

## Board of Directors



*from left to right:*

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

**Edwin F. Payne**  
*Director*  
Liberty Brokerage Inc.

**Allen Clark**  
*Senior Vice President*  
The Chase Manhattan Bank

**Mario J. Pierro**  
*Managing Director*  
Deutsche Bank Securities Inc.

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

**Edward Almeida**  
*(Chairman of the Board, GSCC)*  
*Senior Managing Director*  
Bear, Stearns & Co., Inc.

**Sal Ricca**  
*President & COO*  
Government Securities Clearing Corporation

**David M. Kelly**  
*(Vice Chairman & CEO, GSCC)*  
*President & CEO*  
National Securities Clearing Corporation

## Senior Officers

*Top row, left to right:*

**Neal Arbon**  
*Managing Director*  
 Technology

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

**Steven M. Jukofsky**  
*Managing Director*  
 Marketing



**David Lohuis**  
*Managing Director*  
 Lehman Brothers Inc.

**Mary E. Richards**  
*Managing Director*  
 Salomon Smith Barney

**Ernest A. Pittarelli**  
*Managing Director*  
 Warburg Dillon Read

**Douglas Gardner**  
*Executive Managing Director*  
 Cantor Fitzgerald

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

**Stephen R. Tilton** *(not pictured)*  
*Non-Executive Director & Consultant*  
 Garban LLC

**Thomas Wipf** *(not pictured)*  
*Managing Director*  
 Morgan Stanley UK Group



*Second row, left to right:*

**Robert P. Palatrick**  
*Managing Director*  
 Technology

**Thomas Quaranta**  
*Managing Director*  
 Marketing

**William LeComte**  
*Managing Director*  
 Global Operations  
 (Joined GSCC January 2000)

*Front row, left to right:*

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

**David Buckmaster**  
*Managing Director*  
 Planning

## Balance Sheets

December 31,	(in thousands)	1999	1998
<b>Assets</b>			
Cash and cash equivalents		\$ 90,018	\$ 82,327
Investments in marketable securities		29,009	16,999
Settlement receivable		2,008	56,477
Accounts receivable		2,715	2,533
Clearing fund		3,314,570	3,153,770
Fixed assets, net of accumulated amortization and depreciation of \$11,606,000 and \$9,671,000 at December 31, 1999 and 1998, respectively		5,097	3,680
Other assets		4,238	2,960
<b>Total assets</b>		<b>\$3,447,655</b>	<b>\$3,318,746</b>
<b>Liabilities and Shareholders' Equity</b>			
<b>Liabilities</b>			
Settlement payable		\$ 2,008	\$ 56,478
Clearing fund			
Participants' cash deposits		96,676	79,974
Other participant deposits		3,314,570	3,153,770
Other liabilities		9,179	7,149
<b>Total liabilities</b>		<b>3,422,433</b>	<b>3,297,371</b>
Commitments and contingent liabilities (Note 8)			
<b>Shareholders' equity</b>			
<b>Common stock</b>			
Class A, \$0.50 par value: 75,000 shares authorized, 20,400 and 20,100 shares issued and outstanding at December 31, 1999 and 1998, respectively		10	10
Capital in excess of par		8,940	8,790
Retained earnings		16,272	12,575
<b>Total shareholders' equity</b>		<b>25,222</b>	<b>21,375</b>
<b>Total liabilities and shareholders' equity</b>		<b>\$3,447,655</b>	<b>\$3,318,746</b>

The accompanying notes are an integral part of these statements.

## Statements of Income and Retained Earnings

<i>For the Year Ended December 31,</i>	<i>(in thousands)</i>	<b>1999</b>	1998
<b>Revenues:</b>			
Revenue from comparison, netting, settlement and related services		<b>\$ 32,461</b>	\$ 31,076
Discounts to participants		<b>(1,011)</b>	(1,139)
Net revenues from services		<b>31,450</b>	29,937
Interest income		<b>6,284</b>	5,126
Total revenues		<b>37,734</b>	35,063
<b>Expenses:</b>			
Computer equipment depreciation, licenses, software amortization, processing and maintenance costs		<b>16,603</b>	14,580
Employee compensation and related benefits		<b>9,922</b>	8,610
General and administrative expenses		<b>4,072</b>	3,513
Occupancy costs		<b>630</b>	333
Professional fees		<b>646</b>	436
Total expenses		<b>31,873</b>	27,472
Income before income taxes		<b>5,861</b>	7,591
Provision for income taxes		<b>2,164</b>	3,004
Net income		<b>3,697</b>	4,587
Retained earnings, beginning of year		<b>12,575</b>	7,988
Retained earnings, end of year		<b>\$ 16,272</b>	\$ 12,575

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

## Statements of Cash Flows

For the Year Ended December 31,

(in thousands)

1999

1998

Cash flows from operating activities		
Net income	\$ 3,697	\$ 4,587
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization and depreciation of fixed assets	2,102	1,440
Net premium amortized (discount accreted) on securities owned	5	(29)
Changes in operating assets and liabilities:		
Decrease (increase) in settlement receivable	54,469	(29,913)
Increase in accounts receivable	(182)	(556)
Increase in other assets	(1,278)	(834)
(Decrease) increase in settlement payable	(54,470)	29,914
Increase (decrease) in participants' cash deposits	16,702	(62,035)
Increase in other liabilities	2,030	1,439
Net cash provided by (used in) operating activities	23,075	(55,987)
Cash flows from investing activities		
Maturity of investments in marketable securities	17,000	8,000
Purchases of investments in marketable securities	(29,015)	—
Purchases of fixed assets	(3,944)	(2,646)
Transfer of fixed assets to National Securities Clearing Corporation	425	—
Net cash (used in) provided by investing activities	(15,534)	5,354
Cash flows from financing activity — proceeds from issuance of Class A common stock	150	—
Net increase (decrease) in cash and cash equivalents	7,691	(50,633)
Cash and cash equivalents, beginning of year	82,327	132,960
Cash and cash equivalents, end of year	\$ 90,018	\$ 82,327
Supplementary disclosures — income taxes paid	\$ 2,355	\$ 3,332

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. Independent custodians designated by GSCC take possession of the securities. Overnight reverse repurchase agreements are recorded at the contract amounts and totaled \$78,772,000 and \$82,166,000 at December 31, 1999 and 1998, respectively. At December 31, 1999, one financial institution was counterparty to this agreement.

**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, 1999 and December 31, 1998, are as follows:

**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.

The AICPA has issued Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained For Internal Use," effective for fiscal years beginning after December 15, 1998, which requires that certain costs incurred in the development of software be capitalized. During 1999, GSCC capitalized \$287,000 which is net of amortization of \$57,000. These costs are being amortized over a three-year period.

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

**Estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

	Carrying Value (in thousands)			Market Value (in thousands)		
	U.S. Treasury Securities	Corporate Notes	Total	U.S. Treasury Securities	Corporate Notes	Total
<b>1999</b>						
Due in one year or less	\$ 5,995	\$ 1,034	\$ 7,029	\$ 5,923	\$ 1,017	\$ 6,940
Due in one to two years	21,980	—	21,980	21,781	—	21,781
<b>Total</b>	<b>\$ 27,975</b>	<b>\$ 1,034</b>	<b>\$ 29,009</b>	<b>\$ 27,704</b>	<b>\$ 1,017</b>	<b>\$ 28,721</b>
<b>1998</b>						
Due in one year or less	\$ 15,999	\$ 1,000	\$ 16,999	\$ 16,094	\$ 1,006	\$ 17,100

**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, 1999 and 1998, were \$2,791,901,000 and \$2,786,262,000, 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, 1999 and 1998, follows:

	1999	1998
Cash	<b>\$ 96,676,000</b>	\$ 79,974,000
U.S. Treasury and book entry non-mortgage-backed Agency securities, at market	<b>3,028,890,000</b>	2,961,991,000
Letters of credit issued by authorized banks	<b>285,680,000</b>	191,779,000
<b>Total deposits</b>	<b>\$3,411,246,000</b>	\$3,233,744,000

**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 1999 and 1998 totaled approximately \$5,933,000 and \$4,768,000, respectively. At December 31, 1999, the amount receivable from NSCC under this agreement was \$12,000; the amount payable at December 31, 1998 was \$206,000.

GSCC is contingently liable for a portion of NSCC's office lease which expires on December 31, 2012. At December 31, 1999, the contingent commitment of GSCC for the remaining lease period totals approximately \$6,414,000.

**Note 5 Income Taxes:**

GSCC files Federal, New York State and New York City income tax returns. The differences between the 34% Federal statutory rate and GSCC's 37% and 40% effective tax rates for the years ended December 31, 1999 and 1998, respectively, are primarily attributed to state and local taxes.

The provision for income taxes for the years ended December 31, 1999 and 1998 consists of the following:

	1999	1998
Current income taxes	<b>\$ 2,368,000</b>	\$ 3,151,000
Deferred income taxes	<b>(204,000)</b>	(147,000)
<b>Total income taxes</b>	<b>\$ 2,164,000</b>	\$ 3,004,000

**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 1999, costs for these plans aggregated \$846,000 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 1999 financial statements.

**Note 7 Shareholders' Equity:**

	Class A Common Stock		Capital In Excess Of Par	Retained Earnings
	Shares	Par Value		
<i>(Dollars in thousands, except share data)</i>				
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
Issuance of Class A common stock	<b>300</b>	—	<b>150</b>	—
Net income 1999	—	—	—	<b>3,697</b>
Balance at December 31, 1999	<b>20,400</b>	<b>\$10</b>	<b>\$8,940</b>	<b>\$16,272</b>

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. In September 1999, GSCC issued 300 shares of Class A common stock to a participant.

**Note 8 Commitments and Contingent Liabilities:**

GSCC's netting system interposes GSCC between netting participants for eligible trades that have been netted. At the time of netting, GSCC's guarantee is effected. The guarantee of net settlement positions by GSCC results in potential liability to GSCC. Guaranteed positions that have not yet settled are margined and marked-to-market daily. Margin deposits are held by GSCC; marks are debited from and credited to the responsible participants through the funds-only settlement process. At December 31, 1999, the gross amount of guaranteed positions due from netting participants to GSCC which are scheduled to settle on or before January 3, 2000 approximated \$114,747,009,000; the amount scheduled to

settle after January 3, 2000 approximated \$145,966,624,000. 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, Emerging Markets 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 LLP  
1177 Avenue of the Americas  
New York, NY 10036

### 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, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States. 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 auditing standards generally accepted in the United States 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.

February 9, 2000



## Management's Report on Responsibility for Internal Control Over Financial Reporting

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

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

GSCC's management assessed its internal control over financial reporting as of December 31, 1999, in relation to criteria for effective internal control described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations

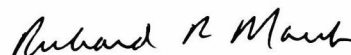
of the Treadway Commission. Based on this assessment, GSCC believes that, as of December 31, 1999, its system of internal control over financial reporting met those criteria.



David M. Kelly, *Vice Chairman & Chief Executive Officer*



Sal Ricca, *President & Chief Operating Officer*



Richard R. Macek, *Treasurer*

February 9, 2000

## Report of Independent Accountants on Internal Control Over Financial Reporting



PriceWaterhouseCoopers LLP  
1177 Avenue of the Americas  
New York, NY 10036

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

We have examined management's assertion that Government Securities Clearing Corporation (GSCC) maintained effective internal control over financial reporting as of December 31, 1999, which is included in the accompanying Management's Report on Responsibility for Internal Control Over Financial Reporting. Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

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

In our opinion, management's assertion that GSCC maintained effective internal control over financial reporting as of December 31, 1999 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.



February 9, 2000







**Government Securities  
Clearing Corporation**  
55 Water Street  
New York, NY 10041-0099

212.412.8400  
[www.gsc.com](http://www.gsc.com)