

ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
May 03, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2019
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____
COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.
(Exact Name of Registrant as Specified in its Charter)
MARYLAND 22-3479661
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

1211 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10036
(Address of principal executive offices) (Zip Code)
(212) 696-0100
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

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Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	NLY	New York Stock Exchange
7.625% Series C Cumulative Redeemable Preferred Stock	NLY.C	New York Stock Exchange
7.50% Series D Cumulative Redeemable Preferred Stock	NLY.D	New York Stock Exchange
6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	NLY.F	New York Stock Exchange
6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	NLY.G	New York Stock Exchange
8.125% Series H Cumulative Redeemable Preferred Stock	NLY.H	New York Stock Exchange

The number of shares of the registrant's Common Stock outstanding on April 30, 2019 was 1,456,197,143.

ANNALY CAPITAL MANAGEMENT, INC.
FORM 10-Q
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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in thousands, except per share data)

	March 31, 2019 (Unaudited)	December 31, 2018 ⁽¹⁾
Assets		
Cash and cash equivalents (includes pledged assets of \$1,338,507 and \$1,581,775, respectively) ⁽²⁾	\$ 1,522,605	\$ 1,735,749
Securities (includes pledged assets of \$95,845,559 and \$87,193,316, respectively) ⁽³⁾	104,993,271	92,623,788
Loans, net (includes pledged assets of \$2,243,369 and \$2,997,051, respectively) ⁽⁴⁾	3,879,324	4,585,975
Mortgage servicing rights (includes pledged assets of \$3,260 and \$3,616, respectively)	500,745	557,813
Assets transferred or pledged to securitization vehicles	4,365,300	3,833,200
Real estate, net	734,239	739,473
Derivative assets	148,178	200,503
Reverse repurchase agreements	523,449	650,040
Receivable for unsettled trades	1,574,251	68,779
Interest receivable	390,930	357,365
Goodwill and intangible assets, net	98,551	100,854
Other assets	441,706	333,988
Total assets	\$ 119,172,549	\$ 105,787,527
Liabilities and stockholders' equity		
Liabilities		
Repurchase agreements	\$ 88,554,170	\$ 81,115,874
Other secured financing	4,144,623	4,183,311
Debt issued by securitization vehicles	3,693,766	3,347,062
Mortgages payable	510,386	511,056
Derivative liabilities	775,980	889,750
Payable for unsettled trades	4,763,376	583,036
Interest payable	424,391	570,928
Dividends payable	434,431	394,129
Other liabilities	89,982	74,580
Total liabilities	103,391,105	91,669,726
Stockholders' equity		
Preferred stock, par value \$0.01 per share, 75,950,000 authorized, 73,400,00 issued and outstanding	1,778,168	1,778,168
Common stock, par value \$0.01 per share, 1,924,050,000 authorized, 1,448,103,248 and 1,313,763,450 issued and outstanding, respectively	14,481	13,138
Additional paid-in capital	20,112,875	18,794,331
Accumulated other comprehensive income (loss)	(319,376)	(1,979,865)
Accumulated deficit	(5,809,931)	(4,493,660)
Total stockholders' equity	15,776,217	14,112,112
Noncontrolling interests	5,227	5,689
Total equity	15,781,444	14,117,801
Total liabilities and equity	\$ 119,172,549	\$ 105,787,527

- (1) Derived from the audited consolidated financial statements at December 31, 2018.
- (2) Includes cash of consolidated Variable Interest Entities (“VIEs”) of \$40.7 million and \$30.4 million at March 31, 2019 and December 31, 2018, respectively.
Excludes \$273.4 million and \$83.6 million at March 31, 2019 and December 31, 2018, respectively, of
- (3) non-Agency mortgage-backed securities and \$246.6 million and \$224.3 million at March 31, 2019 and December 31, 2018, respectively, of commercial mortgage-backed securities in consolidated VIEs pledged as collateral and eliminated from the Company’s Consolidated Statements of Financial Condition.
Includes \$101.3 million and \$97.5 million of residential mortgage loans held for sale, \$42.0 million and \$42.2
- (4) million of commercial mortgage loans held for sale and \$44.5 million and \$0 of corporate loans held for sale at March 31, 2019 and December 31, 2018, respectively.

See notes to consolidated financial statements.

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(dollars in thousands, except per share data)

(Unaudited)

	For The Three Months Ended March 31,	
	2019	2018
Net interest income		
Interest income	\$866,186	\$ 879,487
Interest expense	647,695	367,421
Net interest income	218,491	512,066
Realized and unrealized gains (losses)		
Net interest component of interest rate swaps	134,035	(48,160)
Realized gains (losses) on termination or maturity of interest rate swaps	(588,256)	834
Unrealized gains (losses) on interest rate swaps	(390,556)	977,285
Subtotal	(844,777)	929,959
Net gains (losses) on disposal of investments	(93,916)	13,468
Net gains (losses) on other derivatives	(115,159)	(47,145)
Net unrealized gains (losses) on instruments measured at fair value through earnings	47,629	(51,593)
Loan loss provision	(5,703)	—
Subtotal	(167,149)	(85,270)
Total realized and unrealized gains (losses)	(1,011,926)	844,689
Other income (loss)	30,502	34,023
General and administrative expenses		
Compensation and management fee	44,833	44,529
Other general and administrative expenses	38,904	17,981
Total general and administrative expenses	83,737	62,510
Income (loss) before income taxes	(846,670)	1,328,268
Income taxes	2,581	564
Net income (loss)	(849,251)	1,327,704
Net income (loss) attributable to noncontrolling interests	(101)	(96)
Net income (loss) attributable to Annaly	(849,150)	1,327,800
Dividends on preferred stock	32,494	33,766
Net income (loss) available (related) to common stockholders	\$(881,644)	\$ 1,294,034
Net income (loss) per share available (related) to common stockholders		
Basic	\$(0.63)	\$ 1.12
Diluted	\$(0.63)	\$ 1.12
Weighted average number of common shares outstanding		
Basic	1,398,614,205	1,159,617,848
Diluted	1,398,614,205	1,160,103,185
Other comprehensive income (loss)		
Net income (loss)	\$(849,251)	\$ 1,327,704
Unrealized gains (losses) on available-for-sale securities	1,599,398	(1,879,479)
Reclassification adjustment for net (gains) losses included in net income (loss)	61,091	5,419
Other comprehensive income (loss)	1,660,489	(1,874,060)
Comprehensive income (loss)	811,238	(546,356)
Comprehensive income (loss) attributable to noncontrolling interests	(101)	(96)
Comprehensive income (loss) attributable to Annaly	811,339	(546,260)

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Dividends on preferred stock	32,494	33,766
Comprehensive income (loss) attributable to common stockholders	\$778,845	\$(580,026)

See notes to consolidated financial statements.

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(dollars in thousands)

(Unaudited)

	For The Three Months Ended March 31,	
	2019	2018
Preferred stock		
Beginning of period	\$ 1,778,168	\$ 1,720,381
Issuance	—	411,335
Redemption	—	(408,548)
End of period	\$ 1,778,168	\$ 1,723,168
Common stock		
Beginning of period	\$ 13,138	\$ 11,596
Issuance	1,342	—
Direct purchase and dividend reinvestment	1	1
End of period	\$ 14,481	\$ 11,597
Additional paid-in capital		
Beginning of period	\$ 18,794,331	\$ 17,221,265
Stock compensation expense	178	133
Issuance	1,317,475	—
Redemption of preferred stock	—	(3,952)
Direct purchase and dividend reinvestment	891	745
End of period	\$ 20,112,875	\$ 17,218,191
Accumulated other comprehensive income (loss)		
Beginning of period	\$ (1,979,865)	\$ (1,126,020)
Unrealized gains (losses) on available-for-sale securities	1,599,398	(1,879,479)
Reclassification adjustment for net gains (losses) included in net income (loss)	61,091	5,419
End of period	\$ (319,376)	\$ (3,000,080)
Accumulated deficit		
Beginning of period	\$ (4,493,660)	\$ (2,961,749)
Net income (loss) attributable to Annaly	(849,150)	1,327,800
Dividends declared on preferred stock ⁽¹⁾	(32,494)	(33,766)
Dividends and dividend equivalents declared on common stock and share-based awards ⁽¹⁾	(434,627)	(347,897)
End of period	\$ (5,809,931)	\$ (2,015,612)
Total stockholder's equity	\$ 15,776,217	\$ 13,937,264
Noncontrolling interests		
Beginning of period	\$ 5,689	\$ 6,100
Net income (loss) attributable to noncontrolling interests	(101)	(96)
Equity contributions from (distributions to) noncontrolling interests	(361)	(333)
End of period	\$ 5,227	\$ 5,671
Total equity	\$ 15,781,444	\$ 13,942,935

⁽¹⁾ See Note titled "Capital Stock" for dividends per share for each class of shares.

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

	For The Three Months Ended March 31,	
	2019	2018
Cash flows from operating activities		
Net income (loss)	\$(849,251)	\$ 1,327,704
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Amortization of premiums and discounts of investments, net	246,150	92,976
Amortization of securitized debt premiums and discounts and deferred financing costs	(3,627)	408
Depreciation, amortization and other noncash expenses	7,072	5,822
Net (gains) losses on disposals of investments	93,916	(13,468)
Net (gains) losses on investments and derivatives	458,086	(878,547)
Income from unconsolidated joint ventures	1,960	618
Loan loss provision	5,703	—
Payments on purchases of loans held for sale	(49,070)	(37,190)
Proceeds from sales and repayments of loans held for sale	44,817	30,178
Net receipts (payments) on derivatives	(633,221)	951,021
Net change in		
Other assets	(107,040)	(42,361)
Interest receivable	(29,491)	(2,963)
Interest payable	(146,537)	31,628
Other liabilities	18,436	(132,910)
Net cash provided by (used in) operating activities	(942,097)	1,332,916
Cash flows from investing activities		
Payments on purchases of residential securities	(18,374,100)	(3,718,947)
Proceeds from sales of residential securities	7,822,334	463,214
Principal payments on residential securities	2,343,383	2,696,245
Payments on purchases of MSRs	—	(249)
Payments on purchases of corporate debt	(125,351)	(230,103)
Proceeds from sales of corporate debt	179,112	—
Principal payments on corporate debt	33,545	92,820
Originations and purchases of commercial real estate investments	(269,489)	(91,647)
Proceeds from sales of commercial real estate investments	41,013	9,556
Principal repayments on commercial real estate investments	578,031	130,555
Proceeds from sales of real estate	6,661	—
Proceeds from reverse repurchase agreements	28,107,306	20,050,112
Payments on reverse repurchase agreements	(27,980,715)	(20,250,571)
Distributions in excess of cumulative earnings from unconsolidated joint ventures	241	2,813
Payments on purchases of residential mortgage loans held for investment	(373,745)	(167,124)
Proceeds from repayments of residential mortgage loans held for investment	107,783	67,384
Net cash provided by (used in) investing activities	(7,903,991)	(945,942)
Cash flows from financing activities		
Proceeds from repurchase agreements and other secured financing	1,411,469,975	1,299,589,620
Principal payments on repurchase agreements and other secured financing	(1,404,070,367)	(1,299,277,944)
Proceeds from issuances of securitized debt	905,265	279,203
Principal repayments on securitized debt	(561,955)	(317,773)

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Payment of deferred financing cost	(1,781) —
Net proceeds from stock offerings, direct purchases and dividend reinvestments	1,319,709	412,081
Redemptions of preferred stock	—	(412,500)
Principal payments on mortgages payable	(722) —
Net contributions (distributions) from (to) noncontrolling interests	(361) (333)
Dividends paid	(426,819) (381,642)
Net cash provided by (used in) financing activities	8,632,944	(109,288)
Net (decrease) increase in cash and cash equivalents	\$(213,144)	\$ 277,686
Cash and cash equivalents including cash pledged as collateral, beginning of period	1,735,749	706,589
Cash and cash equivalents including cash pledged as collateral, end of period	\$ 1,522,605	\$ 984,275
Supplemental disclosure of cash flow information		
Interest received	\$ 1,079,294	\$ 1,017,534
Dividends received	\$ 2,116	\$ 1,650
Interest paid (excluding interest paid on interest rate swaps)	\$ 633,805	\$ 320,988
Net interest paid on interest rate swaps	\$ 34,663	\$ 39,206
Taxes received (paid)	\$(30) \$ 2
Noncash investing activities		
Receivable for unsettled trades	\$ 1,574,251	\$ 45,126
Payable for unsettled trades	\$ 4,763,376	\$ 91,327
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	\$ 1,660,489	\$ (1,874,060)
Noncash financing activities		
Dividends declared, not yet paid	\$ 434,431	\$ 347,897
See notes to consolidated financial statements.		

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. DESCRIPTION OF BUSINESS

Annaly Capital Management, Inc. (the “Company” or “Annaly”) is a Maryland corporation that commenced operations on February 18, 1997. The Company is a leading diversified capital manager that invests in and finances residential and commercial assets. The Company owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, credit risk transfer (“CRT”) securities, other securities representing interests in or obligations backed by pools of mortgage loans, residential mortgage loans, mortgage servicing rights (“MSRs”), commercial real estate assets and corporate debt. The Company’s principal business objective is to generate net income for distribution to its stockholders and to preserve capital through prudent selection of investments and continuous management of its portfolio. The Company is externally managed by Annaly Management Company LLC (the “Manager”).

The Company’s four investment groups are primarily comprised of the following:

Investment Groups	Description
Annaly Agency Group	Invests in Agency mortgage-backed securities (“MBS”) collateralized by residential mortgages which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.
Annaly Residential Credit Group	Invests primarily in non-Agency residential mortgage assets within securitized products and residential mortgage loan markets.
Annaly Commercial Real Estate Group	Originates and invests in commercial mortgage loans, securities, and other commercial real estate debt and equity investments.
Annaly Middle Market Lending Group	Provides financing to private equity-backed middle market businesses across the capital structure.

The Company has elected to be taxed as a Real Estate Investment Trust (“REIT”) as defined under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”).

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”).

The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company’s most recent Annual Report on Form 10-K for the fiscal year ended December 31, 2018 (the “2018 Form 10-K”). The consolidated financial information as of December 31, 2018 has been derived from audited consolidated financial statements included in the Company’s 2018 Form 10-K.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported balance sheet amounts and/or disclosures at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

In the opinion of management, all normal, recurring adjustments have been included for a fair presentation of this interim financial information. Interim period operating results may not be indicative of the operating results for a full year.

3. SIGNIFICANT ACCOUNTING POLICIES

The Company’s significant accounting policies are described below or are included elsewhere in these notes to the Consolidated Financial Statements.

Principles of Consolidation – The consolidated financial statements include the accounts of the entities where the Company has a controlling financial interest. In order to determine whether the Company has a controlling financial interest, it first evaluates whether an entity is a voting interest entity (“VOE”) or a variable interest entity (“VIE”). All intercompany balances and transactions have been eliminated in consolidation.

Voting Interest Entities – A VOE is an entity that has sufficient equity and in which equity investors have a controlling financial interest. The Company consolidates VOEs where it has a majority of the voting equity of such VOE.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

Variable Interest Entities – A VIE is defined as an entity in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A VIE is required to be consolidated by its primary beneficiary, which is defined as the party that has both (i) the power to control the activities that most significantly impact the VIE’s economic performance and (ii) the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

The Company performs ongoing reassessments of whether changes in the facts and circumstances regarding the Company’s involvement with a VIE causes the Company’s consolidation conclusion to change. Refer to the “Variable Interest Entities” Note for further information.

Equity Method Investments - For entities that are not consolidated, but where the Company has significant influence over the operating or financial decisions of the entity, the Company accounts for the investment under the equity method of accounting. In accordance with the equity method of accounting, the Company will recognize its share of earnings or losses of the investee in the period in which they are reported by the investee. The Company also considers whether there are any indicators of other-than-temporary impairment of joint ventures accounted for under the equity method. These investments are included in Real estate, net and Other assets with income or loss included in Other income (loss).

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, cash held in money market funds on an overnight basis and cash pledged as collateral with counterparties. Cash deposited with clearing organizations is carried at cost, which approximates fair value. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to the Company’s interest rate swaps and other derivatives totaled \$1.3 billion and \$1.6 billion at March 31, 2019 and