

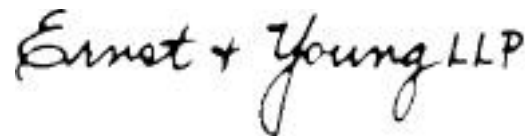
## Report of Ernst & Young LLP Independent Auditors

Board of Directors  
Securities Investor Protection Corporation

We have audited the accompanying statement of financial position of Securities Investor Protection Corporation as of December 31, 1998, 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 generally accepted auditing standards. 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. An audit also includes 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, 1998, and the changes in its net assets and its cash flows for the year then ended, in conformity with generally accepted accounting principles.



Washington, D.C.  
March 31, 1999

# Securities Investor Protection Corporation

## Statement of Financial Position December 31, 1998

### ASSETS

Cash	\$	783,275
U.S. Government securities, at fair value and accrued interest receivable (\$16,643,418); (amortized cost \$1,105,173,919) (Note 6)		1,195,911,965
Advances to trustees for customer protection proceedings in progress, less allowance for possible losses (\$74,963,895) (Note 4)		2,000,000
Other		348,277
		<b>\$1,199,043,517</b>

### LIABILITIES AND NET ASSETS

Advances to trustees – in process (Note 4)	\$	307,925
Accounts payable and accrued expenses (Note 8)		1,507,298
Estimated costs to complete customer protection proceedings in progress (Note 4)		39,600,000
Member assessments received in advance (Note 3)		180,000
		41,595,223
Net assets		1,157,448,294
		<b>\$1,199,043,517</b>

## Statement of Activities for the year ended December 31, 1998

Revenues:		
Interest on U.S. Government securities	\$	69,844,413
Member assessments (Note 3)		1,186,279
		<b>71,030,692</b>
Expenses:		
Salaries and employee benefits (Note 8)		2,890,318
Legal and accounting fees (Note 4)		298,839
Credit agreement commitment fee (Note 5)		1,251,315
Rent (Note 5)		430,743
Other		1,085,086
		<b>5,956,301</b>
Provision for estimated costs to complete customer protection proceedings in progress (Note 4)		20,979,807
		<b>26,936,108</b>
Total net revenues		44,094,584
Realized and unrealized gain on U.S. Government securities (Note 6)		38,094,997
Increase in net assets		82,189,581
Net assets, beginning of year		1,075,258,713
Net assets, end of year		<b>\$1,157,448,294</b>

See notes to financial statements.

# Securities Investor Protection Corporation

## Statement of Cash Flows for the year ended December 31, 1998

Operating activities:	
Interest received from U.S. Government securities	\$ 69,222,865
Member assessments received	1,066,430
Advances paid to trustees	(17,605,579)
Recoveries of advances	1,609,695
Salaries and other operating activities expenses paid	(5,676,805)
Net cash provided by operating activities	48,616,606
Investing activities:	
Proceeds from sales of U.S. Government securities	106,045,869
Purchases of U.S. Government securities	(154,755,759)
Purchases of furniture and equipment	(88,224)
Net cash used in investing activities	(48,798,114)
Decrease in cash	(181,508)
Cash, beginning of year	964,783
Cash, end of year	\$ 783,275

See notes to financial statements.

## 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 generally accepted accounting principles 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 \$1,196,695,240.

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 1998 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 27 proceedings in progress at December 31, 1998. Customer claims have been satisfied in 15 of these proceedings and in 12 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 has advanced \$77.1 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, \$75.1 million is not expected to be recovered.

The following table summarizes transactions during the year that result from these proceedings:

	<b>Customer Protection Proceedings</b>	
	<b>Advances to trustees, less allowance for possible losses</b>	<b>Estimated costs to complete</b>
Balance, beginning of year	\$4,000,000	\$36,900,000
Add:		
Provision for current year recoveries	600,000	
Provision for estimated costs to complete proceedings		20,600,000
Less:		
Recoveries	1,600,000	
Reduction in estimated recoveries	1,000,000	
Advances to trustees		17,900,000
<b>Balance, end of year</b>	<b>\$2,000,000</b>	<b>\$39,600,000</b>

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 annual rentals for office space under a ten-year lease effective September 1, 1995, at the rate of \$410,136 for the first five years and \$437,628 thereafter, total \$2,871,700. Additional rental based on increases in operating expenses, including real estate taxes, and in the Consumer Price Index, is required by the lease.

A credit agreement with a consortium of banks, which terminated March 30, 1999, provided SIPC with a \$1 billion revolving line of credit. A commitment fee, payable quarterly on the unused portion of the commitment, was increased from .09% per annum to .11% per annum during 1998. Effective March 31, 1999, a new \$1 billion credit agreement with a consortium of banks was entered into by SIPC, consisting of (i) a \$250 million 364-day revolving credit facility with a commitment fee of .09% per year, and (ii) a \$750 million 5-year revolving credit facility at .11% per year.

## 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, 1998.

U.S. Government securities as of December 31, 1998, included gross unrealized gains of \$74,101,104 and gross unrealized losses of \$6,476.

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

Increase in net assets	\$82,189,581
Increase in realized and unrealized gains on U.S. Government securities	(38,094,997)
Net increase in estimated cost to complete customer protection proceedings	2,700,000
Net decrease in estimated recoveries of advances to trustees	2,000,000
Increase in accrued interest receivable on U.S. Government securities	(1,136,628)
Decrease in amortized premium on U.S. Government securities	515,532
Increase in payables	344,550
Other reconciling items	98,568
<b>Net cash provided by operating activities</b>	<b>\$48,616,606</b>

## 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; the life insurance plan is noncontributory.

Information regarding these plans is provided in accordance with the Financial Accounting Standards Board Statement No. 132, Employers' Disclosure about Pensions and Other Postretirement Benefits

	Pension Benefits	Other Postretirement Benefits
<b>CHANGE IN BENEFIT OBLIGATION</b>		
Benefit obligation at beginning of year	\$8,387,236	\$1,456,731
Service cost	284,288	71,811
Interest cost	575,802	101,128
Actuarial loss	639,879	321,012
Benefits paid	(287,476)	(23,022)
Benefit obligation at end of year	\$9,599,729	\$1,927,660
<b>CHANGE IN PLAN ASSETS</b>		
Fair value of plan assets at beginning of year	\$8,983,291	-
Actual return on plan assets	843,486	-
SIPC contributions	-	-
Benefits paid	(287,476)	-
Fair value of plan assets at end of year	\$9,539,301	-
Funded status	\$ (60,428)	\$(1,927,660)
Unrecognized asset	(35,013)	-
Unrecognized actuarial loss	892,663	4,699
Unrecognized prior service credit	(61,072)	-
Prepaid (accrued) benefit cost	\$736,150	\$(1,922,961)
<b>WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31, 1998</b>		
Discount rate	6.50%	6.50%
Expected return on assets	9.00%	
Rate of compensation increase	5.00%	
For measurement purposes, 8.5%/7.0% (non-Medicare/Medicare) annual rates of increase in the per capita cost of covered health care benefits were assumed for 1998. These rates were assumed to decrease gradually to 5% for 2003 and remain at that level thereafter.		
<b>COMPONENTS OF NET PERIODIC BENEFIT COST</b>		
Service cost	\$ 284,288	\$ 71,811
Interest cost	575,802	101,128
Amortization of unrecognized asset	(35,014)	-
Amortization of unrecognized actuarial gain	-	(14,583)
Amortization of prior service credit	(7,634)	-
Expected return on assets	(793,961)	-
Benefit cost	\$ 23,481	\$158,356
<b>DEFINED CONTRIBUTION PLAN</b>		
SIPC contributions (60% of employee contributions, up to 3.6% of salary)	\$ 75,656	

The assumed health care cost trend rate has a significant effect on the amounts reported.

A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service and interest cost components in 1998	\$52,000	\$(47,000)
Effect on postretirement benefit obligation as of December 31, 1998	\$420,000	\$(340,000)