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

FEB 29 2016

Washington D.C.  
409

SEC FILE NUMBER  
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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 January 1, 2015 AND ENDING December 31, 2015  
 MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER: Diffusion Markets, L.L.C.

OFFICIAL USE ONLY  
 FIRM I.D. NO.

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

1166 Avenue of the Americas, Ninth Floor

(No. and Street)

New York

(City)

NY

(State)

10036

(Zip Code)

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

Jeffrey Ahn

212-403-8584

(Area Code - Telephone Number)

**B. ACCOUNTANT IDENTIFICATION**

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report\*

Ernst & Young LLP

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

5 Times Square

(Address)

New York

(City)

NY

(State)

10036

(Zip Code)

CHECK ONE:

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

**FOR OFFICIAL USE ONLY**

\*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)

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SEC 1410 (06-02)

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AKB

**Diffusion Markets, L.L.C.**

1166 Avenue of the Americas  
Ninth Floor  
New York, NY 10036

(212) 478-0000  
Fax (212) 478-0100

## Oath or Affirmation

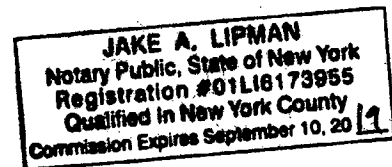
I, Stephen Rossi, swear (or affirm) that, to the best of my knowledge and belief the accompanying statement of financial condition pertaining to the firm of Diffusion Markets, L.L.C., as of December 31, 2015, is true and correct. I further swear (or affirm) that neither the Company nor any member, proprietor, principal officer, or director has any proprietary interest in any account classified solely as that of a customer.

Diffusion Markets, L.L.C.

By: Stephen Rossi  
Stephen Rossi  
Authorized Signatory

Subscribed and sworn to before  
me this 26<sup>th</sup> day of February, 2016

By: Jake A. Lipman  
Notary Public *AL*



**Diffusion Markets, L.L.C.**

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Ninth Floor  
New York, NY 10036

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**CONTENTS OF REPORT**

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

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Income.
- (d) Statement of Cash Flows.
- (e) Statement of Changes in Member's Capital.
- (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- (g) Computation of Net Capital Pursuant to Uniform Net Capital Rule 15c3-1.
- (h) Computation for Determination of Reserve Requirements for Broker-Dealers 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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Building a better  
working world

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ey.com

## Report of Independent Registered Public Accounting Firm

To the Manager of  
Diffusion Markets, L.L.C.:

We have audited the accompanying statement of financial condition of Diffusion Markets, L.L.C. (the "Company") as of December 31, 2015. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit 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 statement of financial condition is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the statement of financial condition referred to above presents fairly, in all material respects, the financial position of Diffusion Markets, L.L.C. at December 31, 2015, in conformity with U.S. generally accepted accounting principles.

February 26, 2016

*Ernst & Young LLP*

*Diffusion Markets, L.L.C.*

## **Statement of Financial Condition**

*December 31, 2015*

*(Expressed in United States dollars)*

*(in thousands)*

### **Assets**

Cash equivalents	\$	2,216
Financial instruments owned		127,567
Other assets		<u>50</u>

**Total Assets** **\$ 129,833**

### **Liabilities and Member's Capital**

Payables		
Affiliates	\$	918
Clearing broker		10,353
Financial instruments sold, but not yet purchased		<u>91,587</u>

**Total Liabilities** **102,858**

### **Commitments, Contingencies and Guarantees**

**Member's Capital** **26,975**

**Total Liabilities and Member's Capital** **\$ 129,833**

*The accompanying notes are an integral part of this statement.*

## **Notes to Statement of Financial Condition**

*Year Ended December 31, 2015*

### **1. Organization and Basis of Presentation**

Diffusion Markets, L.L.C. (the "Company") is a Delaware limited liability company. Diffusion Markets Holdings, L.L.C. ("Diffusion Holdings") is the manager (in such capacity, the "Manager") and the sole member of the Company. D. E. Shaw Asymptote Portfolios, L.L.C. ("Asymptote Portfolios") is the manager of Diffusion Holdings, and D. E. Shaw & Co., L.P. ("DESCO LP") and Asymptote Portfolios are the members of Diffusion Holdings.

The Company is a broker-dealer registered with the U. S. Securities and Exchange Commission ("SEC") and is an approved market maker on the Chicago Board Options Exchange, NYSE MKT, LLC, NYSE Arca, Inc., and the NASDAQ Options Market. The Company is also a member of the NYSE Amex Options, LLC and the NASDAQ Stock Market LLC.

The principal investment objective of the Company is to achieve positive returns from capital appreciation and income generation. The primary purpose of the Company is to purchase, sell, hold, trade, structure, and restructure securities, commodities, other financial instruments, other interests, and any other real or personal property of any kind (including cash and cash equivalents). While the Company may pursue a variety of strategies and other activities which may or may not be related to each other, it focuses predominantly on certain options-related strategies, including market making, during the year.

As of July 1, 2015, DESCO LP spun-off a substantial portion of its back- and middle-office technology platform and related staff into a new, independently operated company named Arcesium LLC ("Arcesium"). A subsidiary of DESCO LP owns the substantial majority of Arcesium, with a minority investment by a third-party. As of such date, DESCO LP engaged its affiliate, Arcesium, to provide both software services and support for a variety of post-trade and portfolio accounting functions with respect to the Company.

Nothing in this statement of financial condition or notes shall (a) create or imply any limit on the discretion of the Manager or (b) be deemed to modify any provisions of the Company's limited liability company agreement or other operating documents.

## **Notes to Statement of Financial Condition (Continued)**

*Year Ended December 31, 2015*

### **2. Significant Accounting Policies**

The Company's statement of financial condition is prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"), which may require management to use its judgment in making certain estimates. Such estimates relate primarily to the valuation of financial instruments when quoted market prices are not available, as discussed further below. It is expected that such estimates will differ from the amounts ultimately realized due to the uncertainties inherent in any such estimation process, and the differences may be material.

The statement of financial condition of the Company is expressed in United States dollars.

The Company considers short-term, highly liquid investments that are readily convertible to known amounts of cash and having original maturities of three months or less, at the time of purchase, to be cash equivalents. This may include certain government securities and money market investments. Money market investments are carried at net asset value, which approximates fair value. As of year-end, the Company's liquidity is maintained in cash equivalents which are held by HSBC Bank USA, N.A.

Receivables and payables (including those resulting from contractual commitments, and cash or other collateral) are reported net by counterparty, provided that there is a legally enforceable netting agreement and the other requirements of U.S. GAAP have been satisfied.

Dividends are recorded on the ex-dividend date, and operating and other expenses, as well as interest income and interest expense, are recorded on an accrual basis.

Principal transactions in financial instruments are recorded on a trade date basis. It should be noted that "trade date" is the date when the Company believes that all material financial and other contractual terms and conditions are determined.

Substantially all of the Company's assets and liabilities are carried at fair value or recorded at contracted amounts that approximate fair value.



## **Notes to Statement of Financial Condition (Continued)**

*Year Ended December 31, 2015*

### **2. Significant Accounting Policies (Continued)**

- a. Fair value is the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date ("Fair Value Measurement").

The Company determines the fair value of its assets and liabilities based on the fair value hierarchy established in Fair Value Measurement, which requires the Company to maximize the use of relevant observable inputs and minimize the use of unobservable inputs when measuring the fair value of its assets and liabilities.

Observable inputs are inputs that are developed using market data, such as publicly available information about actual events or transactions, and reflect the assumptions market participants would use when pricing an asset or liability. Unobservable inputs are inputs for which market data are not available and that are developed using the best information available about the assumptions market participants would use when pricing an asset or liability. The hierarchy gives the highest priority to observable inputs (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below.

- i. Level 1: Financial instruments with unadjusted quoted market prices in active markets for identical assets or liabilities. Active markets may be, but are not limited to, established securities exchanges. Financial instruments that are principally traded on a particular established securities exchange are generally valued at their "official closing" prices as determined by or published by such exchange. Financial instruments not principally traded on an established securities exchange or cleared by an established clearinghouse but actively traded over-the-counter are generally valued at the last "bid" or "ask" price or at the mean between such prices, as such prices are reported by the established quotation system for that financial instrument. Examples of Level 1 assets and liabilities include equity financial instruments and derivative financial instruments that are principally traded in active markets, as well as certain other financial instruments that are highly liquid and are actively traded in over-the-counter markets;

- ii. Level 2: Financial instruments with valuations that have observable inputs other than Level 1 prices, such as quoted market prices for similar assets or liabilities, quoted market prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the

## **Notes to Statement of Financial Condition (Continued)**

*Year Ended December 31, 2015*

### **2. Significant Accounting Policies (Continued)**

#### **a. (Continued)**

full term of the assets or liabilities. The fair value of financial instruments for which quoted market prices are not readily available may be determined based on other relevant factors, including dealer price quotations, the price activity of similar instruments, and valuation pricing models. Examples of Level 2 assets and liabilities include equity financial instruments with quoted market prices that are traded less frequently than financial instruments traded on an established securities exchange or cleared by an established clearinghouse and derivative financial instruments whose values are determined using pricing models with inputs that are observable in the market or can be derived principally from or corroborated by observable market data;

iii. Level 3: Financial instruments with valuations that have unobservable inputs that are significant to the determination of the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose values are determined using certain market standard methodologies (including market and/or income approaches) and input factors where independent pricing information cannot be obtained for a significant portion of the underlying assets or liabilities.

The DESCO LP pricing group (the "Pricing Group") determines the final valuation of the Company's investments. The Pricing Group is a unit of DESCO LP's finance and operations department that is independent of DESCO LP's trading and portfolio management functions. DESCO LP utilizes Arcesium to provide all pricing information used in connection with the valuation of non-private investments and such valuations are independently reviewed by the Pricing Group. The Pricing Group submits periodic analyses and findings to DESCO LP's Valuation Working Group ("VWG"), which comprises several senior managers, including DESCO LP's Chief Financial Officer, who manages the Pricing Group. The VWG meets on a periodic basis (primarily monthly with respect to Level 3 assets and liabilities, and quarterly with respect to any general valuation matters) to review DESCO LP's valuation processes and the findings of the Pricing Group and to discuss, among other things, significant enhancements or material exceptions to pricing methodologies and procedures. The VWG also reviews from time to time DESCO LP's written valuation policies and the Pricing Group's assessment of the quality of pricing information provided by Arcesium or obtained from third parties that is used in the valuation process.

## **Notes to Statement of Financial Condition (Continued)**

*Year Ended December 31, 2015*

### **2. Significant Accounting Policies (Continued)**

- b. Financial instruments owned and financial instruments sold, but not yet purchased may include equity securities and options. Such financial instruments are reflected on the statement of financial condition at fair value. The resulting net change in unrealized gains and losses on these financial instruments is reflected in member's capital on the statement of financial condition.

The Company accounts for the effect of uncertain tax positions in its statement of financial condition. The Company measures such tax positions against the more-likely-than-not threshold, based on whether those positions would be expected to be sustained if examined by the relevant tax authority. With respect to the tax positions that do not meet the more-likely-than-not threshold, the Company records a corresponding liability in the statement of financial condition, though no liabilities (or expenses), including interest and penalties, were deemed necessary for recording during the year. While there can be no assurances that the taxing authority in any jurisdiction will agree with the tax positions adopted by the Company, the Company does not expect that any assessments would be material to its financial position if a taxing authority did not agree with such tax positions.

### **3. Payable to Clearing Broker**

The Company enters into transactions in financial instruments with one clearing broker pursuant to clearance agreements and other collateral arrangements that subject the Company to credit and liquidity risk. Clearance agreements permit the clearing broker to pledge or otherwise hypothecate the Company's financial instruments and/or other positions, subject to certain limitations, typically based on the Company's margin borrowings. Substantially all financial instruments owned, as well as cash with the clearing broker, are held as collateral against various margin obligations and as collateral against financial instruments sold, but not yet purchased. The clearing broker may also liquidate such financial instruments and/or other positions where required collateral is not posted on a timely basis.

The table below provides a breakdown of amounts included in payable to clearing broker on the Company's statement of financial condition.

## Notes to Statement of Financial Condition (Continued)

Year Ended December 31, 2015

### 3. Payable to Clearing Broker (Continued)

Clearing Broker Overview (in thousands)

	<i>Payable</i>
Margin Borrowings <sup>(1)</sup>	\$ 18,253
Amounts Not Yet Settled <sup>(2)</sup>	(8,693)
Fees Payable	784
Other	9
<b>Net Exposure</b>	<b>\$ <u>10,353</u></b>

<sup>(1)</sup> Margin Borrowings may include cash deposited towards margin obligations for exchange-traded option contracts.

<sup>(2)</sup> Amounts Not Yet Settled may include (a) amounts associated with unsettled trades in financial owned and/or financial instruments sold, but not yet purchased and (b) realized balances on certain derivative financial instruments which are pending settlement.

### 4. Related Party Transactions

The Manager may utilize DESCO LP and other affiliates (collectively, the “Shaw-Related Entities”), directly and/or indirectly, to provide substantially all personnel, administrative functions, overhead, and other services with respect to the Company. In consideration for providing these services and in accordance with the applicable operating documents, the Company directly and/or indirectly reimburses the Shaw-Related Entities. Payable to affiliates represents net amounts due to the Shaw-Related Entities with respect to such charged amounts. Any receivables and/or payables resulting from the aforementioned related party transactions are due on demand.

### 5. Regulatory Considerations and Net Capital Requirement

As a registered broker-dealer, the Company is subject to Rule 15c3-1 of the SEC, which specifies uniform net capital requirements for registered broker-dealers. The Company has elected the alternative net capital method permitted and as defined by Rule 15c3-1, which requires that it maintain minimum net capital, equal to the greater of \$250,000 or two percent of aggregate debit items arising from customer transactions. At December 31, 2015, the Company had net capital, calculated based on SEC Rule 15c3-1 requirements, of approximately \$19.6 million, which exceeded the minimum requirement by approximately \$19.3 million.

## Notes to Statement of Financial Condition (Continued)

Year Ended December 31, 2015

### 6. Certain Financial Instruments, Associated Risks and Off-Balance-Sheet Risk

In the normal course of business, the Company enters into transactions in financial instruments sold, but not yet purchased and derivative financial instruments, primarily (a) for the purpose of hedging its exposure to risk, and (b) in connection with its normal investing activities. Risk in these transactions arises from changes in the fair value of the underlying financial instruments.

Through the use of hedging strategies and various credit-monitoring techniques, the Company attempts to reduce its exposure to certain market risk arising from the use of these financial instruments with on- and off-balance-sheet risk. A further description of the Company's financial instruments with off-balance-sheet risk appears below.

#### *a. Financial Instruments Sold, But Not Yet Purchased*

Financial instruments sold, but not yet purchased represent obligations to deliver specified financial instruments at contracted prices, thereby creating liabilities to purchase such financial instruments at some date in the future at then-prevailing market prices, thus subjecting the Company to market risk.

#### *b. Derivative Financial Instruments*

Derivative financial instruments contain varying degrees of off-balance-sheet risk, whereby the occurrence of certain credit events, or changes in interest rates, equity indices, or the fair value of the underlying financial instruments may result in losses in excess of any amounts reflected on the statement of financial condition. The specific types of derivative financial instruments traded by the Company are described as follows:

Option contracts written are derivative financial instruments that provide a counterparty with (a) the right, but not the obligation, to purchase or sell financial instruments at a specified price on or before a specified future date, or (b) the right to exchange cash flows based on the changes in the values of the financial instruments underlying the option contract. A premium is received by the option contract writer in exchange for bearing the risk of unfavorable changes in the values of the financial instruments underlying the option contract.

**Notes to Statement of Financial Condition (Continued)**

Year Ended December 31, 2015

**6. Certain Financial Instruments, Associated Risks and Off-Balance-Sheet Risk (Continued)****b. Derivative Financial Instruments (Continued)**

The following table identifies the fair value of the Company's derivative assets, and derivative liabilities, and their average notional amounts, each on a gross basis, categorized by each derivative financial instrument's primary underlying risk, as determined by management. Management believes that average notional amounts are an indication of volume because of the relatively constant activity throughout the year.

At December 31, 2015, the fair value of the Company's derivative financial instruments was as follows (in thousands):

<i>Primary Underlying Risk</i>	<i>Derivative Assets</i>	<i>Derivative Liabilities</i>	<i>Gross Average Notional Amounts</i>
Equity Contracts			
Exchange-Traded	\$ 72,406	\$ (62,301)	\$ 2,383,319
<b>Total Derivative Financial Instruments, Gross</b>	<b>72,406</b>	<b>(62,301)</b>	<b>\$ 2,383,319</b>
Counterparty Netting	-	-	
<b>Fair Value</b>	<b>72,406</b>	<b>(62,301)</b>	
Collateral Received/Paid	(21,159)	18,859	
<b>Total Derivative Financial Instruments, Net</b>	<b>51,247</b>	<b>(43,442)</b>	

The fair value amounts in the table above are presented on the statement of financial condition as either financial instruments owned or financial instruments sold, but not yet purchased. The derivative financial instruments included in the table above, are subject to netting agreements, however, they are presented gross because management has either (i) made an election not to net, (ii) not yet determined the relevant agreement to be enforceable, or (iii) determined the relevant netting agreement is not enforceable.

Due to the fact that the Company receives or posts cash collateral pursuant to cross margining arrangements under its agreements with its clearing broker, the cash

## Notes to Statement of Financial Condition (Continued)

Year Ended December 31, 2015

### 6. Certain Financial Instruments, Associated Risks and Off-Balance-Sheet Risk (Continued)

#### *b. Derivative Financial Instruments (Continued)*

collateral received/paid amount presented in the table above is an amount calculated to represent the amount of collateral associated with each derivative financial instrument, limited to the fair value of the instrument in accordance with U.S. GAAP and thus does not represent the total aggregate cash collateral received/paid that is associated with the instrument.

While, individually, these derivative financial instruments carry the risks referred to above, the measurement of risk associated with these instruments is meaningful only when all related and offsetting transactions used to limit (though not eliminate) certain risks to the Company are identified. In any case, it should be noted that the Company's exposure to credit risks associated with counterparty nonperformance on these instruments is limited to the fair value of such contracts (as well as any cash or other collateral on such contracts). It is the Company's policy to monitor its exposure to credit risks, to pledge collateral where deemed necessary, and to obtain collateral where permitted and deemed necessary.

### 7. Fair Value Measurements

Based upon the fair value hierarchy established in Fair Value Measurements, the Company's assets and liabilities that are recorded at fair value have been categorized, as discussed further in Note 2.

**Notes to Statement of Financial Condition (Continued)**

Year Ended December 31, 2015

**7. Fair Value Measurements (Continued)**

The following table presents information about the Company's assets and liabilities measured at fair value and assigned a hierarchy as of year-end.

	<i>(in thousands)</i>			
	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	<i>Total</i>
<i>Assets</i>				
Cash Equivalents	\$ 2,216	\$ -	\$ -	\$ 2,216
Financial Instruments Owned				
Common Stock	55,161	-	-	55,161
Options	<u>60,332</u>	<u>12,074</u>	<u>-</u>	<u>72,406</u>
<b>Assets, at Fair Value</b>	<b><u>\$ 117,709</u></b>	<b><u>\$ 12,074</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 129,783</u></b>
<i>Liabilities</i>				
Financial Instruments Sold, but Not Yet Purchased				
Common Stock	\$ 29,286	\$ -	\$ -	\$ 29,286
Options	<u>56,539</u>	<u>5,762</u>	<u>-</u>	<u>62,301</u>
<b>Liabilities, at Fair Value</b>	<b><u>\$ 85,825</u></b>	<b><u>\$ 5,762</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 91,587</u></b>

**8. Commitments, Contingencies and Guarantees**

The Company may trade and hold certain derivative financial instruments, such as written put options which may constitute guarantees. As of year-end, the Company holds written put option contracts with expiration dates ranging from January 2016 to January 2018. The Company's maximum payout for each written put option is limited to the notional amount of the relevant option, which in the aggregate was \$531.1 million. Maximum payouts may be offset by the subsequent sale of assets received by the Company in the settlement of the relevant written put option. The aggregate fair value of the Company's written put options amounted to \$22.3 million.

While individually written put options carry the risks referred to above, the measurement of risk associated with these instruments is meaningful only when all related and offsetting transactions used to limit (though not eliminate) certain risks to the Company are identified.



## **Notes to Statement of Financial Condition (Continued)**

*Year Ended December 31, 2015*

### **8. Commitments, Contingencies and Guarantees (Continued)**

Finally, in the normal course of business, the Company enters into certain contracts that provide a variety of indemnities. The Company's maximum exposure under these indemnities is generally unknown. However, no claims have been made under these indemnities in the past, and while there can be no assurances in this regard, the Company is not aware of any such claims that may be made in the future. Therefore, the Company does not consider it necessary to record a liability for these indemnities under U.S. GAAP.

### **9. Subsequent Events**

The Company has evaluated events subsequent to year-end through February 26, 2016, the date the statement of financial condition was available to be issued, and there is nothing material to disclose.

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409

Diffusion Markets, L.L.C.

## **Statement of Financial Condition**

December 31, 2015