

Report of Independent Certified Public Accountants

To the Board of Directors of:
Securities Investor Protection Corporation

We have audited the accompanying statement of financial position of Securities Investor Protection Corporation (the Corporation) as of December 31, 2005, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Securities Investor Protection Corporation as of December 31, 2005, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.



Vienna, VA
March 22, 2006

Securities Investor Protection Corporation

Statement of Financial Position as of December 31, 2005

ASSETS

Cash	\$ 3,710,019
U.S. Government securities, at fair value including accrued interest receivable of \$17,700,071; (amortized cost \$1,269,472,374) (Note 6)	1,282,382,212
Advances to trustees for customer protection proceedings in progress, less allowance for possible losses (\$194,062,438) (Note 4)	91,700,000
Prepaid benefit costs (Note 8)	3,097,068
Other (Note 5)	1,668,550
	\$1,382,557,849

LIABILITIES AND NET ASSETS

Advances to trustees - in process (Note 4)	\$ 71,545
Accrued benefit costs (Note 8)	4,122,032
Accounts payable and other accrued expenses	545,576
Deferred rent (Note 5)	373,972
Estimated costs to complete customer protection proceedings in progress (Note 4)	32,300,000
	37,413,125
Net assets	1,345,144,724
	\$1,382,557,849

Statement of Activities for the year ended December 31, 2005

Revenues:	
Interest on U.S. Government securities	\$ 62,758,304
Member assessments (Note 3)	927,597
	63,685,901
Expenses:	
Salaries and employee benefits (Note 8)	5,244,719
Legal and accounting fees (Note 4)	395,573
Credit agreement commitment fee (Note 5)	2,218,971
Rent (Note 5)	631,764
Other	1,713,120
	10,204,147
Excess estimated future recoveries over provision for estimated costs to complete customer protection proceedings in progress (Note 4)	(95,690,136)
	(85,485,989)
Total net revenues	149,171,890
Realized and unrealized losses on U.S. Government securities (Note 6)	(39,972,573)
Increase in net assets	109,199,317
Net assets, beginning of year	1,235,945,407
Net assets, end of year	\$1,345,144,724

The accompanying notes are an integral part of these statements.

Securities Investor Protection Corporation

Statement of Cash Flows for the year ended December 31, 2005

Operating activities:

Interest received from U.S. Government securities	\$ 66,085,639
Member assessments received	927,597
Advances paid to trustees	(21,883,938)
Recoveries of advances	6,457,179
Salaries and other operating activities expenses paid	(9,362,622)
Net cash provided by operating activities	42,223,855

Investing activities:

Proceeds from sales of U.S. Government securities	123,691,565
Purchases of U.S. Government securities	(162,624,393)
Purchases of furniture and equipment	(70,975)
Leasehold improvements	(314,956)
Net cash used in investing activities	(39,318,759)
Increase in cash	2,905,096
Cash, beginning of year	804,923
Cash, end of year	\$ 3,710,019

The accompanying notes are an integral part of this statement.

Notes to Financial Statements

1. Organization and general

The Securities Investor Protection Corporation (SIPC) was created by the Securities Investor Protection Act of 1970 (SIPA), which was enacted on December 30, 1970, primarily for the purpose of providing protection to customers of its members. SIPC is a nonprofit membership corporation and shall have succession until dissolved by an Act of Congress. Its members include all persons registered as brokers or dealers under Section 15(b) of the Securities Exchange Act of 1934 except for those persons excluded under SIPA.

SIPC is exempt from income taxes under 15 U.S.C. § 78 kkk(e) of SIPA. Accordingly, no provision for income taxes is required.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

2. The "SIPC Fund" and SIPC's resources

The "SIPC Fund," as defined by SIPA, consists of cash and U.S. Government securities aggregating \$1,286,092,231.

In the event the SIPC Fund is or may reasonably appear to be insufficient for the purposes of SIPA, the Securities and Exchange Commission is authorized to make loans to SIPC and, in that connection, the Commission is authorized to issue notes or other obligations to the Secretary of the Treasury in an aggregate amount not to exceed \$1 billion. In addition, SIPC maintains a \$1 billion revolving line of credit with a consortium of banks.

3. Member assessments

For calendar year 2005 each member's assessment is \$150. Assessments received in advance will be applied to future assessments, or refunded to the member after it fulfills certain requirements.

4. Customer protection proceedings

Customer protection proceedings (proceedings) include liquidations conducted by court appointed trustees and direct payment proceedings conducted by SIPC. There are 31 proceedings in progress at December 31, 2005. Customer claims have been satisfied in 26 of these proceedings and in 5 proceedings customer claims and distributions are being processed.

Advances to trustees represent net amounts disbursed and amounts currently payable for proceedings in progress, less an allowance for possible losses.

Estimated costs to complete proceedings are accrued based upon the costs of completed cases of comparable size and complexity and other costs that can be reasonably estimated. Recoveries are estimated based upon the expected disposition of the debtors' estates.

SIPC and Trustees appointed under SIPA are subject to legal claims arising out of the proceedings and there are certain legal claims pending seeking coverage under SIPA. These claims are considered in determining estimated costs to complete proceedings and management believes that any liabilities or settlements arising from these claims will not have a material effect on SIPC's net assets.

SIPC has advanced a net of \$285.9 million for proceedings in progress (including direct payment proceedings of \$.1 million) to carry out its statutory obligation to satisfy customer claims and to pay administration expenses. Of this amount, \$194.2 million is not expected to be recovered.

The following table summarizes transactions during the year ended December 31, 2005 that result from these proceedings:

	Customer Protection Proceedings	
	Advances to trustees, less allowance for possible losses	Estimated costs to complete
Balance, beginning of year	\$ 700,000	\$52,200,000
Add:		
Provision for current year recoveries	5,800,000	—
Provision for estimated future recoveries	91,700,000	—
Provision for estimated costs to complete proceedings	—	2,000,000
Less:		
Recoveries	6,500,000	—
Advances to trustees	—	21,900,000
Balance, end of year	<u>\$91,700,000</u>	<u>\$32,300,000</u>

Customer payments and related expenses of direct payment proceedings are recorded as expenses as they are incurred.

Legal and accounting fees include fees and expenses of litigation related to proceedings.

These financial statements do not include accountability for assets and liabilities of members being liquidated by SIPC as Trustee. Such accountability is reflected in reports required to be filed with the courts having jurisdiction.

5. Commitments

Future minimum rentals for office space under a ten-year lease expiring August 31, 2015, are as follows: 2006 - \$501,376; 2007 - \$513,944; 2008 - \$526,790; 2009 - \$539,911; 2010 - \$553,447; 2011 - \$567,259; 2012 - \$581,485; 2013 - \$595,988; 2014 - \$610,905; 2015 - \$417,491; for a total of \$5,408,595, as of December 31, 2005. Additional rental based on increases in operating expenses and real estate taxes is required by the lease. The rent holiday of \$41,567 and the leasehold improvement incentive of \$345,300 are being amortized over the life of the lease.

On June 25, 2003, SIPC signed a five-year lease for additional office space in Fairfax, Virginia, expiring July 31, 2008. Future minimum rentals for the space are as follows: 2006 - \$90,230; 2007 - \$92,936; 2008 - \$55,150; for a total of \$238,316 as of December 31, 2005. Additional rental is based on increases in operating expenses, including real estate taxes.

In March, 2004, SIPC entered into a \$1 billion credit agreement with a consortium of banks, consisting of (i) a \$500 million, 364-day, revolving credit facility, with a commitment fee of .09% per annum, and (ii) a \$500 million, 3-year, revolving credit facility at .11% per annum, both paid quarterly. Additionally, fees ranging from .2% to .3% were paid to certain banks based on the level of their commitment.

In March, 2005, SIPC renewed the \$500 million 364-day, facility at the same commitment fee. In March of 2006, this facility was replaced by a new 3-year, \$500 million revolving credit facility with commitment fees of .10% per year. Additionally, fees ranging from .12% to .15% were paid to certain banks based on the level of their commitment.

6. Fair value of securities

Fair value of U.S. Government securities is based on the Federal Reserve Bank of New York bid quote as of December 31, 2005.

U.S. Government securities as of December 31, 2005, included gross unrealized gains of \$21,073,064 and gross unrealized losses of \$8,163,226.

7. Reconciliation of increase in net assets to net cash provided by operating activities:

Increase in net assets	\$109,199,317
Net increase in estimated recoveries of advances to trustees	(91,000,000)
Unrealized loss on U.S. Government securities	40,016,547
Net decrease in estimated cost to complete customer protection proceedings	(19,900,000)
Net amortized premium on U.S. Government securities	3,071,720
Deferred rent	373,972
Decrease in accrued interest receivable on U.S. Government securities	211,644
Increase in payables and accrued expenses	178,197
Depreciation and amortization	150,247
Increase in prepaid expenses	(79,612)
Loss on disposal of assets	1,823
Net cash provided by operating activities	\$ 42,223,855

8. Pensions and Other Postretirement Benefits

SIPC has a noncontributory defined benefit plan and a contributory defined contribution plan which cover all employees. SIPC also has two defined benefit postretirement plans that cover all employees. One plan provides medical and dental insurance benefits and the other provides life insurance benefits. The postretirement health care plan is contributory,

with retiree contributions adjusted annually to reflect changes in gross premiums; the life insurance plan is noncontributory. The following valuation results are based on actuarial assumptions and methods mandated by the Statement of Financial Accounting Standards No. 132 (FAS 132), No. 106 (FAS 106), and No. 87 (FAS 87).

	Pension Benefits	Other Postretirement Benefits
Change in Benefit Obligation		
Benefit obligation at beginning of year	\$16,541,722	\$ 3,541,305
Service cost	569,079	134,865
Interest cost	980,053	210,984
Actuarial losses	159,853	629,794
Plan participant's contributions	-	9,835
Benefits paid	(391,825)	(53,963)
Benefit Obligation at end of year	\$17,858,882	\$ 4,472,820
Change in Plan Assets		
Fair value of plan assets at beginning of year	\$14,377,856	\$ -
Actual return on plan assets	983,478	-
Employer contribution	1,500,000	44,128
Plan participants' contributions	-	9,835
Benefits paid	(391,825)	(53,963)
Fair value of plan assets at end of year	\$16,469,509	\$ -
Reconciliation of Funded Status		
Funded status	\$ (1,389,373)	\$(4,472,820)
Unrecognized net actuarial losses	4,348,435	350,788
Unrecognized prior service cost	138,006	-
Net amount recognized	\$ 3,097,068	\$(4,122,032)
Amounts Recognized in the Financial Statements		
Prepaid (Accrued) benefit cost	\$ 3,097,068	\$(4,122,032)
Net Periodic Benefit Cost		
Service cost	\$ 569,079	\$ 134,865
Interest cost	980,053	210,984
Expected return on assets	(1,208,628)	-
Amorization of prior service cost	13,172	-
Recognized net loss	256,584	957
Net Periodic Benefit Cost	\$ 610,260	\$ 346,806
Information for Pension Plans		
Projected benefit obligation	\$17,858,882	
Accumulated benefit obligation	\$15,753,406	
Fair value of plan assets	\$16,469,509	

Actuarial Assumptions

Weighted-average assumptions used to determine benefit obligations and net periodic benefit cost for the year ended December 31 and assumed health care cost trend rates at December 31

	Pension Benefits	Other Postretirement Benefits
Discount rate	5.75%	5.75%
Rate of compensation increase	4.50%	N/A
Expected return on plan assets	8.00%	N/A
Health care cost trend rate assumed for next year	N/A	10.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	N/A	5.00%
Year that the rate reaches the ultimate trend rate	N/A	2011
Average expected future working lifetime of active plan participants	10 years	11 years

The change in unrecognized net gain/loss is one measure of the degree to which important assumptions have coincided with actual experience. During 2005, the pension unrecognized net loss increased by 0.78% of the 12/31/2004 projected benefit obligation. SIPC with its actuary changes important assumptions whenever conditions warrant. The discount rate is reviewed annually. Other material assumptions include the compensation increase rates, rates of employee termination, rates of retirement and rates of participant mortality, which are reviewed periodically and changed as expectations about the future change.

The discount rate at January 1, 2006 used for FAS 87 and FAS 106 purposes has been chosen based on a discounted cash flow analysis and the Buck Consultants FASB Discount Rate Model. Recent SEC guidelines indicate that the discount cash flow model is an acceptable method for the selection of a discount rate. These spot curve plots yield rates as a function of time. Each point on the curve represents a spot rate that can be used to discount a benefit amount expected to be paid at that time. The curve is constructed by examining the yield on selected highly rated (AAA or AA) corporate bonds from the Bloomberg database. After yield and duration are obtained for each bond, Nelson Siegel curve fitting methodology is used to construct a regression curve of yield as a

function of duration. The regression minimizes the least squares error of observed vs. fitted yields. The regression produces a single equivalent discount rate that, when applied to all future benefit payments, will result in the same obligation as the obligation obtained by discounting all future benefit payments using duration specific spot rates from the yield curve. The single discount rate produced from this model, as of January 1, 2006 rounded to the nearest 25 basis points, results in a rate of 5.75% to be used for FASB purposes.

A 1% increase/(decrease) in the discount rate would have (decreased)/increased the pension net periodic benefit cost for 2005 by (\$216,000)/\$315,000. The expected return on plan assets was determined based on historical and expected future returns of the various asset classes, using the target allocations described below. A 1% change in the expected rate of return assumption would have changed the net periodic benefit cost for 2005 by \$151,000.

A 1% increase/(decrease) in the assumed health care trend rate would have increased/(decreased) the service cost and interest cost for 2005 by \$77,000/(\$63,000). A 1% increase/(decrease) in the assumed health care trend rate would have increased/(decreased) the APBO for 2005 by \$711,000/(\$592,000).

Plan Assets

<u>Asset Category</u>	<u>Expected Long-Term Return</u>	<u>Target Allocations</u>	<u>Actual Allocation 12/31/2005</u>
Equity securities	10.25%	60–70%	66%
Debt securities	4.50%	40–30%	34%
TOTAL	8.00–8.50%	100%	100%

The plan's investment policy includes a mandate to diversify assets and invest in a variety of asset classes to achieve that goal. The plan's assets are currently invested in a variety of funds representing most standard equity and debt security classes.

Contributions

SIPC expects to contribute \$1,200,000 to the pension plan and \$62,000 to the postretirement benefit plan during 2006. Funding requirements for subsequent years are uncertain and will significantly depend on changes in interest rates used to calculate plan funding levels, the actual return on plan assets and any legislative or regulatory changes affecting plan funding requirements. For financial planning, cash flow management, or cost reduction purposes SIPC may increase, accelerate, decrease, or delay contributions to the plan to the extent permitted by law.

Estimated Future Benefit Payments

The following benefit payments, which include expected future service, are anticipated:

	<u>Pension</u>	<u>Other Benefits</u>
2006	\$ 524,000	\$ 62,000
2007	\$ 592,000	\$ 78,000
2008	\$ 683,000	\$ 97,000
2009	\$ 790,000	\$ 129,000
2010	\$ 948,000	\$ 160,000
2011–2015	\$6,372,000	\$1,211,000

Defined Contribution Plan

SIPC contributions (60% of employee contributions, up to 3.6% of compensation)	\$114,904
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