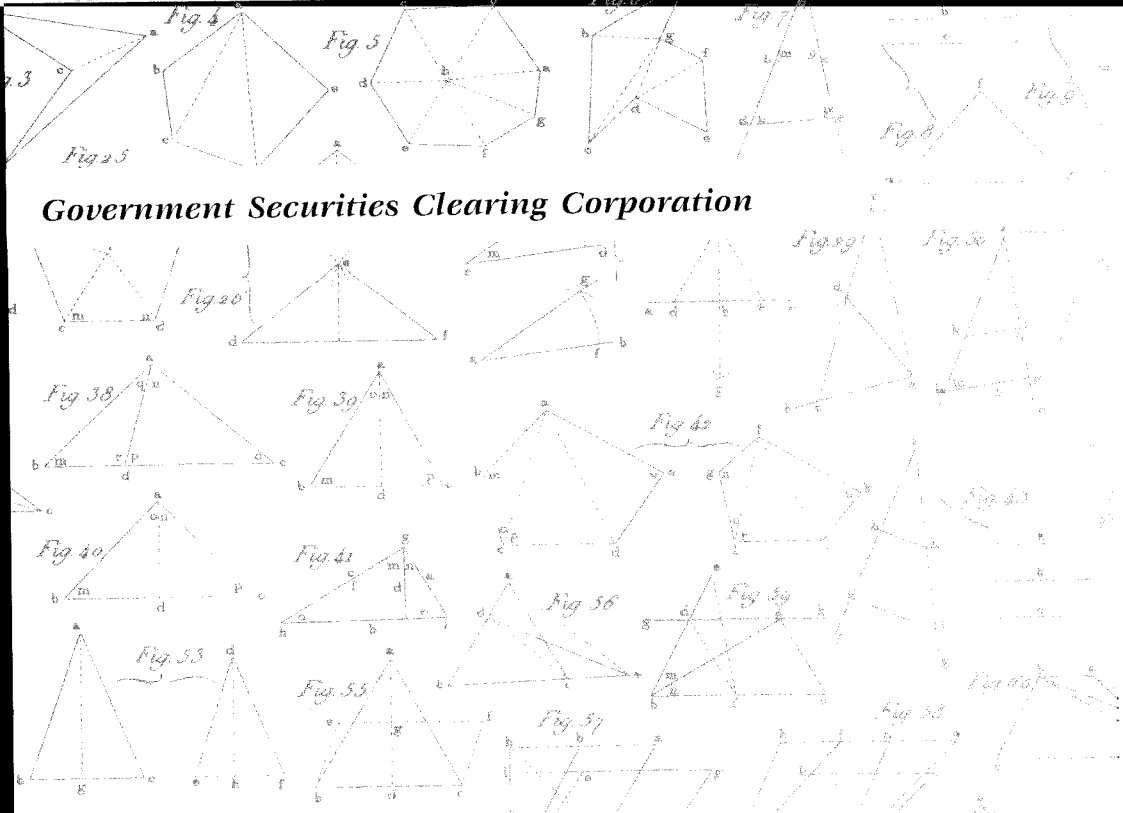
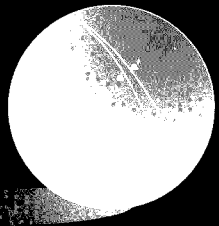
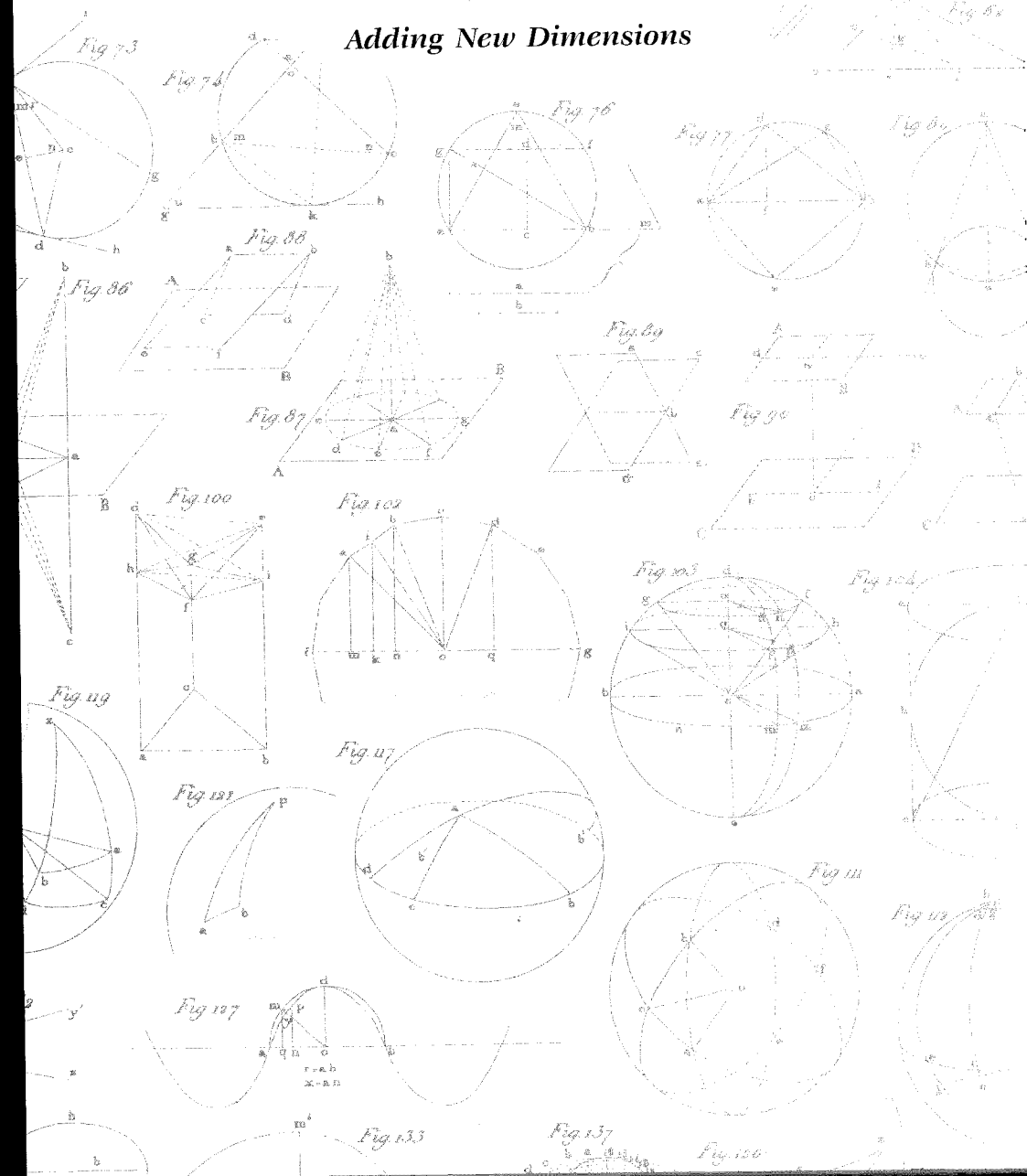


Government Securities Clearing Corporation



Adding New Dimensions



About GSCC

Government Securities Clearing Corporation (GSCC) clears and settles a broad range of U.S. Government securities transactions for brokers, dealers, banks and other financial institutions involved in this dynamic marketplace. These transactions include buy/sell and repurchase agreement transactions in, and original auction purchases of, Treasury bills, bonds, notes, zero-coupon securities, Government Agency securities and inflation-indexed securities.

By providing highly sophisticated, fail-safe automated trade comparison, netting and settlement processing services, GSCC ensures the timely, accurate and cost-efficient completion of transactions for more than 100 member firms and the more than 400 correspondent firms that clear through these

members. Underlying GSCC's systems is a risk-management process that provides stability to the marketplace and our participants by minimizing the risks arising from the process of clearing and settling Government securities.

Established in 1986 by National Securities Clearing Corporation (NSCC), GSCC is a clearing agency registered with, and regulated by, the Securities and Exchange Commission. Owned primarily by its members, GSCC is guided by a Board of Directors that reflects the organization's membership; it includes representatives from the large community of dealers, brokers and other financial entities that trade in or clear U.S. Government securities.

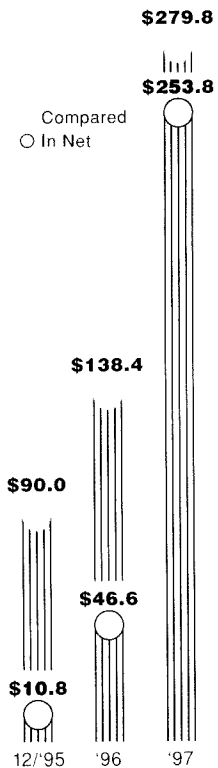
1997 Achievements

Processed \$148.5 Trillion in Transactions

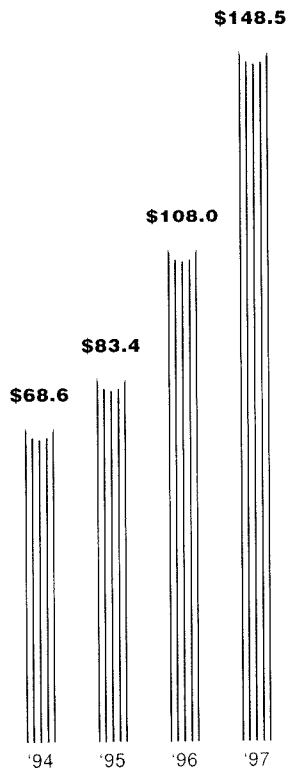
Removed \$91 Trillion from Settlement through Netting

Provided \$166 Million in Industry Opportunity Benefits

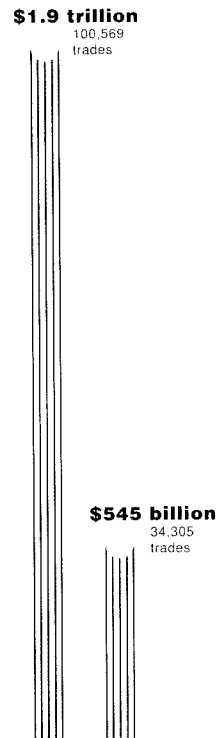
Average Daily Repo Transactions
(in billions)



Value of Transactions Processed
(in trillions)



Peak Volume Day Compared with Daily Average



Effect of Netting on Peak Volume Day



To Our Participants

Events at the end of October 1997 clearly demonstrated that Government Securities Clearing Corporation (GSCC) has fulfilled its mandate to bring capacity, efficiency and stability to the U.S. Government securities marketplace. While some markets worldwide were awash in unsettled trades, GSCC processed transactions valued at \$1.27 trillion on October 30 with ease. GSCC also smoothly handled 10 other days in 1997 when volume exceeded \$1 trillion, including a 1997 peak \$1.9 trillion day.

For the year, GSCC posted substantial increases in both the number and value of U.S. Government securities processed. Total volume for the year rose to 10.3 million transactions, and dollar value of these transactions climbed to \$148.5 trillion from \$108 trillion in 1996. Average daily netting moved up to 34,305 transactions worth \$545 billion. Importantly, GSCC eliminated through netting a daily average of more than \$360 billion, and its associated risk, from settlement.

Since 1986, GSCC has earned the trust and confidence of participants by processing ever-increasing cash market transactions quickly and efficiently, without service interruptions and at decreasing cost. But our experience in the repurchase agreement (repo) market, which we entered in 1995, is compelling us to add more dimensions to our services that will provide even more value for our members.

Because GSCC becomes the counterparty for all netted transactions, our members are able to offset repos and reverse repos under FASB Interpretation No. 41. This already supplies substantial opportunities for our participants to book increased business with the same amount of capital. And we believe we can do even more.

Therefore, we not only took steps in 1997 to insure the continuing high quality of our services, but also began to mold GSCC into a company that can provide greater tangible value to its participants by further enhancing their capital efficiency.

Reengineering Our Systems

Early in the year we offered our vision for the future in a White Paper that met with enthusiastic endorsement from the industry. In it, GSCC discussed its support of straight-through processing and point-of-trade guarantee by developing real-time, interactive processing capabilities.

Moving in this direction, we began the reengineering of our systems in 1997 by converting all processing hardware to advanced 64 bit Alpha systems. We replaced our network with a fiber-based switched architecture and began offloading analytic processing onto a relational database. In addition, we are dividing our single massive system into component parts. And we are completing these considerable projects without missing a processing or operational beat.

Growth in our repo business continues to be impressive, reaching a 1997 daily average of 9,200 transactions in netting in just over two years. In 1997, GSCC gave members even more flexibility in selecting repo collateral by comparing and netting repos with underlying collateral that matures prior to the repo close date. This service supplements our repo-to-maturity processing, begun at the end of 1996, and our recently added ability to net repos with a term of up to two years. Also in 1997, we began to net and guarantee general collateral and other forward-starting repos.

Automating Repo Processing

GSCC is advancing rapidly toward our goal of automating every aspect of start- and close-leg repo processing. On deck for 1998 is the initial work on start-leg repo processing that will clear and settle on the same day in GSCC's account, instead of in the broker/dealer's account.

Recognizing the need for new mechanisms to engage in repo trading that is most efficient from a capital perspective, we are eager to begin the planned General Collateral Finance (GCF) Repo service in 1998. Dealers will be able to trade general collateral repos throughout the day without requiring intra-day, trade-for-trade settlement on a DVP basis.

Guided by our Repo Implementation Committee and developed in partnership with our clearing banks, GCF repo signifies a significant change in the way financing transactions are

**We began to mold
GSCC into a
company that can
provide greater
tangible value to
its participants
by further
enhancing their
capital efficiency.**



David M. Kelly

Sal Ricca

Edward F. Watts, Jr.

processed. It utilizes Broker-Assisted Comparison (which processes data based solely on broker input) and represents an early start on real-time, interactive trade processing at GSCC.

GSCC continued to extend our customer base when non-U.S.-based broker/dealers, banks and other industry entities became eligible for membership in 1997, and GSCC is targeting still more industry sectors for the substantial benefits of centralized, automated processing. In the immediate future, we plan to create new services that will be of direct benefit to mutual funds and other providers of securities and monies used in financing trades that employ U.S. Government securities.

Risk management is a critical element in the value that we add to the U.S. Government securities market, and our policies undergo continuous scrutiny. Since blind-brokered trades are an ever-growing portion of our total transactions, we revised our loss allocation process to reflect better our business environment and more equitably allocate loss among dealers. This is crucial in view of weaknesses exposed in some segments of the financial markets late in 1997. In addition, GSCC continues its work with the futures industry on cross-margining and potentially, cross-settlement.

GSCC has also reviewed our shareholder agreement to be sure it reflects the kind of organization we are creating. We recently established a nominating committee for Board of Directors election purposes and assured a broader representation of membership categories on our Board. These revisions will provide us with greater flexibility in corporate governance going forward.

One of the great satisfactions in leading GSCC is working with a multi-talented team of staff, Board members and participants. GSCC could not possibly expand its scope without the strong support of our Board. Their hands-on operations, technology and business management experience at broker/dealers, interdealer brokers and clearing agent banks helps us to steer a steady course in our new endeavors.

Our staff is peerless in its understanding of the U.S. Government securities marketplace and the technological and business issues that surround it. They are also unbounded in their enthusiasm for the challenge of the work we do.

Certainly our numbers indicate that 1997 was an outstanding year, reflecting our ability to provide the industry with a safe and sound settlement process, cost-reduction, risk management and capital efficiency. But we can also measure our accomplishments in 1997 by our leadership in strengthening the infrastructure that will support the industry over the long-term. By this standard, 1997 was enormously successful.

Edward F. Watts, Jr.
Chairman of the Board

David M. Kelly
Vice Chairman

Sal Ricca
President and Chief Operating Officer

Adding New Dimensions

Evolving member needs are driving Government Securities Clearing Cor-

poration (GSCC) to add new dimensions to its core services of comparison, netting, settlement and risk management. Building out from the infrastructure GSCC developed for the cash market, we are adding benefits for our members through innovative systems that support processing of a broad array of instruments used in financing transactions.

GSCC was established in 1986 in response to the explosive growth in trading volume for U.S. Government securities. The industry was faced with three major challenges: first, inefficient manual processing; second, frequent settlement delays because of late Fedwire closings due to high volume and third, increasing concerns about risk exposure. GSCC was formed to provide the industry with standardization, operating efficiencies and risk-management benefits.

GSCC's primary systems — comparison, netting, settlement and risk management — ensure that after a trade is concluded, it is cleared and settled in an orderly, efficient manner with the least possible risk to the market and its participants.

Fierce competition and narrowing margins are now turning our members' attention increasingly from issues of operational efficiency — now mostly solved — to those of capital sufficiency. The adoption of FASB Interpretation No. 41 (FIN 41) in late 1994, which permits the offsetting of repurchase agreements (repos) and reverse repos with a common counterparty, has set the stage for firms not only to utilize repos collateralized by Treasury securities for short-term funding at favorable rates, but also to reduce the assets and liabilities shown on their books. This frees up capital that can be put to use for additional transactions.

Developing Balance-Sheet-Offset Mechanisms

The potential offered by repos through FIN 41, however, was limited because of processing inefficiencies, counterparty risk and trading limitations. The marketplace needed new mechanisms that would make the benefits of the balance-sheet offsets fully realizable.

GSCC quickly responded with innovative systems for processing repos and other short-term financing vehicles that provide not only our traditional benefits of efficiency and risk abatement, but also facilitate balance-sheet management. GSCC, by becoming the counterparty for all netted transactions, satisfies the common counterparty requirement of FIN 41.

In 1995, GSCC introduced centralized, automated systems for overnight, term and forward repos. By 1996, GSCC had added comparison and netting services for blind-brokered repos, allowing dealers to execute repos on an anonymous basis through interdealer brokers.

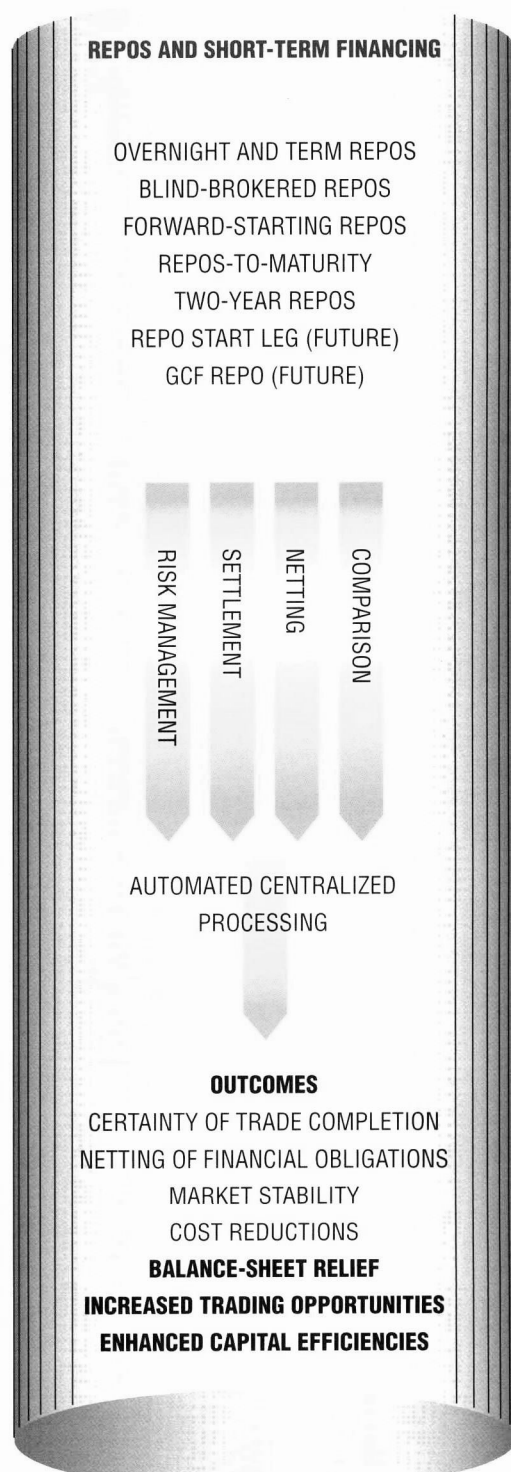
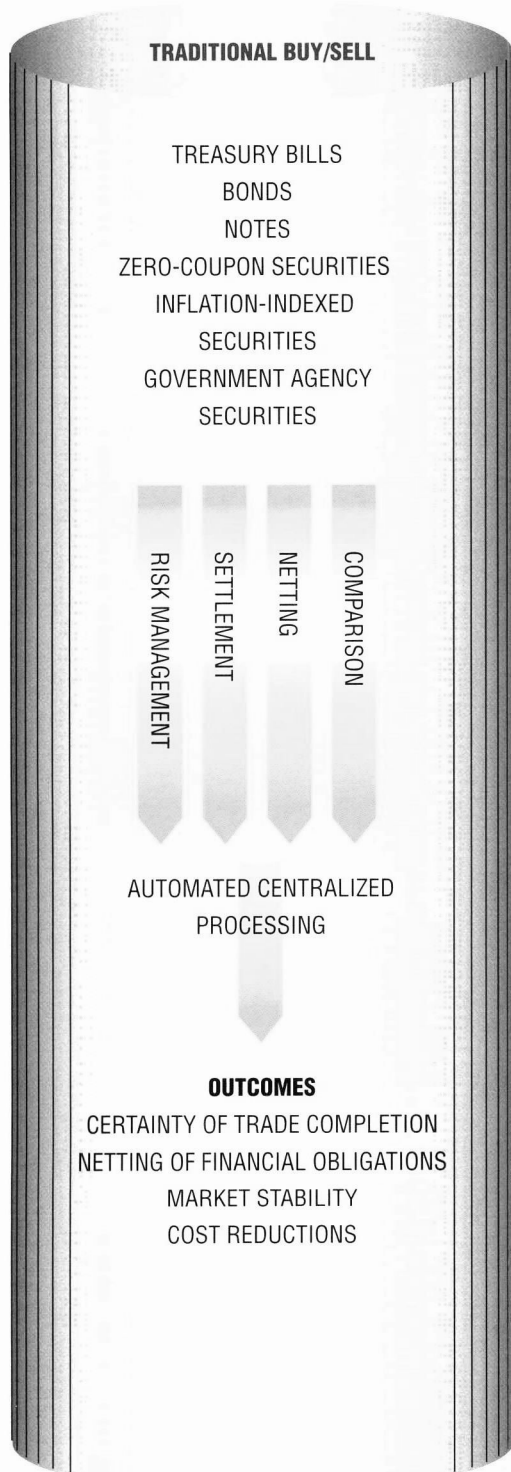
Reaching Beyond Operational Issues

To further expand the flexibility members have in selecting repo collateral, GSCC now provides comparison and netting of repos with underlying collateral that matures prior to the repo close date, repo-to-maturity processing and the netting of repos with a term of up to two years. In 1997, we also began to net and guarantee forward-starting repos from their date of execution.

GSCC will add even more value for participants in 1998 with the advent of start-leg repo processing and our new General Collateral Finance (GCF) Repo service, which provides a more efficient way to initiate collateral financing through repos. These and other new services will attract new segments of the repo market to our systems, bringing increased benefits to all.

GSCC began with the goal of adding value through processing efficiency and risk management. To a large extent, we have achieved this. Now, by adding new dimensions to our services, we are reaching far beyond operational issues to assist members in achieving other business objectives.

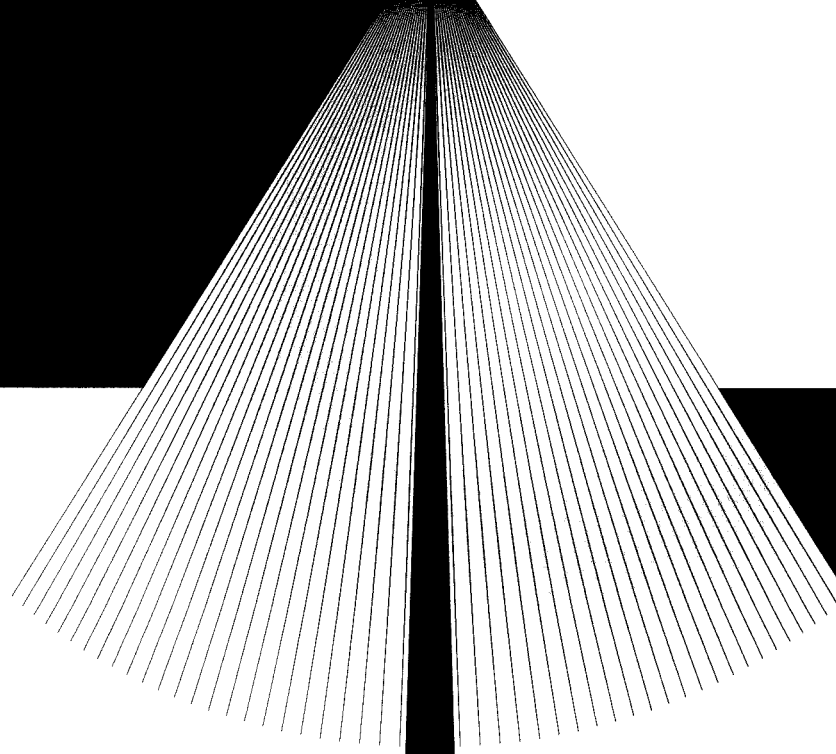
GSCC provides not only our traditional benefits of efficiency and risk abatement, but also facilitates balance-sheet management.



GSCC adds value by building on the infrastructure developed for cash markets to support a broad array of instruments used in financing transactions.

Enhancing Trade Processing

The \$1.9 trillion spike in transactions on November 14, 1997, was more than triple our average daily netting activity.



6

GSCC's capacity and netting ensure certainty and safety in the marketplace.

Real-time, Interactive Processing

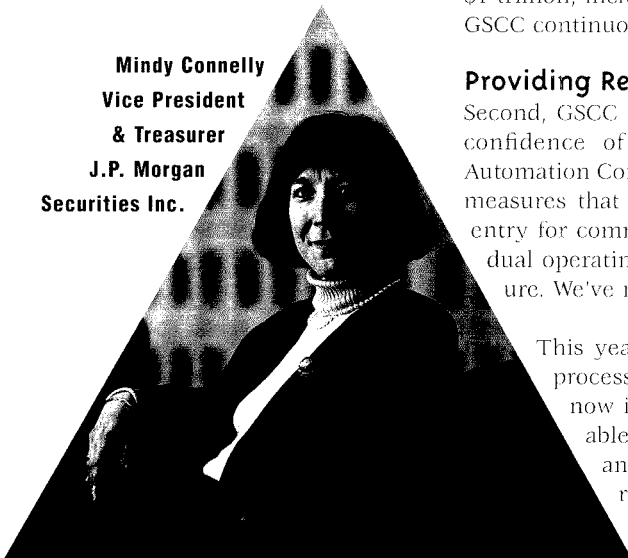
Supporting the need for real-time, interactive processing in our dynamic marketplace, GSCC is replacing its entire systems hardware platform and network architecture. GSCC computers now operate with a 64-bit architecture, we archive and retrieve information through optical disk and CD-ROM technology and utilize a high-speed fiber network. Reengineering our systems makes them faster, cheaper and more reliable — and provides the foundation on which to facilitate earlier capture of trade data, interactive communications, expanded on-line access and, where appropriate, use of the Internet.

Reducing Uncertainty

The U.S. Government securities marketplace is the largest and most liquid in the world, attracting investors because of the stability of the U.S. Government. The appeal of this solid foundation could be eroded by credit and other risks inherent in any marketplace. GSCC plays a critical role in ensuring the safety and soundness of the U.S. Government securities marketplace by utilizing a variety of risk-management techniques.

First, GSCC assures that there is always the systems capacity necessary to process not only the constantly rising number of average daily transactions, but also the unprecedented spikes in volume that accompany volatile periods in the markets. In 1997, GSCC dealt with eleven days of processing volume in excess of more than \$1 trillion, including a 1997 high netting volume of \$1.9 trillion on November 14. GSCC continuously monitors the marketplace and adjusts capacity as needed.

Mindy Connelly
Vice President
& Treasurer
J.P. Morgan
Securities Inc.



Providing Reliability

Second, GSCC provides the clearing and settlement reliability that is key to the confidence of market participants. Working with the Securities Industry Automation Corporation (SIAC), our facilities manager, GSCC has in place fail-safe measures that range from emergency backup generators to multiple points of entry for communications lines. GSCC also maintains geographically separated, dual operating sites that offer full redundancy and avoid a single point of failure. We've maintained a flawless record of nine years without an outage.

This year, to support the business requirements of real-time, interactive processing, GSCC replaced its entire systems hardware platform and is now in the process of changing its network architecture. We have been able to undertake this major project without members experiencing any diminution of service. The new platform provides a safer, more reliable overall architecture, further minimizing single points of failure. And along with faster processing cycles, the new platform allows us to deliver systems enhancements and recover more quickly if that should ever be necessary.

Third, GSCC guarantees that a trade will be completed once it enters our system. This guarantee of settlement minimizes risk in the unusual event that a firm becomes insolvent.

Reducing Financial Obligations

Fourth, GSCC's netting system mitigates market risk by reducing or netting the total number of financial obligations requiring settlement. On an average daily basis, netting eliminates four out of five securities and settlement obligations.

In addition to netting cash and repo transactions, GSCC provides further risk-management benefits to the industry through the pass-thru of coupon payments, which ensures that the true beneficiaries of coupon payments actually receive them. On our 1997 peak day, coupons amounted to \$8.7 billion. Through the netting of coupon payments, an additional amount of settlement risk is eliminated from the system.

GSCC's risk-management methodology includes multiple membership categories with high minimum financial standards; conservative and dynamically calculated margin and collateral requirements; a forward margin procedure that revalues forward-settling cash trades and term repos by marking them daily from contract value to market value and a multi-stage loss allocation procedure that ensures a systemic failure of the settlement process should never occur.

As we add to our capacity, augment our activities and diversify our constituency, we are always keenly aware of the implications of that growth. In whatever ways we increase the scope of our business, we will always take prudent steps to eliminate uncertainty from the marketplace as well.

Keeping the Market Stable
With the average cash trade reaching more than \$8 million and repo trade over \$42 million, participants are reassured by the presence of a strong clearing corporation in the background, keeping the U.S. Government securities market stable by reducing both systemic and participant risk. The key to GSCC's success is keeping pace with changes in the marketplace. GSCC continues to develop new products and services that bring cost benefits, risk benefits and balance sheet benefits to the industry.

Extending Opportunities

GSCC's internal analysis has estimated that GSCC's services, including balance-sheet offsetting, provided \$166 million to the industry in opportunity benefits in 1997. While not an insignificant sum, it could pale in comparison to the benefits offered by two services slated for 1998 and beyond — support for repo start-leg processing and the General Collateral Finance (GCF) Repo. With these and other innovative services that expedite the processing of investment vehicles, we extend opportunities for our members to efficiently utilize their capital.

Supporting Real-Time Processing

Underpinning our new product developments is an advanced technology platform that supports the real-time, interactive processing necessary for same-day trade guarantee and settlement. Repo start legs have been settled outside GSCC due to the constraints of a batch processing environment. Our reengineered systems will enable these same-day settling trades to enjoy the full benefits of GSCC's netting, risk management and clearance services.

A GSCC participant asked us to develop a vehicle whereby the industry could freely and actively trade general collateral repos without requiring intraday, trade-for-trade settlement on a delivery versus payment (DVP) basis. Working with the Repo Implementation Committee, and in conjunction with The Bank of New York and The Chase Manhattan Bank, GSCC designed a service that will permit dealers to execute general collateral repos, based on rate and term, throughout the day via eligible brokers. Standardized, generic CUSIPs will be used to specify the acceptable type of underlying collateral, which could be U.S. Treasury, agency or mortgage-backed securities.

Brokers will submit these repos as soon as possible after trade execution and GSCC will guarantee settlement of GCF Repos upon data receipt. Collateral allocation exclusively for GCF Repos will be conducted after the close of the Fedwire.

The new GCF Repo service removes current constraints on collateral notification and allocation and ensures liquidity across clearing banks. Because members will settle on a net basis, they will incur fewer Fedwire charges. Importantly, GSCC will become the legal counterparty to all GCF repos, eliminating counterparty credit risk while maximizing balance-sheet offset under FIN 41.

Shifting the Information Flow

To put these new services in place, GSCC is leading the industry in a significant change in the way transactions are processed. As a first step, we will reengineer the traditional trade comparison process, shifting the flow of information from the back office to the trading desk. The broker will provide single-sided data input, rather than today's dual submission of matching trade details by deliverers and receivers. With comparison no longer a prerequisite for netting and settlement, transmissions can be processed immediately. Along with processing efficiencies, a settlement guarantee closer to the time of trade execution will enhance risk protection.

Our ability to do both start- and close-leg repo processing, and the addition of new services like GCF Repo, bring additional settlement efficiency and risk management to the combined cash and repo markets. Expanding the scope of our services should also provide an incentive for those on the money lending and securities lending side of the finance market — mutual funds and bank securities lending agents — to join GSCC for a more efficient way to handle all of their repo transactions.

Total Repo Dollars in Net

(in trillions)

\$63.5

\$11.7

\$3.1

12/'95

'96

'97



Thomas Wipf, Principal
Morgan Stanley & Co.
Incorporated

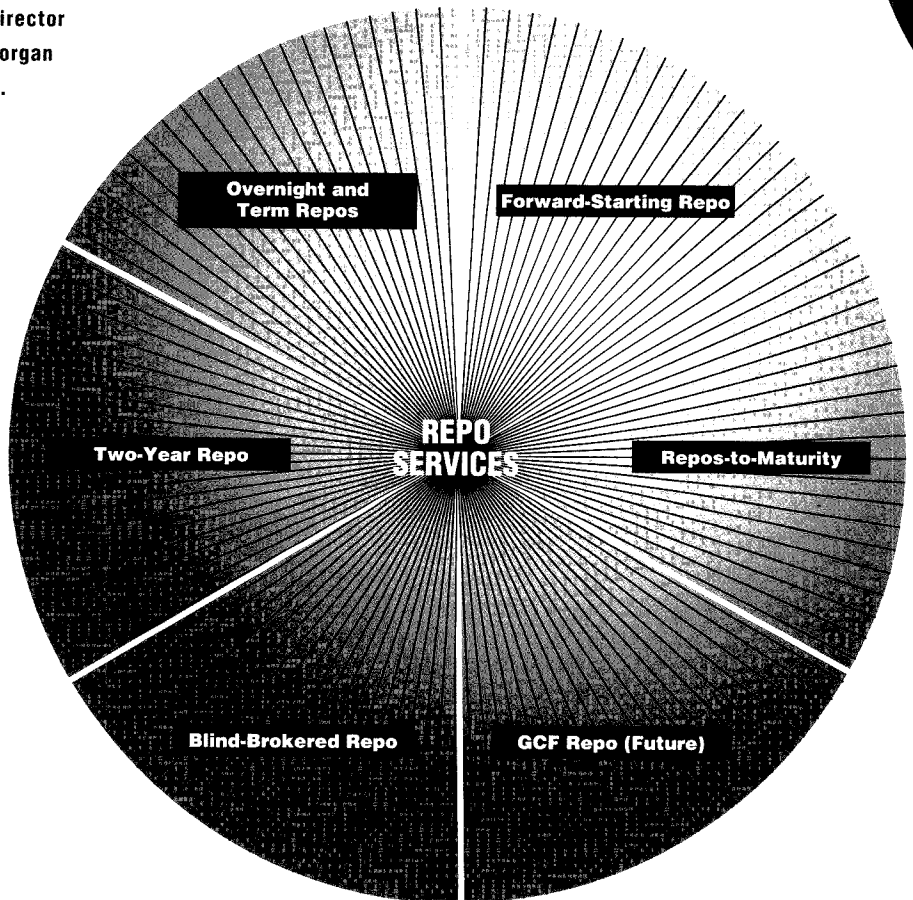
Easing Operational Burdens
The development of GCF Repo will allow our traders to focus on the economics of a transaction, rather than worry about collateral availability at the point of execution. In addition, GSCC is once again easing some of our operational burdens. With the combined benefits of liquidity, better and more readily available pricing, and netting, we expect GCF Repo to become the standard for the industry in dealer-to-dealer markets.



Mario Pierro
Managing Director
Deutsche Morgan
Grenfell Inc.

Creating Marketplace Liquidity

In less than two years GSCC has revived a sluggish repo market and helped our return on assets. Before GSCC came into the picture, the repo industry was maturing, margins were compressed and volume was down. GSCC created liquidity in the marketplace through the benefits of netting and balance-sheet reduction and was able to virtually eliminate the risk inherent in repos because of the maturity spectrum.



GSCC's goal is to automate all aspects of repo start- and close-leg processing.

At GSCC, we are expanding our scope by extending capacity, increasing our activities and multiplying our customer base. But no matter how sweeping the changes to our business, there are certain basic principles to which our commitment remains steadfast. They provide the footing for our efforts to foster growth in the U.S. Government securities marketplace.

Talent

GSCC's management takes very seriously its obligation, both to our staff and to the industry we serve, to maintain a work environment that nurtures talent. Our responsibility begins with hiring knowledgeable and dedicated people and then focusing their energies on both cutting-edge technology and the quickly changing U.S. Government securities marketplace.

Recently, we have altered our management paradigm and shifted responsibility for decision-making to those with the hands-on responsibility for — and hands-on knowledge of — specific issues. GSCC now has various clusters of staff to work on thorny problems, each group determined by the nature of the challenge it is seeking to overcome.

A more fluid management structure, with decisions and solutions bubbling up through the organization, is a powerful tool to release the creative force of our people and provide more effective problem-solving to the industry.

Technology

GSCC is determined to bring the best of new technologies to bear on the issues that concern the U.S. Government securities marketplace — efficiency, cost containment, risk management and capital efficiency. So we continuously study new technologies, evaluate them in partnership with our members and apply them in support of industry growth.

Today, with markets increasingly fast-paced and global, it is imperative that GSCC develop real-time, interactive processing that will support the industry's initiative for straight-through processing and enable transactions to settle through GSCC on the same day they are executed. The benefits of shifting technology will not only be increased efficiency, but also enhanced risk protection by adding our settlement guarantee closer to the time of trade execution.

To achieve these goals requires migration toward standardized message formats, communications protocols and systems interfaces. Importantly, the technology we use needs the flexibility to handle batch and multi-batch processing, along with interactive processing.

Since preparing a White Paper for the industry early in 1997, which set out our vision for interactive, on-line systems and platform, we have made substantial progress toward that goal by replacing our entire systems hardware and network architecture.

Risk Management

Our mandate is to ensure that the U.S. Government securities industry has a stable and reliable trading environment and that GSCC has sufficient liquidity at all times to meet participant settlement obligations.

GSCC was formed during an unprecedented upswing in U.S. Government securities trading and developed systems to deal with the risk exposures inherent in explosive growth. But what was once unprecedented has now become a normal growth pattern. With huge volume increases an ongoing issue, we have continued to make risk management an integral component of all GSCC's netting and settlement services.

To ensure that GSCC's risk management procedures always keep pace with changes in our industry, we review our policies in light of these changes. Then, through a variety of collateral and financial standards, as well as risk-minimizing netting and settlement procedures, we manage the risk associated with the significant industry-wide consequences that could result if a participant firm failed.

Communication

GSCC has resolved to maintain an open and honest exchange of ideas with our members and our industry. Our people meet regularly with user and advisory groups and participate in a host of industry forums. Our participants seek input from us as they deal with new in-house systems, communications lines and vendors. Training sessions bring members up-to-speed on new services and review existing services to keep turnover at participant staff from affecting the quality of clearance and settlement.

Our Web site, found at www.gsc.com, has become an important link between GSCC and participants. Important Notices, participant and contact lists, articles on technology and news about GSCC are now instantly available, and other frequently requested information is being added.

In addition to close partnership with our members, we also maintain ongoing communications with the exchanges, the SEC, the Bureau of Public Debt, the Federal Reserve Bank of New York and other regulatory agencies to ensure that our activities truly meet the needs of the entire industry.

Value

GSCC has been entrusted by the industry to add value to our members' businesses. We don't see ourselves solely as a provider of post-trade processing, but as an organization that supports our participants' business objectives. So we ask the tough questions about where our industry is headed, what our customers want and where we will have to be to serve their needs.

Our core systems for comparison, netting, settlement and risk management have brought to the U.S. Government securities industry post-trade processing that is orderly, efficient and risk-averse. Now we are adding even greater value by moving our focus beyond operations to the treasury and finance side of our members' businesses. By facilitating balance-sheet management through innovative systems for processing repos and other financing vehicles, GSCC is providing even more valuable benefits that flow through to the bottom line.

Board of Directors



from left to right:

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

Sal Ricca
*President &
Chief Operating Officer
Government Securities
Clearing Corporation*

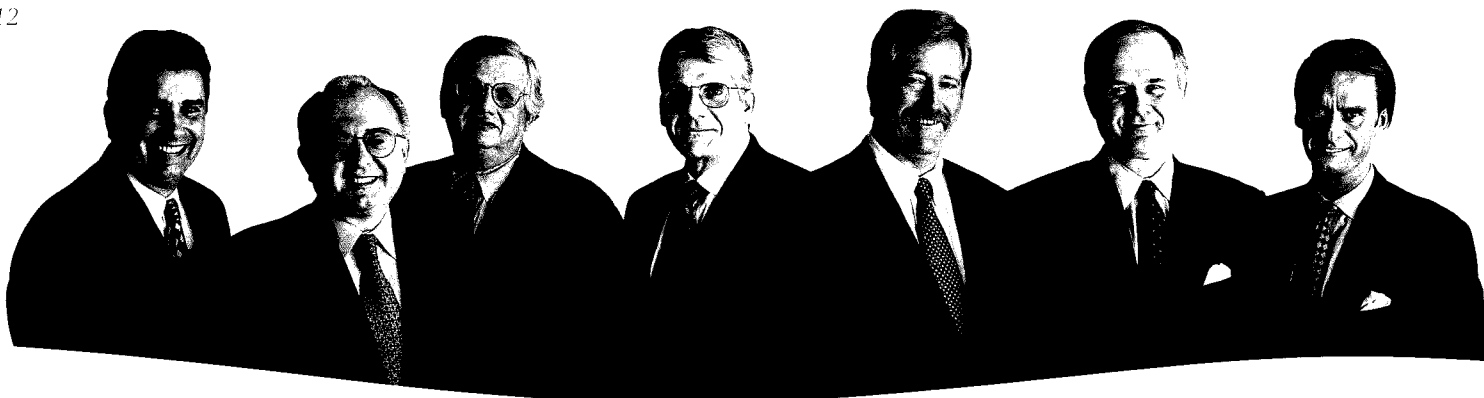
Edward F. Watts, Jr.
*Chairman, GSCC
Managing Director
Goldman, Sachs & Co.*

Peter J. Murray
*Director
Credit Suisse First
Boston Corporation*

David M. Kelly
*Vice Chairman, GSCC
President &
Chief Executive Officer
National Securities Clearing
Corporation*

Daniel O. Minerva
*Co-President
Co-Chief Executive Officer
Eastbridge Capital Inc.*

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from left to right:

Mario J. Pierro
*Managing Director
Deutsche Morgan Grenfell Inc.*

Joseph R. LaBato
*Managing Director
The Chase Manhattan Bank*

Stephen R. Tilton
*President
Garban LLC.*

Ralph Mastrangelo
*Executive Vice President
The Bank of New York*

Thomas Wipf
*Principal
Morgan Stanley & Co.
Incorporated*

Edwin F. Payne
*Chairman &
Chief Executive Officer
Liberty Brokerage Investment
Corporation*

Clive Cooke
*Chief Executive Officer
Exco USA Securities Inc.*

Executive Management



from left to right:

Robert P. Palatnick
*Managing Director
Technology*

Jeffrey F. Ingber
*Managing Director
General Counsel &
Secretary*

Thomas F. Costa
*Managing Director
Marketing, Planning,
Operations & Technology*

Steven M. Jukofsky
*Managing Director
Marketing*

Joseph J. Grima
*Managing Director
Operations*

Sandy Manata
*Managing Director
Planning*

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Neal Arbon
Vice President

David P. Buckmaster
Vice President

Kate Connelly
Vice President

Steven D. Kling
Vice President

Salvatore Matera
Vice President

Tracy Penwell
Vice President

Thomas Quaranta
Vice President

Richard Sabel
Vice President

Bart Schiavo
Vice President

Robert L. Trapani
Vice President

Richard Visco
Vice President

Diane E. Waller
*Vice President, Associate
General Counsel &
Assistant Secretary*

Marvin B. Koehler
Treasurer

Robert Bennett
Assistant Treasurer

Balance Sheets

December 31,	(in thousands)	1997	1996
Assets			
Cash and cash equivalents		\$ 132,960	\$ 80,457
Investments in marketable securities		24,970	15,950
Settlement receivable		26,564	—
Accounts receivable		1,977	1,387
Clearing fund		2,534,993	1,217,591
Fixed assets, net of accumulated amortization and depreciation of \$8,231,000 and \$7,258,000 at December 31, 1997 and 1996, respectively		2,474	2,132
Other assets		2,126	1,620
Total assets		\$2,726,064	\$1,319,137
Liabilities and Shareholders' Equity			
Liabilities			
Settlement payable		\$ 26,564	\$ —
Clearing fund			
Participants' cash deposits		142,009	80,488
Other participant deposits		2,534,993	1,217,591
Other liabilities		5,710	3,968
Total liabilities		2,709,276	1,302,047
Commitments and contingent liabilities (Note 8)			
Shareholders' equity			
Common stock			
Class A, \$.50 par value: 75,000 shares authorized, 20,400 and 20,100 shares issued and outstanding at December 31, 1997 and 1996, respectively		10	10
Class B, \$.50 par value: 30,000 shares authorized, 7,400 shares issued and outstanding at December 31, 1996		—	4
Capital in excess of par		8,790	12,336
Retained earnings		7,988	4,740
Total shareholders' equity		16,788	17,090
Total liabilities and shareholders' equity		\$2,726,064	\$1,319,137

The accompanying notes are an integral part of these statements.

Statements of Income and Retained Earnings

<i>For the Year Ended December 31,</i>	<i>(in thousands)</i>	1997	<i>1996</i>
Revenues:			
Revenue from comparison, netting, settlement and related services	\$	21,125	\$ 16,419
Discounts to participants		1,124	1,110
Net revenue from services		20,001	15,309
Interest income		5,164	3,920
Total revenues		25,165	19,229
Expenses:			
Computer equipment rental, licenses, depreciation, amortization, processing and maintenance costs		10,366	7,521
Employee compensation and related benefits		6,790	5,355
General and administrative expenses		2,341	1,963
Occupancy costs		367	337
Professional fees		226	143
Total expenses		20,090	15,319
Income before income taxes		5,075	3,910
Provision for income taxes		1,827	1,407
Net income		3,248	2,503
Retained earnings, beginning of year		4,740	2,237
Retained earnings, end of year	\$	7,988	\$ 4,740

The accompanying notes are an integral part of these statements.

Statements of Cash Flows

For the Year Ended December 31,

(in thousands)

1997

1996

Cash flows from operating activities

Net income	\$ 3,248	\$ 2,503
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation of fixed assets	973	850
Accretion of discount on securities owned, net of premium amortized	(51)	(33)
Changes in operating assets and liabilities:		
Increase in settlement receivable	(26,564)	—
Increase in accounts receivable	(590)	(269)
Increase in other assets	(506)	(661)
Increase in settlement payable	26,564	—
Decrease in cash margin deposits	—	(10,724)
Increase in participants' cash deposits	61,521	27,348
Increase in other liabilities	1,742	1,874
Net cash provided by operating activities	66,337	20,888

Cash flows from investing activities:

Maturity of investments in marketable securities	7,000	7,000
Purchases of investments in marketable securities	(15,969)	(8,936)
Purchases of fixed assets	(1,315)	(1,604)
Net cash used in investing activities	(10,284)	(3,540)

Cash flows from financing activity:

Proceeds from issuance of Class A common stock	150	—
Redemption of Class B common stock	(3,700)	—
Net cash used in financing activities	(3,550)	—

Net increase in cash and cash equivalents	52,503	17,348
Cash and cash equivalents, beginning of year	80,457	63,109
Cash and cash equivalents, end of year	\$ 132,960	\$ 80,457

Supplementary disclosure:

Interest paid	\$ —	\$ 3
Income taxes paid	\$ 2,131	\$ 1,405

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

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, settlement and risk management services for buy/sell, original issue purchase and repurchase transactions in U.S. Government securities for 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 securi-

ties having a market value of at least 102% of the amount of the agreement. An independent custodian designated by GSCC takes possession of the securities. Overnight reverse repurchase agreements are recorded at the contract amounts and totaled \$132,953,000 and \$80,028,000 at December 31, 1997 and 1996, respectively. At December 31, 1997, 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 recorded at amortized cost and are considered to be held-to-maturity securities as GSCC has both the positive intent and ability to hold these securities to maturity. The contractual maturities, carrying value and market value of these securities at December 31, 1997, and December 31, 1996, are as follows:

Investments in Marketable Securities

(in thousands)	Carrying Value			Market Value		
	U.S. Treasury Securities	Corporate Notes	Total	U.S. Treasury Securities	Corporate Notes	Total
1997						
Due in one year or less	\$ 7,986	\$ —	\$ 7,986	\$ 7,994	\$ —	\$ 7,994
Due in one to two years	15,984	1,000	16,984	16,029	1,002	17,031
Total	\$ 23,970	\$ 1,000	\$ 24,970	\$ 24,023	\$ 1,002	\$ 25,025
1996						
Due in one year or less	\$ 5,996	\$ 1,000	\$ 6,996	\$ 6,011	\$ 1,006	\$ 7,017
Due in one to two years	7,954	1,000	8,954	7,947	998	8,945
Total	\$ 13,950	\$ 2,000	\$ 15,950	\$ 13,958	\$ 2,004	\$ 15,962

Settlement receivable and payable: Settlement receivables and payables arise from an inability to complete the settlement process before the close of the Fedwire.

Participant clearing fund deposits: GSCC accepts cash, U.S.

Treasury and book entry non-mortgage-backed Agency securities, and letters of credit issued by authorized banks as clearing fund deposits, and records total deposits on its balance sheet.

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. Deferred tax assets relate principally to depreciation and employee benefit costs.

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 three or five-year period.

Financial Instruments: Management believes that the carrying value of all 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 the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 3 Participant Clearing Fund Deposits

GSCC's rules require certain participants to maintain minimum clearing fund deposits based upon calculated requirements which, at December 31, 1997 and 1996, were \$2,200,798,000 and \$1,038,212,000, 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, 1997 and 1996, follows:

	1997	1996
Cash	\$ 142,009,000	\$ 80,488,000
U.S. Treasury and book entry non-mortgage-backed Agency securities, at market	2,331,948,000	1,072,884,000
Letters of credit issued by authorized banks	203,045,000	144,707,000
Total deposits	\$ 2,677,002,000	\$ 1,298,079,000

Note 4 Transactions with Related Parties

National Securities Clearing Corporation (NSCC), a minority shareholder of GSCC, provides various computer services to GSCC through the Securities Industry Automation Corporation (SIAC) under NSCC's agreement with SIAC. NSCC also provides 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 1997 and 1996 totaled approximately \$4,470,000 and \$3,982,000, respectively. Amounts payable to NSCC at December 31, 1997 and 1996 were \$103,000 and \$36,000, respectively.

Note 7 Shareholders' Equity

<i>(Dollars in thousands, except share data)</i>	Class A Shares	Common Stock Par Value	Class B Shares	Common Stock Par Value	Capital In Excess of Par	Retained Earnings
Balance at December 31, 1995	20,100	\$ 10	7,400	\$ 4	\$ 12,336	\$ 2,237
Net income 1996	—	—	—	—	—	2,503
Balance at December 31, 1996	20,100	10	7,400	4	12,336	4,740
Issuance of Class A common stock, \$.50 par value	300	—	—	—	150	—
Redemption of Class B common stock, \$.50 par value	—	—	(7,400)	(4)	(3,696)	—
Net income 1997	—	—	—	—	—	3,248
Balance at December 31, 1997	20,400	\$ 10	—	\$ —	\$ 8,790	\$ 7,988

In October 1997, the Board of Directors of GSCC approved the repurchase of the 7,400 outstanding Class B shares at their original cost of \$500 a share.

GSCC is contingently liable, under a service agreement, for a portion of NSCC's office lease which expires on December 31, 2012. At December 31, 1997, the contingent commitment of GSCC for the remaining lease period totals approximately \$3,041,000.

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 36% effective tax rates for the years ended December 31, 1997 and 1996 are primarily attributed to state and local taxes.

The provision for income taxes for the years ended December 31, 1997 and 1996 consists of the following:

	1997	1996
Current income taxes	\$ 2,013,000	\$ 1,423,000
Deferred income taxes	(186,000)	(16,000)
Total income taxes	\$ 1,827,000	\$ 1,407,000

Note 6 Post-Retirement Benefit Plans

All eligible employees of GSCC participate in NSCC's trustee, non-contributory defined benefit pension plan. In addition, GSCC also participates in NSCC's noncontributory supplemental executive retirement and benefit restoration plans which provide for certain benefits to identified executives of GSCC upon retirement. Further, GSCC 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 1997, costs for these plans aggregated \$524,000 and were determined based upon an actuarial calculation using information related to all eligible GSCC employees. Disclosure of post-retirement benefit obligations, expense components and actuarial assumptions for the NSCC plans are included in NSCC's 1997 financial statements.

Note 8 Commitments and Contingent Liabilities

GSCC's netting system interposes GSCC between netting participants for eligible trades that have been netted. At the time of netting, GSCC's guarantee is effected. 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 funds-only settlement process. At December 31, 1997, the gross amount of guaranteed positions due from netting participants to GSCC which are scheduled to settle on or before January 2, 1998 approximated \$123,283,856,000; the amount scheduled to settle after January 2, 1998 approximated \$74,247,459,000. There is an equal amount due from GSCC to certain other participants after consideration of deliveries pending from GSCC.

Note 9 Off-Balance-Sheet Risk and Concentrations of Credit Risk

In the normal course of business, because it guarantees certain settlement obligations of its netting participants (see Note 8), GSCC could be exposed to credit risk. GSCC mitigates its exposure to credit risk by requiring such participants to meet minimum financial standards for membership, monitoring compliance with financial and other standards, requiring participants to meet daily mark-to-market obligations, and requiring participants to provide clearing fund deposits (see Note 3) in the form of cash, U.S. Treasury and book entry non-mortgage-backed Agency securities, and eligible letters of credit.

If a participant fails to fulfill its settlement obligations to GSCC, and GSCC determines that such participant is insolvent, 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 outstanding obligation and/or loss. GSCC has entered into a limited cross-guaranty agreement separately with NSCC, International Securities Clearing Corporation and MBS Clearing Corporation under which these clearing agencies have agreed to make payment to each other for any remaining unsatisfied obligations of a common defaulting participant to the extent that these agencies have excess resources belonging to the defaulting participant.

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 subject to various priorities and limitations as defined in GSCC's Rules. If one or more of such participants does not pay its assessment, GSCC would satisfy such deficiency by utilizing 25% of its retained earnings, 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, settlement and risk management services for buy/sell, original issue purchase and repurchase transactions in U.S. Government securities for 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.

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Report of Independent Accountants

Price Waterhouse LLP



February 12, 1998

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 retained earnings and of cash flows present fairly, in all material respects, the financial position of Government Securities Clearing Corporation at December 31, 1997 and 1996, 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 Internal Control Over Financial Reporting

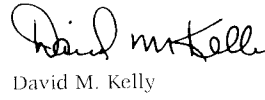
February 12, 1998

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, 1997, 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, 1997, its system of internal control over financial reporting met those criteria.



David M. Kelly
Vice Chairman & Chief Executive Officer



Sal Ricca
President and Chief Operating Officer



Marvin B. Koehler
Treasurer

Report of Independent Accountants on Internal Control Over Financial Reporting

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Price Waterhouse LLP



February 12, 1998

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

We have examined management's assertion that Government Securities Clearing Corporation (GSCC) maintained effective internal control over financial reporting as of December 31, 1997 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 GSCC maintained effective internal control over financial reporting as of December 31, 1997 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.



Comparison and Netting Participants

Brokers

Exco USA Securities Inc.
Hilliard Farber & Co., Inc.
Liberty Brokerage Inc.
Garban LLC.
Tradition (Global Clearing) Inc.
Tullett & Tokyo Securities, Inc.
Cantor Fitzgerald Securities^o
Euro Brokers Maxcor Inc.
Exco USA Securities
Inc./Repos^o
Liberty Brokerage Inc./Repos^o
Garban LLC./Repos^o
Tradition (Global Clearing)
Inc./Repos^o
Tullett & Tokyo Securities,
Inc./Repos^o
C.F. Kross^o
GFI Securities LLC^o
Prebon Securities (USA) Inc.^o
Euro Brokers Maxcor
Inc./Repos^o

Dealers

BancAmerica Robertson
Stephens^o
Bankers Trust Company^o
Bear, Stearns & Co., Inc.^o
HSBC Securities, Inc.^o
Chase Securities, Inc.^o
Citibank, N.A.^o
NationsBank, N.A./Dealer^o
Refco Securities, Inc.^o
NationsBank Montgomery
Securities, Inc.^o
Daiwa Securities America Inc.^o
Dean Witter Reynolds Inc.^o
Zions First National
Bank-Capital Markets^o
Donaldson, Lufkin & Jenrette
Securities Corporation^o
Spear, Leeds & Kellogg^o
Eastbridge Capital Inc.^o
Credit Suisse First Boston
Corporation^o
Charles Schwab & Co., Inc.*
The First National Bank
Of Chicago*†
Goldman, Sachs & Co.^o
Greenwich Capital
Markets, Inc.^o
Nesbitt Burns Securities Inc.^o
Morgan Keegan & Co., Inc.*
Fuji Securities Inc.^o
NationsBank, N.A./Corporate
Investments
Lehman Brothers Inc.^o
Aubrey G. Lanston & Co. Inc.^o

NationsBank Of Texas, N.A.*
Merrill Lynch Government
Securities Inc.^o
J.P. Morgan Securities Inc.^o
Morgan Stanley & Co.
Incorporated^o
Wheat, First Securities, Inc.*
The Nikko Securities
Co. Int'l, Inc.^o
Nomura Securities
International, Inc.^o
BT Alex. Brown Incorporated/
Alex Brown†
Painewebber Incorporated^o
Prudential Securities
Incorporated^o
Sanwa Securities
(USA) Co., L.P.^o
Salomon Brothers Inc.^o
Raymond James
Associates, Inc.*
Smith Barney Inc./Dealer^o
SBC Warburg Dillon Read Inc.^o
National Financial
Services Corp.
UBS Securities LLC.^o
Schroder & Co. Inc.^o
Cowen & Co.*
BZW Securities Inc.^o
BT Alex. Brown Incorporated/
New York^o
Citicorp Securities, Inc.^o
Scotia Capital Markets (USA)
Inc./Dealer^o
CIBC Oppenheimer Corp.^o
Deutsche Morgan
Grenfell Inc.^o
First Chicago Capital
Markets, Inc.^o
Dresdner Kleinwort Benson
North America LLC.^o
Merrill Lynch Pierce,
Fenner & Smith, Inc.*
Federal Home Loan
Mortgage Corporation
Internationale Nederlanden
(U.S.) Securities
Corporation*
Bank of America National
Trust And Savings
Association*†
Long-Term Capital
Portfolio, L.P.*
Daiwa Securities America
Inc./Oddlot^o
CIBC Oppenheimer
Corp./WG^o

ED&F Man International Inc.*
ABN AMRO Chicago
Corporation^o
Pershing Division Of
Donaldson Lufkin &
Jenrette*
TD Securities (USA) Inc.*†
Tokai Securities, Inc.^o
Tokyo-Mitsubishi Securities
(USA), Inc.^o
Commerzbank Capital
Markets Corp.^o
David Lerner Associates, Inc.*
Credit Lyonnais, NY^o
Langdon P. Cook Government
Securities Inc.*
Societe Generale^o
BancBoston Securities Inc.^o
BHC Securities, Inc.*
Everen Clearing Corp.*
Stifel, Nicolaus & Company
Incorporated*
Interra Clearing Services Inc.*
Scotia Capital Markets (USA)
Inc./CCS^o
Piper Jaffray Inc.*
ABN AMRO Chicago/Chicago
Corporation†
Paribas Corporation^o
Societe Generale Securities
Corporation^o
Lazard Freres & Co., Llc.
The Bank of New York
Legg Mason Wood Walker, Inc.*
Sumitomo Bank
Securities, Inc.^o
State Street Bank & Trust
Company
Bear, Stearns Securities Corp.*
International Bank For
Reconstruction &
Development*
Nomura International PLC*
International Development
Association*
U.S. Clearing Corp.
Rosenthal-Collins Group^o
Fuji Capital Markets
Corporation
The Chase Manhattan Bank*†
International Finance
Corporation*
Edward D. Jones & Co.*

* Comparison-Only Participant

^o Repo Netting

† Repo Comparison



Government Securities
Clearing Corporation
55 Water Street
New York, NY 10041

212.412.8400
www.gsc.com