



Government

Securities

Clearing

Corporation

1994

Annual

Report

Government Securities Clearing Corporation (GSCC) was established in 1986 to offer centralized clearance and settlement services for U.S. Government securities transactions.

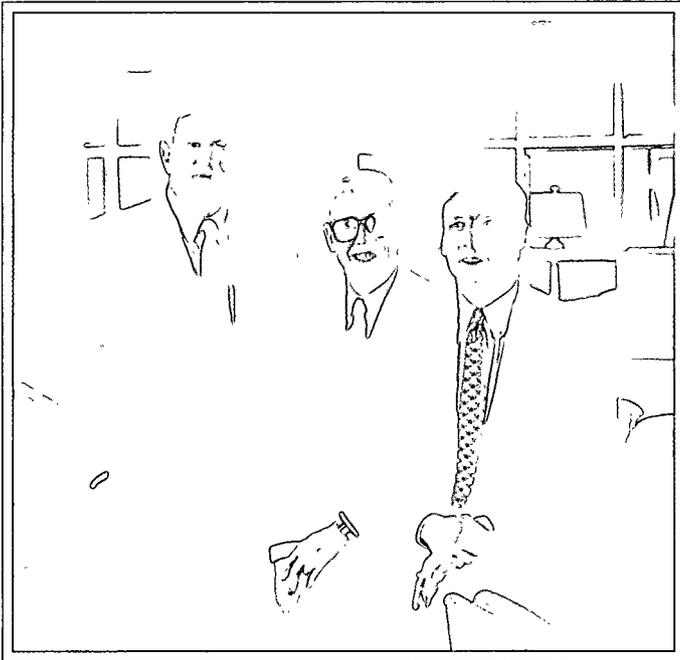
GSCC provides brokers, dealers, and other firms active in the Government debt market with automated comparison, netting and settlement services. Market participants that trade Treasury bills, notes, bonds and zero-coupon securities, and non-mortgage-backed agency securities, benefit from the operational efficiencies and risk management advantages afforded by GSCC.

The Board of Directors guides GSCC in addressing the needs of participant firms, and works closely with management to ensure that GSCC continues to offer high-quality products and services to its 91 members and to the 300 correspondents that clear through members. The Board is composed primarily of representatives of GSCC participant shareholders.

GSCC is an affiliate of National Securities Clearing Corporation (NSCC) and is registered with and regulated by the Securities and Exchange Commission (SEC).

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To our participants



David M. Kelly

Vice Chairman, Government Securities
Clearing Corporation

Charles A. Moran

President, Government Securities
Clearing Corporation

John G. Macfarlane III

Chairman of the Board, Government
Securities Clearing Corporation

In 1994, GSCC successfully processed record volume for the Government securities industry and met the challenges that arose from growing trading volume and an increasing membership base.

Over the years, we have accomplished the initial goals that were established in GSCC's charter. Our clearance and settlement systems servicing the Government securities marketplace have performed exceptionally well, and we have succeeded in providing participants with safe and efficient transaction processing, along with the risk management benefits that stem from our services.

A look at the past five years demonstrates the growth in GSCC's business and membership. Between 1990 and 1994, the average daily value of U.S. Government securities trades compared by GSCC more than doubled from \$128 billion to \$273 billion. In 1990, GSCC compared, netted and settled 3.1 million trades worth \$21.9 trillion; by 1994, the number of netted transactions had jumped to 6.4 million, and the value of those trades had nearly tripled to \$63.3 trillion. In the same five-year time frame, the number of GSCC members rose 54% to 91 from 59.

To manage this rising volume and the increased demand for services, GSCC completed a number of projects over the years that expanded services for existing members, as well as extended the benefits of GSCC membership to a broader range of participants and activities.

Among these projects was GSCC's yield-to-price service, which streamlined comparison processing of when-issued trades. In addition, improvements to GSCC's technology platform led to processing systems that are more flexible, easier to use, and operationally superior. Changes to the clearing fund process provided members with more options for collateralizing their margin obligations, while the tightening of margin call collection timeframes strengthened the risk protection that GSCC offers its members. New membership categories established over the years have resulted in an ever-widening circle of firms that use GSCC's services. And the "executing firm" feature opened access to GSCC to many firms that are not direct members.

During 1994, GSCC took additional steps to meet the growing needs of the Government securities market, and a number of milestones were reached. For the first time, GSCC handled the settlement of more than \$1 trillion in securities in a single day – demonstrating the capacity and reliability of our netting and settlement systems. With the introduction of the Treasury auction takedown service, GSCC greatly expanded its processing to include new issue U.S. Treasury debt. And GSCC enhanced the processing capabilities in its back-up facility, recognizing that the industry can ill-afford any interruption in the clearance and settlement of Government securities.

Today, GSCC is strong, stable, and structured for continued growth. We have put in place a powerful engine that can handle our core business as well as accommodate the expansion that we and the industry anticipate in the future.

As we look to the year 2000, our strategy is to continue to expand both the range of services we offer and the breadth of membership. We plan to broaden the types of transactions that will be eligible for clearance and settlement through GSCC. In addition to the brokers, dealers and banks that currently are the majority of our participants, we are looking to include in GSCC membership insurance companies, investment firms, non-U.S. entities, and other institutions that represent the contra side of our members' trading activity, but have not traditionally been GSCC members.

In 1995 we will introduce in stages a service for post-trade processing of repurchase agreements, building on the clearance and settlement systems currently in place. The repo service will begin with a comparison pilot in the first quarter, followed by live comparison of transactions in the second quarter, and a netting pilot and live netting in the second half of the year. In addition, we expect our strong financial position to allow us to pass on to our participants the advantages of lower costs, reflecting economies of scale stemming from processing efficiencies.

Each day, GSCC provides safe and reliable services that deliver economic benefits. At the same time, we are making prudent expenditures now in order to always be prepared with cost-effective, high-quality services to meet our members' current and future requirements in a demanding, rapidly changing environment.

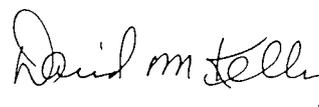
We further recognize that as a rising share of activity comes into GSCC, our responsibility to the industry will increasingly extend throughout the marketplace. By consistently delivering a high level of service to our members, and by anticipating and quickly responding to their needs, we will continue to demonstrate that the commitment of our participants' time, money and trust in GSCC is an investment well-made.

We would like to extend a special thanks to our Board of Directors for their guidance, to our staff for their hard work and dedication, and to our participants for their continuing cooperation and support. We look forward to a future that is as productive and rewarding as our formative years.

Sincerely,



John G. Macfarlane III
Chairman of the Board
Government Securities Clearing Corporation



David M. Kelly
Vice Chairman
Government Securities Clearing Corporation



Charles A. Moran
President
Government Securities Clearing Corporation

GSCC: Strong, Stable & Structured for Growth

The U.S. Government securities arena is safer and more efficient today than it was before GSCC assumed its vital function. By comparing trades and netting each participant's trading activity into one settlement position per issue, and subsequent guarantee of that position, GSCC plays a key role in the safety and soundness of the world's largest securities marketplace.

In 1994, GSCC continued to provide the most cost-effective means of serving the post-trade processing needs of the U.S. Government debt industry, while making investments to assure the quality of current services and to prepare for added responsibilities going forward.

1994 Performance

The average daily value of U.S. Government securities trades compared by GSCC increased 16.8% to \$273 billion in 1994. For the full year, GSCC compared, netted and settled a total of \$63.3 trillion in Government debt transactions, a 16.5% rise from 1993. GSCC's netting system eliminated \$48.5 trillion from settlement, an 18.7% jump from the prior year.

Reflecting an increase in Government securities trading volume and the addition of member firms, revenues rose 19% in 1994 – allowing GSCC to pay off start-up costs and fund investments in technology that will further increase the safety of the Government

securities market. GSCC expects to retire its accumulated deficit during 1995.

GSCC's success in creating a solid operational structure is also apparent in the performance of its systems – particularly on high-volume days. On March 31, 1994, GSCC set a record by settling more than \$1 trillion in securities in one day – demonstrating the dependability of GSCC's services, as well as the value of netting: GSCC reduced the obligations requiring settlement on that day by 88.5%, from \$1 trillion to \$124 billion.

Building a Framework for Expansion

In 1994, GSCC continued to build a strong, reliable framework for the years ahead.

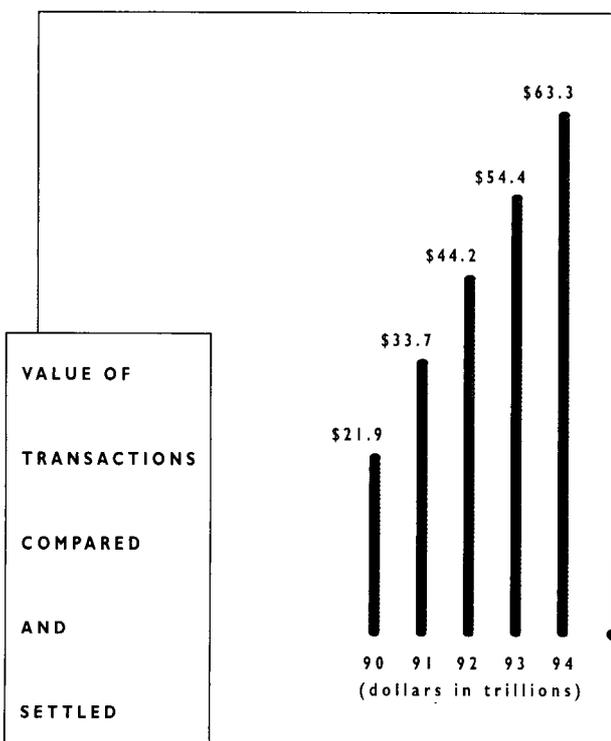
GSCC took steps to expand its membership base, including instituting membership categories for futures commission merchants and filing for SEC approval of financial standards to admit insurance companies and investment companies. In addition, GSCC began discussions with the Commission on a new membership category for non-U.S. entities active in U.S. Government securities.

By year-end, GSCC membership had increased to 91 firms from 80 in 1993, including 64 netting members versus 58 a year earlier. The number of executing firms that have trades submitted to GSCC through members rose to 300 from 290 in 1993 – allowing a growing number of firms that are not direct GSCC members to benefit from GSCC services.

GSCC remains committed to managing risk in the Government securities marketplace – a goal that is furthered by including an increasing number of active market participants in GSCC's membership. The high admission standards and prudent margin and collateral requirements employed by GSCC are designed to sustain the level of risk protection that the firm provides to the industry, even as GSCC's membership circle grows.

During 1994, GSCC also expanded the types of securities transactions eligible for clearance and settlement.

Concluding a multi-year cooperative effort with the Federal Reserve, U.S. Treasury and our participants, GSCC incorporated members' Treasury auction purchases in its netting and settlement systems. The Treasury auction service lets GSCC more efficiently net members' trading activity by using auction purchases to offset secondary market sales, moving securities directly to the ultimate buyer, and more appropriately manage settlement exposure.



GSCC's safe and efficient auction processing also has resulted in the elimination of a number of securities movements, before the Fedwire opens, which reduces daylight overdrafts and lowers participants' costs. In addition, the service extends the reach of GSCC's benefits to the U.S. Treasury, which stated with the SEC and the Federal Reserve in a 1992 joint report to Congress that by assuming responsibility for auction purchases netted against when-issued trades, GSCC reduces risk to the Treasury.

An advanced processing capability was introduced in conjunction with the auction takedown service that allows transactions to be submitted to GSCC on a locked-in basis for comparison and netting. In the first use of this facility, the Federal Reserve Banks are providing GSCC with Treasury auction purchase information.

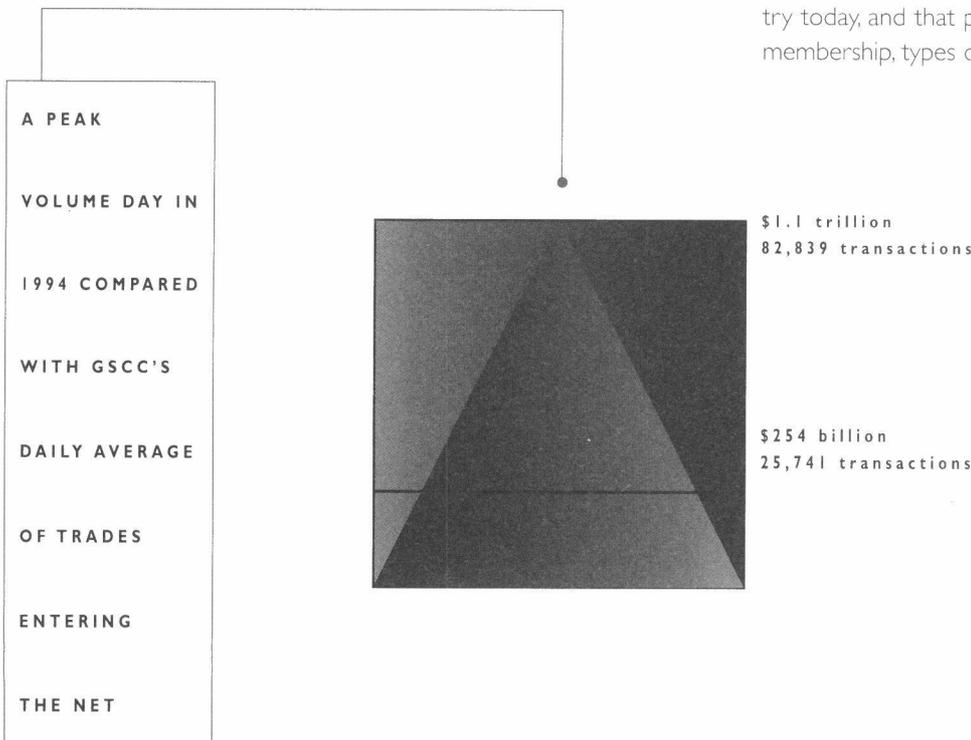
Working with its Board of Directors and other industry participants, GSCC took steps in 1994 toward extending its automated comparison, netting and risk management services to encompass repurchase agreements (repos) and reverse repurchase agreements. During the year, GSCC distributed to members and others in the industry a comprehensive plan for implementing repo services, using a phased-in approach beginning with a comparison pilot program in February 1995, followed by comparison and netting of repos later in 1995. Ultimately, GSCC will offer services for the open and close legs of all overnight, term and

open repos, including the same-day-settling aspects of those transactions – leading to a significant increase in the dollar volume of trades handled by GSCC.

Repo processing provides numerous benefits to the industry, such as eliminating the need for physical confirmations; improving the timeliness of trade comparison; facilitating the monitoring of open repos and changes made to open transactions; and improving recordkeeping and access to audit trail information. And when repo netting is introduced, members will gain the advantages of guaranteed settlement, financial statement relief, reductions in underlying collateral movements, lower daylight overdraft charges, rate change and open repo interest tracking, coupon protection for funds borrowers, and easier collateral substitutions.

The firm's processing infrastructure was reinforced in 1994, and new capabilities were introduced. GSCC enhanced its back-up site, assuring faster recovery in trade processing in the event that the primary site cannot be used, and a redundant administrative site was installed with the necessary office equipment to enable GSCC staff to quickly resume operations if the main office becomes inaccessible.

GSCC's risk management benefits to the marketplace increase with the addition of new activity. By taking in more types of transactions from a growing number of sources and participants, GSCC has succeeded in building a structure that better serves the industry today, and that positions it to accommodate future growth in membership, types of transactions, and market volume.



A Vision for the Future

GSCC is looking ahead to anticipate the needs of its growing client base in the coming years.

The repo service provides centralized processing services for this large market segment, directly addressing the needs of current members. Also, both current and new GSCC members will be able to reap economies of scale from netting both their cash market activity and their repo activity through GSCC – leading to an increase in firms interested in GSCC membership. As new members join GSCC, current members will compare and net more of their transactions, since the contra sides of their transactions will be captured in GSCC systems.

The expansion of the repo service will remain a priority for GSCC. After the launch of the comparison phase for overnight and term repos in early 1995, GSCC will move to netting those transactions later in the year, followed by the inclusion of open repos and intraday processing of transactions.

GSCC strives to add value in a variety of areas when introducing new services. The goal in the repo service is to provide operational advantages and risk management benefits, as well as to help enhance members' use of their capital. GSCC's multilateral netting process will enable participants to make optimal use of

the balance sheet benefits stemming from the recent Financial Accounting Standards Board (FASB) interpretation concerning the offsetting of amounts related to repos and reverse repos.

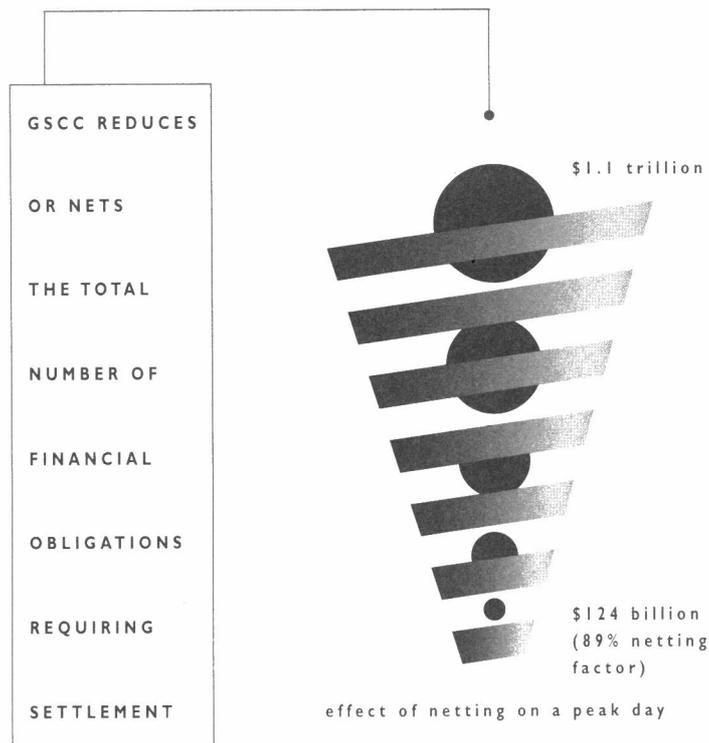
We recognize that our participants' activity in Government securities is conducted in a variety of markets, including the futures and options markets. As a result, GSCC continues to explore the best ways of extending the benefits of its processes to activity in markets that we do not currently serve – for example, by potentially establishing arrangements with other clearing corporations that would permit the cross-margining of positions of a common member. GSCC remains committed to identifying instances where we can leverage our existing base to provide necessary, valuable support in new areas.

The facility for accepting locked-in trades that is currently used in the Treasury auction service positions GSCC to offer services for additional types of Government securities activity. With this capability, GSCC can accommodate input from other sources of locked-in transactions, such as exchanges and other clearing corporations, to meet future industry needs.

Encouraging on-line, interactive communication by members is another high priority for GSCC, since real-time processing is critical to implementing the netting of same-day-settling trades, as well as for meeting other industry requirements. GSCC members increasingly have been taking advantage of the interactive terminal input and data access that GSCC provides, and we will support and encourage direct system-to-system connectivity to facilitate repo processing and earlier settlement guarantee.

A product of GSCC's core business is data that could be made available to member firms to help manage and report compliance and audit information – which is increasingly important given the increased industrywide demand for regulatory reporting and record retention, and the rising level of trading activity moving into GSCC. Our trade processing and recordkeeping systems will enable GSCC to provide trading history and audit information to members as the need arises.

In looking toward the future, GSCC is committed to continuing to increase efficiencies and lower risk in the Government securities marketplace. By listening to our members and working closely with market participants, we will identify and address the needs of our customers in the coming years – maintaining our reputation for dependable support and sound leadership in the market we serve.



GSCC Board of Directors



From left to right:

Charles A. Moran
President, Government Securities Clearing Corporation

John G. Macfarlane III
Chairman of the Board, Government Securities Clearing Corporation
Managing Director & Treasurer, Salomon Brothers Inc

John M. Gavin, Jr.
Chief Financial Officer, RMJ Securities Corp.

Stephen R. Tilton
President, Garban Ltd.



From left to right:

Edward Almeida
Senior Managing Director, Bear Stearns & Co., Inc.

Thomas M. Wendel
President, Liberty Brokerage Inc.

Kenneth J. Halpin
Managing Director & Treasurer, Zions First National Bank – Capital Markets

Jeremiah F. O'Leary
Senior Vice President, Chemical Bank
(not pictured)



From left to right:

Daniel O. Minerva
Managing Director, Eastbridge Capital Inc.

Kurt D. Woetzel
Senior Vice President, The Bank of New York

David M. Kelly
Vice Chairman, Government Securities Clearing Corporation
President & CEO, National Securities Clearing Corporation



From left to right:

James P. Mahoney
Principal, Morgan Stanley & Co. Incorporated

Edward F. Watts, Jr.
Director, Goldman, Sachs & Co.

Richard M. Kijewski
Senior Vice President, Fuji Securities Inc.

GSCC Balance Sheet

December 31,	1994	1993
	(in thousands)	
Assets		
Cash and cash equivalents	\$ 90,382	\$ 33,937
Receivable from NSCC - Funds invested on behalf of GSCC	—	2,953
Investments in marketable securities	12,389	8,992
Accounts receivable	1,154	754
Clearing fund	420,833	376,865
Fixed assets, net of accumulated amortization and depreciation of \$5,608,000 and \$4,711,000 at December 31, 1994 and 1993, respectively	1,367	1,588
Deferred tax and other assets	1,088	2,086
Total assets	<u>\$527,213</u>	<u>\$427,175</u>
Liabilities and Shareholders' Equity		
Liabilities:		
Deferred revenue	\$ —	\$ 637
Cash margin deposits	45,922	1,443
Clearing fund:		
Participants' cash deposits	47,498	37,733
Other participant deposits	420,833	376,865
Other liabilities	1,941	1,656
Total liabilities	<u>516,194</u>	<u>418,334</u>
Commitments and contingent liabilities (Note 7)		
Shareholders' equity:		
Common stock:		
Class A, \$0.50 par value: 75,000 shares authorized, 19,800 shares issued and outstanding at December 31, 1994 and 1993	10	10
Class B, \$0.50 par value: 30,000 shares authorized, 7,400 shares issued and outstanding at December 31, 1994 and 1993	4	4
Capital in excess of par	12,186	12,186
Accumulated deficit	(1,181)	(3,359)
Total shareholders' equity	<u>11,019</u>	<u>8,841</u>
Total liabilities and shareholders' equity	<u>\$527,213</u>	<u>\$427,175</u>

The accompanying notes are an integral part of this statement.

GSCC Statement of Income and Accumulated Deficit

For The Year Ended December 31,	1994	1993
	(in thousands)	
Revenues:		
Revenue from comparison, netting, settlement and related services	\$ 14,082	\$ 12,522
Interest income	2,124	1,111
Total revenues	16,206	13,633
Expenses:		
Computer equipment rental, licenses, depreciation, processing and maintenance costs	6,215	5,836
Employee compensation and related benefits	3,003	2,692
General and administrative expenses	2,524	2,263
Amortization of software costs	364	798
Occupancy costs	361	372
Professional fees	178	131
Total expenses	12,645	12,092
Income before income taxes	3,561	1,541
Provision for income taxes	1,383	616
Net income	2,178	925
Accumulated deficit, beginning of year	(3,359)	(4,284)
Accumulated deficit, end of year	(\$ 1,181)	(\$ 3,359)

The accompanying notes are an integral part of this statement.

GSCC Statement of Cash Flows

For The Year Ended December 31,	1994	1993
	(in thousands)	
Cash flows from operating activities:		
Net income	\$ 2,178	\$ 925
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation of fixed assets	897	1,056
Accretion of discount on securities owned, net of premium amortized	(124)	(138)
Changes in operating assets and liabilities:		
Increase in accounts receivable	(400)	(6)
Decrease in settlement receivable	—	18,272
Decrease in deferred tax and other assets	998	1,031
(Decrease) increase in deferred revenue	(637)	30
Decrease in settlement payable	—	(18,157)
Increase in cash margin deposits	44,479	1,354
Increase in participants' cash deposits	9,765	9,752
Increase in other liabilities	285	297
Net cash provided by operating activities	<u>57,441</u>	<u>14,416</u>
Cash flows from investing activities:		
Decrease in receivable from NSCC - funds invested on behalf of GSCC	2,953	320
Maturity of investments in marketable securities	8,500	7,000
Purchase of investments in marketable securities	(11,773)	(4,965)
Purchase of fixed assets	(676)	(1,079)
Net cash (used in) provided by investing activities	<u>(996)</u>	<u>1,276</u>
Net increase in cash and cash equivalents	56,445	15,692
Cash and cash equivalents, beginning of year	33,937	18,245
Cash and cash equivalents, end of year	<u>\$ 90,382</u>	<u>\$ 33,937</u>
Supplementary disclosures:		
Interest paid	\$ 9	\$ 15
Income taxes paid	\$ 320	\$ 60

The accompanying notes are an integral part of this statement.

GSCC Notes to Financial Statements

December 31, 1994

Note 1 Organization and Operations:

Government Securities Clearing Corporation (GSCC), a clearing agency registered with the Securities and Exchange Commission, provides automated trade comparison, netting and settlement services for U.S. Government securities to brokers, dealers, banks and other market participants.

Note 2 Summary of Significant Accounting Policies:

Cash equivalents: GSCC invests in overnight reverse repurchase agreements which are considered cash equivalents. Such agreements provide for GSCC's delivery of cash in exchange for securities having a market value of at least 102% of the amount of the agreement. A custodian designated by GSCC takes pos-

session of the securities. Overnight reverse repurchase agreements are recorded at the contract amounts and totaled \$90,238,000 and \$33,183,000 at December 31, 1994 and 1993, respectively. At December 31, 1994, two financial institutions were counterparties to these agreements.

Investments in marketable securities: These investments, which include U.S. Treasury securities and investment grade corporate notes, are considered to be held-to-maturity securities under Statement of Financial Accounting Standard (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and are recorded at amortized cost. The contractual maturities, carrying value and market value of these securities at December 31, 1994 and December 31, 1993 are as follows:

	Carrying Value (in thousands)			Market Value (in thousands)		
	U.S. Treasury Securities	Corporate Notes	Total	U.S. Treasury Securities	Corporate Notes	Total
1994						
Due in one year or less	\$ 4,931	\$ 500	\$ 5,431	\$ 4,884	\$ 492	\$ 5,376
Due in one through three years	5,958	1,000	6,958	5,802	973	6,775
	\$10,889	\$1,500	\$12,389	\$10,686	\$1,465	\$12,151
1993						
Due in one year or less	\$ 5,988	\$ 500	\$ 6,488	\$ 6,012	\$ 505	\$ 6,517
Due in one through two years	2,004	500	2,504	2,011	502	2,513
	\$ 7,992	\$ 1,000	\$ 8,992	\$ 8,023	\$ 1,007	\$ 9,030

Settlement receivable and payable: Settlement receivables and payables may arise due to one-day time lags in the settlement process with participants and settlement banks.

Participant clearing fund deposits: GSCC accepts cash, U.S. Treasury securities, and letters of credit issued by authorized banks as clearing fund deposits, and records total deposits on its balance sheet.

Income taxes: The provision for income taxes was calculated in accordance with SFAS No. 109, "Accounting for Income Taxes." Deferred tax assets and liabilities are provided for the expected future tax consequences of temporary differences between the carrying amount and tax basis of assets and liabilities.

Fixed assets: These assets consist primarily of computer equipment which is being depreciated over a three-year period and purchased computer software which is being amortized over a five-year period.

Reclassifications: Certain reclassifications of 1993 amounts have been made in the accompanying financial statements to conform to the 1994 presentation.

Note 3 Participants' Clearing Fund Deposits:

GSCC's rules require certain participants to maintain minimum clearing fund deposits based upon calculated requirements which, at December 31, 1994 and 1993, were \$232,101,000 and \$189,707,000, respectively. All participant deposits made to the clearing fund are available to secure participant obligations and, in certain circumstances, to satisfy other losses and liabilities of GSCC, should they occur.

A summary of clearing fund deposits held at December 31, 1994 and 1993 follows:

	1994	1993
Cash	\$ 47,498,000	\$ 37,733,000
U.S. Treasury securities, at market	342,423,000	293,203,000
Letters of credit issued by authorized banks	78,410,000	83,662,000
Total deposits	\$468,331,000	\$414,598,000

Note 4 Transactions with Related Parties:

National Securities Clearing Corporation (NSCC), a minority shareholder of GSCC, provides various computer and other support services and office facilities to GSCC. The costs of providing these services are charged to GSCC in accordance with the provisions of a service agreement. The agreement continues in effect unless cancelled by either party upon prior written notice. Charges to GSCC pursuant to this agreement during 1994 and 1993 amounted to approximately \$4,832,000 and \$4,497,000, respectively. Amounts payable to NSCC at December 31, 1994 and 1993 were \$239,000 and \$384,000, respectively.

Through October 1994, GSCC's excess cash was aggregated with funds held by NSCC for investment purposes. Interest income, which was allocated to GSCC on a pro-rata basis, aggregated \$134,000 and \$102,000 in 1994 and 1993, respectively.

Note 5 Income Taxes:

GSCC files Federal, New York State and New York City income tax returns. The differences between the 34% Federal statutory rate and GSCC's 39% and 40% effective tax rates for the years ended December 31, 1994 and 1993, respectively, are primarily attributed to state and local taxes.

The provisions for income taxes for the years ended December 31, 1994 and 1993 consist of the following:

	1994	1993
Current income taxes	\$ 200,000	\$ 91,000
Deferred income taxes	1,183,000	525,000
Total income taxes	\$1,383,000	\$ 616,000

At December 31, 1994, GSCC had approximately \$1,400,000 of net operating loss carryforwards for Federal income tax purposes which expire in the years 2004 and 2005.

Note 6 Pension Plan:

All eligible employees of GSCC participate in NSCC's trustee, noncontributory defined benefit pension plan. In addition, GSCC also participates in NSCC's noncontributory supplemental executive retirement plan which provides for certain benefits to identified executives of GSCC upon retirement. Further, GSCC also participates in NSCC's noncontributory benefit restoration plan which was established to restore to identified executives certain retirement income benefits which have been limited by recent changes in income tax regulations. Costs of these plans are allocated to GSCC based on its relative percentage of eligible salaried payroll. Pension costs allocated to GSCC for these plans aggregated \$134,000 and \$156,000 for 1994 and 1993, respectively.

Note 7 Commitments and Contingent Liabilities:

GSCC's netting system interposes GSCC between netting participants for eligible trades that have been netted and guaranteed. The guarantee of net settlement positions by GSCC results in potential liability to GSCC. Guaranteed positions that have not yet settled are margined and marked-to-market daily. Margin deposits are held by GSCC; marks are debited from and credited to the responsible participants through the daily funds-only settlement process. At December 31, 1994, the gross amount of guaranteed positions due from certain participants to GSCC approximated \$3,517,697,000; there is an equal amount due from GSCC to certain other participants.

Note 8 Off-Balance-Sheet Risk and Concentrations of Credit Risk:

In the normal course of business, because it guarantees certain settlement obligations of its participants (see Note 7), GSCC is exposed to credit risk. GSCC mitigates its exposure to credit risk by requiring participants to meet GSCC established minimum financial standards for membership, monitoring compliance with its financial and other standards, requiring participants to meet daily mark-to-market obligations, and requiring participants to provide clearing fund (see Note 3) and other margin deposits in the form of cash, U.S. Treasury securities and eligible letters of credit.

If a participant fails to fulfill its settlement obligations to GSCC, and GSCC ceases to act on behalf of the participant, GSCC would liquidate that participant's netted security positions and apply the failed participant's margin and mark deposits, including clearing fund deposits, to satisfy any net outstanding obligation and/or loss. In the event that a deficiency still exists, GSCC would satisfy the deficiency by assessing the participants with whom the defaulting participant most recently conducted trading activity.

If one or more of such participants does not pay its assessment, GSCC would satisfy such deficiency by utilizing 25% of its retained earnings, if any, or such greater amount of retained earnings to be determined by the Board of Directors. Thereafter, if necessary, each remaining participant would be assessed on an equal basis up to \$50,000. Finally, if a deficiency still remains, GSCC would assess all remaining participants on a pro-rata basis based upon their average daily level of required clearing fund deposits over the prior year; however, any such remaining participant may limit its liability to the amount of its required clearing fund deposit by terminating its membership in GSCC.

As discussed in Note 1, GSCC provides automated trade comparison, netting and settlement services for U.S. Government securities to brokers, dealers, banks and other market participants. As such, GSCC has a significant group concentration of credit risk since its participants may be impacted by economic conditions affecting the securities industry. As described above, such risk is mitigated in a number of ways.

Report of Independent Accountants

Price Waterhouse LLP

1177 Avenue of the Americas
New York, NY 10036



February 10, 1995

To the Board of Directors and Shareholders of
Government Securities Clearing Corporation

In our opinion, the accompanying balance sheets and the related statements of income and accumulated deficit and of cash flows present fairly, in all material respects, the financial position of Government Securities Clearing Corporation at December 31, 1994 and 1993, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles. 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 audits. We conducted our audits of these statements in accordance with generally

accepted auditing standards which 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 audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Management's Report on Responsibility for Financial Reporting

February 10, 1995

To the Board of Directors and Shareholders of Government Securities
Clearing Corporation

Government Securities Clearing Corporation (GSCC) maintains a system of internal control over financial reporting which is designed to provide reasonable assurance regarding the preparation of reliable published financial statements. The system contains self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified. Even an effective internal control system, no matter how well designed, has inherent limitations – including the possibility of the circumvention or overriding of controls – and therefore can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control system effectiveness may vary over time.

GSCC's management assessed its internal control over financial reporting as of December 31, 1994, in relation to criteria for effective internal control described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, GSCC believes that, as of December 31, 1994, its system of internal control over financial reporting met those criteria.



David M. Kelly
Vice Chairman



Charles A. Moran
President



Marvin B. Koehler
Treasurer

**GSCC's Report of Independent
Accountants on Internal Control Over Financial Reporting**

Price Waterhouse LLP

1177 Avenue of the Americas
New York, NY 10036



February 10, 1995

To the Board of Directors and Shareholders of Government Securities
Clearing Corporation

We have examined management's assertion that, as of December 31, 1994, Government Securities Clearing Corporation's (GSCC's) internal control over financial reporting met the criteria for effective internal control described in "Internal Control-Integrated Framework." Management's assertion is included in the accompanying Management's Report on Responsibility For Financial Reporting.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the internal control structure over financial reporting, testing and evaluating the design and operating effectiveness of the internal control structure, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Also, projections of any evaluation of the internal control structure over financial reporting to future periods are subject to the risk that the internal control structure may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that, as of December 31, 1994, GSCC's system of internal control over financial reporting met the criteria for effective internal control established by the Committee of Sponsoring Organizations of the Treadway Commission is fairly stated, in all material respects, based upon criteria established in "Internal Control-Integrated Framework."

Price Waterhouse LLP

GSCC Comparison & Netting Participants

Brokers

Cantor Fitzgerald Securities[†]
Garban Ltd.[†]
Hilliard Farber & Co., Inc.[†]
Liberty Brokerage Inc.[†]
RMJ Securities Corp.[†]
Tullett & Tokyo Securities, Inc.

Dealers

BA Securities, Inc.[†]
BHC Securities, Inc.*
BT Securities Corporation[†]
The Bank of New York[†]
Bankers Trust Company*
Barclays de Zoete Wedd Securities Inc.
Bear, Stearns & Co., Inc.
Bear, Stearns Securities Corp.*[†]
Alex. Brown & Sons Incorporated
Chase Securities, Inc.[†]
Chemical Securities Inc.[†]
The Chicago Corporation
Citibank, N.A.[†]
Citicorp Securities, Inc.
CS First Boston Corporation[†]
Daiwa Securities America Inc.[†]
Dean Witter Reynolds Inc.[†]
Deutsche Bank Securities Corporation
Dillon Read & Co. Inc.[†]
Zions First National Bank — Capital Markets[†]
Donaldson, Lufkin & Jenrette Securities Corporation[†]
Dresdner Securities (USA) Inc.
Eastbridge Capital Inc.
Federal Home Loan Mortgage Corporation
First Chicago Capital Markets, Inc.
The First National Bank Of Chicago*[†]
Fuji Securities Inc.[†]
Goldman, Sachs & Co.[†]
Greenwich Capital Markets, Inc.[†]
Harris-Nesbitt Thomson Securities, Inc.[†]
HSBC Securities, Inc.[†]
International Bank for Reconstruction & Development*
International Development Association*
International Finance Corporation*

Internationale Nederlanden (U.S.) Securities Corporation*
Jacobson Capital, Inc.*
Edward D. Jones & Co.*
Kemper Clearing Corp.*
Kidder, Peabody & Co. Inc.[†]
Lazard Freres & Co.
Legg Mason Wood Walker, Inc.*
Lehman Government Securities Inc.[†]
Long-Term Capital Portfolio, L.P.*
Mabon Securities Corp.*
Merrill Lynch Government Securities Inc.[†]
J.P. Morgan Securities Inc.[†]
Morgan Keegan & Co., Inc.*
Morgan Stanley & Co. Incorporated[†]
National Financial Services Corp.*
National Westminster Bank USA
NationsBank Capital Markets, Inc.
NationsBank Of North Carolina, N.A.
The Nikko Securities Co. Int'l, Inc.[†]
Nomura International PLC*
Nomura Securities International, Inc.[†]
Oppenheimer & Co., Inc.
PaineWebber Incorporated[†]
Paribas Corporation
Piper Jaffray Inc.*
Prudential Securities Incorporated[†]
Refco Securities, Inc.
Regional Operations Group, Inc.*
Rosenthal-Collins Group*
SBC Government Securities Inc.
Salomon Brothers Inc.[†]
Sanwa Securities (USA) Co., L.P.[†]
Charles Schwab & Co., Inc.*
ScotiaMcLeod (USA) Inc.
Smith Barney Inc.[†]
Spear, Leeds & Kellogg
State Street Bank & Trust Company
Stifel, Nicolaus & Company Incorporated*
Sumitomo Bank Securities, Inc.*
UBS Securities Inc.
U.S. Clearing Corp.
S.G. Warburg & Co., Inc.[†]
Wheat, First Securities, Inc.*
Yamaichi Int'l (America), Inc.[†]

* Comparison-Only Participant

[†] Shareholder

GSCC Officers

John G. Macfarlane III

Chairman of the Board

David M. Kelly

Vice Chairman

Charles A. Moran

President

Thomas F. Costa

Executive Vice President

Jeffrey F. Ingber

General Counsel & Secretary

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First Vice President

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Vice President & Director of Operations

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Thomas Quaranta

Vice President

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Treasurer

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Assistant Secretary

Robert S. Bennett

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