

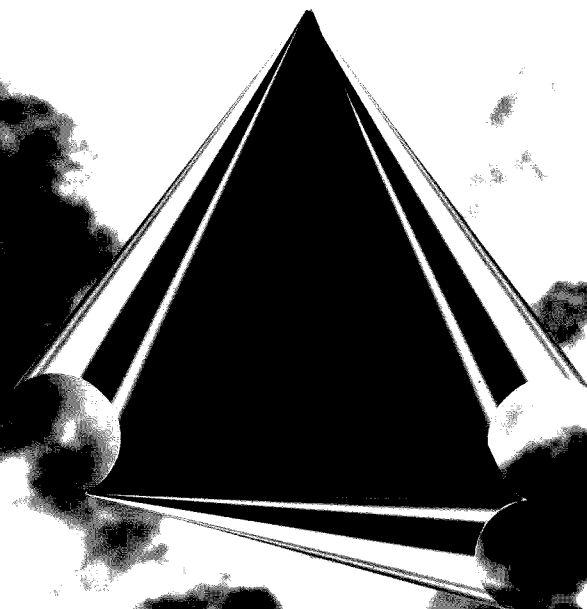


National Securities Clearing Corporation

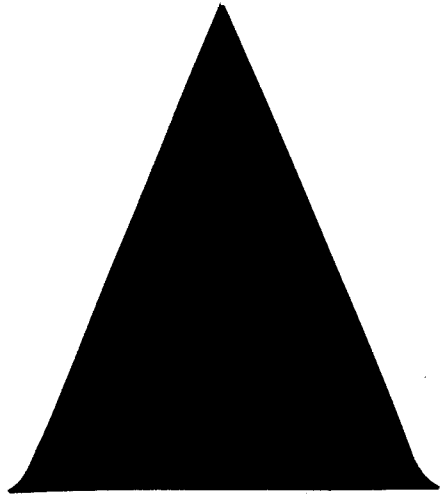
*Annual Report 1997*

the  
next  
century





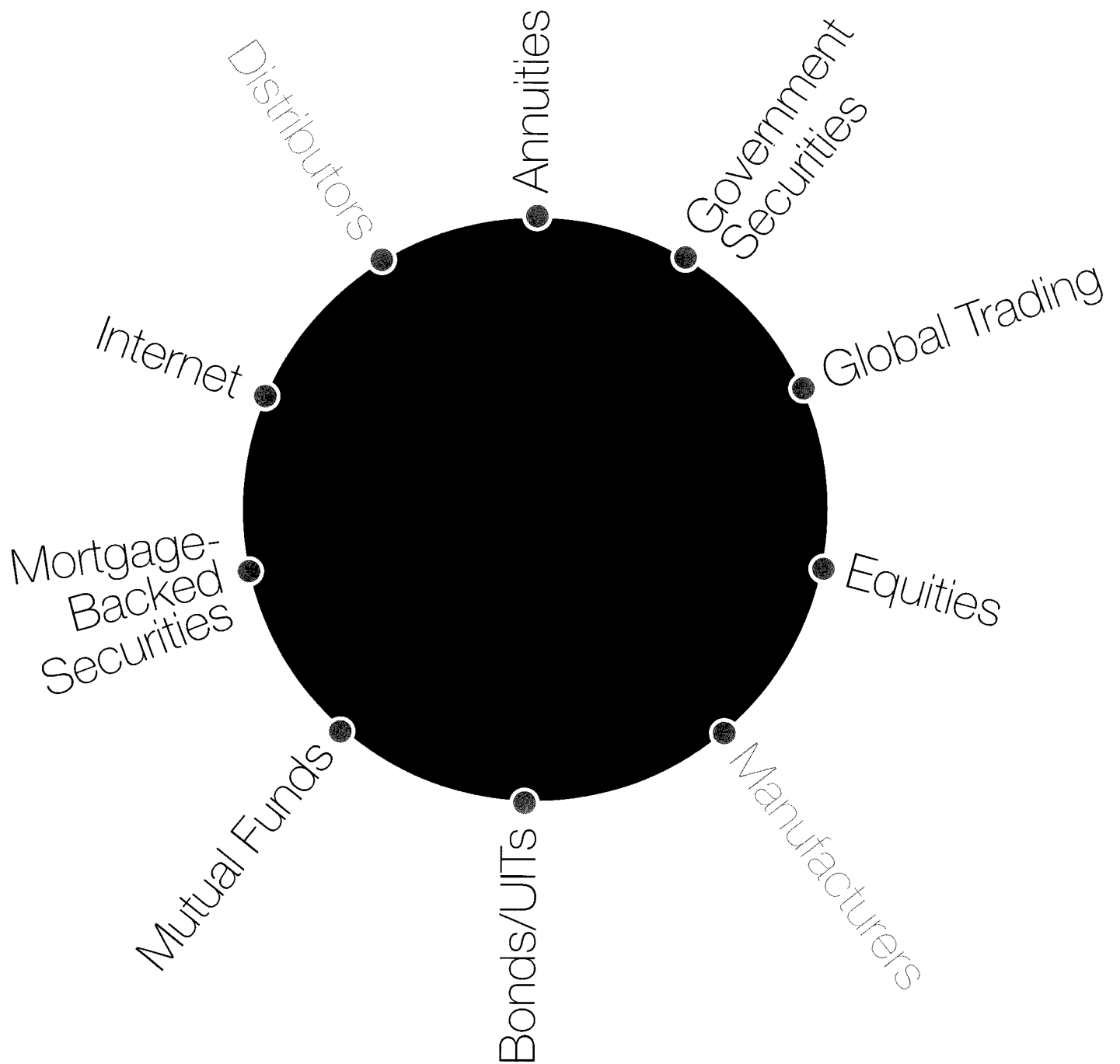
In the next century,  
what the **financial  
services industry**  
may look like is  
still an unknown...



But  
whatever shape it takes,

NSCC

will be there...



...to provide centralized, standardized  
automated **solutions** that promote  
connectivity, efficiency and lower risk.

National Securities Clearing Corporation (NSCC), established in 1976, is the nation's leading provider of centralized clearance, settlement and information services for equities, bonds, mutual fund and annuity transactions to more than 2,000 brokers, dealers, banks, mutual funds, insurance carriers and other financial organizations.

NSCC's affiliates and subsidiaries each support a unique segment of the financial services industry, but share a common charter: to deliver high-quality, innovative systems and services that standardize, centralize and automate post-trade processing activities, and increase efficiency, reduce risk, lower costs and foster the financial industry's continued growth.

## Government Securities Clearing Corporation

(GSCC), an affiliate, clears and settles a broad range of U.S. Government securities, including Treasury bills, bonds, notes, zero coupon securities and repurchase agreements.

MBS Clearing Corporation (MBSCC), an affiliate, is this market's sole provider of clearance, settlement and electronic pool notification services for mortgage-backed securities.

International Securities Clearing Corporation (ISCC), a subsidiary, provides clearance and settlement services to U.S. brokers trading in overseas markets. ISCC also promotes the development of global standards for trade processing, reporting, settlement and custody.

Emerging Markets Clearing Corporation (EMCC), an affiliate, is the latest clearing corporation to be established. It provides trade matching, clearance and settlement services to global dealers, interdealer brokers and correspondent clearing firms involved in emerging market debt instruments.

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The next century

a  
Roadmap  
to the  
Future

To say we live in interesting times is perhaps an understatement. All around we see change occurring at breakneck speed.

Change in the way markets operate. Change resulting from merger and acquisition activity in the financial community, which is redefining the players and how their processing needs will be met. Changes in technology, which are revolutionizing financial services. Change in the globalization of markets that requires us to overcome processing obstacles inhibiting the settlement of cross border trading.

# To Our Participants

At NSCC, the next century is already here. We have to stay ahead of what we see as the "curve of change," anticipating and responding to trends, being prepared to support new financial products, and ever mindful of our responsibility to develop highly flexible and reliable technology and

David M. Kelly (left) Melvin B. Taub



operational solutions. Our activities in 1997, we believe, have established a post-trade processing road map for the new millennium.

During 1997, the national clearance and settlement infrastructure demonstrated once again its ability to handle large swings in trading volume. On a single day last October, NSCC processed in excess of six million transactions, reflecting a record two billion share trading day, without disruptions.

Overall, volume at NSCC last year was up significantly and compared with the past two years, average daily transaction volumes have doubled. The combined trading volume from the NYSE, Amex

and Nasdaq ran at a billion shares a day for nearly 90% of the trading days in 1997.

Transaction volume growth has produced record revenues, up 16% over 1996. As always, revenue in excess of expenses is returned to our participants in the form of discounts, which in 1997 were 61% on discountable services. While revenue was up, we maintained what we believe to be sound fiscal management of NSCC's activities.

As we closed the book on 1997, the Board approved a 20% reduction in prices. These reductions represent an approximate fee reduction to the industry of \$30-35 million.

Anticipation and planning are ingrained in the culture of NSCC. An example of this is our ongoing preparation for Year 2000. We've pursued an aggressive strategy that includes giving the industry the option of using six or eight digit formats, to lessen the burden on firms in preparing for the conversion. We've communicated extensively through seminars, newsletters, important notices and even a special Internet site to reach a state of readiness. Further, we've worked to ensure coordination between industry utilities and the marketplaces.



We set a goal to be ready for testing by mid-1998. We are confident about achieving this target and having the Year 2000 transition go as smoothly as the move to T+3.

In preparing for the next century, NSCC has been working closely with the marketplaces to address a range of processing issues, including the move to decimal pricing, changes to support trade date matching, elimination of redundant odd-lot processing and the development of capabilities to support index-type products.

In addition, we've focused our efforts on providing connectivity between manufacturers of financial products and services and their distribution channels. Two significant efforts this past year have been the introduction of our services to support Defined Contribution Clearance and Settlement (DCC&S) and our Annuity Processing Service (APS). Working closely with mutual funds, banks, broker/dealers, insurance carriers and trade groups like the Investment Company Institute and the National Association for Variable Annuities, NSCC is looking to automate and streamline the post-trade processing of these instruments.

Our DCC&S service will automate and streamline the processing of 401(k) and other defined contribution activity, providing expanded communication capabilities among plan administrators, trustees and mutual fund families.

NSCC's APS service will provide a full range of processing solutions, first allowing for the exchange of information between insurance carriers and marketers of the product on commissions, positions and money settlement. Expanding APS in 1998 will add the purchase and redemption of annuity contracts and premiums.

Plans are set to introduce the new Automated Customer Account Transfer Service (ACATS) by year-end 1998. The enhanced system will include more financial

products and broaden participation to banks, mutual funds, trusts and other financial institutions, as well as broker/dealers.

We continued to address some of the remaining Vision 2000 objectives. First, we successfully brought over to NSCC 15 firms and 20 specialists following the decision by the Philadelphia Stock Exchange to exit the clearing business. Second, we've established plans to migrate our New York Window operation to The Depository Trust Company (DTC). Since 1993, the Window has been very successful at centralizing the processing of non-DTC eligible physical securities, immobilizing certificates and saving significant dollars in fixed costs. It now makes sense to merge the operation with DTC and expand those savings to more participants.

In the area of risk management, we've strengthened the technology tools and staffing needed to monitor firm trading activity and amended our rules to increase our requirements for member capitalization and collateral on the trading of less liquid issues. Broadening our capabilities here will continue to be a high priority in 1998.

On the international front, we're pleased with the SEC's approval of the Emerging Markets Clearing Corporation (EMCC), which started operation in April 1998 with Brady bonds. EMCC will automate, centralize and guarantee the cross-border trading of these debt instruments, which will substantially reduce market risk.

In addition to record breaking volumes, both the Government Securities Clearing Corporation (GSCC) and MBS Clearing Corporation (MBSCC) have taken innovative steps this year to broaden their traditional participant bases. GSCC is continuing to expand its repo service offerings, providing added support to the financing of the industry. MBSCC has pushed to broaden the involvement of institutional players in the mortgage-backed securities market.

We've provided highlights of GSCC and MBSCC activities in this annual report. Each of these organizations provide more detailed information in separate reports to their members.

Our Board of Directors deserves considerable credit for helping us keep up with the pace of change. Their experience and skill provide us with valuable insight, guidance and support in running our businesses, as well as in building industry consensus. We are grateful to them and their firms for the time and effort they commit to our mission.

Over the years, NSCC has had a very positive working relationship with DTC. This relationship is now taking on new dimensions as we expand services and identify new synergies.

We were pleased to formally recognize this new collaboration with the appointment of Bill Jaenike to our Board, and with Dave Kelly joining the DTC Board.

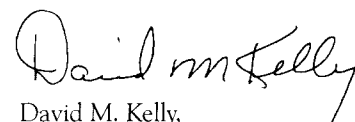
We'd also like to congratulate Charlie McQuade and all the employees of SIAC on their 25th Anniversary. More than a facilities manager, SIAC has been a close working partner to NSCC and an important contributor to the industry.

We regret that two of our senior executives, Bob Schultz and Marv Koehler, have announced their plans to retire in 1998. Each of them has served NSCC with distinction and dedication—and we wish them the best.

And finally, we want to express appreciation to our employees, who distinguish this organization with their professionalism, high standards and commitment to NSCC—and the industry.

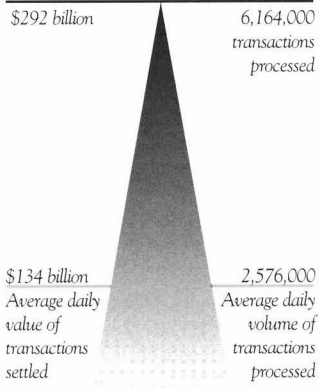


Melvin B. Taub,  
Chairman of the Board

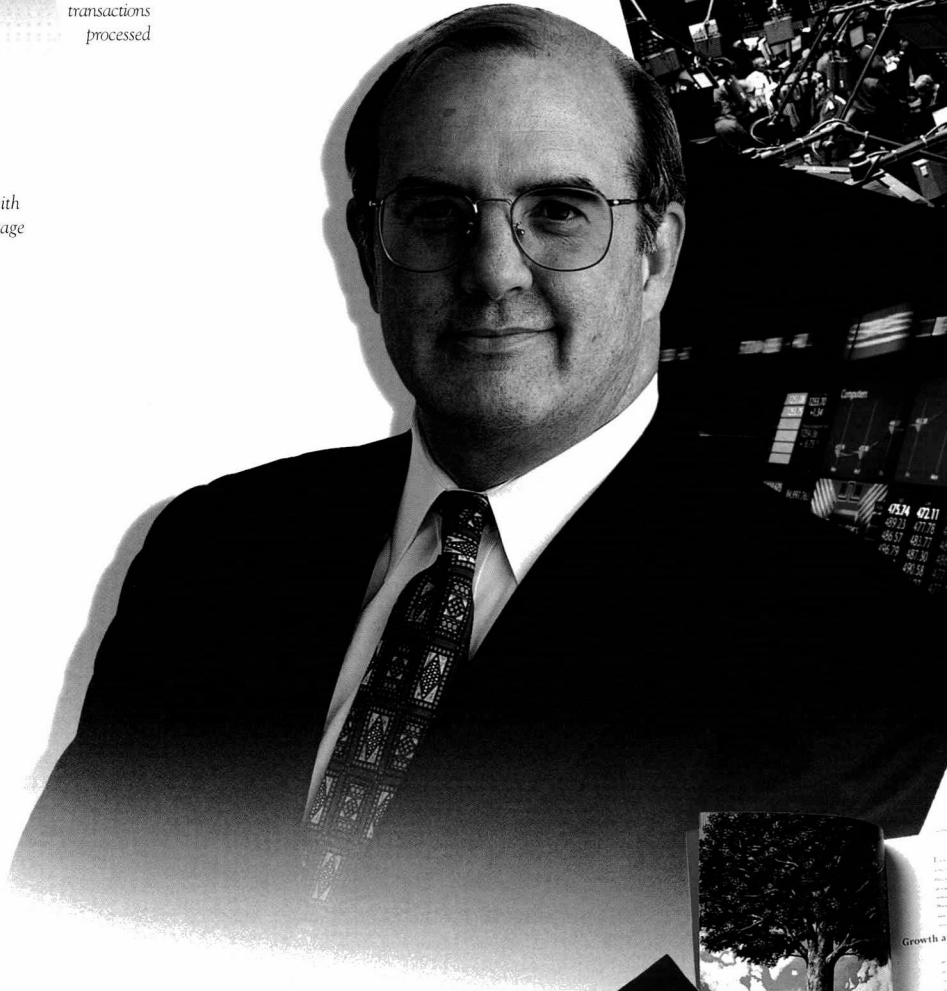


David M. Kelly,  
President and Chief Executive Officer

A Peak Day -  
October 28, 1997



A peak Volume Day in 1997 compared with NSCC's Daily Average



Wilson Snyder  
President,  
Lewco Securities  
Corporation

Last October, an historical threshold was passed when volume in all marketplaces exceeded two billion shares traded in one day. The significance of this event was heightened by the seamlessness with which it passed. And once again NSCC demonstrated that regardless of the unpredictable spikes in volume that can occur, the national clearance and settlement system had the capacity to support trading markets.

Over six million transactions were handled by NSCC on October 28 with a total market value of \$292 billion, compared to a daily average volume of 2.6 million transactions in 1997 and an average daily value of almost \$134 billion. Trading volume overall continued to grow in 1997, with average daily transaction volume up 36 percent over 1996. NSCC reports volume based on transactions processed by the clearing corporation. In 1997, the average number of shares per transaction was 1,525 shares.

The industry took its final step to centralize all clearance and settlement activity for equity and corporate bond transactions at NSCC this past year, with the decision by the Philadelphia Stock Exchange to exit the clearing business. By the fourth quarter of 1997, 20 specialists and 15 firms had been successfully converted to NSCC, either as direct members or through another member firm.

In 1997, NSCC launched a major effort to ensure its participants were Year 2000 compliant, offering firms flexible options like using six-digit or eight-digit date formats, an 18-month-long testing period, extensive training seminars, and access to information and new file formats over the Internet. NSCC is working very closely with participants on this transition and is supporting extensive coordination with The Depository Trust Company (DTC), Securities Industry Automation Corporation (SIAC), the marketplaces, the SEC and the Securities Industry Association. Firms will not have to support two different record formats waiting for a single conversion date. Once a participant has successfully tested its Year 2000 applications, NSCC will immediately begin supporting that application.

During 1997, NSCC worked closely with the marketplaces to address a number of processing issues. We worked on system changes to support decimal pricing. We played a key role in NASD's efforts to move its Trade and Acceptance Reconciliation Service (TARS) to the Automated Confirmation Transaction Service (ACTS). NSCC assisted the NYSE in its move to eliminate redundant odd-lot processing and reporting. We also expanded our support for index-type products like the Amex's DIAMONDS, a product based on the Dow Jones Industrial Average.

We ensure there is  
post-trade processing

capacity

Whether it's capacity planning for volume surges, transitioning the industry to T+3 or getting ready for Year 2000, anticipating and preparing for events is part of our culture at NSCC.

NSCC has set its sights on a new century with unlimited market-driven opportunities—and a confidence in its ability to support this growth.



NSCC provides three critical and unique services to financial markets: the capacity to handle unpredictable spikes in trading volume, the guarantee that trades will be completed once they have been received by NSCC and acknowledged as compared, and the netting (reducing) of total trading positions requiring financial settlement.

Nothing can undermine the stability and confidence in markets more than the threat of a trading party defaulting on its obligations. This point takes on added significance considering the volume and dollar value of trading that occurred in 1997. NSCC not only guarantees

concentrated positions that pose added risk to the market. Toughening up standards has shown results in 1997, as NSCC was able to close out W.S. Clearing, Inc.'s unsettled positions without a loss, due almost entirely to increased collateral that was collected under this new procedure.

This past year, NSCC has restructured and added staff to enhance surveillance of a firm's financial health, its trading activities and our management of the clearing fund. A significant initiative was begun to create STARS II, an integrated database that will provide twenty-first century capabilities to calculate multiple "what if" risk scenarios, integrate data from other self-regulatory organizations (SROs)

# we guarantee trades

## will be completed once they're received by NSCC

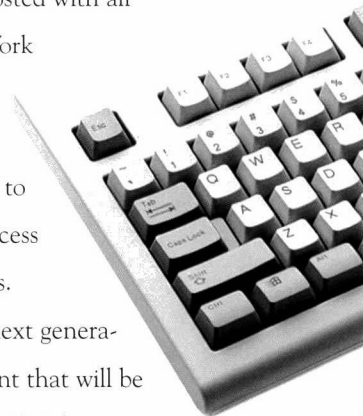
trade completion, it has a rigorous surveillance and risk management program in place to identify issues of concern to market regulators and to monitor the financial soundness of member firms.

While risk management is an on-going effort, there were several significant steps taken in 1997 in response to lessons learned following the demise of Adler Coleman Clearing Corporation and in preparation for increased trading activity in the next century. First, NSCC adopted new minimum capital requirements, requiring firms to have \$500,000 in excess net capital compared to the previous level of \$50,000. Thinly capitalized firms were given a fixed period of time to strengthen their financial position or cease operating as a direct member. This effort complements previous steps in 1996 to implement special margining of market maker-dominated issues and unduly

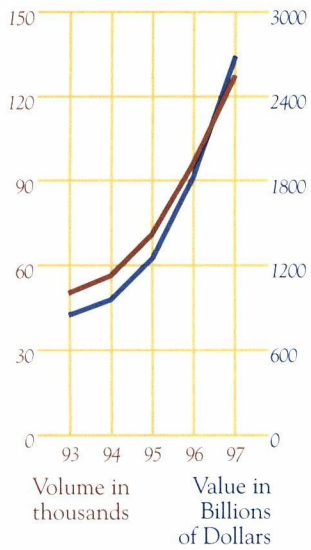
and provide automated close-out capabilities to assist in the event of a firm failure.

In addition to managing risk, NSCC is working to ensure firms can efficiently manage the collateral they are required to maintain with member SROs. NSCC's Collateral Management System (CMS) now allows member firms to view their collateral posted with all participating SROs. Work continued in 1997 on CMS enhancements that would allow firms to electronically move excess collateral among SROs.

Preparing for the next generation of risk management that will be required if the industry decides to move to T+1, NSCC has prompted—and is continuing—an aggressive dialogue with its Board, the marketplaces and member firms on the issues associated with intra-day risk management. NSCC recognizes that in order to maintain its guarantee of trades, it must continually strive to minimize financial risk associated with trade settlement.



NSCC Average Daily Transactions Processed



C. Michael Viviano

President, Everen

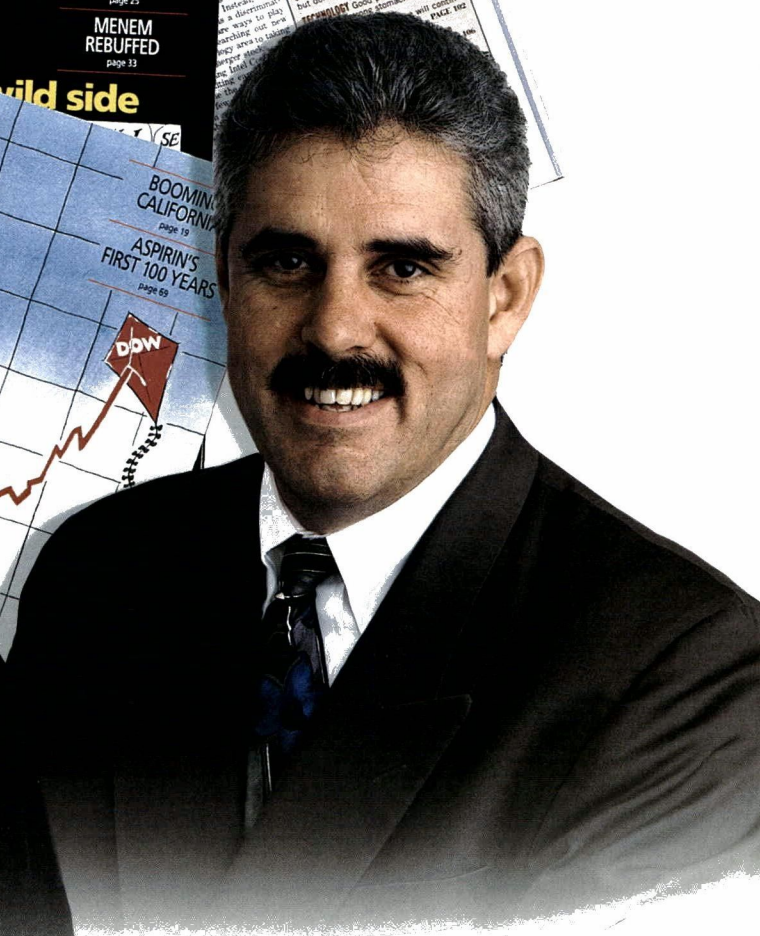
Clearing Corporation (left)

Steve Callan

Associate Director, Cashiering,

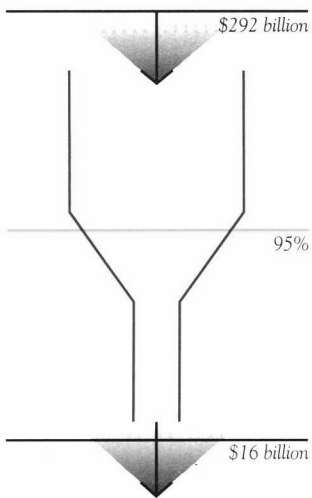
Bear, Stearns Securities

Corporation (right)





Netting Factor  
for Peak Day, 1997



NSCC reduces or nets  
the total number  
of financial obligations  
requiring settlement

Diane L. Schueneman  
Senior Director and  
First Vice President,  
Debt and Derivatives Operations,  
Merrill Lynch, Pierce,  
Fenner and Smith, Inc.

Netting is a concept that is unique to clearing corporations. By electronically reducing or netting down the number of trading positions requiring financial settlement, NSCC enhances the capital efficiency of the firms it serves and protects safety and soundness in financial markets. Money having to change hands is dramatically reduced and payments of obligations are settled in one wire payment of funds each day.

The significance of netting is best illustrated on a peak volume day like October 28. The value of transactions processed reached \$292 billion. Through our Continuous Net Settlement (CNS) system, buy and sell positions were netted down by 95 percent, leaving \$16 billion in obligations requiring settlement.

intermediaries, not just between brokers. The new system, planned for rollout in 1998, will also reduce the number of days required to transfer an account, have the capability to handle the transfer of government and mortgage-backed securities and more easily identify foreign equity and debt issues.

During 1997, we introduced the Participant Information and Efficiency Report (PIER) to over 180 firms. PIER reports provide firms with a benchmark of statistics on how their operational performance in the use of NSCC services compares with industry averages. Response to this information tool has been



# By netting down, NSCC enhances capital efficiency and lowers risk

NSCC also has a cross-endorsement agreement with DTC for dual members, for obligations covering both street-side and institutional activity. This cross endorsement of debit and credit obligations at both organizations further reduced financial settlement from \$16 billion on October 28 to \$8 billion.

Streamlining processes and supporting greater operational efficiencies is a hallmark of NSCC. Our Automated Customer Account Transfer Service (ACATS) is being revised to extend our ability to transfer accounts between brokers, banks, mutual funds, trusts and other financial

extremely positive and NSCC is working with participants to enhance the content and expand the number of services included. NSCC is also supporting the Municipal Securities Rulemaking Board's (MSRB) call for the reporting of trade information by municipal bond dealers. NSCC has automated the mechanism for delivering information on dealer-to-dealer trades and time-of-trade information that are part of the MSRB's market surveillance efforts.

Since its inception in 1993, the New York Window has saved millions of dollars for its 25 participating firms and served as a catalyst for further immobilizing certificates and expanding eligibility of securities at DTC. Plans have now been established to merge the Window with DTC's expanded branch and custody services department. While NSCC looks to create innovative approaches to solving problems, it does not look to perpetuate its involvement longer than is needed to achieve the economies of scale and results that were intended.

As we approach the next century, nowhere are the changes more apparent than in the growing interest in retirement savings. And once again, after a decade of supporting expansion in the sale of mutual fund shares through Fund/SERV, NSCC is now poised to facilitate growth in the industry's fastest growing segment — defined contribution plans.

The launch of NSCC's Defined Contribution Clearance and Settlement service (DCC&S) in 1997 provides new processing capabilities that will automate the purchase, redemption, transfer and settlement of 401(k) and other defined contribution transactions — and streamline communication between third party administrators (TPAs), trustees and fund families. In addition, banks will be able to access DCC&S either directly, as members of NSCC, or through a link to this service for banks who are members of DTC.

Interest in DCC&S has grown rapidly following a series of seminars in the summer given by NSCC across the country. This interest no doubt reflects the fivefold increase in defined contribution investments, which now exceed \$471 billion yearly.

Reflecting the general growth in mutual fund investing, post-trade processing for the purchase and redemption of mutual fund shares through NSCC's Fund/SERV system in 1997 jumped 48% to more than 111,000 transactions daily. The average daily value of these transactions surpassed \$1.3 billion compared to \$830 million in the prior year. Significantly, the number of mutual funds and firms joining Fund/SERV continued to climb to 401 funds and 278 firms, up 36% and 12%, respectively. And no-load mutual funds, which represented only a handful of participants several years ago, now number 170, nearly 42% of all fund families using NSCC's Fund/SERV and Networking services.

NSCC also continues to work closely with DTC to support its links to our portfolio of mutual fund services. The DTC Interfaces will help facilitate access for their bank members and recognizes the changing nature of who markets and distributes financial products.

Networking, a companion service to Fund/SERV that permits funds to share customer account information electronically

We  
create

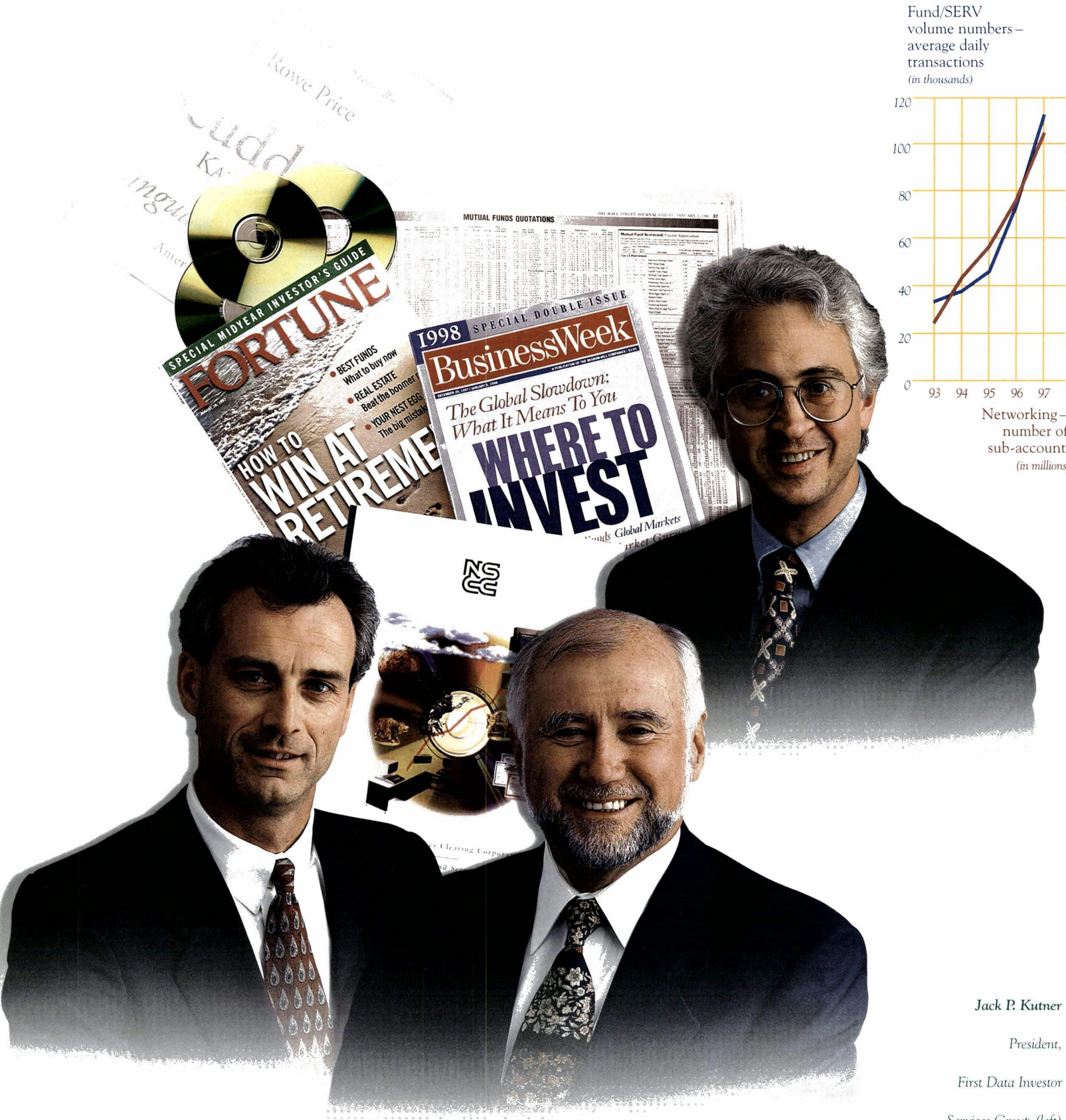
processing

efficiencies by  
centralizing  
communication  
between mutual  
funds, banks and  
brokerage firms

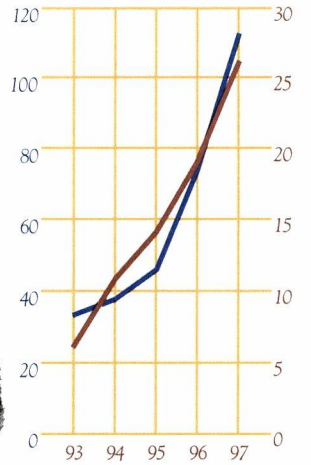
with brokers and other financial firms, also grew substantially this year. The number of sub-accounts supported by the system reached nearly 27 million in 1997, up 36%, virtually doubling the number of sub-accounts in Networking over the past two years.

Enhancements to NSCC's Mutual Fund Profile Service (MFPS) continued in 1997. MFPS will now support both ISO/SWIFT and new non-ISO messaging formats for submitting and obtaining daily pricing and dividend rate data. NSCC also continued development to extend MFPS' capabilities in 1998, as we prepare for a new era of retirement investing.





Fund/SERV  
volume numbers –  
average daily  
transactions  
(in thousands)



Networking –  
number of  
sub-accounts  
(in millions)

**Jack P. Kutner**

President,  
First Data Investor  
Services Group (left)

**William Smith**

President,  
Pioneer Services Corp. (center)

**J. Charles Cardona**

Executive Vice President,  
Dreyfus Service Corp. (right)

Mark Mackey

President and CEO,

National Association

for Variable Annuities (left)

Gretchen E. Wilson

Director, Annuities &

Advisor Services,

National Financial (right)

