



2004

NATIONAL SECURITIES CLEARING CORPORATION

Annual Financial Statements

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To NSCC Participants:

We are pleased to provide you with a copy of the audited financial statements of NSCC.

Jill M. Considine
Chairman & Chief Executive Officer
The Depository Trust & Clearing Corporation

Report of Independent Auditors



PricewaterhouseCoopers LLP
300 Madison Avenue
New York, NY 10017

To the Board of Directors and Shareholder of
National Securities Clearing Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of National Securities Clearing Corporation and its subsidiary at December 31, 2004 and 2003, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 of America. Those standards 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 our opinion.

PricewaterhouseCoopers LLP

February 18, 2005

Consolidated Balance Sheets

(IN THOUSANDS)

December 31, 2003		2004
Assets		
Cash and cash equivalents	\$2,403,257	\$2,014,930
U.S. Treasury securities	134,866	95,622
Accounts receivable	22,735	11,948
Clearing fund	538,158	464,027
Fixed assets, less accumulated depreciation and amortization of \$46,511,000 and \$38,919,000 at December 31, 2004 and 2003, respectively	41,200	32,815
Other assets	14,469	17,131
Total assets	\$3,154,685	\$2,636,473
Liabilities and Shareholder's Equity		
Liabilities:		
Accounts payable and other liabilities	\$96,726	\$36,140
Payable to participants	251,660	216,589
Long-term debt	26,336	18,720
Clearing fund:		
Cash deposits	2,201,930	1,874,324
Other deposits	538,158	464,027
Total liabilities	3,114,810	2,609,800
Commitments and contingent liabilities (Note 9)		
Shareholder's equity:		
Common stock, \$.50 par value: 30,000 shares authorized, 20,000 shares issued and outstanding	10	10
Capital in excess of par	590	590
Retained earnings	39,275	29,400
Treasury stock	-	(3,327)
Total shareholder's equity	39,875	26,673
Total liabilities and shareholder's equity	\$3,154,685	\$2,636,473

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income and Retained Earnings

<i>(IN THOUSANDS)</i>		
For the Year Ended December 31,	2004	2003
Revenues:		
Revenue from services	\$319,880	\$293,133
Interest income	35,607	22,096
Total revenues	355,487	315,229
Discounts and other refunds to participants	(72,322)	(106,728)
Net revenues	283,165	208,501
Expenses:		
Employee compensation and related benefits	113,553	97,380
Information technology	97,607	61,057
The Depository Trust Company fees	8,511	6,909
Professional and other services	28,756	27,221
Occupancy	16,340	12,813
Other general and administrative	7,936	5,274
Reimbursement from affiliates	(7,236)	(2,153)
Total expenses	265,467	208,501
Income before income taxes	17,698	—
Provision for income taxes	7,823	—
Net income		9,875
Retained earnings, beginning of year	29,400	29,400
Retained earnings, end of year	\$39,275	\$29,400

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

(IN THOUSANDS)

For the Year Ended December 31,	2004	2003
Cash flows from operating activities:		
Net income	\$ 9,875	\$ —
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of fixed assets	11,167	9,290
Loss on fixed asset disposals	2,315	597
Net premium amortized on securities owned	653	1,587
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(10,787)	5,468
Decrease in other assets	2,662	2,375
Increase (decrease) in accounts payable and other liabilities	60,586	(56)
Increase in payable to participants	35,071	90,812
Increase in clearing fund cash deposits	327,606	819,640
Net cash provided by operating activities	439,148	929,713
Cash flows from investing activities:		
Maturities of investments in U.S. Treasury securities	95,000	90,000
Purchases of investments in U.S. Treasury securities	(134,897)	(96,555)
Purchases of fixed assets	(21,867)	(10,116)
Net cash used in investing activities	(61,764)	(16,671)
Cash flows from financing activities:		
Notes payable issuance	7,500	—
Proceeds from sale of treasury stock	3,327	—
Proceeds from sale-leaseback transaction	—	1,800
Capitalized leases	2,873	659
Principal payments on debt and capital lease obligations	(2,757)	(2,423)
Net cash provided by financing activities	10,943	36
Net increase in cash and cash equivalents	388,327	913,078
Cash and cash equivalents, beginning of year	2,014,930	1,101,852
Cash and cash equivalents, end of year	\$2,403,257	\$2,014,930
Supplemental disclosure:		
Income taxes paid, net of refunds	\$5,620	\$ 214
Interest paid		\$1,036
\$ 882		

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1 BUSINESS AND OWNERSHIP

National Securities Clearing Corporation (NSCC), a clearing agency registered with the Securities and Exchange Commission (SEC), provides various services to members of the financial community (participants), consisting principally of securities trade comparison, clearance and settlement.

NSCC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (DTCC). The other principal operating subsidiaries of DTCC are The Depository Trust Company (DTC), Fixed Income Clearing Corporation (FICC), Emerging Markets Clearing Corporation (EMCC), DTCC Deriv/SERV LLC and Global Asset Solutions LLC. In December 2002, the SEC approved the merger of MBS Clearing Corporation (MBSCC) into Government Securities Clearing Corporation (GSCC) to form FICC, which commenced operations on January 1, 2003.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: The consolidated financial statements include the accounts of NSCC and its wholly-owned subsidiary. Intercompany accounts and transactions are eliminated in consolidation.

Treasury stock: At December 31, 2001, NSCC had ownership interests in GSCC, MBSCC and EMCC. Effective January 1, 2002, the shareholders of GSCC, MBSCC and EMCC exchanged their ownership interests in these respective corporations for common stock issued by DTCC. The primary purpose of the exchanges was to achieve greater efficiencies between DTCC and these companies. As a result of the exchange, NSCC became a shareholder of DTCC, its parent, which for financial statement purposes was reflected as treasury stock, valued on a historical basis. In March 2004, DTCC repurchased its common shares from NSCC at the historical value and no gain or loss was recognized.

Cash equivalents: NSCC invests funds in overnight reverse repurchase agreements, commercial paper and money market accounts which are considered cash equivalents. Reverse repurchase agreements provide for NSCC's delivery of cash in exchange for securities having a market value which is at least 102% of the amount of the agreement. Independent custodians designated by NSCC take possession of the securities. Overnight reverse repurchase agreements are recorded at the contract amounts and totaled \$2,265,291,000 and \$1,889,481,000 at December 31, 2004 and 2003, respectively. At December 31, 2004, the counterparties to these agreements were five major financial institutions that are also participants.

Overnight investments in commercial paper totaling \$24,630,000 and \$20,004,000 are also included in cash equivalents at December 31, 2004 and 2003, respectively. At December 31, 2004, the issuer of the commercial paper was one major U.S. bank holding company that is also a participant.

U.S. Treasury securities: U.S. Treasury securities are recorded at amortized cost and are considered to be held-to-maturity securities. The market values of these securities, which are due in less than one year, at December 31, 2004 and 2003 are \$134,505,000 and \$95,608,000, respectively. At December 31, 2004 and 2003, these securities were held in an account for the exclusive benefit of participants to facilitate their compliance with customer protection rules of the SEC.

Notes to Consolidated Financial Statements December 31, 2004

Fixed assets: Fixed assets consist of the following at December 31, 2004 and 2003:

(Dollars in thousands)	2004	2003
Land	\$1,156	\$700
Buildings and improvements	12,445	8,560
Leasehold improvements	11,138	7,409
Furniture and equipment	26,662	26,433
Software	33,037	26,289
Leased property under capital leases	3,273	2,343
Total cost	87,711	71,734
Less accumulated depreciation and amortization	46,511	38,919
Net book value	\$41,200	\$32,815

Buildings and improvements are primarily amortized over 39 years using the straight-line method. Leasehold improvements are amortized using the straight-line method over their useful lives or the remaining term of the related lease, whichever is shorter. Furniture and equipment are depreciated over estimated useful lives ranging from three to eight years, principally using accelerated methods. Software is amortized using the straight-line method over an estimated useful life of three years.

NSCC capitalized software developed for internal use or purchased totaling \$7,155,000 and \$4,513,000 in 2004 and 2003, respectively. The amortization of capitalized software costs was \$4,968,000 in 2004 and \$5,150,000 in 2003.

During 2004, fixed asset disposals resulted in a charge of \$2,315,000 and the removal of \$5,890,000 and \$3,575,000, respectively, from the related cost and accumulated depreciation and amortization accounts. The comparable amounts in 2003 were \$597,000, \$924,000 and \$327,000, respectively.

Income taxes: Deferred tax assets and liabilities represent 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 employee benefit costs and depreciation and amortization, partially offset by the cost of software developed for internal use. At December 31, 2004 and 2003, the net deferred tax asset included in other assets totaling \$11,715,000 and \$9,504,000, respectively, was expected to be fully realized and, accordingly, no valuation allowance was established.

Discounts: NSCC provides discounts on its billing to participants based upon the amount of earnings to be retained in a given year with due regard to current and anticipated needs, as determined by its Board of Directors. Such discounts amounted to \$40,844,000 in 2004 and \$86,712,000 in 2003.

Payable to participants: Payable to participants includes settlement accounts payable of \$247,363,000 at December 31, 2004 and \$199,951,000 at December 31, 2003 which primarily represent deposits received from participants to facilitate their compliance with customer protection rules of the SEC.

Revenue recognition: Revenue is recognized as services are rendered. Activities are captured daily and billed on a monthly basis.

Expense allocations: Substantially all expenses are recorded at DTCC and are allocated to its subsidiaries based upon their use of such goods or services as determined by applicable allocation factors.

Financial instruments: Management believes that the carrying value of all financial instruments approximates market value based upon current rates of return on investments and borrowing rates available to companies with similar credit ratings.

Notes to Consolidated Financial Statements December 31, 2004

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 CLEARING FUND

NSCC's rules require certain participants to maintain clearing fund deposits based on calculated requirements, which were \$1,760,118,000 and \$1,422,531,000, at December 31, 2004 and 2003, respectively. The clearing fund is available to secure participants' obligations and certain liabilities of NSCC should they occur. All clearing fund cash and securities are recorded on the balance sheet. A summary of the total deposits held at December 31, 2004 and 2003, including \$1,113,293,000 and \$1,046,243,000, respectively, in excess of calculated requirements follows:

(Dollars in thousands)	2004	2003
Cash	\$2,201,930	\$1,874,324
Securities issued or guaranteed by the U.S. Government, at market value	538,158	464,027
Letters of credit issued by authorized banks	133,323	130,423
Total	\$2,873,411	\$2,468,774

NSCC invests available clearing fund cash deposits principally in overnight reverse repurchase agreements. The earnings on these investments are passed through to participants and are included in interest income and discounts and other refunds to participants. Such earnings totaled \$31,478,000 and \$20,016,000 in 2004 and 2003, respectively.

NOTE 4 TRANSACTIONS WITH RELATED PARTIES

SIAC: Under the terms of an agreement, the Securities Industry Automation Corporation (SIAC), an entity owned by the New York Stock Exchange (NYSE) and the National Association of Securities Dealers, Inc. (NASD), provides computer facilities, personnel and services in support of NSCC's operations. SIAC charges NSCC for these services based on its direct and overhead costs arising from providing such services. Charges under this agreement included in information technology expenses totaled \$41,008,000 in 2004 and \$49,950,000 in 2003. Beginning in 2004, NSCC and SIAC have agreed to migrate certain systems applications to DTCC. The insourcing of these applications as specified in the agreement was completed by year-end. As a result, in accordance with Statement of Financial Accounting Standards No. 146 "Accounting for Costs Associated with Exit or Disposal Activities," NSCC accrued \$31,604,000 to recognize contractual obligations for real estate, severance pay, fixed asset abandonment, overhead and related expenses. In addition, NSCC incurred certain Voluntary Early Retirement Option costs of \$10,085,000. These charges are also included in information technology expenses. At December 31, 2004 and 2003, amounts payable to SIAC included in accounts payable and other liabilities were \$35,500,000 and \$654,000, respectively.

DTCC: NSCC has an agreement with DTCC whereby DTCC disburses substantially all funds required to sustain the operations of NSCC. The principal exceptions are SIAC and DTC costs. The related expenses are allocated to NSCC based upon an estimate of NSCC's use of such goods or services. Further, the agreement provides that DTCC performs certain other services for NSCC including administrative, audit, financial and legal services which are billed at 110% of cost. The fee representing the

Notes to Consolidated Financial Statements December 31, 2004

amount over actual cost was \$2,432,000 in 2004 and \$2,279,000 in 2003. At December 31, 2004 and 2003, the net payable to DTCC included in accounts payable and other liabilities totaled approximately \$47,573,000 and \$21,386,000, respectively.

DTC: DTC fees in 2004 and 2003 included \$8,361,000 and \$6,772,000, respectively, relating to charges for NSCC participants which NSCC sponsors at DTC. Such amounts are rebilled to the related participants and are included in revenues from services. Further, NSCC provides various computer services to DTC through SIAC under NSCC's agreement with SIAC. The net amounts payable to DTC at December 31, 2004 and 2003 were \$12,000 and \$10,000, respectively.

NYSE and NASD: NSCC collects certain regulatory fees on behalf of NYSE and NASD. At December 31, 2004 and 2003, no amounts were due to NYSE or NASD.

EMCC: NSCC has an agreement to provide risk management, personnel, technical and operations services to EMCC. At December 31, 2004 and 2003, no amounts were due from EMCC.

NSCC has an arrangement with EMCC whereby NSCC pays for the computer services performed by SIAC for EMCC and charges EMCC a transaction fee based on the number of trades settled. The SIAC charges paid by NSCC for 2004 and 2003 were \$227,000 and \$490,000, respectively, and the transaction fees paid by EMCC for 2004 and 2003 were \$373,000 and \$459,000, respectively. In December, 2004, the cumulative excess of the SIAC charges over the transaction fees since the inception of this arrangement totaling \$755,000 was charged to EMCC.

FICC: NSCC has an agreement to provide risk management, personnel, technical and operations services to FICC. NSCC also provides various computer services to FICC through SIAC under NSCC's agreement with SIAC. Further, NSCC has entered into an arrangement with FICC whereby FICC provides software development services to NSCC. At December 31, 2004 and 2003, no amounts were due from FICC.

Omgeo LLC: DTCC has an agreement with Omgeo LLC (Omgeo), a joint venture with Thomson Financial, whereby if Omgeo reduces or terminates certain services it receives from DTCC or its affiliates, Omgeo will pay certain extraction costs as specified in the agreement. Such charges relating to NSCC were \$730,000 in 2004.

A summary of the charges to DTC, EMCC, FICC and Omgeo LLC by NSCC for the years ended December 31, 2004 and 2003 follows:

(Dollars in thousands)	SIAC	Occupancy	Other, Net	Total
2004				
DTC		\$2,797	\$—	\$—
\$2,797				
EMCC	373	—	1,691	2,064
FICC	7,811	1,031	4,815	13,657
Omgeo LLC	—	—	730	730
Total	\$10,981	\$1,031	\$7,236	\$19,248
2003				
DTC		\$1,533	\$—	\$—
\$1,533				
EMCC	459	—	1,695	2,154

Notes to Consolidated Financial Statements December 31, 2004

FICC	5,392	1,340	458	7,190
Total	\$7,384	\$1,340	\$2,153	\$10,877

NSCC's information technology and occupancy expenses are presented net of these SIAC and occupancy charges, respectively.

NOTE 5 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

All eligible employees of NSCC participate in DTCC's trustee, noncontributory defined benefit pension plan. In addition, NSCC participates in DTCC's noncontributory supplemental executive retirement and benefit restoration plans which provide for certain benefits to eligible executives of NSCC upon retirement. Further, NSCC participates in DTCC's life insurance program which provides payment of death benefits to beneficiaries of eligible retired employees and DTCC's health insurance program which provides benefits to eligible retired employees. In 2004, costs for these plans aggregated \$43,765,000.

On December 31, 2004, the accumulated benefit obligation related to DTCC's pension plans exceeded the fair value of the pension plan assets (such excess is referred to as an unfunded accumulated benefit obligation). This difference is attributed to an increase in the accumulated benefit obligation resulting from a reduction in the interest rate used to discount the projected benefit obligation to its present settlement amount from 6.00% to 5.75%, partially offset by an increase in the fair value of the plan assets due to the actual rate of return on plan assets exceeding the expected return on plan assets in 2004. As a result, in accordance with Statement of Financial Accounting Standards No. 87, DTCC recognized an additional minimum pension liability of \$1,929,000 which was charged to accumulated other comprehensive loss.

NSCC's share of the periodic and accumulated other comprehensive charges totaled \$12,790,000 based primarily upon the proportion of NSCC's salary costs to aggregate salary costs for DTCC and its wholly-owned subsidiaries. Such amount is included in employee compensation and related benefits. The equivalent amount for 2003 was \$10,670,000.

Disclosures of pension and other post-retirement benefit obligations, expense components and actuarial assumptions for the DTCC plans are included in DTCC's consolidated financial statements.

NOTE 6 INCOME TAXES

NSCC files consolidated Federal and combined New York State and New York City income tax returns with DTCC. The provisions for income taxes for the years ended December 31, 2004 and 2003, consist of the following:

(Dollars in thousands)	2004	2003
Current income taxes (benefit):		
Federal	\$6,993	(\$538)
State and Local	3,042	(315)
Deferred income taxes (benefit):		
Federal	(2,184)	842
State and Local	(28)	11
Provision for income taxes	\$7,823	\$—

Notes to Consolidated Financial Statements December 31, 2004

NSCC's effective tax rate is higher than the 35% Federal statutory rate primarily due to state and local taxes. Since NSCC is filing consolidated Federal and combined New York State and New York City income tax returns with DTCC, the current taxes for 2004 represent an amount payable to DTCC, net of estimated payments made by NSCC in 2004.

NOTE 7 LONG-TERM DEBT AND LINES OF CREDIT

Long-term debt at December 31, 2004 and 2003 consists of the following:

(Dollars in thousands)	2004	2003
Notes payable	\$21,100	\$15,300
Sale-leaseback obligation	1,775	1,775
Capital lease obligations	3,461	1,645
Total	\$26,336	\$18,720

Notes payable at December 31, 2004 consist of secured borrowings totaling \$13,600,000 from two insurance companies on September 15, 2002, at a fixed rate of 4.62%. The notes are secured by property, plant and equipment. Principal and interest payments are due semi-annually on March 15 and September 15 of each year through 2012, beginning in 2003. Interest expense related to these notes totaled \$664,000 in 2004 and \$743,000 in 2003. Notes payable also include unsecured borrowings totaling \$7,500,000 from an insurance company on November 22, 2004, at a fixed rate of 5.03%. Principal payments are due annually on December 15 of each year through 2023, beginning in 2005. Interest payments are due semi-annually on June 15 and December 15 of each year, through the same period. Interest expense related to these notes totaled \$40,000 in 2004.

In March 2003, the Company entered into a sale-leaseback transaction covering certain assets aggregating \$1,800,000 with an initial payment at closing. The Company treated this transaction as a financing arrangement under generally accepted accounting principles and no gain or loss was recognized. Accordingly, NSCC will continue to depreciate the assets for accounting purposes using its normal depreciation policy. Payments under this arrangement are due in installments from 2004 to 2009. The implicit interest rate on the obligation is 4.7%.

Leased property meeting certain criteria is capitalized and the present value of the related lease payments is recorded as a liability. At December 31, 2004, future minimum payments including interest, which are due through 2009, totaled \$3,790,000.

At December 31, 2004, NSCC maintained a committed line of credit of \$2,050,000,000 with 16 major banks, that are primarily participants, to provide for potential liquidity needs. During 2004, there were no borrowings under this credit facility. NSCC also maintains a \$50,000,000 shared credit line with DTC and DTCC to support potential short-term operating cash requirements. In June 2004, NSCC borrowed \$4,000,000 under this credit line to temporarily finance the acquisition of real estate at an average rate of 1.84%. The temporary borrowing was repaid when permanent long-term financing was completed in November.

Notes to Consolidated Financial Statements December 31, 2004

NOTE 8 SHAREHOLDER'S EQUITY

(Dollars in thousands)	Common Stock	Capital in Excess of Par	Retained Earnings	Treasury Stock
Balance at December 31, 2003 and 2002	\$ 10	\$ 590	\$ 29,400	(\$3,327)
Sale of treasury stock (see Note 2)	—	—	—	3,327
Net income 2004	—	—	9,875	—
Balance at December 31, 2004	\$ 10	\$ 590	\$39,275	\$ —

NOTE 9 COMMITMENTS AND CONTINGENT LIABILITIES

The CNS system interposes NSCC between participants in securities clearance and settlement. CNS transactions are generally guaranteed as of midnight of the day they are reported to the membership as compared/recorded. The failure of participants to deliver securities to NSCC on settlement date, and the corresponding failure of NSCC to redeliver the securities, results in open positions. Open positions are marked-to-market daily. Such marks are debited or credited to the involved participants through the settlement process. At the close of business on December 31, 2004, open positions due to NSCC approximated \$4,346,655,000 (\$3,025,467,000 at December 31, 2003), and open positions due by NSCC to participants approximated \$3,328,295,000 (\$2,303,717,000 at December 31, 2003) for unsettled positions and \$1,018,360,000 (\$721,750,000 at December 31, 2003) for securities borrowed through NSCC's Stock Borrow Program. At December 31, 2004, NSCC has an obligation to complete pending transactions totaling \$44.0 billion.

During 1995, a SIPC trustee was appointed to liquidate the business of Adler Coleman Clearing Corporation (ACCC), a former NSCC participant. NSCC and the SIPC trustee entered into an agreement in connection with the settlement of certain positions held by ACCC at NSCC whereby NSCC would be liable to the trustee under certain conditions for amounts which management estimates could be up to \$17,000,000 plus interest. In October 2002, NSCC transferred proceeds of \$15,000,000 to the SIPC trustee to satisfy a written demand made by the trustee pursuant to the agreement. At December 31, 2004 and 2003, the remaining balance of the accrual for potential losses included in accounts payable and other liabilities is \$3,582,000.

Net rental expense amounted to \$15,478,000 and \$11,293,000, in 2004 and 2003, respectively. At December 31, 2004, future minimum rental payments under all noncancelable leases follows:

(Dollars in thousands)	
2005	\$3,715
2006	3,540
2007	3,441
2008	3,180
2009	2,973
thereafter	8,561
Total minimum rental payments	\$25,410

NOTE 10 OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

In the normal course of business, NSCC guarantees certain obligations of its participants under specified circumstances (see Note 9). If a participant fails to fulfill its obligations, NSCC could be exposed to risk in amounts in excess of those recorded in NSCC's settlement accounts receivable and payable.

NSCC mitigates its exposure to risk by requiring participants to meet established NSCC financial standards for membership, monitoring compliance with other financial standards established by NSCC and by requiring participants to provide clearing fund deposits in the form of cash, marketable securities or acceptable letters of credit (see Note 3).

If a participant fails to fulfill its settlement obligations to NSCC and NSCC ceases to act on behalf of the participant, NSCC will liquidate that participant's guaranteed security receive and deliver obligations and apply that defaulting participant's clearing fund deposit to satisfy any net outstanding obligation and/or loss.

NSCC has entered into a netting contract and limited cross-guaranty agreement with DTC which includes certain arrangements and financial guarantees to ensure that securities delivered by DTC to NSCC to cover CNS allocations are fully collateralized. NSCC has also entered into a multilateral netting contract and limited cross-guaranty agreement with DTC, FICC, EMCC and The Options Clearing Corporation (OCC) 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 they have excess resources of the defaulting participant. NSCC and OCC have also entered into an agreement providing for payments to each other relating to the settlement of certain option exercises and assignments in the event of a mutual participant's failure.

In the event that a deficiency still exists after the application of the guaranty payments from the other clearing agencies, before NSCC may assess the membership, NSCC is required to apply against the deficiency at least 25% of its retained earnings or such greater amount to be determined by the Board of Directors. NSCC may then assess the balance of the deficiency in accordance with NSCC's Rules.

As discussed in Note 1, NSCC provides various services to members of the financial community who participate in securities trade comparison, clearance and settlement. As such, NSCC 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.

NOTE 11 OTHER MATTERS

In connection with the acquisition of real estate (see Note 7), NSCC incurred certain relocation and severance expenses totaling \$3,323,000 that are included in employee compensation and related benefits expense. In addition, the company entered into an agreement to surrender space on certain floors of leased premises at another location prior to the expiration of the remaining lease term. Accordingly, a provision of \$1,533,000 was recorded to reflect the net cost of surrendering the space, including the impairment in the carrying value of leasehold improvements.

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