

10 YEARS OF MAKING A DIFFERENCE

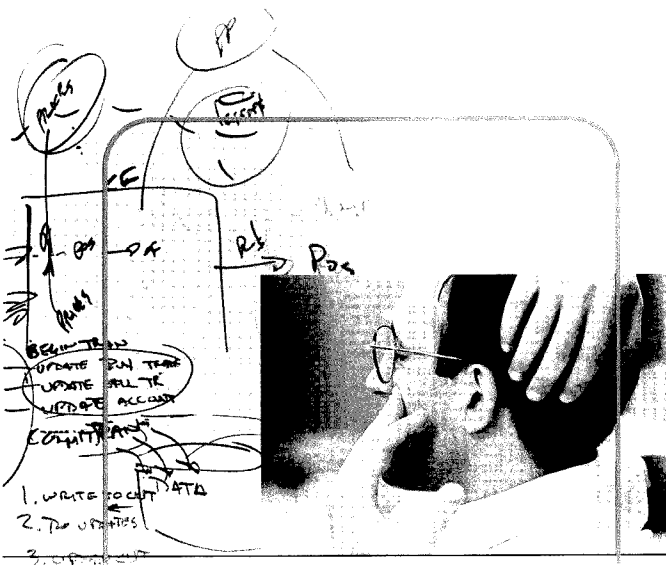
In 1998, GSCC celebrated our 10th anniversary of making a fundamental difference in the U.S. Government securities and financing marketplaces, as we smoothly handled increasing volumes and dollar values of post-trade transactions — without missing a processing or operational beat.

GSCC's most important mission in any year is to bring order, stability and efficiency to post-trade processing in this marketplace — even in times of high volatility — and to enhance trading opportunities for our growing number of members. In 1998, we did just that — successfully processing a record of over \$213 trillion in total dollar volume for our participants, a 43.7% increase over 1997.

For a decade, day in and day out, GSCC's core services of comparison, netting, guaranteed settlement, and risk management of U.S. Government securities have provided unparalleled support in what, from a total dollars point-of-view, is the world's largest securities market.

Making A Difference: Processing at Record Levels GSCC turned in a stellar year in 1998 on all processing fronts. We handled a daily average of over \$854 billion in buy/sell trades and repurchase agreements (repos), and eliminated an average of more than \$585 billion through netting and settlement each day — compared to \$594 billion in average daily transaction volume and over \$365 billion eliminated from settlement in 1997.

In addition, GSCC efficiently handled ever-higher individual peak volume days, including November 16, which set a new volume record for a single day when nearly \$2.8 trillion entered the net. That amount was 47 percent higher than the biggest peak day in 1997 (\$1.9 trillion). On November 16, we also netted down 94 percent of the total transactions and 89 percent of the money value.



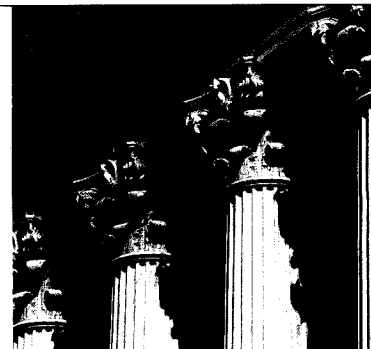
GSCC PROCESSED OVER

\$213
TRILLION

"The risk management benefits of netting are enormous as can be seen by the fact that, on November 16 (GSCC's peak processing day for dollar volume in 1998), of the nearly \$2.8 trillion in transactions that went into the net, the netting process eliminated the need to settle \$2.5 trillion."

DOLLAR VOLUME, A 43.7% INCREASE OVER 1997.

- GSCC Update -



Making A Difference: Fueling Growth in the Repo Market GSCC's record growth reflects our proven ability to provide not only superior comparison, clearance and settlement services to the cash market for Government securities, but also, since 1995, an increasing array of automated, centralized systems for the fast growing repurchase agreement (repo) segment of the marketplace.

It is the repo market that is fueling GSCC's phenomenal growth in dollar volume of trades processed, as participants increasingly try to leverage their capital efficiency in this high stakes market.

In 1998, the average dollar value of repo trades netted topped \$527 billion, more than double that for 1997. GSCC processed, on average, 13,000 repos valued at more than \$521 billion each

day. The average daily dollar value of term repos also was more than twice that of 1997 at \$1.6 trillion.

The repo market is an elaborate, multilayered system of collateralized securities lending between financial entities. With GSCC guaranteeing settlement and becoming the legal counterparty for all repo transactions that are netted, participants can take full advantage of netting for accounting purposes under FASB Interpretation No. 41 (FIN 41). This 1994 ruling permits the off-setting of repos and reverse repos with a common counterparty provided certain criteria are met.

GSCC's innovative systems provide participants with our traditional benefits of efficiency and risk reduction and facilitate balance-sheet relief. In fact, according to GSCC's internal analysis, the netting of repo activity afforded participants opportunity benefits of over \$227 million in total balance-sheet relief in 1998, more than twice that of 1997.

In addition to netting cash and repo transactions, GSCC provides further risk management benefits to the industry with the pass-through of coupon payments on repos, which ensures that the true beneficiaries of coupon payments actually receive them. On our 1998 peak day, coupon payments amounted to \$26.7 billion. Through netting, 96.5 percent of these payments was eliminated, further reducing settlement risk from the system.

Making A Difference: Enhancing Repo Services In 1998, our latest achievement was introducing the General Collateral Finance Repurchase (GCF Repo) service. At the request of members and other industry entities, implementing the new service was one of GSCC's top priorities last year.

The service allows dealer members to freely and actively trade general collateral repos throughout the day without requiring intra-day, trade-for-trade settlement on a Delivery-versus-Payment (DVP) basis. Essentially, this means that dealers aren't burdened with tracking collateral and cash movements throughout the day for each repo trade.

GSCC guarantees all GCF Repos upon receipt, and conducts an afternoon net exclusively for GCF Repo activity, with settlement occurring at some point after the close

THE AVERAGE DAILY DOLLAR VALUE OF
REPO TRADES NETTED IN 1998 WAS

\$527.3

BILLION,

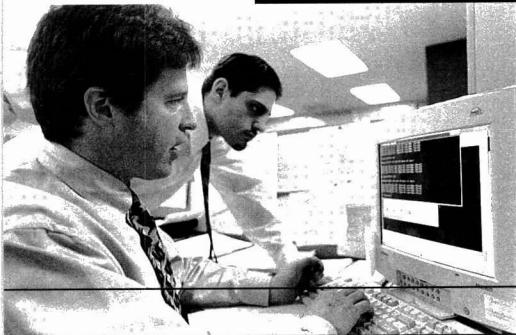
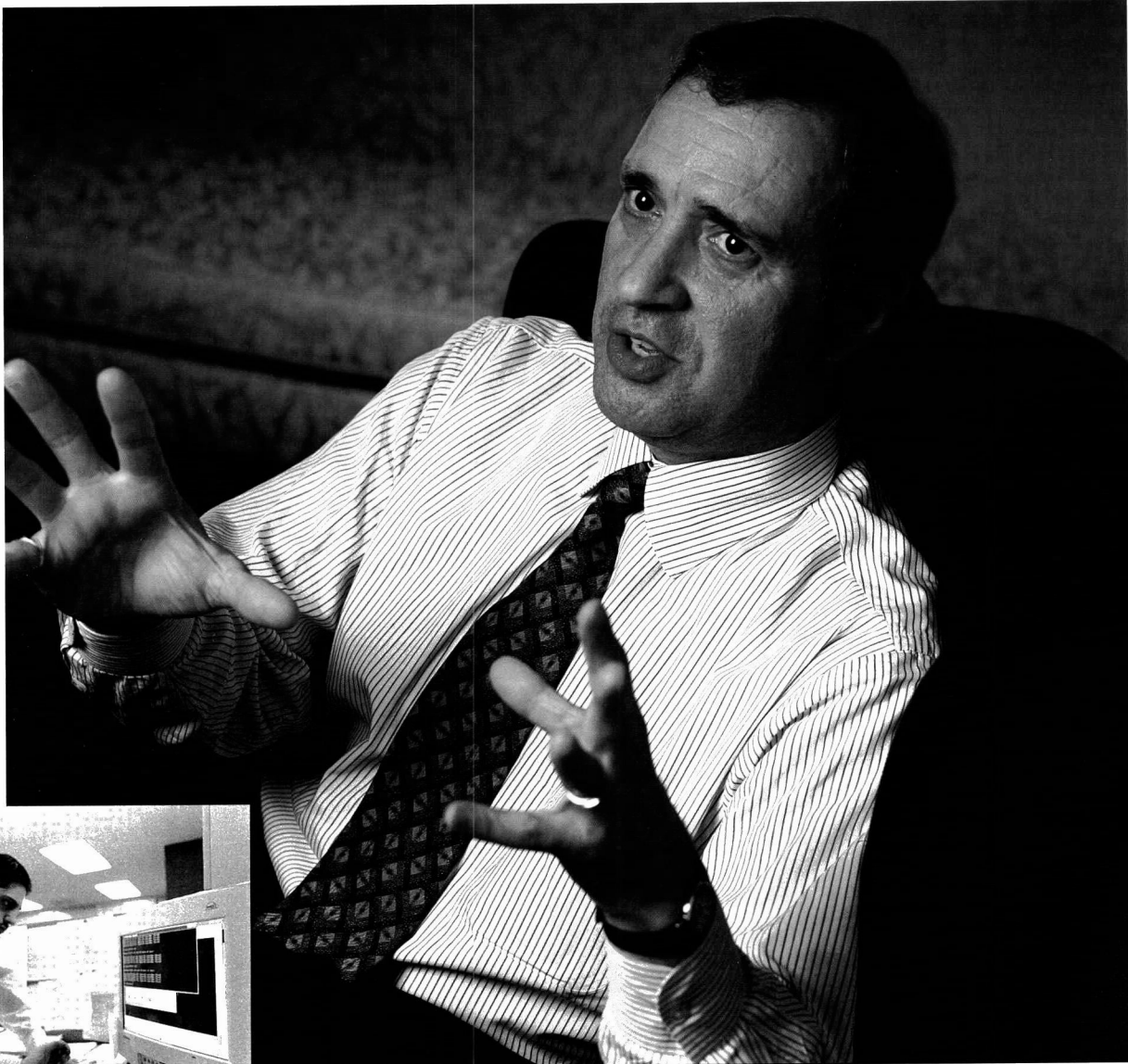
MORE THAN TWICE THE

"Called general collateral financing, the program (from GSCC) would unburden dealers of following parts of their repo transactions throughout the trading day and provide a bridge between clearing banks...to exchange cash and government bond collateral once at the close of business....Sal Ricca, GSCC president, added that collateral can be exchanged for long- and short-term repo deals through the program. Dealers currently cannot do this."

- Securities Industry News -

of the securities Fed Wire. The service substantially boosts liquidity for participants by adding an additional borrowing source to their current options and enhances their ability to trade general collateral repos by removing constraints on collateral notification and allocation. Further, because members settle on a net basis after the close of the securities Fed Wire, they will incur fewer Fed Wire charges.

GSCC launched the first phase of the GCF Repo service on an intra-bank basis only, meaning that participating dealers are able to trade GCF Repos only with other dealers who use the same clearing bank. We expect to activate the second phase of the service in 1999, in which dealers will be able to trade with any other participating dealers across GSCC's two clearing banks. Phase 2 also will



William Santangelo

Managing Director, Chase Securities, Inc.

“With its launch of the GCF Repo service last fall, GSCC provides a significant opportunity for our industry. The new service brings us increased liquidity because it adds an additional trading tool to dealers’ current options and enhances the ability to trade general collateral repos by removing constraints on collateral notification and eliminating the need for settlement on a trade-for-trade basis. With greater liquidity, readily available pricing, and netting, we expect GCF Repo will become one of the industry standards in dealer-to-dealer markets.”

AMOUNT FOR 1997.





David Lohuis

Managing Director, Lehman Brothers Inc.



“In our ever-growing marketplace, this firm’s ability to compete as a top-tier investment bank is dependent on our ability to deliver superior service to our customers while properly managing our risk capital usage. By providing an efficient and reliable netting process, GSCC has helped Lehman Brothers strengthen its market share and, at the same time, reduced its credit exposure and operational workload.”



IN ACTIVITY

allow firms to add Fed Wire book-entry eligible, mortgage-backed securities to products that can be netted for balance sheet purposes, thereby offering members an additional source of collateral for GCF Repo transactions.

Making A Difference: Ready Participants for Year 2000 Processing Equally important to maintaining the soundness of the marketplace and participants' businesses in 1998 — and beyond — has been preparation for the Year 2000.

GSCC is ahead of the curve when it comes to Y2K compliance in that processing Government securities required our original systems to accommodate maturity dates into the next century.

Since GSCC began Y2K testing in July with participants, substantially all have completed the critical four-day applications testing with us. GSCC will continue through 1999 to work with participants, GSCC's clearing banks, SIAC, the Securities Industry Association, and the Federal Reserve, as well as providing essential Y2K data requested by the Securities and Exchange Commission.

Making A Difference: Responding to Changing Participant Needs

Real-Time Processing In this increasingly fast-paced and dynamic marketplace, GSCC is evaluating our current processing capabilities. A major technological thrust targets the establishment of real-time, interactive processing that will enable the settlement and guarantee of transactions on the same day they are executed.

Moving to trade date settlement instead of trade date plus one (T+1) is extremely significant because it will enhance risk protection for participants by bringing GSCC's settlement guarantee closer to the time of trade execution. At the same time, it will identify exposures more quickly, collect margin to cover exposures more frequently and offer netting benefits interactively.

To achieve real-time, interactive processing means migrating toward an advanced technology platform supporting standardized



GSCC SET A NEW PROCESSING RECORD FOR A SINGLE DAY WHEN NEARLY

\$2.8 TRILLION

"GSCC is gearing up to offer real-time netting....GSCC is working toward a procedure that will allow trades to be compared, guaranteed and netted as soon as one counterparty submits a trade. Currently, the GSCC requires that both counterparties submit the trade for clearance before the process can begin, which delays the procedure."



ENTERED THE NET (NOVEMBER 16, 1998).

- Operations Management -

message formats, communications protocols and systems interfaces. Working toward that solution, GSCC in 1998 began focusing on providing same-day settlement services for repo start legs with a series of interrelated systems projects. Repo start legs have been settled outside GSCC due to the constraints of a batch processing environment.

The projects include creating an automated clearing bank telecommunications link to handle all incoming and outgoing messages from our clearing banks; drafting an interactive trading specification model that allows participants to submit trades and receive trade information in real-time and

supplements GSCC's existing terminal functionality with a Web-based user interface; and developing a new Participant Access Network.

The Participant Access Network allows multiple users within a member organization to access all GSCC services, including the new GCF Repo service, through a single connection. With this network, designed jointly by GSCC and National Securities Clearing Corporation (NSCC) and managed by SIAC, our facilities manager, members can now perform multiple functions simultaneously, such as affirming incoming trades while monitoring positions in real-time. This is especially critical for members who require access to both the current cash Delivery-versus-Payment (DVP) system and the GCF Repo system input and output. Members can also use a Web browser to view and print reports online as soon as they are generated by GSCC's system at the close of day, and perform bulk file transfers.

Cross Margining During 1998, the SEC approved a cross margining agreement with The New York Board of Clearing (formerly the Commodity Clearing Corporation). This agreement will serve as the basis for eventually establishing similar relationships with other clearing corporations.

Under the proposed agreement, GSCC would act as the hub linking the over-the-counter (OTC) cash market with individual futures exchanges. We would then assess market positions among participants and allocate margin reductions among clearing entities.

Cross margining will improve collateral management, provide greater liquidity and enhance the overall safety and soundness of the settlement process for the U.S. Government securities marketplace.

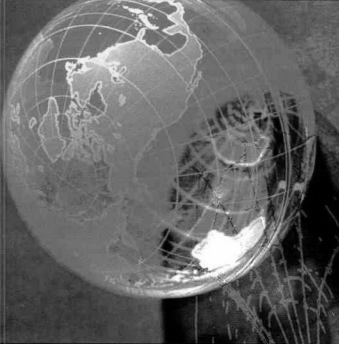
Making A Difference: Supporting Participants' Global Initiatives Many of GSCC's members are, or have, European affiliates that are major players in the European market. And, as participants increasingly look beyond the domestic horizon, we want to be prepared to serve them.

THE AVERAGE DAILY DOLLAR VALUE OF TERM REPO TRADES

MORE THAN DOUBLED IN 1998

\$1.6

TRILLION.

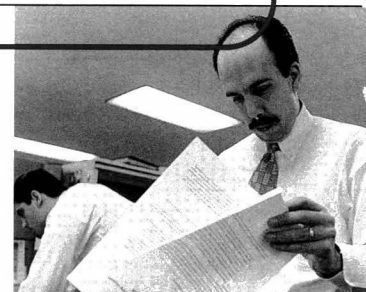


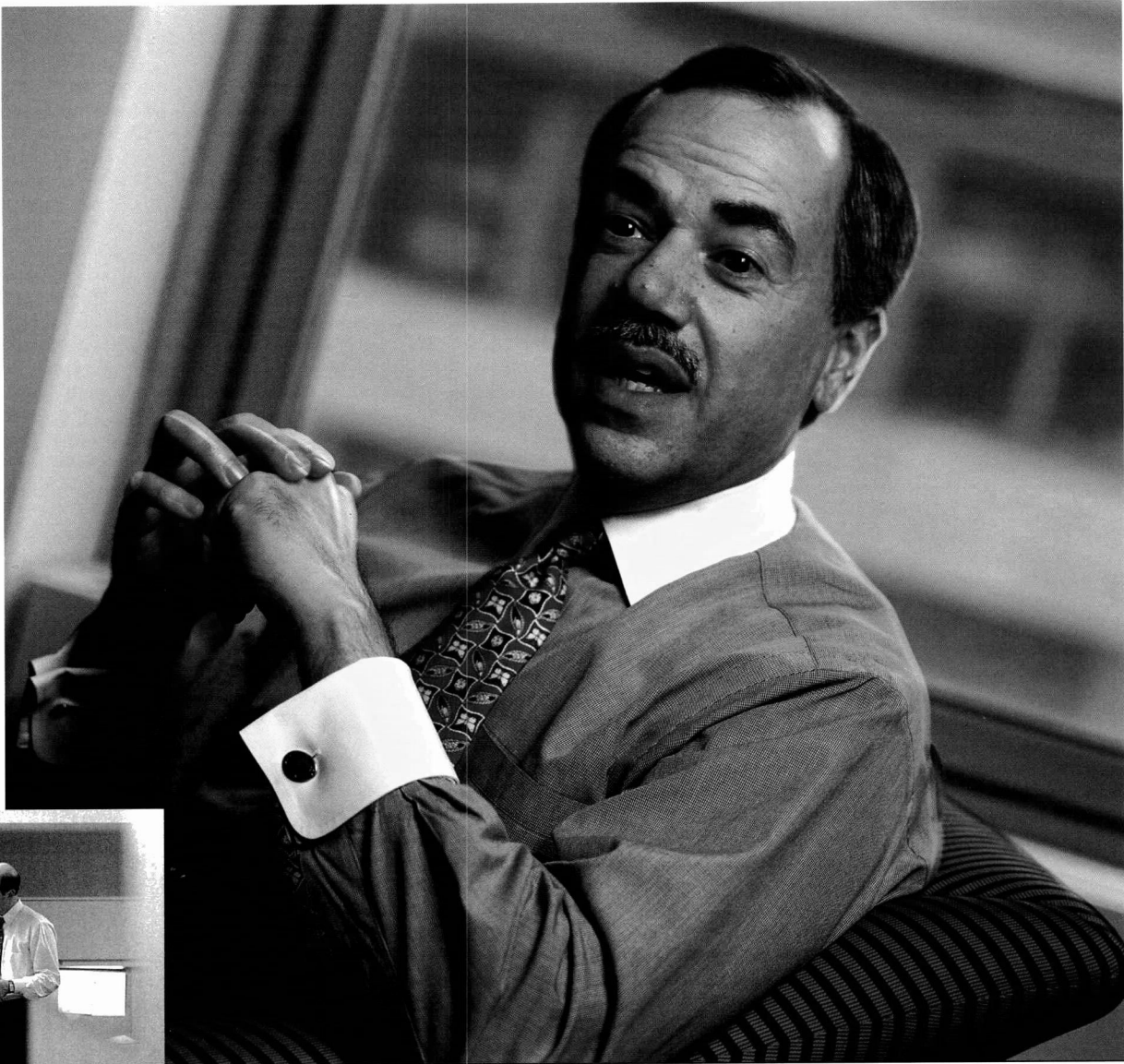
"Repo netting (in Europe) has long been looked forward to...but finding the right firm to provide the service is proving more difficult than anticipated....GSCC already has a successful multilateral repo netting system in the U.S., with an excess of \$2 trillion in outstanding term repos. GSCC is a popular choice with U.S. banks, not only because they are familiar with it, but also because of the promise of global repo netting at some point in the future."

- International Securities Lending -

GSCC has conducted a study, with the assistance of independent consultants, that suggests that the potential benefits of providing European and U.S. participants with netting and risk management services for both their cash buy/sell and repo activities in the European sovereign debt market would be quite large — especially as the effect of the Euro grows upon global financial transactions.

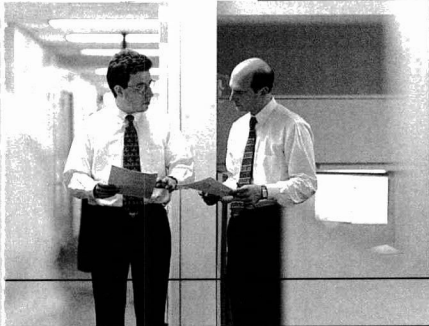
Consequently, we have launched an initiative with Euroclear and the Euroclear Operator, Morgan Guaranty Trust Company of New York, Brussels office, to develop netting services for cash and repo trades in the European sovereign debt markets. Euroclear is the





Edward Almeida

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



FROM 1997 TO

“GSCC’s new initiative with Euroclear to develop netting services for the European sovereign debt markets is right on target. GSCC is recognizing that market globalization and the introduction of Euro-backed debt securities presents participants with new opportunities for growth and expansion, as we increasingly look across the Atlantic. A centralized netting service will bring balance-sheet relief for sovereign debt repo activity and reduce counterparty risk for participants.”



world's largest clearance and settlement system for internationally traded securities, serving as the premier hub for cross-border securities services, particularly in the Euro environment. Not only does a single currency make netting possible, it also makes it even more necessary due to the expected increases in volume. And netting, in turn, will free up balance sheets, and reduce costs and counterparty risk, enabling firms and banks to do even more business.

Making A Difference: Maintaining Sound Risk Management The U.S. Government securities marketplace, along with other markets both in the U.S. and abroad, was marked by a particularly high level of turbulence and uncertainty in 1998. However, GSCC has in place a comprehensive set of risk management controls and techniques with regard to comparison, netting and settlement services, dedicated to ensuring market stability and member confidence.

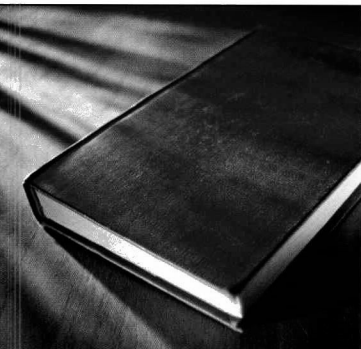
With these controls, GSCC continued our impressive record of reliability and consistency of service in 1998, marking 10 years without a systems outage. And careful risk management closed out three members' accounts without disruption last year.

GSCC requires netting members to post two types of margin. They are required to maintain deposits in a clearing fund account to ensure that enough funds are on hand to cover

risks associated with member activities. Netting members are also required to post margin against their forward net settlement positions as part of GSCC's daily mark-to-market process.

Second, participants in the netting process must meet and maintain, on an ongoing basis, high financial requirements. Additionally, the financial status of every participant is continuously monitored by GSCC, and should a member, or its parent or a significant affiliate, enter a period of actual or potential financial difficulty, a sequence of procedures is triggered to work with that member and protect the interests of all other GSCC members.

Finally, GSCC began work in 1998 on a project to develop and implement a robust, quantitative, real-time risk management process that will supplement, and, where appropriate, replace current methods of evaluating credit, market concentration, or operational or event-caused risks. This risk management protocol will enable GSCC to conduct more comprehensive and frequent analysis of our various exposures.



“By guaranteeing settlement of trades included in the net, GSCC has given market participants greater certainty of settlement....Nevertheless, the guarantee is only as good as GSCC's ability to meet its obligation. GSCC, therefore, has adopted many safeguards to ensure that members and GSCC are able to meet their settlement obligations.”

- Joint Report on the Government Securities Market (1992) -
*Issued by: U.S. Department of the Treasury, Securities and Exchange Commission,
Board of Governors of the Federal Reserve System*

Making a Difference for a Decade and Beyond Because our customers are also our shareholders and partners, GSCC's mission flows directly from their business requirements. GSCC recognizes that our success is built upon our ability to fully satisfy the needs of our growing participant base in a timely fashion, while providing world-class customer service.

In other words — to make a difference in the post-trade processing world of U.S. Government securities and financing. We have met this strategic objective every year for 10 years and we will continue to do so as we enter the 21st century.

BOARD OF DIRECTORS*



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 Lehman Brothers Inc.*

Kenneth Miller
*Managing Director
 Goldman, Sachs & Co.*

Daniel O. Minerva
*(Chairman of the Board, GSCC)
 Managing Director
 Lehman Brothers Inc.*



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

Sal Ricca
*President & COO
 Government Securities Clearing Corporation*

Thomas Wipf (not shown)
*Principal
 Morgan Stanley UK Group*



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

Mary E. Richards
*Managing Director
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David M. Kelly
*(Vice Chairman, GSCC)
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Clive Cooke
*CEO
 Intercapital Government Securities Inc.*

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

*All photos should be read left to right.

SENIOR OFFICERS

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*Managing Director
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Thomas F. Costa
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 Operations & Technology*

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 General Counsel &
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Steven M. Jukofsky
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 Marketing*

Robert P. Palatnick
*Managing Director
 Technology*

Thomas Quaranta
*Managing Director
 Marketing*

BALANCE SHEETS

December 31,	(in thousands)	1998	1997
Assets			
Cash and cash equivalents		\$ 82,327	\$ 132,960
Investments in marketable securities		16,999	24,970
Settlement receivable		56,477	26,564
Accounts receivable		2,533	1,977
Clearing fund		3,153,770	2,534,993
Fixed assets, net of accumulated amortization and depreciation of \$9,671,000 and \$8,231,000 at December 31, 1998 and 1997, respectively		3,680	2,474
Other assets		2,960	2,126
Total assets		\$3,318,746	\$2,726,064
Liabilities and Shareholders' Equity			
Liabilities			
Settlement payable		\$ 56,478	\$ 26,564
Clearing fund			
Participants' cash deposits		79,974	142,009
Other participant deposits		3,153,770	2,534,993
Other liabilities		7,149	5,710
Total liabilities		3,297,371	2,709,276
Commitments and contingent liabilities (Note 8)			
Shareholders' equity			
Common stock			
Class A, \$.50 par value: 75,000 shares authorized, 20,100 and 20,400 shares issued and outstanding at December 31, 1998 and 1997, respectively		10	10
Capital in excess of par		8,790	8,790
Retained earnings		12,575	7,988
Total shareholders' equity		21,375	16,788
Total liabilities and shareholders' equity		\$3,318,746	\$2,726,064

The accompanying notes are an integral part of these statements.

STATEMENTS OF INCOME AND RETAINED EARNINGS

For the Year Ended December 31,	(in thousands)	1998	1997
Revenues:			
Revenue from comparison, netting, settlement and related services		\$31,076	\$21,125
Discounts to participants		(1,139)	(1,124)
Net revenue from services		29,937	20,001
Interest income		5,126	5,164
Total revenues		35,063	25,165
Expenses:			
Computer equipment depreciation, licenses, software amortization, processing and maintenance costs		14,580	10,366
Employee compensation and related benefits		8,610	6,790
General and administrative expenses		3,513	2,341
Occupancy costs		333	367
Professional fees		436	226
Total expenses		27,472	20,090
Income before income taxes		7,591	5,075
Provision for income taxes		3,004	1,827
Net income		4,587	3,248
Retained earnings, beginning of year		7,988	4,740
Retained earnings, end of year		\$12,575	\$ 7,988

The accompanying notes are an integral part of these statements.

STATEMENTS OF CASH FLOWS

For the Year Ended December 31,	(in thousands)	1998	1997
Cash flows from operating activities			
Net income		\$ 4,587	\$ 3,248
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Amortization and depreciation of fixed assets		1,440	973
Accretion of discount on securities owned, net of premium amortized		(29)	(51)
Changes in operating assets and liabilities:			
Increase in settlement receivable		(29,913)	(26,564)
Increase in accounts receivable		(556)	(590)
Increase in other assets		(834)	(506)
Increase in settlement payable		29,914	26,564
(Decrease) increase in participants' cash deposits		(62,035)	61,521
Increase in other liabilities		1,439	1,742
Net cash (used in) provided by operating activities		(55,987)	66,337
Cash flows from investing activities:			
Maturity of investments in marketable securities		8,000	7,000
Purchases of investments in marketable securities		—	(15,969)
Purchases of fixed assets		(2,646)	(1,315)
Net cash provided by (used in) investing activities		5,354	(10,284)
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 (decrease) increase in cash and cash equivalents		(50,633)	52,503
Cash and cash equivalents, beginning of year		132,960	80,457
Cash and cash equivalents, end of year		\$ 82,327	\$ 132,960
Supplementary disclosure — income taxes paid		\$ 3,332	\$ 2,131

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 securities 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 \$82,166,000 and \$132,953,000 at December 31, 1998 and 1997, respectively. At December 31, 1998, 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, 1998, and December 31, 1997, are as follows:

	Carrying Value (in thousands)			Market Value (in thousands)		
	U.S. Treasury Securities	Corporate Notes	Total	U.S. Treasury Securities	Corporate Notes	Total
1998						
Due in one year or less	\$15,999	\$1,000	\$16,999	\$16,094	\$1,006	\$17,100
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

Settlement Receivable and Payable: Settlement receivables and payables arise from an inability to complete the settlement process before the close of the Fed Wire.

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. The straight-line method is used to compute the depreciation and amortization.

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, 1998 and 1997, were \$2,786,262,000 and \$2,200,798,000, 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, 1998 and 1997, follows:

	1998	1997
Cash	\$ 79,974,000	\$ 142,009,000
U.S. Treasury and book entry non-mortgage-backed Agency securities, at market	2,961,991,000	2,331,948,000
Letters of credit issued by authorized banks	191,779,000	203,045,000
Total deposits	\$3,233,744,000	\$2,677,002,000

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 1998 and 1997 totaled approximately \$4,768,000 and \$4,470,000, respectively. Amounts payable to NSCC at December 31, 1998 and 1997 were \$206,000 and \$103,000, respectively, and were included in other liabilities.

GSCC is contingently liable for a portion of NSCC's office lease which expires on December 31, 2012. At December 31, 1998, the contingent commitment of GSCC for the remaining lease period totals approximately \$6,907,000.

Note 7 Shareholders' Equity

(Dollars in thousands, except share data)

	Class A Common Stock		Class B Common Stock		Capital In Excess of Par	Retained Earnings
	Shares	Par Value	Shares	Par Value		
Balance at December 31, 1996	20,100	\$10	7,400	\$ 4	\$12,336	\$ 4,740
Issuance of Class A common stock	300	—	—	—	150	—
Redemption of Class B common stock	—	—	(7,400)	(4)	(3,696)	—
Net income 1997	—	—	—	—	—	3,248
Balance at December 31, 1997	20,400	10	—	—	8,790	7,988
Redemption of Class A common stock	(300)	—	—	—	—	—
Net income 1998	—	—	—	—	—	4,587
Balance at December 31, 1998	20,100	\$10	—	\$—	\$ 8,790	\$12,575

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. In March 1998, GSCC redeemed 300 shares of Class A common stock which was owned by the estate of a former participant after payment of nominal administration fees.

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 40% and 36% effective tax rates for the years ended December 31, 1998 and 1997, respectively, are primarily attributed to state and local taxes.

The provision for income taxes for the years ended December 31, 1998 and 1997 consists of the following:

	1998	1997
Current income taxes	\$3,151,000	\$2,013,000
Deferred income taxes	(147,000)	(186,000)
Total income taxes	\$3,004,000	\$1,827,000

Note 6 Post-Retirement Benefit Plans

All eligible employees of GSCC participate in NSCC's trustee, noncontributory defined benefit pension plan. In addition, GSCC also participates in NSCC's noncontributory supplemental executive retirement 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 1998, costs for these plans aggregated \$943,000 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 1998 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 affected. 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, 1998, the gross amount of guaranteed positions due from netting participants to GSCC which are scheduled to settle on or before January 4, 1999 approximated \$150,572,474,000; the amount scheduled to settle after January 4, 1999 approximated \$116,979,696,000. There is an equal amount due from GSCC to certain other participants after consideration of deliveries pending from GSCC.

In the ordinary course of its business, GSCC may become involved in legal proceedings and litigation. In the opinion of management, after consulting with outside counsel, the outcome of such proceedings and litigation will not materially affect GSCC's financial statements.

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, verifying compliance with financial and other standards, monitoring financial status and trading activity, 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 additional liability to the amount of its required clearing fund deposit by terminating its membership in GSCC. Further, interdealer brokers have an absolute cap of \$5,000,000 on losses associated with each insolvency.

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.

REPORT OF INDEPENDENT ACCOUNTANTS

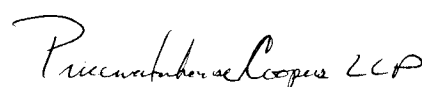
PRICEWATERHOUSECOOPERS 

February 12, 1999

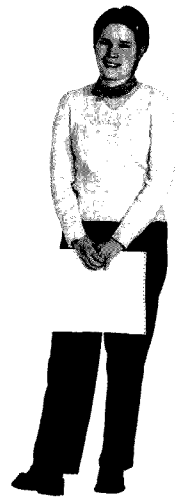
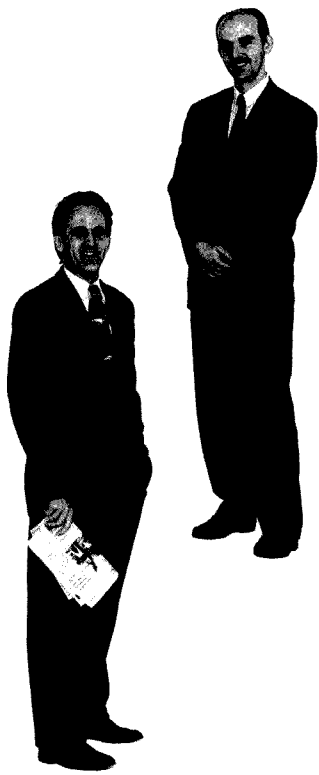
To the Board of Directors and Shareholders of
Government Securities Clearing Corporation

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, 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.



PricewaterhouseCoopers LLP
New York, NY



Government Securities Clearing Corporation Comparison and Netting Participants

(Listed alphabetically)

(As of April 1, 1999)

Brokers

Cantor Fitzgerald Securities ^{OG}	BNP Securities (USA), Inc. ^{**}	Goldenberg, Hehmeyer & Co. [*]	Pershing Division of Donaldson Lufkin & Jenrette [*]
C.F. Repo Brokerage Division ^{OG}	BNY Clearing Services LLC [*]	Goldman, Sachs & Co. ⁰	Piper Jaffray Inc. [*]
Garban LLC.	BT Alex. Brown Incorporated/ Alex Brown ⁺	Greenwich Capital Markets, Inc. ⁰	Prudential Global Funding Inc. ⁰
Garban LLC./Repos ^{OG}	BT Alex. Brown Incorporated/ New York ⁰	HSBC Bank USA ⁰	Prudential Securities Incorporated ^{OG}
GFI Securities LLC ^{OG}	Charles Schwab & Co., Inc. [*]	HSBC Securities, Inc. ⁰	Rabobank Nederland, New York Branch ^{**}
Hilliard Farber & Co., Inc.	Chase Securities, Inc. ^{OG}	Ing Baring Furman Selz LLC [*]	Raymond James Associates, Inc. [*]
Hilliard Farber & Co., Inc./Repos ^{OG}	CIBC Oppenheimer Corp. ⁰	International Bank for Reconstruction & Development ^{**}	RBC Dominion Securities Corp. ⁰
Intercapital Government Securities Inc.	CIBC Oppenheimer Corp./WG ⁰	International Development Association ^{**}	Refco Securities, Inc. ⁰
Intercapital Government Securities Inc./Repos ^{OG}	Citibank, N.A. ⁰	International Finance Corporation ^{**}	Rosenthal-Collins Group ⁰
Liberty Brokerage Inc.	Commerzbank Capital Markets Corp. ⁰	J.P. Morgan Securities Inc. ⁰	Salomon Smith Barney Inc./ Salomon Brothers ⁰
Liberty Brokerage Inc./Repos ^{OG}	Credit Lyonnais, NY ⁰	Lazard Freres & Co., LLC.	Salomon Smith Barney Inc./ Smith Barney ⁰
Maxcor Financial Inc.	Credit Suisse First Boston Corporation ^{OG}	Legg Mason Wood Walker, Inc. [*]	Schroder & Co. Inc. ⁰
Maxcor Financial Inc./Repos ^{OG}	Dain Rauscher Incorporated [*]	Lehman Brothers Inc. ⁰	Scotia Capital Markets (USA) Inc./CCS ⁰
Prebon Securities (USA) Inc. ^{OG}	Daiwa Securities America Inc. ⁰	Long-Term Capital Portfolio, L.P. [*]	Scotia Capital Markets (USA) Inc./Dealer ⁰
Tradition (Global Clearing) Inc.	Daiwa Securities America Inc./ Oddlott ⁰	Merrill Lynch Government Securities Inc. ⁰	SG Cowen/Dealer ⁰
Tradition (Global Clearing) Inc./Repos ^{OG}	David Lerner Associates, Inc. [*]	Merrill Lynch Pierce, Fenner & Smith, Inc. [*]	SG Cowen/Retail [*]
Tullett & Tokyo Securities, Inc.	Dean Witter Reynolds Inc. ⁰	Morgan Keegan & Co., Inc. [*]	Societe Generale ⁰
Tullett & Tokyo Securities, Inc./Repos ^{OG}	Deutsche Bank Securities Inc. ⁰	Morgan Stanley & Co. Incorporated ⁰	Spear, Leeds & Kellogg ⁰

General Users

ABN Amro Incorporated ⁰	Dresdner Kleinwort Benson North America LLC. ^{OG}	National Financial Services Corp. [*]	State Street Bank & Trust Company ⁰
Aubrey G. Lanston & Co. Inc. ⁰	ED&F Man International Inc. [*]	NationsBanc Montgomery Securities LLC ⁰	Stifel, Nicolaus & Company Incorporated [*]
BancBoston Securities Inc. ⁰	Edward D. Jones & Co. [*]	NationsBank, N.A./Corporate Investments ⁰	Sumitomo Bank Securities, Inc. ^{OG}
Banc One Capital Markets, Inc. ⁰	Fahnestock & Co., Inc. [*]	NationsBank, N.A./Dealer ⁰	TD Securities (USA) Inc. ⁰
Bank of America National Trust and Savings Association ^{**}	Federal Home Loan Mortgage Corporation	Nesbitt Burns Securities Inc. ⁰	The Chase Manhattan Bank ^{**}
Bank of New York ⁰	Fimat USA, Inc. ^{**}	Nikko Securities Co. Int'l, Inc. ⁰	Tokyo-Mitsubishi Securities (USA), Inc. ^{OG}
Bankers Trust Company ⁰	First Clearing Corporation [*]	Nomura International PLC [*]	U.S. Clearing Corp.
Barclays Capital Inc. ⁰	First National Bank of Chicago ⁰	Nomura Securities International, Inc. ^{OG}	Warburg Dillon Read LLC. ⁰
Bear, Stearns & Co., Inc. ⁰	First Options of Chicago, Inc. [*]	Painwebber Incorporated ⁰	Westdeutsche Landesbank Girozentrale, New York Branch ⁰
Bear, Stearns Securities Corp. [*]	First Union Capital Markets Corporation ^{**}	Paribas Corporation ⁰	Zions First National Bank- Capital Markets ⁰
BHC Securities, Inc. [*]	Fuji Capital Markets Corporation		
	Fuji Securities Inc. ⁰		
	Glickenhau & Co. ⁰		

^{*} Comparison-Only Participant

⁰ Repo Netting

⁺ Repo Comparison

^G GCF



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