and the seller, the Company earns the commission through the difference in price between the two matched principal trades. Fee programs for certain products include distribution fees which are recognized monthly.

Information Services. The Company generates revenues from information services provided to our broker-dealer clients, institutional investor clients and data-only subscribers. Information services are invoiced monthly, quarterly or annually. When billed in advance, revenues are deferred and recognized monthly on a straight-line basis.

Income Taxes

Income taxes are accounted for using the asset and liability method. Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized against deferred tax assets if it is more likely than not that such assets will not be realized in future years. The Company recognizes interest and penalties related to unrecognized tax benefits in general and administrative expenses in the Statement of Operations.

MarketAxess Corporation
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Notes to Financial Statements, continued
December 31, 2016

The Company files consolidated federal and combined state and local income tax returns with its Parent and U.S. affiliates. Pursuant to a tax sharing agreement between the Company and the Parent, income tax expense recorded by the Company is determined on a separate company basis.

Stock-Based Compensation for Employees

The Company measures and recognizes compensation expense for all share-based payment awards based on their estimated fair values measured as of the grant date. These costs are recognized as an expense in the Statement of Operations over the requisite service period, which is typically the vesting period, with an offsetting liability to the Parent.

Use of Estimates

The preparation of the Company's financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Credit Risk

The Company acts as a matched principal counterparty in certain transactions that the Company executes between clients. The Company acts as an intermediary in these transactions by serving as counterparty to both the buyer and the seller in trades which then settle through a third-party clearing broker. Settlement typically occurs within one to three trading days after the trade date. Cash settlement of the transaction occurs upon receipt or delivery of the underlying instrument that was traded.

The Company is exposed to credit and performance risks in its role as a matched principal trading counterparty to its clients executing bond trades on its platform, including the risk that counterparties that owe the Company money or securities will not perform their obligations. These parties may default on their obligations due to bankruptcy, lack of liquidity, operational failure or other reasons. Adverse movements in the prices of securities that are the subject of these transactions can increase the Company's risk. Where the unmatched position or failure to deliver is prolonged, there may also be regulatory capital charges required to be taken by the Company. There can be no assurance that the policies and procedures the Company uses to manage this credit risk will effectively mitigate the credit risk exposure.

Cash and cash equivalents includes cash and money market instruments that are primarily maintained at one major global bank. Given this concentration, the Company is exposed to certain credit risk in relation to the Company's deposits at this bank. As of December 31, 2016, the Company had a cash balance that exceeded the Federal Deposit Insurance Corporation limit of \$250,000.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09") requiring an entity to recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. The standard can be implemented using either a retrospective method or a cumulative-effect approach. In August 2015, the FASB deferred the effective date of the new revenue standard for periods beginning after December 15, 2016 to December 15, 2017, with early adoption permitted but not earlier than the original effective date. The ASU will be effective for the Company beginning January 1, 2018. While certain implementation issues are still pending resolution, including trade date versus settlement date recognition for broker dealers, the adoption of this accounting guidance is not expected to have a material effect on the Company's financial condition or results of operations.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 simplifies several aspects related to the accounting for share-based

MarketAxess Corporation
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Notes to Financial Statements, continued
December 31, 2016

payment transactions, including the accounting for income taxes, statutory tax withholding requirements and classification on the statement of cash flows. The Company will adopt ASU 2016-09 beginning January 1, 2017 and, since the tax effects related to share-based payments will be recorded through the income tax provision, expects the new standard will have a significant impact and cause volatility in the Company's net income and effective tax rate. The volatility in future periods will depend on the Parent's stock price at the vest date for restricted stock awards or exercise date for stock options and the number of awards that vest or are exercised in each period.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash" ("ASU 2016-18") requiring amounts generally described as restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. ASU 2016-18 will be effective for the Company beginning January 1, 2018 and early adoption is permitted. The Company is in the process of determining the method of adoption and assessing the impact of ASU 2016-18 on the Company's Financial Statements.

3. Net Capital and Customer Protection Requirements

Pursuant to the Uniform Net Capital Rule under the Securities Exchange Act of 1934, the Company is required to maintain minimum net capital, as defined, equal to the greater of \$250,000 or 6 2/3% of aggregate indebtedness, as defined. As of December 31, 2016, the Company had net capital of \$72,727,530 which exceeded its required net capital of \$2,759,386 by \$69,968,144. The Company's ratio of aggregate indebtedness to net capital was 0.57 to 1.

The Company claims exemption from SEC Rule 15c3-3(k)(2)(ii), as it does not hold customer securities or funds on account, as defined.

4. Fair Value Measurements

The following table summarizes the valuation of the Company's assets and liabilities measured at fair value as categorized based on the hierarchy described in Note 2:

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 26,420,056	\$ —	\$ —	\$ 26,420,056
Trading securities				
Corporate debt	—	74,207,022	—	74,207,022
Mutual funds held in rabbi trust	—	446,520	—	446,520
Total	<u>\$ 26,420,056</u>	<u>\$ 74,653,542</u>	<u>\$ —</u>	<u>\$ 101,073,598</u>

Securities classified within Level 2 were valued using a market approach utilizing prices and other relevant information generated by market transactions involving comparable assets. The mutual funds held in a rabbi trust represent investments associated with the deferred cash incentive plan (see Note 11). There were no financial assets classified within Level 3 during the year ended December 31, 2016.

The following is a summary of the Company's investments:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Corporate debt	\$ 74,393,469	\$ 47,075	\$ (233,522)	\$ 74,207,022
Mutual funds held in rabbi trust	401,805	44,715	—	446,520
Total trading securities	<u>\$ 74,795,274</u>	<u>\$ 91,790</u>	<u>\$ (233,522)</u>	<u>\$ 74,653,542</u>

MarketAxess Corporation
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Notes to Financial Statements, continued
December 31, 2016

The following table summarizes the fair value of the corporate debt investments based upon the contractual maturities as of December 31, 2016:

Less than one year	\$ 28,811,840
Due in 1 - 5 years	45,395,182
Total	<u>\$ 74,207,022</u>

Proceeds from the sales and maturities of investments during the year ended December 31, 2016 was \$23,141,218.

The following table provides fair values and unrealized losses on investments and by the aging of the securities' continuous unrealized loss position as of December 31, 2016:

	Less than Twelve Months		Twelve Months or More		Total	
	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses
Corporate debt	<u>\$49,115,134</u>	<u>\$ (233,522)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$49,115,134</u>	<u>\$ (233,522)</u>

The trading gains and (losses) related to corporate debt trading securities for the year ended December 31, 2016 are as follows:

Net (losses) recognized during the period on corporate debt securities	\$ (174,556)
Less: Net realized gains recognized during the period on corporate debt sold during the period	11,892
Unrealized net (losses) during the reporting period on corporate debt still held at the reporting date	<u>\$ (186,448)</u>

5. Equipment

Equipment is comprised of the following:

Software licenses, computer and related equipment	\$ 11,129,614
Office hardware	18,169,646
Accumulated depreciation	(21,662,573)
Total equipment, net	<u>\$ 7,636,687</u>

For the year ended December 31, 2016 depreciation expense was \$5,502,910.

MarketAxess Corporation
(A wholly-owned subsidiary of MarketAxess Holdings Inc.)
Notes to Financial Statements, continued
December 31, 2016

6. Software Development Costs

Software development costs are comprised of the following:

Software development costs	\$ 61,985,205
Accumulated amortization	<u>(49,120,391)</u>
Total software development costs, net	<u>\$ 12,864,814</u>

For the year ended December 31, 2016 software development costs of \$9,284,454 were capitalized and amortization expense was \$7,227,150. Non-capitalized software costs and routine maintenance costs are expensed as incurred and are included in employee compensation and benefits and professional and consulting fees in the Statement of Operations, respectively.

7. Income Taxes

The provision for income taxes consists of the following:

Current:

Federal	\$ 55,026,980
State and local	<u>8,953,950</u>
Total current provision	<u>63,980,930</u>

Deferred:

Federal	2,595,902
State and local	<u>670,419</u>
Total deferred provision	<u>3,266,321</u>
Provision for income taxes	<u>\$ 67,247,251</u>

The difference between the Company's reported provision for income taxes and the U.S. Federal statutory rate of 35% is as follows:

Federal tax at statutory rate	\$ 63,399,896	35.0%
State and local taxes, net of federal benefit	6,243,997	3.4%
Other, net	<u>(2,396,642)</u>	<u>(1.3%)</u>
Provision for income taxes	<u>\$ 67,247,251</u>	<u>37.1%</u>

The following is a summary of the Company's net deferred tax assets:

Net operating loss carryforwards	\$ 1,908,714
Stock-based compensation	4,481,584
Other	<u>438,057</u>
Total deferred tax as sets	<u>6,828,355</u>
Depreciation and amortization	<u>(5,554,522)</u>
Deferred tax assets, net	<u>\$ 1,273,833</u>

MarketAxess Corporation

(A wholly-owned subsidiary of MarketAxess Holdings Inc.)

Notes to Financial Statements, continued

December 31, 2016

In 2001, the Company had an ownership change within the meaning of Section 382 of the Internal Revenue Code. As of December 31, 2016, the Company had restricted U.S. federal net operating loss carryforwards of \$5,435,425, which begin to expire in 2021. The Company's net operating loss carryforwards may be subject to additional annual limitations if there is a 50% or greater change in the Company's ownership, as determined over a rolling three-year period.

The Company or Parent files U.S. federal, state and local income tax returns. Income tax returns for U.S. Federal (through 2013), for New York City (through 2003) and state (through 2009) and Connecticut state (through 2003) tax returns have been audited. An examination of the Parent's New York State income tax returns for 2010 through 2012 is currently underway. The Company cannot estimate when the examination will conclude or the impact such examination will have on the Company's financial statements, if any.

The unrecognized tax benefits balance decreased by \$235,721 during the year ended December 31, 2016. This was a result of the release of reserve due to finalization of the IRS audit.

8. Affiliate transactions

The Company allocates total compensation costs for legal and compliance, finance and accounting, sales and marketing, IT and trade support and general management personnel to an affiliate. The allocated costs are based on an internal methodology and amounted to \$589,168 for the year ended December 31, 2016. The amount due from the affiliate was \$682,676 as of December 31, 2016 and is included in accounts receivable on the Statement of Financial Condition.

The Company incurred allocated expenses from the Parent including occupancy, utilities and office maintenance, audit, insurance and depreciation and amortization of leasehold improvements and furniture and fixtures based on an internal methodology. The allocated costs were \$3,402,016 for the year ended December 31, 2016. The amount due to the Parent was \$8,703,659 and is primarily comprised of federal and income state taxes payable to the Parent as of December 31, 2016 and is included in accounts payable and other liabilities on the Statement of Financial Condition.

The Company allocates charges for shared resources to an affiliate. The amount receivable from this affiliate was \$54,221 as of December 31, 2016 and is included in accounts receivable on the Statement of Financial Condition.

Pursuant to an intermediary services agreement with an affiliate, the Company provides access to its trading platform for certain users located in Canada. In addition, the Company provides sales and customer support, legal and compliance and finance and accounting services to this affiliate. The Company charges the affiliate transaction fees for these services. The transaction fees amounted to \$1,361,800 and are included in other revenues to affiliates in the Statement of Operations for the year ended December 31, 2016. The amount due to the affiliate was \$11,246 as of December 31, 2016 and is included in accounts payable and other liabilities on the Statement of Financial Condition.

The Company provides support for an overseas affiliate that operates a trading platform for certain users principally located in Europe and Asia. The Company also provides marketing, legal and compliance and finance and accounting services to this affiliate. This affiliate provides intermediary services to the Company for sales and customer support for clients in the region that trade U.S. products. The net costs charged to the Company by this affiliate amounted to \$23,362,626 and are included in service agreement fees to affiliates in the Statement of Operations for the year ended December 31, 2016. The amount due from the affiliate was \$2,673,354 as of December 31, 2016 and is included in accounts payable and other liabilities on the Statement of Financial Condition.

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An affiliate provides the Company with trade matching, regulatory transaction reporting and market data services. The related costs charged to the Company by this affiliate amounted to \$1,013,169. This amount is offset by charges of \$470,963 for IT services and related infrastructure support that the Company provides to this affiliate, at cost. These amounts are included in service agreement fees to affiliates in the Statement of Operations for the year ended December 31, 2016. The amount due to the affiliate was \$175,336 as of December 31, 2016 and is included in accounts payables and other liabilities on the Statement of Financial Condition.

An affiliate provides sales and customer support to the Company for certain clients located in Latin America. The related costs charged to the Company by this affiliate amounted to \$1,305,353 and are included in other revenues in the Statement of Operations for the year ended December 31, 2016. The amount due to the affiliate was \$225,609 as of December 31, 2016 and is included in accounts payable and other liabilities on the Statement of Financial Condition.

9. Stock-based Compensation Plans

The Company's employees participate in the stock incentive plan of the Parent. Stock compensation expense related to restricted stock and stock options was \$6,200,744 and is included in employee compensation and benefits in the Statement of Operations.

Stock Options

The exercise price of each option granted is equal to the market price of the Parent's common stock on the date of grant. Generally, option grants have provided for vesting over a three or five-year period. Options generally expire in six or ten years from the date of grant. The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model ("Black-Scholes"). The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Parent's stock price as well as assumptions regarding a number of highly complex and subjective variables, including the expected stock price volatility over the term of the awards, the risk-free interest rate, the expected dividend yield rate and the expected term. Expected volatilities are based on historical volatility of the Parent's stock. The risk-free interest rate is based on U.S. Treasury securities with a maturity value approximating the expected term of the option. The dividend yield rate is based on the expected annual dividends to be paid divided by the expected stock price. The expected term represents the period of time that options granted are expected to be outstanding based on actual and projected employee stock option exercise behavior.

The weighted-average fair value for options granted during 2016 was \$32.35. The following table represents the assumptions used for Black-Scholes to determine the per share weighted-average fair value for options granted for the year ended December 31, 2016:

Expected life (years)	6.00
Risk-free interest rate	1.93%
Expected volatility	33.03%
Expected dividend yield	1.01%

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The following table reports stock option activity for the year ended December 31, 2016 and the intrinsic value as of December 31, 2016:

	Number of Shares	Weighted Average Exercise Price (\$)	Remaining Contractual Term	Intrinsic Value (\$)
Outstanding at December 31, 2015	122,225	13.21		
Granted	68,866	103.14		
Exercised	(47,257)	12.90		5,235,582
Cancelled	(874)	101.77		
Outstanding at December 31, 2016	142,960	56.10	3.19	12,984,234
Exercisable at December 31, 2016	74,526	13.07	1.45	9,975,199

The intrinsic value is the amount by which the closing price of the Parent's common stock on December 31, 2016 of \$146.92 or the price on the day of exercise exceeds the exercise price of the stock options multiplied by the number of shares. As of December 31, 2016, there was \$1,931,743 of total unrecognized compensation cost related to non-vested stock options. That cost is expected to be recognized over a weighted-average period of 3.88 years.

Restricted Stock and Performance Shares

Restricted stock generally vests over a three or five-year period. Compensation expense is measured at the grant date and recognized ratably over the vesting period. Annual performance share awards are granted to certain officers and senior managers. Each performance share award is earned or forfeited based on the level of achievement by the Parent of pre-tax operating income, as defined. The pay-out ranges from zero to 150% of the performance share award. For each performance share earned, a participant is awarded an equal number of shares of restricted stock. Any restricted stock awarded to a participant vests and ceases to be restricted stock in two equal installments on each of the second and third anniversaries of the date of grant of the applicable performance share award. Compensation expense for performance shares is measured at the grant date and recognized on a graded basis over the vesting period.

The following table reports performance share activity for annual awards for the year ended December 31, 2016:

Share pay-out at plan	2,070
Actual share pay out in the following year	2,881
Weighted average fair value per share on grant date	\$101.77

In January 2016, the Company granted 26,576 multi-year performance shares to certain officers and senior managers. Each performance share award is earned or forfeited based on the level of achievement by the Company of aggregate operating income over the three year period beginning January 1, 2016. The pay-out ranges from zero to 150% of the performance award value. Any restricted stock awarded will vest 50% on January 31, 2020 and 50% on January 31, 2021. The fair value per share of the awards on the grant date was \$103.30.

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December 31, 2016

The following table reports restricted stock and performance share activity during the year ended December 31, 2016:

	Number of Restricted Shares	Weighted- Average Grant Date Fair Value
Outstanding at December 31, 2015	167,820	\$ 58.61
Granted	65,355	
Performance share pay-out	12,971	
Forfeited	(85,644)	
Vested	(10,889)	
Outstanding at December 31, 2016	<u>149,613</u>	<u>\$ 53.05</u>

As of December 31, 2016, there was \$9,808,877 of total unrecognized compensation expense related to non-vested restricted stock and performance shares. That cost is expected to be recognized over a weighted-average period of 2.1 years.

Employee Stock Purchase Plan

During 2015, the Parent established a non-qualified employee stock purchase plan for non-executive employees. Under the plan, participants are granted the right to purchase shares of the Parent's common stock based on the fair market value on the last day of the six-month offering period. On the purchase date, the Parent will grant to the participants a number of shares of common stock equal to 20% of the aggregate shares purchased by the participant. These matching shares vest over a one-year period. The Parent issued 1,009 matching shares in connection with the plan for the year ended December 31, 2016.

10. Commitments and Contingencies

Credit Agreement

In January 2013, the Parent entered into a three-year credit agreement that provided for revolving loans and letters of credit up to an aggregate of \$50,000,000. In October 2015, the Parent entered into an amended and restated credit agreement (the "Credit Agreement") increasing the borrowing capacity to an aggregate of \$100,000,000, including a \$5,000,000 sub-limit for standby letters of credit. The Credit Agreement will mature in October 2017. As of December 31, 2016, the Parent had \$939,016 in letters of credit outstanding and \$99,060,984 in available borrowing capacity under the Credit Agreement. Subject to certain specified conditions, the Parent is permitted to upsize the borrowing capacity under the Credit Agreement by an additional \$50,000,000. The Parent's borrowings under the Credit Agreement are collateralized by first priority pledges (subject to permitted liens) of substantially all of the Parent's personal property assets, including the equity interest of the Parent in the Company.

Other

The Company executes certain bond transactions between and among institutional investor and broker-dealer clients on a matched principal basis by serving as counterparty to both the buyer and the seller in trades which settle through a third-party clearing broker. Settlement typically occurs within one to three trading days after the trade date. Cash settlement of the transaction occurs upon receipt or delivery of the underlying instrument that was traded. For the year ended December 31, 2016, revenue from matched principal trading was approximately \$30,534,099. Under a securities clearing agreement with a third-party clearing broker, the Company maintains a collateral deposit with the clearing broker in the form of cash. As of December 31, 2016, the amount of the collateral deposit included in prepaid expenses and other assets in the Statements of Financial Condition was \$500,000. For the year ended December 31, 2016, clearing expense associated with matched principal transactions was \$3,587,995 and is classified under general and administrative expense in the Statement of Operations. The Company is exposed to credit risk in the event a counterparty does not fulfill its obligation to complete a transaction or if there is a miscommunication or other error in executing a matched principal transaction. Pursuant to the terms of the securities

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December 31, 2016

clearing agreement, the clearing broker has the right to charge the Company for any losses they suffer resulting from a counterparty's failure on any of the Company's trades. The Company did not record any liabilities or losses with regard to this right for the year ended December 31, 2016.

11. Retirement and Deferred Compensation Plans

The Parent offers the Company's employees the opportunity to participate in a defined contribution 401(k) plan (the "401(k) Plan"). Participation in the 401(k) Plan is available to all full time employees of the Company. The Company made \$987,858 in matching contributions to the 401(k) Plan for the year ended December 31, 2016.

In 2015, the Parent adopted a non-qualified deferred cash incentive plan for certain officers and other employees. Under the plan, eligible employees may defer up to 100% of their annual cash incentive pay. The Parent has elected to fund its deferred compensation obligations through a rabbi trust. The rabbi trust is subject to creditor claims in the event of insolvency but such assets are not available for general corporate purposes. Assets held in the rabbi trust are invested in mutual funds, as selected by the participants, which are designated as trading securities and carried at fair value. The initial deferrals occurred in January 2016 and as of December 31, 2016, the fair value of the mutual fund investments and deferred compensation obligation were \$446,520. Changes in the fair value of securities held in the rabbi trust are recognized as trading gains and losses and included in other revenues and offsetting increases or decreases in the deferred compensation obligation are recorded in employee compensation and benefits. For the year ended December 31, 2016, the trading gains and compensation expense were each \$61,520.

12. Subsequent Events

The Company evaluated whether any other events or transactions occurred subsequent to the date of Statement of Financial Condition until February 21, 2017, and determined that there were no additional material events or transactions that would require recognition or disclosure in these financial statements.

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Computation of Net Capital under Rule 15c3-1
of the Securities and Exchange Commission
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Supplementary Schedule I

Net Capital	
Total shareholder's equity	\$ 151,821,811
Deductions	
Nonallowable assets included in the following captions from the statement of financial condition	
Investments, at fair value	446,520
Accounts receivable, net	49,347,874
Equipment, net	7,636,687
Software development costs, net	12,864,814
Prepaid expenses and other assets	4,524,077
Deferred tax assets, net	1,273,833
Net Capital before haircuts on securities positions	75,728,006
Haircut on money market funds included in cash and cash equivalents and corporate debt	(3,000,476)
Net capital	72,727,530
Required net capital (greater of \$ 250,000 or 6-2/3% of aggregate indebtedness)	2,759,386
Excess net capital	\$ 69,968,144
Aggregate indebtedness included in statement of financial condition	\$ 41,390,776
Ratio of aggregate indebtedness to net capital	0.57 to 1

There are no material differences between the calculation above and the Company's unaudited FOCUS Report as of December 31, 2016.