

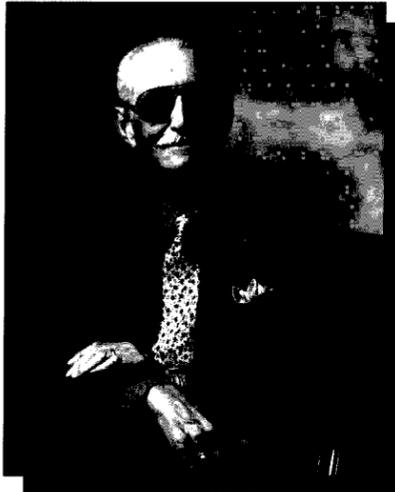
BUILDING ON YESTERDAY
To Chart Tomorrow



MBSCC TIMELINE

-
- 1979 MBS Clearing Corporation is formed as a wholly-owned subsidiary of the Midwest Stock Exchange and initially offers services on Ginnie Mae securities.
 - 1981 Freddie Mac Participation Certificates (PC's) are made eligible for MBSCC services.
 - 1982 Fannie Mae securities are made eligible for MBSCC services
 - 1984 MBSCC eliminates the accumulated deficit that was the result of its start-up costs.
 - 1985 MBSCC's Depository Division begins operations.
 - 1989 MBSCC's Depository Division is transferred to a new entity, the Participants Trust Company.
 - 1994 MBSCC is purchased by 32 of its Participants and the National Securities Clearing Corporation. MBSCC transfers its data center to SIAC.
 - 1995 MBSCC moves its headquarters to New York City from Chicago.
 - 1996 The Electronic Pool Notification system is launched.

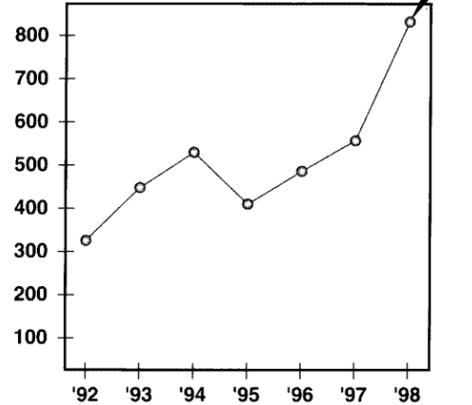
OUR ACCOMPLISHMENTS



"Early on, we had trouble selling Wall Street on MBSCC and the netting concept. They were accustomed to the delivery of physical securities and payments that reflected the full amount of their trades. By the time I left the Board, the industry realized that we were the future."

HARRY A. PANAGOS
Member, Original MBSCC
Board of Directors

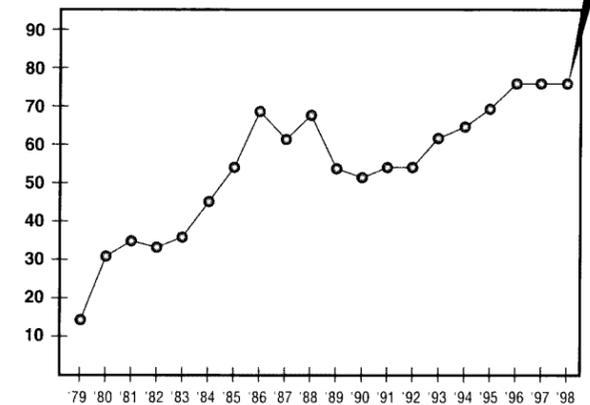
PAR VALUE TRADE SIDES INTO NETTING-MONTHLY AVERAGE (1992-1998 In billions)



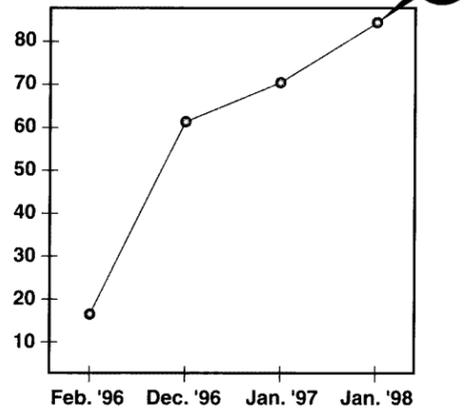
"Because of the growing interest in one of the market's most complex financial instruments, the mortgage-backed securities industry needed an organization which met the needs of both investors and issuers. MBSCC has met these criteria with great success for the past two decades."

WILLIAM D. RILEY
Founding Chairman,
MBSCC Board of Directors

NUMBER OF CLEARING PARTICIPANTS (1979-1998)



NUMBER OF EPN PARTICIPANTS (1996-1998)



LYNN DOUGLAS
Managing Director and
Chief Operating Officer



DENNIS PAGANUCCI
Managing Director,
Marketing and Sales

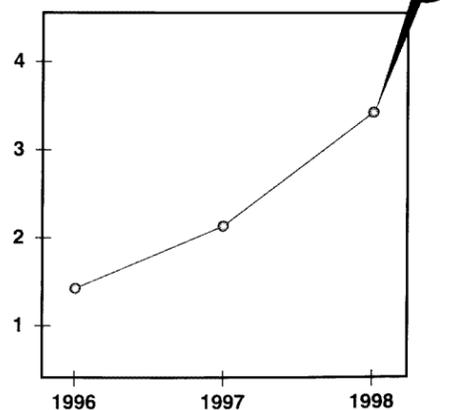


RAMON RODRIGUEZ
Programmer/Analyst



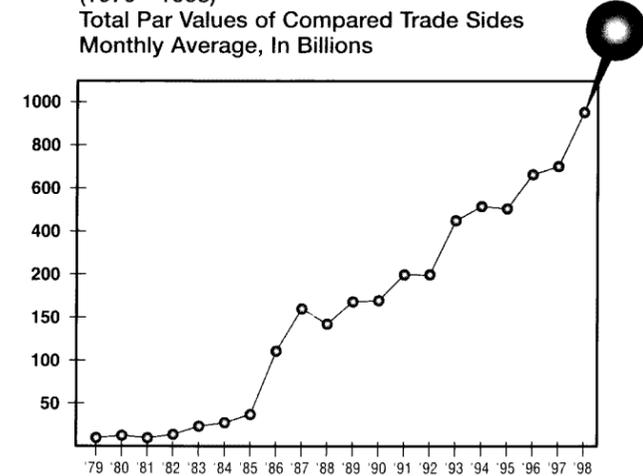
ERICK MAZARIEGOS
Senior Programmer/Analyst

FACE VALUE OF EPN MESSAGES (1996-1998) In trillions



BARBARA MORET
Project Leader,
Information Technology

CLEARING SYSTEM VOLUME (1979 - 1998)



A PROFILE OF MBSCC

| | |
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MBS Clearing Corporation (MBSCC) is the sole provider of automated trade comparison, confirmation, risk management, netting and electronic pool notification services to participants in the mortgage-backed securities market.

These securities, bought and sold in the over-the-counter, cash, forward and options markets, are backed by the Government National Mortgage Association (GNMA), the Federal Home Loan Mortgage Corporation (FHLMC) and Fannie Mae. The key participants in this market — the nation's oldest of the secondary markets for loan assets — are mortgage originators, government-sponsored enterprises, dealers, inter-dealer brokers and institutional investor firms.

MBSCC, established in 1979, is a clearing agency registered with the United States Securities and Exchange Commission and is affiliated with the National Securities Clearing Corporation. MBSCC is majority-owned by its participants.

to our PARTICIPANTS AND COLLEAGUES

With our organization's 20th anniversary upon us, we are devoting portions of this year's Annual Report to the issues and industry leaders that brought us to a point that saw records being set in almost all of our operating measurements. Yet while we have reason to be proud of our history, MBSCC is channeling its considerable energies on the future.

The mortgage-backed securities (MBS) industry is driven by changes in the nation's housing markets, economic policy and conditions, and investor demand for fixed-income securities. As such, the need to adapt to a changing marketplace overshadows the temptation to reflect for too long on past accomplishments.

Nevertheless, this Annual Report provides a forum for an assessment of 1998's activities and how these events may impact MBSCC and our Participants in the years ahead.

Looking at the financial results for 1998, we're pleased to report that revenue from operations totaled \$17.7 million, a 19 percent increase from the \$14.9 million figure as of year-end 1997.

In keeping with our mission to reduce Participants' costs, we were able to institute in January 1998 a 20 percent reduction of our monthly fees. This action resulted in a \$3.6 million fee reduction for Participants. Moreover, an additional \$9.4 million in fee discounts was returned to our Participants.

These fee reductions and discounts are for Settlement Balance Order (SBO), Trade-for-Trade and Option Trade Recording Services.

The Board of Directors also approved a new fee structure to encourage the use of multiple accounts by an investment manager. By taking this step, MBSCC was able to pass through decreased costs for communications, systems overhead, and support services to Participants. At the same time, these new fees fostered the ever growing increase of investors' indirect participation in MBSCC.

Some additional highlights from 1998:

- MBSCC's Clearing Services processed trades with a record par value in excess of \$12.3 trillion, which marked a 43 percent increase over 1997's figure.
- MBSCC's Electronic Pool Notification (EPN) Service processed pools with a current face value of \$3.4 trillion, an astounding 67 percent jump over the previous year.
- MBSCC also eliminated 86 percent of the settlement value of trades entered for netting, or more than \$8.4 trillion par value. This saved our Participants more than \$160 million.

Perhaps the biggest change we've witnessed in recent years is the arrival of new investors in the mortgage-backed securities market. More than half of MBSCC's Participants are now non-dealers. Diversification and liquidity, along with the possibility of a relatively attractive yield, are among the reasons investments in MBS have long been favored. The MBS market's growth which, in turn, has made credit more accessible is also one of the primary reasons for increased American home ownership.

In addition, mortgages backed by government-sponsored enterprises like the Federal Home Loan Mortgage Corporation, Fannie Mae, and the Government National Mortgage Association are experiencing ever increasing investment by life insurance companies, pension funds, and non-domestic entities.

We were pleased this year, for example, to welcome the Bank for International Settlements (BIS) of Basle, Switzerland to our list of Participants.

The BIS was among the dozens of new Participants who joined MBSCC in calendar year 1998, bringing our total list of Clearing and EPN Participants to a record-high of 157.

Since our founding, MBSCC has provided three crucial services to the mortgage-backed securities market-trade comparison, risk management, and netting. Through the years, we've also expanded our services with products such as the Electronic Pool Notification (EPN) system.

In effect for only three years, EPN has become the industry standard when it comes to expediting the flow of mortgage pool information between sellers and buyers. In addition, the EPN system reduces overhead costs and decreases the number of fails all parties used to encounter on a trade's settlement date.

During 1998, we bade farewell to two prominent figures in MBSCC's history. Marvin Koehler, an MBSCC Officer and for many years the Treasurer at National Securities Clearing Corporation (NSCC) retired in the spring. We thank him for his support.

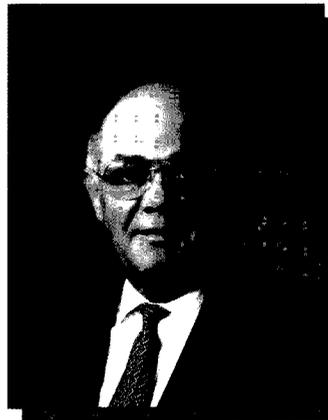
And Robert Woldow, NSCC's and MBSCC's General Counsel and a longtime MBSCC Officer, passed away suddenly in December 1998. Bob was an internationally recognized and highly regarded expert in clearance, settlement, and risk management. More importantly, he was a good friend of ours. His sound advice and good company will be greatly missed.

Finally, we dedicated resources and took steps necessary to meet the Y2K challenge. To assure a seamless computer transition from December 31, 1999 to January 1, 2000, MBSCC and many of its Participants conducted a full testing cycle of its Clearing and EPN services in June 1998 and again, with a much larger group of Participants, in October 1998. The results have been encouraging and MBSCC plans to continue Y2K testing with Participants throughout 1999.

As we look back 20 years ago, few could have imagined that MBSCC, founded in response to a search for an entity that could provide trade comparison and netting services, would grow into the nation's premier provider of automated trade comparison, risk management, netting and EPN services to Participants in the MBS market.

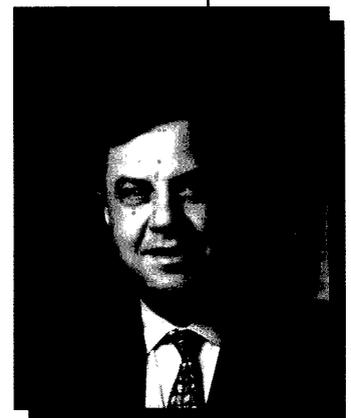
We are fortunate, of course, in that we have a dedicated staff and a Board of Directors that has always provided such valued guidance and support. We particularly thank Ronald Keenan, Eric Miller and Frank DiMarco, all recently retired Directors, for their years of dedicated service to MBSCC.

Looking at the financial results for 1998, we're pleased to report that revenue from operations totaled \$17.7 million, a 19 percent increase from the \$14.9 million figure as of year-end 1997.



A handwritten signature of Ronald A. Stewart in black ink.

RONALD A. STEWART
President and CEO,
MBSCC



A handwritten signature of Frank J. DeCongelio in black ink.

FRANK J. DeCONGELIO
Chairman of the Board

EFFICIENCY



"Most financial institutions, investors and broker/dealers were overwhelmed with the complexity and variability of mortgage-backed securities as they were introduced into active portfolio management strategies in the late 1970's. MBSCC was instrumental in enabling mortgage-backed securities to be traded, cleared and held efficiently and economically by all types of investors."

HOWARD A. SHALLCROSS
*Former Chairman,
 MBSCC Board of Directors*



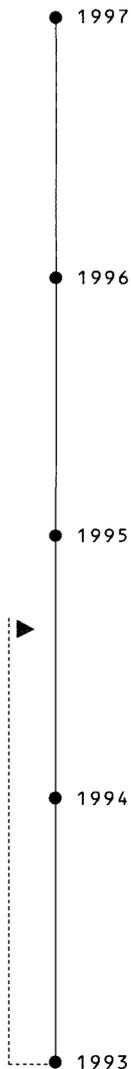
WILLIAM CORRIGAN
Account Manager



SALLY FOO PODRAZA
Senior Programmer/Analyst



STEVEN BORGHARDT
Member Services Coordinator



AUGUST 1994

MBSCC is sold by the Chicago Stock Exchange to 32 securities dealers and banks as well as the National Securities Clearing Corporation (NSCC). The new organization allows MBSCC to more effectively link its operating costs and expenditures for new service developments with the fees charged to Participants.

Mortgage-backed securities (MBS) are today one of the marketplace's most secure investments and a primary reason two of three American families have realized the dream of homeownership.

MBS are a relatively new financial instrument, however, with origins dating back to 1970. That is when the Government National Mortgage Association (GNMA), created by Congress as a spin-off of Fannie Mae, issued the first mortgage-backed security.

In essence, MBS are a debt security collateralized by mortgage loans on real estate with a credit quality comparable to that of U.S. Treasuries.

Between the creation of the MBS in 1970 and MBSCC's debut in 1979, the MBS market had a limited number of rules and best practices and, perhaps most challenging to all involved, lacked a common infrastructure for the processing and settlement of mortgage-backed securities trades.

The MBS trading and processing environment that had evolved during the 1970's was similar to that of any new market, further complicated by the unique characteristics of MBS.

Trading, similar to the futures market, occurred in a TBA (To Be Announced) market with settlements as much as 12 months later. Yield maintenance trading was the most common execution term. Par value could vary by as much as 5% from the traded par. Allocation of specific pools to TBA trades was an intensive manual process. Pool notification was accomplished entirely via phone. All settlements were physical delivery versus payment on a single monthly settlement date. Profitability of MBS trading was threatened by a full-blown paper crisis, 70% fail rate and rampant claims for principal and interest.

The GNMA Dealers Association realized that it was necessary to gain control of the back-office to realize the market potential of MBS. With the support of the trade organization, which eventually merged into what is now The

Bond Market Association, MBSCC established its mission to create a business model to standardize processes, mitigate risk, and decrease costs. At the time, MBSCC was a wholly owned subsidiary of the Midwest Stock Exchange. Today, MBSCC is majority-owned by its Participants.

MBSCC's early years focused on what was best for MBS dealers, largely because they crucially needed our services. A look at our history confirms that MBSCC was consistently able to develop solutions to pressing problems. We did this by first standardizing the methodology for recording trade terms and settlement.

Our next task was to use these standards in the trade comparison and confirmation processes. The par value size and terms of MBS trading dictated that MBSCC develop a risk management system that upheld original business and credit decisions about contra-party risk. Thus, MBSCC met this challenge by developing a non-mutualized contra-party risk management system.

The Effect of Netting

\$9.7 trillion par value went into the netting system in 1998

MBSCC nets or reduces the total number of financial obligations requiring settlement.

86.3% Netting Factor

\$1.3 trillion net financial obligation



more CERTAINTY

To reduce fails and the high cost of settlements, MBSCC then developed and implemented a Settlement Balance Order (SBO) netting system that significantly reduced the number of receive and deliver obligations. As remaining settlements were costly and required physical delivery of securities, we established a Depository Division that paved the way for book-entry settlement of MBS trades in the late 1980's. That Division also provided certificate immobilization and principal and interest collection and distribution services, again greatly reducing costs. This Division eventually became Participants Trust Company, now part of The Depository Trust Company.

MBSCC's Electronic Pool Notification (EPN) system, which began beta testing in 1994 and went live in 1996, was our answer to another industry challenge. It eliminated what had been one of the most burdensome manual steps in the clearance and settlement process—notification by the seller of the actual MBS pools to be delivered—and has since become the industry-recognized standard to achieve pool notification.

There is a tendency to dramatize "the way things used to be" in any business, but that temptation can be set aside when it comes to assessing the MBS industry. MBSCC's first Board of Directors had the keen vision to see the potential of the MBS market. They, along with subsequent Directors, had the drive to realize that vision and ensured that every new product or service we offered helped advance the growth of this business.

In 1998, we moved on a number of fronts to ensure additional efficiencies in the MBS market. For instance, trades executed with Zero Variance Stipulations became eligible for Clearing Services. The introduction of CUSIPs for MBS trades moves our marketplace into a position where we are now poised for the implementation of true, straight-through processing.

Finally, like all of our colleagues in the financial services industry, we took definitive steps to ensure that our computer systems operate without interruption in the Year 2000.

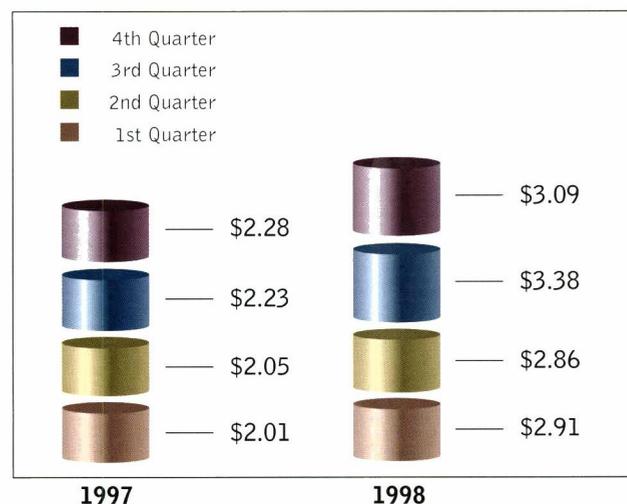
Since so much is at stake, however, our organization's Board of Directors approved a plan in late 1998 whereby all Participants must demonstrate Y2K readiness if they maintain automated computer interfaces to the MBSCC Clearing or EPN systems.

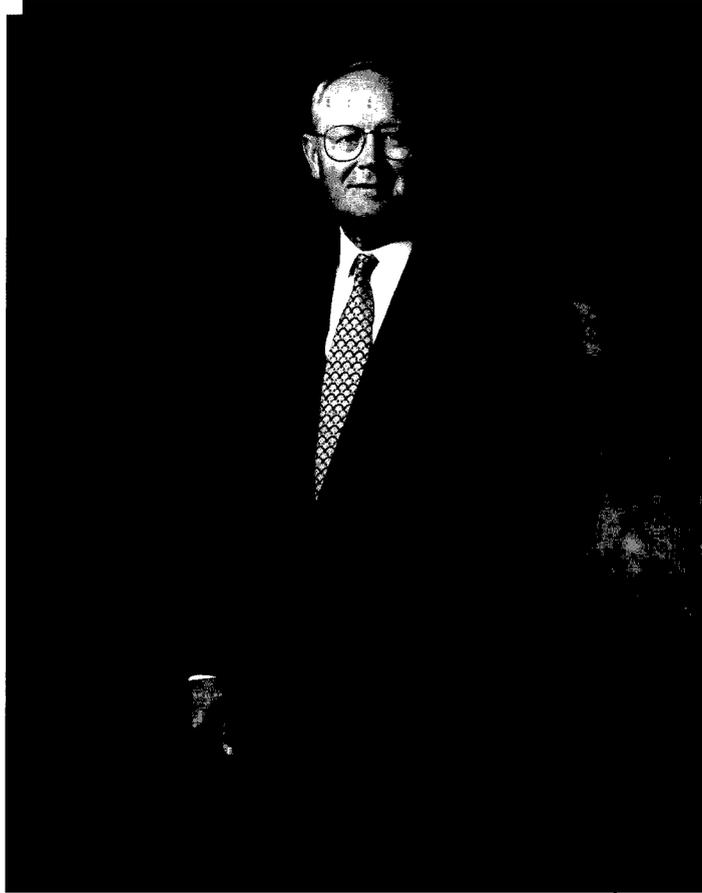
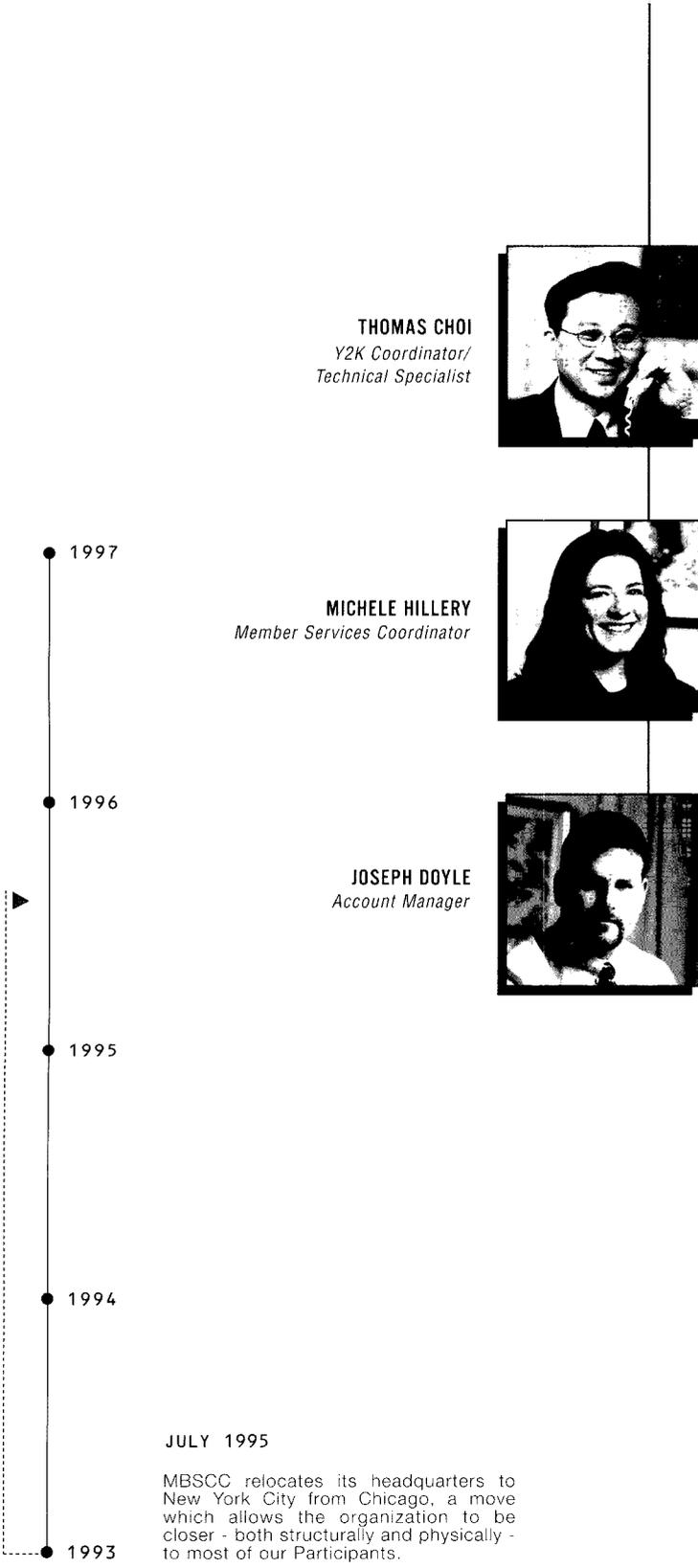
In June 1998 and again in October 1998, our organization completed testing a full cycle of its Clearing and EPN services with a significant number of our customers.

Testing will continue throughout 1999 and, effective October 1, 1999, we expect all Clearing Participants that have an automated interface with MBSCC will have successfully completed testing with MBSCC's systems.

Also, our ongoing consultations with industry Participants in 1998 allowed us to establish effective good delivery guidelines for GNMA II Jumbo securities, a product that became eligible for MBSCC's netting service in early 1999.

1998 Clearing System Volume
Total Par Values of Compared Trade Sides
(in trillions)





“By anticipating the needs of the market and providing innovative solutions on a consistent basis, MBSCC has become one of the most critical elements of the mortgage securities market. In my view, MBSCC’s top-notch staff and a series of committed Boards of Directors have been the keys to success.”

RONALD G. KEENAN
*Former Member,
MBSCC Board of Directors*

COMMUNICATION



"It was a very exciting time when I served on the Board. The phrase 'risk management' took on a whole new meaning back then. We lived through the Drexel experience. It was gratifying to be involved in the design of the risk management systems. There were lessons learned but, in the end, the hard work paid off."

JOE ANASTASIO
*Former Member,
 MBSCC Board of Directors*



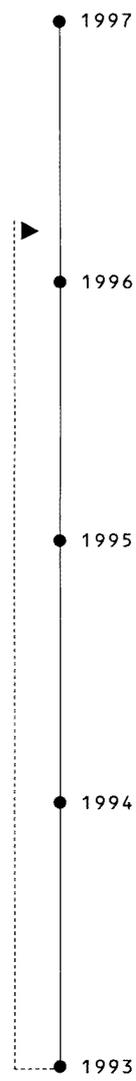
SHARON WARNER
Office Manager



ERIC ZALINKANSKAS
Member Services Coordinator



CHRISTOPHER TAMPOL
Senior Programmer/Analyst



FEBRUARY 1996

MBSCC's Electronic Pool Notification (EPN) system becomes fully operational and eliminates what had been one of the most burdensome manual steps in the clearance and settlement process - notification by the seller of the actual MBS pools to be delivered.

To further reduce Participant risks, a great amount of work was performed by staff and MBSCC's Risk Management Committee last year. This work culminated in a rule change that strengthens MBSCC's process for liquidating open trades when MBSCC ceases to act for a Participant. The analysis of our risk management processes continues and is focused on adapting our methodology to meet the challenges of our ever changing marketplace.

In marking our 20th anniversary, we realize that continued success requires effective adaptation to the new technologies in meeting the needs of our Participants.

One of our organization's key strategic objectives for the next millenium is to facilitate the integration of our Participants' front and back offices. In 1998, leveraging off our experience with the EPN real-time network, we began to evaluate which services should be real-time versus batch.

Initially, Real Time Trade Matching (RTTM) will replace batch trade comparison with interactive trade comparison, thereby reducing from hours to minutes the time necessary to compare a trade. Interactive comparison will eliminate the need for Participants to verbally confirm trades prior to submission to MBSCC for comparison, eliminating a cumbersome and error-prone process.

Recognizing the changing nature of our Participant base - a majority of MBSCC's customers are now non-dealers - we realized the necessity to expand upon the original business model. The safety and soundness of the MBS market can be seen in the unparalleled broadening of the number and types of investors in MBS. The standardization and cost efficiency we offer positions us to continue to expand our member base to the institutional community.

In recognition of strong institutional support of MBS, our Board of Directors voted in 1998 to expand its size from 13 to 15 members.

By expanding the size of our Board of Directors, we'll be in a better position to accommodate another significant

segment of our industry. We're also broadening the way in which we communicate our message to the industry and others with an interest in the MBS market.

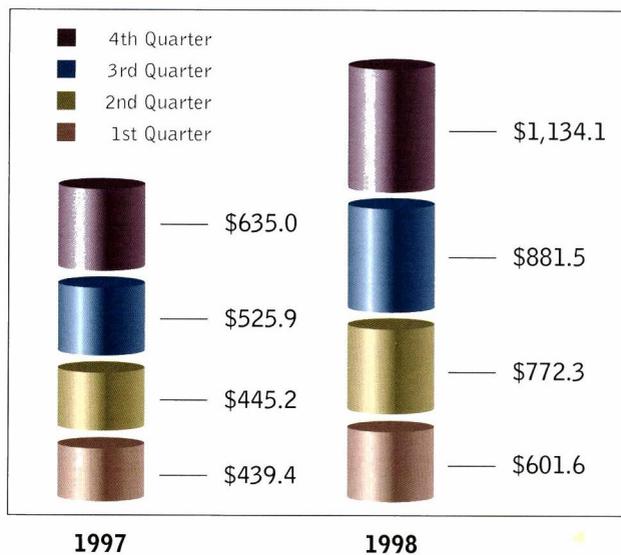
MBSCC's Web Site, launched in 1997, was revamped and now allows visitors to read and download the text from the most recent Annual Report, Product Fact Sheets, as well as past and current editions of *The MBSCC Report*, our newsletter. The enhanced content was unveiled in the first quarter of 1999 at <http://www.mbscc.com>

New features that can be found on our Internet address also include continuous updates of MBSCC's monthly processing schedule, along with links to the newsletters of other clearing corporations.

The way we communicate will continue to change and should further reduce the cost of sharing information. These trends bode well for the issuers and investors in mortgage-backed securities, all of whom share our commitment to a more efficient marketplace.

Face Value of EPN Messages

(in billions)



BALANCE SHEETS

| December 31, | 1998 | 1997 |
|---|---------------------|------------------|
| | (In thousands) | |
| Assets | | |
| Cash and cash equivalents | \$ 6,215 | \$ 5,541 |
| Accounts receivable | 893 | 795 |
| Participants' deposits | 1,043,740 | 639,888 |
| Fixed assets, less accumulated depreciation of \$1,221,000 and \$788,000 at December 31, 1998 and 1997, respectively | 596 | 891 |
| Other assets | 538 | 202 |
| Total assets | \$ 1,051,982 | \$647,317 |
| Liabilities and Stockholders' Equity | | |
| Liabilities: | | |
| Accounts payable and accrued liabilities | \$ 3,242 | \$ 2,429 |
| Participants' deposits | 1,043,740 | 639,888 |
| Total liabilities | 1,046,982 | 642,317 |
| Stockholders' equity: | | |
| Common stock, no par value: | | |
| Class A: 50,500 shares authorized, 38,346 shares issued and outstanding at December 31, 1998 and 1997 | 1 | 1 |
| Class B: 5,000 shares authorized, 4,260 shares issued and outstanding at December 31, 1998 and 1997 | 432 | 432 |
| Retained earnings | 4,567 | 4,567 |
| Total stockholders' equity | 5,000 | 5,000 |
| Total liabilities and stockholders' equity | \$ 1,051,982 | \$647,317 |

The accompanying notes are an integral part of these statements.

STATEMENTS OF INCOME AND RETAINED EARNINGS

| For the Year Ended December 31, | 1998 | 1997 |
|---|----------------|----------|
| | (In thousands) | |
| Revenue: | | |
| Operations | \$ 17,737 | \$14,916 |
| Discount to participants | (9,385) | (8,015) |
| Net revenue from operations | 8,352 | 6,901 |
| Interest income | 1,140 | 826 |
| Amortization of excess of net assets acquired over purchase price (Note 2) | - | 677 |
| Total revenue | 9,492 | 8,404 |
| Expense: | | |
| Employee compensation | 4,058 | 3,430 |
| Systems and related support | 2,524 | 2,179 |
| Rent, maintenance and utilities | 195 | 207 |
| Professional and other services | 1,576 | 872 |
| General and administrative | 706 | 674 |
| Depreciation | 433 | 365 |
| Total expense | 9,492 | 7,727 |
| Income before income taxes | - | 677 |
| Income tax provision: | | |
| Current | 71 | (66) |
| Deferred | (71) | 66 |
| Total income tax provision | - | - |
| Net income | - | 677 |
| Retained earnings, beginning of year | 4,567 | 3,890 |
| Retained earnings, end of year | \$ 4,567 | \$ 4,567 |

The accompanying notes are an integral part of these statements.

STATEMENTS OF CASH FLOWS

| For the Year Ended December 31, | 1998 | 1997 |
|---|----------------|---------|
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net income | \$ - | \$ 677 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of excess of net assets acquired over purchase price | - | (677) |
| Depreciation | 433 | 365 |
| Decrease (increase) in operating assets: | | |
| Accounts receivable | (98) | (159) |
| Other assets | (336) | 285 |
| Increase in operating liabilities — | | |
| accounts payable and accrued liabilities | 813 | 187 |
| Net cash provided by operating activities | 812 | 678 |
| Cash flows from investing activity - purchase of fixed assets | (138) | (214) |
| Net increase in cash and cash equivalents | 674 | 464 |
| Cash and cash equivalents, beginning of year | 5,541 | 5,077 |
| Cash and cash equivalents, end of year | \$6,215 | \$5,541 |
| Supplementary disclosures — | | |
| Income taxes refunded | \$ 163 | \$ 153 |

The accompanying notes are an integral part of these statements.

Note 1 ORGANIZATION AND OPERATIONS

MBS Clearing Corporation (MBSCC), a clearing agency registered with the Securities and Exchange Commission, provides trade comparison and settlement processing for mortgage-backed securities.

MBSCC provides discounts on its billing to participants based upon the amount of earnings to be retained in a given year with due regard to current and anticipated needs, as determined by its independent user Board of Directors.

Note 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash Equivalents: MBSCC invests funds in overnight reverse repurchase agreements, which are considered cash equivalents. Such agreements provide for MBSCC's delivery of cash in exchange for securities having a market value which is at least 102% of the amount of the agreement. An independent custodian designated by MBSCC takes possession of the securities. Overnight reverse repurchase agreements are recorded at the contract amounts and totaled \$6,215,000 and \$5,541,000, at December 31, 1998 and 1997, respectively. At December 31, 1998, one major financial institution was counterparty to this agreement.

Fixed Assets: Fixed assets consist primarily of computer hardware which is depreciated on a straight-line basis over three or five years.

Excess of Net Assets Acquired Over Purchase Price: Under a stock purchase agreement dated August 12, 1994, MBSCC acquired all the outstanding stock of a predecessor corporation which was a subsidiary of the Chicago Stock Exchange, Incorporated. This acquisition had been accounted for as a purchase transaction. The fair value of net assets acquired by MBSCC exceeded the purchase price by \$4,738,000. The excess was first allocated to reduce fixed assets by \$1,488,000. The remaining \$3,250,000 excess was amortized to operations on a straight-line basis over three years ending in 1997.

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.

Financial Instruments: Management believes that the carrying value of financial instruments approximates market value.

Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure

of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 3 PARTICIPANTS' DEPOSITS

The rules of MBSCC require its participants to maintain a minimum deposit in cash and to make additional deposits to cover market differentials to secure participants' obligations. Additional amounts may be assessed against participants in accordance with MBSCC's rules.

Participants' deposits consist of cash, securities issued or guaranteed by the U.S. Government, or its agencies, and letters of credit. A summary of the deposits held at December 31, 1998 and 1997 follows:

| | 1998 | 1997 |
|---|---------------|---------------|
| Cash | \$ 21,532,000 | \$ 44,584,000 |
| Securities issued or guaranteed by the U.S. Government or its agencies, at market | 1,022,208,000 | 595,304,000 |
| Letters of credit | 377,930,000 | 367,119,000 |

MBSCC has entered into a limited cross-guaranty agreement separately with National Securities Clearing Corporation (NSCC), International Securities Clearing Corporation and Government Securities Clearing Corporation under which these entities have agreed to make payment to each other for any remaining unsatisfied obligations of a common defaulting participant to the extent that these entities have excess resources of the defaulting participant.

Note 4 TRANSACTIONS WITH RELATED PARTIES

NSCC, a minority shareholder of MBSCC, provides various support services and office facilities to MBSCC. The costs of providing these services are charged to MBSCC in accordance with the provisions of a service agreement. The agreement expires in 1999 and will automatically be extended after the initial five year term unless canceled by either party upon six months prior written notice. Charges to MBSCC pursuant to this agreement totaled approximately \$862,000 in 1998 and \$653,000 in 1997. Amounts payable to NSCC at December 31, 1998 and 1997 were \$738,000 and \$583,000, respectively.

MBSCC is contingently liable, under a service agreement, for a portion of NSCC's office lease which expires on December 31, 2012. At December 31, 1998, the contingent

commitment of MBSCC for the remaining lease period is approximately \$2,625,000.

Note 5 INCOME TAXES

MBSCC files Federal, New York State, New York City and Illinois income tax returns. The 1997 income tax provisions differ from an amount based upon the statutory Federal income tax rate of 34% due to the amortization of the excess of net assets acquired over purchase price. The tax effect on temporary differences that give rise to significant portions of deferred tax assets consist primarily of depreciation and employee benefit costs.

Note 6 POST-RETIREMENT BENEFIT PLANS

All eligible employees of MBSCC participate in NSCC's trustee, noncontributory defined benefit pension plan. In addition, MBSCC also participates in NSCC's noncontributory supplemental executive retirement and benefit restoration plans which provide for certain benefits to identified executives of MBSCC upon retirement. Further, MBSCC also participates in NSCC's life insurance program which provides payment of death benefits to beneficiaries of eligible retired employees and NSCC's health insurance program which provides benefits to eligible retired employees. In 1998, costs for these plans aggregated \$236,000 and were determined based upon an actuarial calculation using information related to all eligible MBSCC employees. Disclosure of post-retirement benefit obligations, expense components and actuarial assumptions for the NSCC plans are included in NSCC's 1998 financial statements.



REPORT OF INDEPENDENT ACCOUNTANTS

February 12, 1999

To the Board of Directors and Stockholders of MBS Clearing Corporation

In our opinion, the accompanying balance sheets and the related statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of MBS Clearing Corporation at December 31, 1998 and 1997, 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.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP
New York, NY

MANAGEMENT'S REPORT ON RESPONSIBILITY FOR INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Stockholders of MBS Clearing Corporation

February 12, 1999

MBS Clearing Corporation (MBSCC) 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.

MBSCC's management assessed its internal control over financial reporting as of December 31, 1998, 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, MBSCC believes that, as of December 31, 1998, its system of internal control over financial reporting met those criteria.



Ronald A. Stewart
President and Chief
Executive Officer



Richard R. Macek
Chief Financial Officer
and Treasurer

PRICEWATERHOUSECOOPERS 

REPORT OF INDEPENDENT ACCOUNTANTS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Stockholders of MBS Clearing Corporation

February 12, 1999

We have examined management's assertion that MBS Clearing Corporation (MBSCC) maintained effective internal control over financial reporting as of December 31, 1998 which is included in the accompanying Management's Report on Responsibility for Internal Control Over 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 over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, 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, errors or irregularities may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control 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 MBSCC maintained effective internal control over financial reporting as of December 31, 1998 is fairly stated, in all material respects, based upon criteria established in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.



PricewaterhouseCoopers LLP
New York, NY

PARTICIPANTS / USERS

| Member Name | Clearing | EPN | COP | Member Name | Clearing | EPN | COP |
|---|----------|-----|-----|---|----------|-----|-----|
| ABN AMRO, Inc | . | . | | Intercapital Government Securities Inc. | . | . | |
| A.G. Edwards & Sons, Inc. | | . | | Interstate Johnson Lane Corp. | | . | |
| Adams, Viner and Mosler | | . | | Jennison Associates | | . | |
| Allianz of America, Inc. | | . | | J.P. Morgan Investment Management | | . | |
| Anchor National Life Insurance Company | . | | | J.P. Morgan Securities Inc. | . | . | . |
| Atlantic Portfolio Analytics & Management, Inc. | | . | | Lehman Brothers Inc. | . | . | . |
| Bank for International Settlements | . | | | Liberty Brokerage Inc. fao Patriot Securities | . | . | |
| Bankers Trust Company | . | . | | Lincoln Capital Management Co. | | . | |
| Bankers Trust (Delaware) | . | . | | Long Term Capital Portfolio LP | . | . | |
| Barclays Capital | . | . | | Manufacturers and Traders Trust Co. | . | | |
| BNY Clearing Service LLC | . | . | | Marine Midland Bank | . | | |
| BT Alex. Brown Incorporated | . | . | | MBS Fund Alpha | . | . | |
| Bear, Stearns & Company | . | . | . | MBS Fund Caspian | . | . | |
| CalAmerica Life Insurance Co. | . | | | MBS Fund Gamma | . | . | |
| California Public Employees Retirement System (CalPERS) | | . | | McDonald Investments Inc. | . | . | |
| Cantor Fitzgerald Securities | . | | | Merrill Lynch GSI | . | . | . |
| Cantor Fitzgerald & Company | | . | | Morgan Guaranty Trust Company of NY | . | | |
| CDC Financial Products | | . | | Morgan Keegan & Company | . | | |
| CDC Investment Management Corp | | . | | Morgan Stanley Market Products, Inc. | . | . | . |
| Chase Manhattan Bank | . | . | | NationsBanc Montgomery Securities, LLC | . | . | |
| Chase Manhattan Mortgage Corporation | . | | | NationsBanc Mortgage Corp. | | . | |
| Chase Securities Inc. | . | . | . | NationsBank, N.A. (Carolinas) | . | . | |
| CIBC Oppenheimer & Company, Inc. | . | . | . | New York Life Insurance & Annuity Corp. | . | . | |
| Citicorp Mortgage, Inc. | . | | | New York Life Insurance Co. | . | . | |
| CNA Financial Corporation | . | . | | Nikko Securities Co. International, Inc. | . | . | . |
| Compass Bank | | . | | Nomura Securities International, Inc. | . | . | . |
| Countrywide Home Loans, Inc. | . | . | | Norwest Mortgage, Inc. | | . | |
| Countrywide Securities Corp. | . | . | | Pacific Investment Management Company | | . | |
| Craigie Inc. | | . | | PaineWebber Inc. | . | . | . |
| Credit Suisse First Boston Corporation | . | . | . | PFL Life Insurance Co. | . | | |
| Daiwa Securities America, Inc. | . | . | | Prudential Capital Management | | . | |
| Dean Witter Reynolds Inc. | . | . | . | Prudential Securities, Inc. | . | . | . |
| Deutsche Bank Securities | . | . | . | Raymond James & Associates, Inc. | | . | |
| D.E. Shaw | . | | | Republic Bank Delaware, N.A. | | . | |
| Donaldson, Lufkin & Jenrette Securities Corp. | . | . | . | Republic National Bank | | . | |
| Ellington Management Group LLC | | . | | Residential Funding Corporation | . | | |
| Fannie Mae | | . | . | Salomon Smith Barney Inc. | . | . | . |
| Federal Home Loan Mortgage Corp. | . | . | | SG Cowen Securities Corp. | . | . | |
| First Tennessee Bank N.A. (Capital Markets) | | . | | Spear, Leeds & Kellogg | . | . | |
| First Union Corporation fao First Union Capital Markets Corp. | . | . | | Spinnaker I | . | | |
| First Union National Bank | | . | | Standish, Ayer & Wood, Inc. | | . | |
| Fischer Francis Trees and Watts, Inc. | | . | | Stephens Inc. | . | . | |
| Franklin Advisers, Inc. | | . | | SunAmerica Inc. | . | | |
| FFTW - Total Return Trust | . | | | SunAmerica Life Insurance Co. | . | | |
| FFTW - Mortgage Total Return Fund PLC | . | | | SunAmerica National Life Ins. Co. | . | | |
| FFTW Funds, Inc. - Mortgage Total Return Portfolio | . | | | SunTrust Equitable Securities, Inc. | | . | |
| Garban LLC | . | | | Texas Commerce Bank | | . | |
| Goldman, Sachs & Company | . | . | . | Travelers Investment Group | | . | |
| Goldman, Sachs Asset Management | | . | | Vining-Sparks, IBG. | | . | |
| Greenwich Capital Markets, Inc. | . | . | . | Warburg Dillon Read LLC | . | | |
| Hilliard Farber & Co., Inc. | . | . | | Weiss Peck & Greer | | . | |
| HIMCO | | . | | Wellington Management Company, LLP | | . | |
| III Finance Ltd. | . | . | | Western Asset Management Company | | . | |
| III Global Ltd. | . | . | | WestLB Securities Americas Inc. a/c | | . | |
| IndyMac, Inc. | . | | | Westdeutsche Landesbank NY Branch | | . | |

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