

# NOVATIVE STRATEGIES TO ADVANCE MARKET GROWTH

*The mortgage-backed securities industry is dynamic and ever-changing. At MBSCC, we strive to understand the trends that herald change, identify the unique requirements of our participants, and develop high-quality, customer-driven strategies to support market growth well into the future.*



# INNOVATIVE STRATEGIE

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## TO ADVANCE MARKET GROWTH

### A Profile of MBSCC

*MBS Clearing Corporation (MBSCC) is the sole provider of automated trade comparison, confirmation, risk management, net settlement and electronic pool notification services to participants in the dynamic mortgage-backed securities market. These participants are among the growing roster of dealers, inter-dealer brokers and institutional investors who play vital roles in the buying and selling of securities backed*

*by the Government National Mortgage Association (GNMA), the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA) in the cash, forward and over-the-counter options markets.*

■ *Headquartered in New York, NY, MBSCC was established in 1979 to reduce the risks and the expenses associated with mortgage-backed securities trading, and to bring standardization and greater efficiency to the market. ■ MBSCC is a clearing agency registered with the Securities and Exchange Commission. An affiliate of the National Securities Clearing Corporation, MBSCC is majority-owned by its participants.*

## To Our Participants

With the relocation of our headquarters from Chicago to New York completed in late 1995, MBS Clearing Corporation marshalled the full complement of its resources in support of the oldest of the secondary markets for loan assets. Now in its third decade, the mortgage-backed securities industry continues to gain strength and play a vital role in generating investment capital.

*The Year in Review* ■ At the end of 1996, revenue from operations totaled \$13.1 million, a 25 percent increase over last year's figure of \$10.5 million, due in large part to higher-than-expected trade recording and Electronic Pool Notification (EPN) volumes. ■ A healthy financial performance is synonymous with benefits to participants. And so, in keeping with our policy of refunding excess profits to our participants, we announced and paid a cumulative discount of 64 percent on discountable revenues, the highest ever recorded in MBSCC's history.

■ Moving to New York has brought us closer to our customers and strengthened our communications links with them. By making use of common services provided by other clearing agencies, we have lowered our costs and improved our efficiencies. With our affiliate, the National Securities Clearing Corporation, we are sharing space and support services critical to our operation. At the same time, our participants are guaranteed the highest level of operations systems support, as well as disaster recovery capabili-

ties, through our facilities manager, the Securities Industry Automation Corporation. ■ Since its introduction in 1995, EPN has grown steadily, but at no time more significantly than in the latter months of 1996 when staggered time-frames for the notification of MBS pools went into effect. When the Public Securities Association (PSA) announced this change, it also revised its guidelines to give greater flexibility to EPN users. This endorsement was based upon EPN's proven ability to expedite the flow of MBS information between buyers and sellers, reduce overhead costs and decrease the number of fails on settlement date. The fact that EPN handled an enormous volume increase seamlessly was a clear indication of its effectiveness, and of the industry's acceptance of EPN as the standard for the automated transmission of MBS pool information. ■ Key to the mission of MBSCC is a continued effort to expand our services to new market participants. By adapting time-proven solutions to MBS trade processing, we were able to offer a new service — Comparison Only — that allows participants to automatically compare and confirm To Be Announced trades through MBSCC. Comparison Only now complements our Trade for Trade and Settlement Balance Order trade processing services; enhancements will be introduced in 1997.

*Future Initiatives* ■ As we approach the year 2000, we are in a somewhat unique position of readiness, simply because our applications, no more than four years old, were designed to avoid the computer problems associated with the date change. With this situation in order, we can turn our attention to providing assistance to our participants so that all parties ease into the new millennium with little or no disruption to the orderly flow of MBS transactions. ■ Our responsibility to the MBS industry also means applying foresight and developing blueprints for the way we will support the business in the future. Over the next two-to-

three years, we will be devoting time and energy toward completing some major initiatives, including --

- broadening the scope of our services to include more MBS trades, such as specified pool trading and trade assignments;
- working with The Depository Trust Company and the Participants Trust Company to bring straight-through processing to the institutional side of the business;
- expanding our focus from primarily back office to include the point of trade;
- shifting to a real-time environment of trade comparison and settlement to keep pace with the accelerating volume and speed of transactions and communications;
- using technological advancements in communications to broaden our participant base and further lower the costs associated with MBS trade clearing, and
- developing stronger links with nondomestic entities as they evolve into more active market participants.

■ Underlying these initiatives is a course of action founded on industry consensus. And so we will continue to work closely with our own participants — in addition to the ISITC, PSA, FHLMC, FNMA, GNMA and mortgage originators — to identify opportunities where we can bring more efficiencies to bear on the processes associated with mortgage-backed securities. ■ MBSCC benefits greatly from the strategic and tactical guidance of our board members, and we use that intelligence to support the growth of the industry. We thank those board members who retired in 1996 after many years of dedicated service to the organization. We are also grateful to our participants for sharing their insights and sound advice so that, as we advance with the industry, our services will be right on target with their needs. ■ Finally, we salute the

closely-knit team of professionals who comprise the staff of MBSCC and who stand ready to support the industry with the highest degrees of skill and commitment.



FRANK J. DECONGELIO  
-Chairman of the Board  
(right)

RONALD A. STEWART  
-President and  
Chief Executive Officer  
(left)

## An Uncommon Security

### Fashioned from a Common Need

The foundation is laid. The outer frame goes up. The gas, electric and water conduits are installed. The sheetrock, windows, floors put in place. And another individual, mortgage in hand, unlocks the key to the front door, and fulfills a common need — to own a home. ■ Once a relatively simple financial product, a mortgage, combined with others to form a mortgage-backed security (MBS), has come to represent a valued investment instrument to raise capital and spur economic growth. Today, mortgage-backed securities are the predominant form of asset-backed securities in the United States. ■ A mortgage-backed security is different from other securities, and the trade process is complex. First, the time it takes from trade date to settlement date averages 45 to 90 days, and often even longer. Second, the par value of a single trade, at \$12 million, on average, is significantly higher than in other markets.



A third distinction is the variance allowed between the original face value of an MBS trade and the par value at delivery. ■ MBSCC has played an integral part in the MBS post-trade process for the past 17 years. Because we literally have grown up with the market, we know it inside out. That knowledge has allowed us to accommodate different needs and devise solutions that bring to the market increasing efficiencies through services that simplify and streamline an intricate process. ■ MBSCC's core services offer fully-automated trade clearing and netting capabilities to process principal-to-principal and agent-to-principal

transactions. Our Trade for Trade clearing system provides comparison, confirmation and risk management to participants. Settlement Balance Order (SBO), a more encompassing system, includes those services plus trade netting.

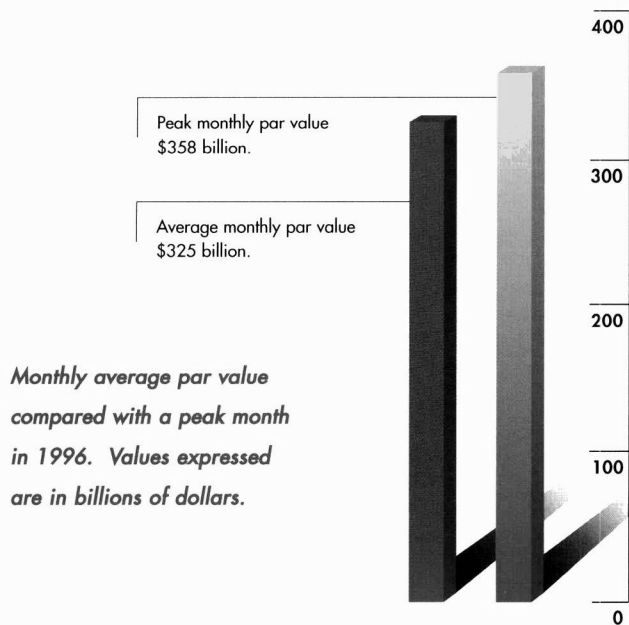
■ As the market grows, so does the importance of our SBO service. Through a process of comparing and pairing buy and sell trades, those transactions requiring settlement are reduced, or "netted down," to the lowest possible number. SBO provides the industry with important benefits in reducing and better managing cash outflow to cover obligations and clearing costs. In 1996, the dollar value

of trades that entered the SBO system totaled \$3.0 trillion, and netting eliminated 81 percent, or nearly \$2.4 trillion. In a peak month in 1996, SBO achieved even greater efficiency by reducing trade settlement obligations by 91 percent. ■ The ability to identify trends and anticipate

*MARKET KNOWLEDGE HAS ALLOWED US TO ACCOMMODATE DIFFERENT NEEDS AND DEVISE SOLUTIONS TO INCREASE EFFICIENCIES THROUGH SERVICES THAT SIMPLIFY AND STREAMLINE AN INTRICATE PROCESS.*

changing market needs led us in 1996 to add an enhancement to our core services — Comparison Only, which we introduced as a pilot program on November 1. Comparison Only was developed to fulfill the needs of market participants for an efficient and cost-effective method to compare and confirm To Be Announced (TBA) trades. After specific terms are matched, MBSCC provides a Purchase and Sale Report which serves as a valid and legally binding contract. After two months of operation, Comparison Only had processed more than \$10 billion in TBA trades.

■ Plans in 1997 call for using this new automated service for specified pool trades and for those trades with stipulations, as well as for trade reassignments. In addition, we will look to add other securities to those eligible for Comparison Only.



CAPACITY TO HANDLE PEAK VOLUME

*PERHAPS THE MOST SIGNIFICANT PROGRESS WE MADE IN 1996 WAS ADVANCING EPN TO FULL OPERATION MODE AND EXPANDING ITS USE TO ACCOMMODATE PSA'S INTRODUCTION OF STAGGERED CUT-OFF TIMES FOR POOL NOTIFICATIONS.*

## Narrowing the Window of Time and the Potential for Risk

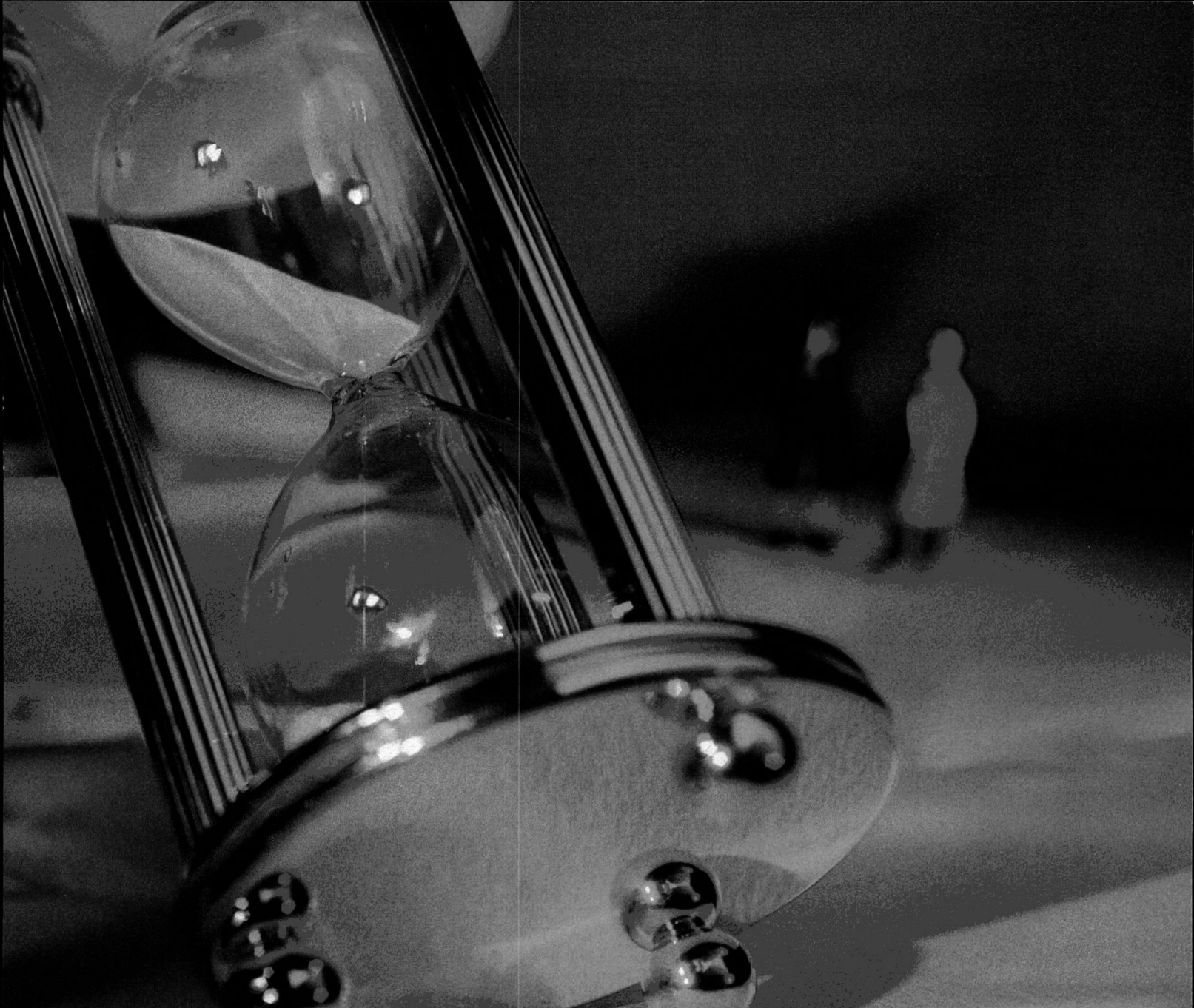
MBSCC's Electronic Pool Notification (EPN) system, another core service, is a real-time centralized computer network that enables MBS sellers and buyers to electronically transfer pool information within the Public Securities Association's (PSA) 48-Hour Guidelines. Before EPN, this was achieved through manual processes, the inefficiencies of which resulted in unacceptably high levels of failed trades and excessive costs to correct those fails. In effect, EPN provided the industry with more security and automation than it ever had before. ■ Perhaps the most significant progress we made in 1996 was advancing EPN to full operation mode and expanding its use to accommodate PSA's introduction of staggered cut-off times for pool notifications this past November. We anticipated that these new guidelines, which gave additional flexibility to those participants using EPN for pool information notification, would generate within a very short period of time an expanded participant base. As a result, we set about to prime

the system so that it could smoothly handle the volume increase, and to conduct a broad-based program of training and pre-testing with more than 40 new firms. Both goals were met. At year-end, the system had successfully processed close to 160,000 messages with a current face value of \$1.42 trillion, and the number of EPN users had tripled. ■ In 1997, we plan to enhance EPN by including pool cancels and corrects, by developing guidelines for processing "Don't Knows" (when a participant does not recognize either a transaction or a settlement) and by adding a real-time, PC-based file transmission service. This

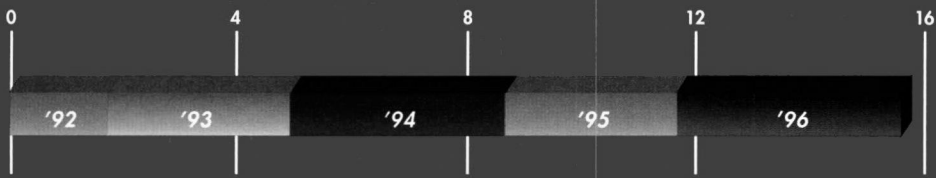
new communication tool, called EaSy Pool, or ESP, will allow members to submit and retrieve messages through our dial-up network. In addition, our relationship with The Depository Trust Company is bringing us closer to realizing straight-through processing through a link with EPN. Such a link would create a highly efficient way to generate confirmation to all interested parties of an MBS trade — institutional investors, broker/dealers, custodians and banks.

■ A key focus for MBSCC is managing risk, not only through net settlement, but also through analyzing and monitoring firms' activities so that their Participants Fund allocations accurately reflect their trading volumes. This past year, upon receiving approval from the Securities and Exchange Commission, MBSCC entered into limited cross-guaranty agreements with other clearing entities. Should a participant organization default, these agreements will allow us to tap into its collateral funds at other clearing entities, giving our members added protection against potential losses.

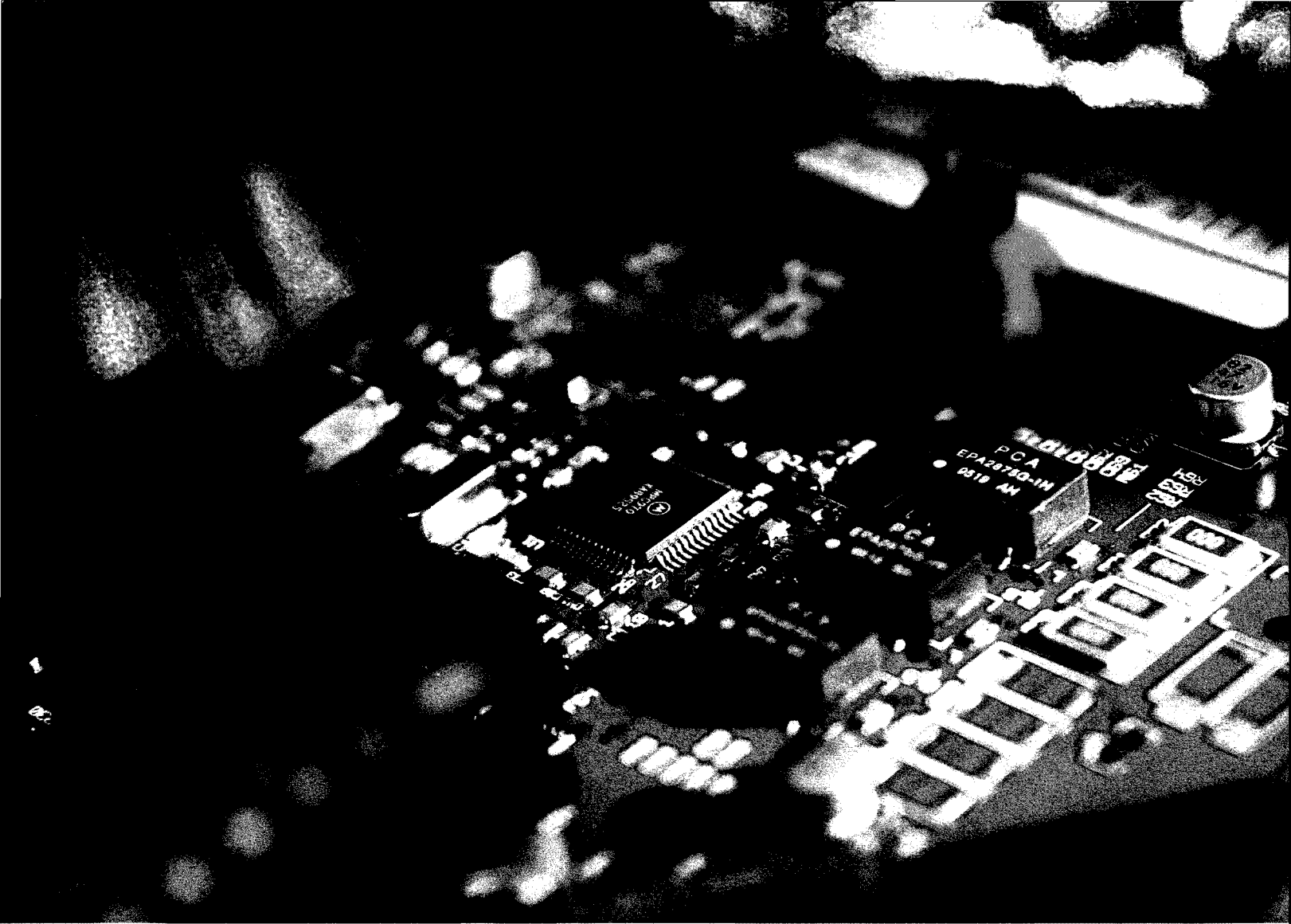




CUMULATIVE VOLUME OVER A FIVE-YEAR PERIOD



*Yearly par values of transactions entered for comparison and settlement. All values expressed are in trillions of dollars.*



## Building Engines

### That Drive the Trade Process

Technology is the force behind the movement of nearly every MBS trade. Flexible and functional, it is the means by which we can enhance our existing systems, bring new products and services to market and expand our participant base. But in order to make these advances, we need to know that our systems are running at peak performance.

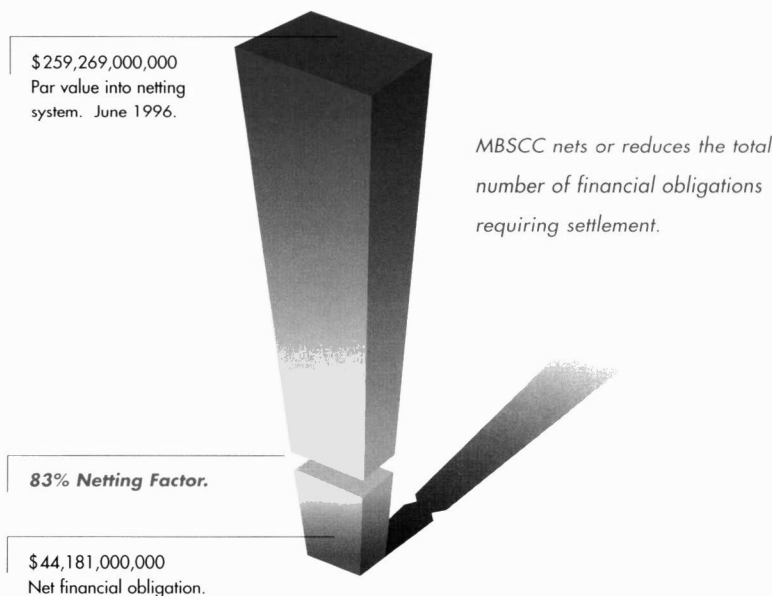
■ As EPN becomes the standard for pool notification, any interruption of the EPN data processing facility would carry with it serious industry-wide consequences. As a result, MBSCC in 1996 put in place a comprehensive disaster recovery system that will shield our operation against the impact of a systems failure. On the last business day of every month, we simulate a disaster on our EPN production

machine, which triggers users to switch from the EPN production facility at the Securities Industry Automation Corporation (SIAC) site to a totally independent system. We set a goal of five minutes or less to complete the roll-over and have achieved it every month since the system was introduced. ■ Our approach to rigorous testing was further refined last year in anticipation of a steep rise in the use of EPN for staggered pool notification deadlines. On three separate occasions prior to its November introduction, those firms who would be utilizing EPN for the first time were put through drills that, in the end, helped guarantee a seamless transition.

■ MBSCC, with SIAC, also made significant upgrades to the EPN Disaster Recovery System, taking advantage of new features installed early in the year by the manufacturers of our operating and database systems. These enhancements increased

the overall capacity of our internal programs and decreased the time it now takes to complete the post-trade processing of MBS trades. ■ As clearing entities begin to more actively pursue closer working relationships with other clearing organizations, the benefits will become more apparent. An important step in that direction was taken by MBSCC on December 8, when we conducted a successful joint test with NSCC of both companies' communications disaster recovery capabilities for common clearing participants. For those taking part in the joint test, it was an efficient and cost-effective way of auditing the effectiveness of the systems.

*FLEXIBLE AND FUNCTIONAL, TECHNOLOGY IS THE MEANS BY WHICH WE CAN ENHANCE OUR EXISTING SYSTEMS, BRING NEW PRODUCTS AND SERVICES TO MARKET AND EXPAND OUR PARTICIPANT BASE.*



THE EFFECT OF NETTING

■ MBSCC took another cost-saving step when we announced a dial-up service to transmit information from participants' host computers to EPN. Used either with or as an alternative to leased lines, participants are now reaping substantial savings on their telecommunications fees.

■ The technology industry is fluid. Breakthroughs in hardware and software occur within the blink of an eye. And so, while we were accomplishing our goals for 1996, we were also planning strategic improvements for 1997, in particular, a PC application for EPN. Historically, MBSCC has been a provider of processing systems through mainframes and computer-to-computer. This extension of our services will propel us toward the next stage of our long-term strategy — to develop new links with industry participants, while continuing to improve the levels of efficiency and risk management that will support the growth of the mortgage-backed securities market in this country.

**Balance Sheets**

<b>December 31,</b>	<b>1996</b>	<b>1995</b>
	(in thousands)	
<b>Assets</b>		
Cash and cash equivalents	\$ 5,077	\$ 6,485
Accounts receivable	636	742
Participants' deposits	1,075,259	996,040
Fixed assets, less accumulated depreciation of \$423,000 and \$137,000 at December 31, 1996 and 1995, respectively	1,042	1,014
Other assets	487	1,910
<b>Total assets</b>	<b>\$1,082,501</b>	<b>\$1,006,191</b>
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Accounts payable and accrued liabilities	\$ 2,242	\$ 3,489
Participants' deposits	1,075,259	996,040
Note payable	-	1,662
<b>Total liabilities</b>	<b>1,077,501</b>	<b>1,001,191</b>
Excess of net assets acquired over purchase price (Note 2)	677	1,760
Stockholders' equity:		
Common stock, no par value:		
Class A: 50,500 shares authorized, 38,346 shares issued and outstanding at December 31, 1996 and 1995	1	1
Class B: 5,000 shares authorized, 4,260 shares issued and outstanding at December 31, 1996 and 1995	432	432
Retained earnings	3,890	2,807
<b>Total stockholders' equity</b>	<b>4,323</b>	<b>3,240</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$1,082,501</b>	<b>\$1,006,191</b>

*The accompanying notes are an integral part of these statements*

## Statements of Income and Retained Earnings

<b>For the Year Ended December 31,</b>	<b>1996</b>	<b>1995</b>
	(in thousands)	
<b>Revenues:</b>		
Operations	\$13,137	\$10,496
Discount to participants	6,949	3,541
Net revenue from operations	6,188	6,955
Interest income	646	869
Amortization of excess of net assets acquired over purchase price (Note 2)	1,083	1,084
<b>Total revenues</b>	<b>7,917</b>	<b>8,908</b>
<b>Expenses:</b>		
Employee compensation	2,850	1,954
Systems and related support	2,016	1,720
Rent, maintenance and utilities	205	224
Professional and other services	940	1,422
General and administrative	537	442
Depreciation	286	414
<b>Total expenses</b>	<b>6,834</b>	<b>6,176</b>
Income before income taxes	1,083	2,732
<b>Income tax provision:</b>		
Current	(283)	161
Deferred	283	382
<b>Total income tax provision</b>	<b>-</b>	<b>543</b>
<b>Net income</b>	<b>1,083</b>	<b>2,189</b>
Retained earnings, beginning of year	2,807	618
<b>Retained earnings, end of year</b>	<b>\$ 3,890</b>	<b>\$ 2,807</b>

*The accompanying notes are an integral part of these statements.*

## Statements of Cash Flows

**For the Year Ended December 31,**

**1996**

**1995**

(in thousands)

Cash flows from operating activities:

Net income

\$ 1,083

\$2,189

Adjustments to reconcile net income to net cash provided by  
(used in) operating activities:

Amortization of excess of net assets acquired over purchase price

(1,083)

(1,084)

Depreciation

286

94

Decrease (increase) in operating assets:

Accounts receivable

106

184

Other assets

1,423

(1,106)

Decrease in operating liabilities:

Accounts payable and accrued liabilities

(1,247)

(833)

Net cash provided by (used in) operating activities

568

(556)

Cash flows from investing activity - purchase of fixed assets

(314)

(1,072)

Cash flows from financing activity - repayment of note  
payable on purchase transaction

(1,662)

(1,663)

Net decrease in cash and cash equivalents

(1,408)

(3,291)

Cash and cash equivalents, beginning of year

6,485

9,776

Cash and cash equivalents, end of year

\$ 5,077

\$6,485

Supplementary disclosures:

Interest paid

\$ 42

\$ 146

Income taxes (refunded) paid

(\$1,467)

\$1,552

*The accompanying notes are an integral part of these statements.*

## Notes to Financial Statements

December 31, 1996

### 1 Organization and Operations

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

### 2 Summary of Significant Accounting Policies

**Cash Equivalents:** MBSCC invests funds in overnight reverse repurchase agreements, which are considered cash equivalents. Such agreements provide for MBSCC's delivery of cash in exchange for securities having a market value which is at least 102% of the amount of the agreement. An independent custodian designated by MBSCC takes possession of the securities. Overnight reverse repurchase agreements are recorded at the contract amounts and totaled \$4,890,000 and \$6,475,000, at December 31, 1996 and 1995, respectively.

■ **Fixed Assets:** Fixed assets consist primarily of computer hardware which is depreciated on a straight-line basis over 5 years.

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

■ **Income Taxes:** Deferred tax assets and liabilities are provided for the expected future tax consequences of temporary differences between the carrying amount and tax basis of assets and liabilities.

■ **Financial Instruments:** Management believes that the carrying value of 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 financial statements and the reported

amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

■ **Reclassifications:** Certain reclassifications of 1995 amounts have been made in the accompanying financial statements to conform to the 1996 presentation.

### 3 Participants' Deposits

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

■ **Participants' deposits** consist of cash, securities issued or guaranteed by the U.S. Government, and letters of credit. A summary of the deposits held at December 31, 1996 and 1995 follows:

	1996	1995
Cash	\$ 4,825,000	\$ 19,253,000
Securities issued or guaranteed by the U.S. Government, at market	1,070,434,000	976,787,000
Letters of credit	491,391,000	457,735,000

MBSCC has entered into a limited cross-guaranty agreement separately with National Securities Clearing Corporation (NSCC), International Securities Clearing Corporation and Government Securities Clearing Corporation under which these 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.

### 4 Transactions with Related Parties

NSCC, a minority shareholder of MBSCC, provides various support services and office facilities to MBSCC. The costs of providing these services are charged to MBSCC in accordance with the provisions of a service agreement. The agreement expires in 1999 and will automatically be extended after the initial five-year term unless canceled by either party upon six months prior written notice. Charges to MBSCC pursuant to this agreement totaled approximately \$567,000 in 1996 and

\$354,000 in 1995. Amounts payable to NSCC at December 31, 1996 and 1995 were \$149,000 and \$61,000, respectively.

■ MBSCC is contingently liable, under a service agreement, for a portion of NSCC's office lease which expires on December 31, 2012. At December 31, 1996, the contingent commitment of MBSCC is approximately \$1,800,000.

### 5 Income Taxes

MBSCC files Federal, New York State, New York City and Illinois income tax returns. The 1996 and 1995 income tax provisions differ from an amount based upon the statutory Federal income tax rate of 34% due principally to the amortization of the excess of net assets acquired over purchase price and state and local taxes. The tax effect on temporary differences that give rise to significant portions of deferred tax assets consist primarily of depreciation and employee benefit costs.

### 6 Post-Retirement Benefit Plans

All eligible employees of MBSCC participate in NSCC's trustee, noncontributory defined benefit pension plan. In addition, MBSCC also participates in NSCC's noncontributory supplemental executive retirement and benefit restoration plans which provide for certain benefits to identified executives of MBSCC upon retirement. Further, MBSCC also participates in NSCC's life insurance program, which provides payment of death benefits to beneficiaries of eligible retired employees, and NSCC's health insurance program, which provides benefits to eligible retired employees. In 1996, costs for these plans aggregated \$90,000 and were determined based upon an actuarial calculation using information related to all eligible MBSCC employees. Disclosure of post-retirement benefit obligations, expense components and actuarial assumptions for the NSCC plans are included in NSCC's 1996 financial statements.

**Price Waterhouse LLP**



## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and  
Stockholders of MBS Clearing Corporation

February 14, 1997

In our opinion, the accompanying balance sheets and the related statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of MBS Clearing Corporation (the Company) at December 31, 1996 and 1995, 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*

New York, New York



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

To the Board of Directors and  
Stockholders of MBS Clearing Corporation

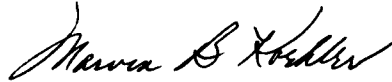
February 14, 1997

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

MBSCC's management assessed its internal control over financial reporting as of December 31, 1996, in relation to criteria for effective internal control described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, MBSCC believes that, as of December 31, 1996, its system of internal control over financial reporting met those criteria.



Ronald A. Stewart  
President and Chief  
Executive Officer



Marvin B. Koehler  
Chief Financial Officer  
and Treasurer

**Price Waterhouse LLP**



**REPORT OF INDEPENDENT ACCOUNTANTS  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

To the Board of Directors and  
Stockholders of MBS Clearing Corporation

February 14, 1997

We have examined management's assertion that MBS Clearing Corporation (MBSCC) maintained effective internal control over financial reporting as of December 31, 1996 which is included in the accompanying Management's Report on Responsibility for Internal Control Over Financial Reporting.

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

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

In our opinion, management's assertion that MBSCC maintained effective internal control over financial reporting as of December 31, 1996 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.



New York, New York

## Participants / Users

ABN AMRO Securities (USA) Inc. \*  
Adams, Viner and Mosler \*  
A.G. Edwards & Sons, Inc. \*  
Alex Brown & Sons, Inc.  
Allianz of America, Inc. \*  
Anchor National Life Insurance Company +  
BancAmerica Securities, Inc. +  
Banc One Capital Corp. \*  
Banc One Mortgage Corporation \*  
Bankers Trust Company  
Bankers Trust (Delaware)  
Bear, Stearns & Company  
BT Securities Corp. +  
BZW Securities, Inc.  
Calfarm Life Insurance Co. +  
Cantor Fitzgerald & Co.  
Cantor Fitzgerald Securities +  
Chase Manhattan Bank  
Chase Manhattan Mortgage Corporation +  
Chase Securities Inc.  
Citicorp Mortgage, Inc. +  
CNA Financial Corporation fao Continental Casualty Corporation  
CNA Financial Corporation fao Continental Insurance Corporation  
Compass Bank \*  
Countrywide Home Loans, Inc. +  
Countrywide Securities Corp.\*  
Cowen & Company  
Credit Suisse First Boston Corporation  
Daiwa Securities America, Inc.  
Dean Witter Reynolds Inc.  
Delaware Securities Processing Corp.\*  
Deutsche Morgan Grenfell Inc.  
Donaldson, Lufkin & Jenrette Securities Corp.  
EVEREN Clearing Corp.  
EXCO RMJ Securities Corporation  
Federal Home Loan Mortgage Corp.  
First Union Corporation fao First Union Capital Markets Corporation  
First Tennessee Bank N.A. (Capital Markets) \*  
Fischer Francis Trees and Watts, Inc.\*  
FFTW Funds, Inc. - Mortgage Total Return Portfolio +  
Garban LLC +  
Goldman, Sachs & Company  
Greenwich Capital Markets, Inc.  
Gruntal & Co., L.L.C. +  
HSBC Securities, Inc.  
Hilliard Farber & Co., Inc.  
Ill Finance Ltd. \*  
Ill Global Ltd.\*  
Jennison Associates \*  
J.P. Morgan Securities, Inc.  
Lehman Brothers Inc.  
Liberty Brokerage Inc. fao Patriot Securities  
Long Term Capital Portfolio LP  
MBS Fund Alpha +  
MBS Fund Caspian +  
MBS Fund Gamma +  
McDonald & Co. Securities  
Merrill Lynch GSI  
Morgan Guaranty Trust Company of NY +  
Morgan Guaranty Trust Company of NY fbo Relative Value Trading +  
Morgan Keegan & Company +  
Morgan Stanley Market Products, Inc.  
Nationsbank Capital Markets, Inc.  
Nationsbank, N.A. (Carolinas)  
Nationsbank, N.A. (Carolinas) Corporate Investments +  
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New York Life Insurance Company  
Nikko Securities Co. International, Inc.  
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PaineWebber Inc.  
PaineWebber Inc. fbo PaineWebber Real Estate Securities \*  
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PFL Life Insurance Co. +  
Principal Financial Securities Inc. +  
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Salomon Brothers Inc. fbo Fischer Francis (Charter Atlantic) +  
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Stephens Inc.  
Sun America Inc. +  
Sun America Life Insurance Co. +  
Sun America National Life Ins. Co. +  
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Texas Commerce Bank \*  
UBS Securities LLC  
Vining Sparks, IBG.\*  
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