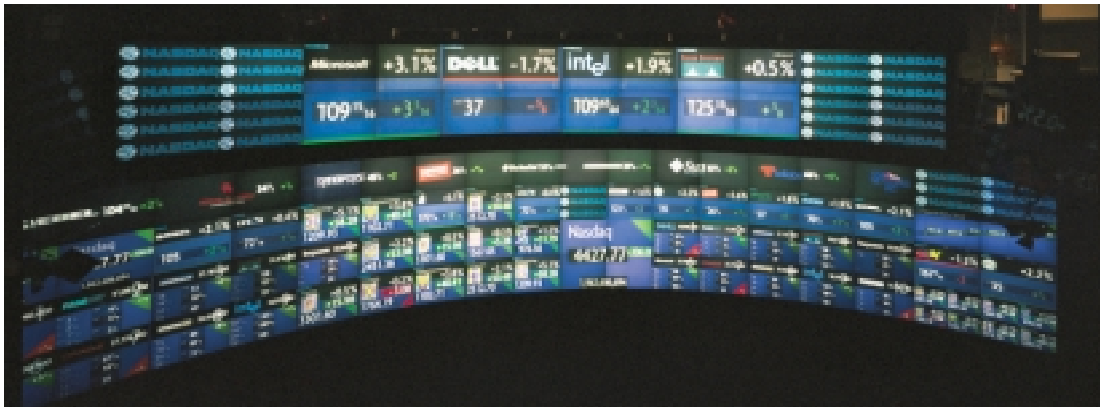
NASD®

EYE OF THE ELECTRONIC REVOLUTION

1999 NASD Annual Report



C O N T E N T S

The Global Market Network

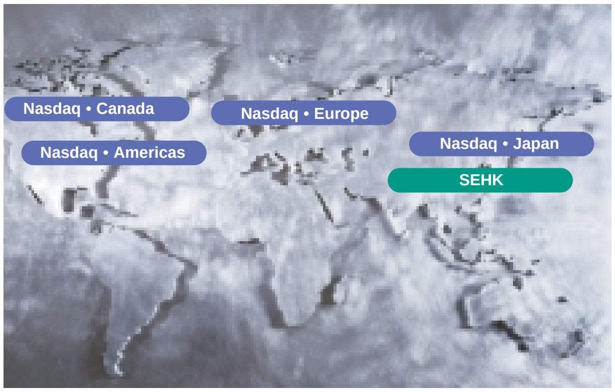
"Nasdaq has the greatest pool of liquidity,
the central marketplace,
for the largest and fastest-growing stocks in the country."
James Marks, Credit Suisse First Boston, January 11, 2000

Economic growth is fueled by capital formation. Today, as the world economy is being transfigured by phenomenal advances in information and communication technology, the global capital markets are being linked into a network, vastly enhancing their power and reach.

The National Association of Securities Dealers (NASD®) is proud to be at the eye of this electronic revolution.

The firms going to the global markets for capital require depth of liquidity, the broadest possible exposure, and comprehensive support. The investors of every size who supply that capital require easy access to complete and accurate information, the widest available range of choices, and swift, sure execution. Employing technology that is unsurpassed in reliability, capacity, and accessibility, The Nasdaq Stock Market® and The American Stock Exchange® are uniting these market components into a system of unprecedented effectiveness.

In 1999, we firmly established our leadership among U.S. stock markets. At the same time, we began implementing our global vision: linking pools of liquidity worldwide. This report summarizes our achievements during an extraordinary year, and tells where that momentum will take us.



Nasdaq Global Plans

"Our mastery of information and communication technology has propelled us to leadership in the capital markets."

Frank G. Zarb, NASD Chairman and Chief Executive Officer

One year ago, in this space, I promised that the NASD would continue to be an instrument of the sweeping changes taking place in the world of investing. I identified three broad areas in which we planned to sustain the leadership we have established: globally linked markets, regulation, and NASD restructuring. Let me report our progress during this year.

Global Markets

The central vision of NASD is to employ our unparalleled technological resources to link pools of liquidity. The logic of this vision leads to global linkage. The benefits are significant for all market participants:

- Global listing provides vastly enhanced exposure and interest for issuers, and enlarges the investor base.
- Investors are provided far broader choices.
- The value of the network increases as the network enlarges, to the benefit of our members.

In 1999, we initiated Nasdaq–Japan and Nasdaq–Europe, while completing a cooperative agreement with the Stock Exchange of Hong Kong. All of these enterprises stemmed from joint ventures with partners around the world who share our vision. Naturally, a great deal of work remains to be done before we integrate the major capital markets, including the United States, with one another. But we are building on solid, carefully constructed foundations.

Regulation

Global markets, the ever-growing role of technology in investing, and the explosion of retail investors make our regulatory responsibility more critical than ever. Technology is the key to more effective surveillance, communication, and transparency. This report describes in some detail how our technology-based regulation serves the needs of investors and of our 5,500 members and how we are embarking on new initiatives to enhance the effectiveness and efficiency of our regulatory efforts.

NASD Restructuring

The idea broached in last year's letter, of restructuring the NASD, spinning off Nasdaq®, and returning the NASD to its original mission of a member-based organization, is nearing fruition. With the overwhelming support of 84 percent of those voting, the membership approved this plan in early 2000. As I write this letter, the sale of up to 49 percent of Nasdaq to members of NASD and major market participants is going forward. A year ago, I also mentioned that we were exploring extended trading hours; in October 1999, we enabled the first phase of extending system hours, keeping certain automated systems open until 6:30 pm.

A Record Year

In 1999, Nasdaq indisputably established itself as the leading stock market in the world, registering the records and leadership positions summarized on the following two pages. The opening of Nasdaq's new MarketSite on New York's Times Square has brought Wall Street to Main Street and has given increased visibility to the Nasdaq companies. The American Stock Exchange has fully justified our confidence and demonstrated that its new strategic direction holds great promise.

Financially, NASD posted another record year. The robust securities markets helped us earn consolidated revenues of $1.177 billion, or 59 percent above last year's total. Net income increased by approximately 224 percent to $154 million. The bulk of this growth is of course attributable to The Nasdaq Stock Market and The American Stock Exchange. But in regulatory operations, assessments based on members' business volumes also increased, along with revenues from registration and qualification fees and from regulatory transaction fees. We also enacted significant fee reductions, volume discounts, and rebates for members, saving the industry approximately $70 million in the course of the year.

The NASD thinks of itself as a technology organization, and rightly so: it is our mastery of information and communication technology that has propelled us to leadership in the capital markets. But behind the extraordinary technology stand the NASD employees, who have labored extensively and imaginatively on behalf of our members and the investors and issuers we all serve. I salute them, in full confidence that they will keep us at the head of this historic revolution.

Frank G. Zarb
NASD Chairman and Chief Executive Officer
May 17, 2000

1999

A Year of Record Achievement . . .

In a year of unprecedented growth, The Nasdaq Stock Market and The American Stock Exchange, supported by NASD Regulation[SM], registered new peaks in virtually every category by which they are measured.

PRICE PERFORMANCE

The Nasdaq Composite topped 4000 in 1999 — performance more than triple that of the Dow Jones Industrial Average. The Amex Composite rose by 27.3 percent, outpacing the Dow, the Standard & Poor's 500 and the Russell 3000.

NUMBER OF NON-U.S. LISTINGS

462 non-U.S. companies listed their shares on Nasdaq as of December 31, 1999, either directly or through American Depositary Receipts (ADRs), more than on any other U.S. market.

DAILY SHARES TRADED

Share volume increased 34.9 percent in 1999 and exceeded 1 billion shares on 125 days, a record for any market.

INDEX SHARES

Total Index Share assets listed on The American Stock Exchange doubled for the fourth straight year, to $33.9 billion. The Nasdaq-100 Index Tracking Stock (QQQ), launched in March 1999, averaged daily volume of 5.9 million shares, with a return of 82 percent for the year.

NUMBER OF COMPANIES LISTED

Nasdaq lists 4,829 companies, more than any other U.S. market.

2000

A Year of Global Growth

From the base of U.S. leadership firmly established by the century's end, Nasdaq will develop its new markets and partnerships in Asia and Europe. The resulting network will constitute the world's first truly global stock market.

DAILY DOLLAR VOLUME

1999 saw a new high in dollar volume traded on Nasdaq — $11 trillion, a 91 percent leap over 1998 and the highest of any market worldwide.

OPTIONS TRADING

The American Stock Exchange registered record options volume of 129.7 million contracts in 1999. The Amex recorded the largest growth in options volume of any U.S. options exchange.

SELF-REGULATORY ORGANIZATION

The NASD is the largest self-regulatory organization on earth, with 5,482 members.

GROWTH COMPANIES

In the *Business Week* list of Hot Growth Companies (May 31, 1999) 70 of 100 companies were listed on Nasdaq. In the *Fortune* 100 Fastest Growing Companies (September 6, 1999), 69 of 100 companies were listed on Nasdaq.

INITIAL PUBLIC OFFERINGS

Altogether, 485 newly public companies, 87.6 percent of new U.S. listings, made Nasdaq their home last year, compared to 49 on the NYSE.

The Performance Market

NASDAQ

“The American economy has been reinventing itself, and we’re proud to have played a large part in the process — helping to make the capital formation process smooth and virtually painless.”

Pat Campbell, Chief Operating Officer, The Nasdaq Stock Market

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The Nasdaq Stock Market offers investors and issuers unmatched performance. The Nasdaq-100 Index has grown 1,749 percent since 1991, exceeding all other major indexes. The Nasdaq-100 Index Tracking Stock, introduced in 1999 and trading under the symbol QQQ, topped $12 billion in assets in just twelve months on the market.

Market value of all companies listed has increased 1,575 percent since 1990, more than four times greater than the nearest major competitor. Trading is executed over a private telecommunications and computer network engaging more than half a million terminals worldwide. Share volume exceeded 1 billion on 125 days — a record for any market.

The Nasdaq business model is designed for an electronic global economy. It is the world’s only screen-based and multi-dealer stock market, with real extended hours and open access to investment and regulatory information through multiple Web sites.

Our regulatory arm protects investors, by carrying on the highest traditions of U.S. market integrity, and meets the needs of our full range of member firms.

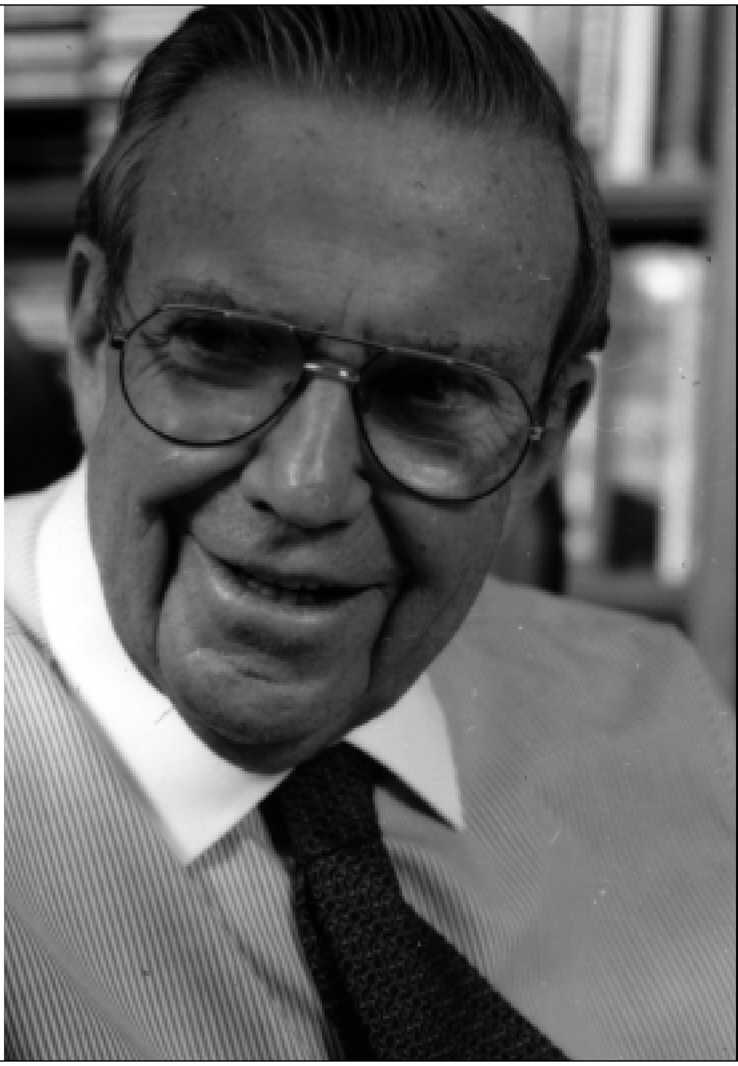
Technology is our polestar, guiding us in a world of constant change. It provides superior connectivity for all market participants, accommodates astounding surges in volume, helps us control costs, and assumes a steadily greater role in our regulatory program.

NASDAQ NYSE

1 MICROSOFT CORP	548,905.5
2 GENERAL ELECTRIC CO	447,399.7
3 CISCO SYSTEMS INC	414,996.6
4 INTEL CORP	360,619.2
5 EXXON MOBIL CORP	280,767.8

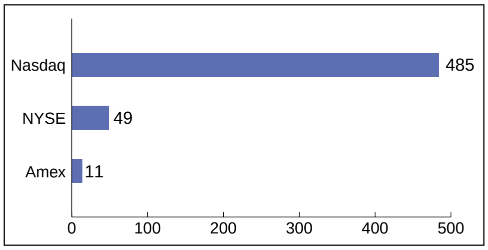
Top 5 Companies by Market Value

Mkt. Val. 2/7/2000 ($ mil.)



"Since its inception, Nasdaq has worked to provide efficient markets and greater visibility for its companies, and thus the opportunity to raise capital from a large universe of investors at a lower cost."

Gordon Macklin, NASD President, 1970-1987



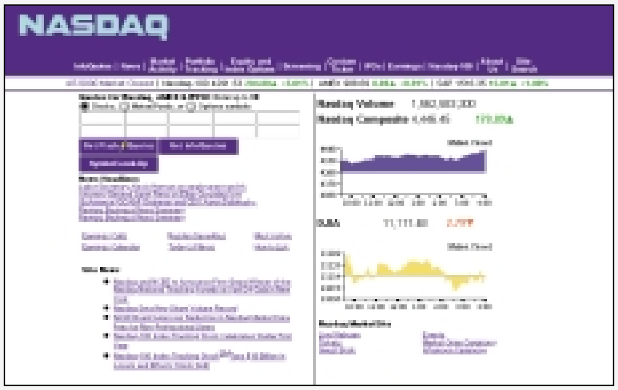
Total Number of IPOs
Source: CommScan LLC & Securities Data Company. As of 12/31/99, excludes closed-end funds.

Nasdaq is the market of choice for high-growth companies because we are a high-growth company. In 1999, we captured 87.6 percent of the new listings for the primary American market. Our 485 IPOs generated more than $50 billion in new capital.

Issuers turn to Nasdaq because of the unparalleled visibility we offer. Visibility and awareness create depth of liquidity for issuers, and in the final analysis result in a lower cost of capital. Listed companies also enjoy access to an extensive portfolio of value-added services, including single-point-of-contact relationship managers. These managers provide assistance on matters from market performance to investor relations programs.

Nasdaq.com averages more than 4.7 million page views a day for its institutional quality information on stocks, options, and mutual funds. Participating companies can make more information available to investors through audio webcasting of their quarterly-earnings conference calls.

The MarketSite Tower, eight stories high, illuminates video market highlights, identifying listed companies by their corporate logos, and features a high-tech interactive exhibit center that has already become a popular center for live broadcasts by the financial news media.



"We will be trading in Japan and Europe, and we will also be listing – seeking those growth-oriented, job-creating entrepreneurs who want global visibility and access to global capital resources."

Masayoshi Son, CEO, Softbank Corp. (Japan), partner in Nasdaq–Japan and Nasdaq–Europe

Independent research studies confirm that Nasdaq name recognition exceeds that of The New York Stock Exchange in the United States and the United Kingdom.

U.S. survey: Response Analysis Corporation, UK survey: MORI

The Nasdaq vision — to link pools of liquidity, investors with issuers — has been realized in the U.S. The next step is to expand it globally, establishing trading centers in major capital markets and then connecting them. The first critical steps:

- June 1999, the launch of Nasdaq–Japan, in partnership with Softbank Corporation of Tokyo and in cooperation with the Osaka Securities Exchange. Nasdaq–Japan will offer Japanese investors the opportunity to invest in the world's leading high-tech and high-growth stocks, generating new visibility and additional investor interest.
- November 1999, the announcement of Nasdaq–Europe, a joint venture with Softbank, Vivendi, and the News Corp. Group. This Internet-accessible market will offer European investors equal trading access to world class U.S., European, and Asian companies' stocks.
- December 1999, an agreement with the Stock Exchange of Hong Kong for cooperative technology use and to trade seven Nasdaq-listed stocks on the SEHK.
- Indigo Markets, a new joint venture with SSI Technology of India, will provide the technology platform that ultimately connects The Nasdaq Stock Market, Nasdaq–Japan, and Nasdaq–Europe.

Total Non-U.S. Nasdaq Companies: 429

Canada	119	British Virgin Islands	5	Switzerland	2
Israel	73	Greece	5	Taiwan	2
United Kingdom	48	Cayman Islands	4	Bahamas	1
Netherlands	23	Mexico	4	Belize	1
Bermuda	17	Singapore	4	Brazil	1
Japan	17	Belgium	3	Indonesia	1
Australia	16	Luxembourg	3	Italy	1
Hong Kong	16	Argentina	2	Netherlands Antilles	1
Ireland	11	Denmark	2	Norway	1
Sweden	11	Finland	2	Papua New Guinea	1
France	10	India	2	Poland	1
Republic of South Africa	9	Korea	2		
Germany	6	New Zealand	2		

14

"Whoever owns price discovery and execution owns the marketplace. Nobody rivals Nasdaq when it comes to these functions."

Carl Sherr, President, Carl P. Sherr & Co., Worcester, MA and Chairman, NASD Small Firm Advisory Board

International Index Growth Comparison

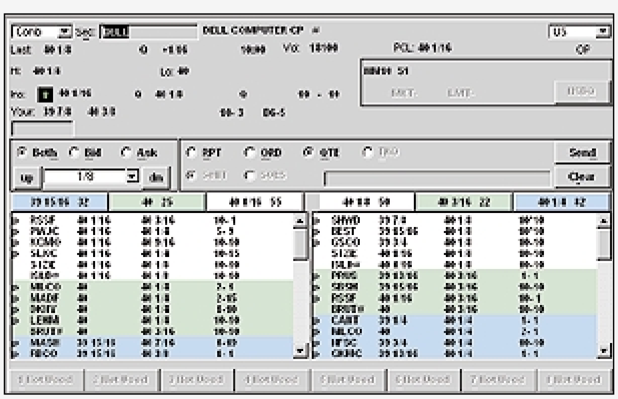
12/31/89 to 12/31/99	% change
Nasdaq 100	1254
Nasdaq Composite	795
Amex Composite *(Amex Comp. did not begin until Dec. 29, 1995)*	59
NYSE Composite	233
S&P 500	316
Dow 30	318
FTSE 100	186
CAC 40	198
DAX 30	289
Nikkei 225	-51

"While investing in America has democratized, Nasdaq has democratized the stock market. We've helped to pass power and control from the insiders to the citizen investors."

Al Berkeley, President, The Nasdaq Stock Market

The 1999 market was energetic, and therefore unpredictable. There were record surges of quotes, the critical price discovery function we perform, going from typically 1.3 million to 4 million a day. Volume of shares traded averaged over a billion daily and frequently flirted with the 2 billion per single day mark in 1999 — then broke through it on February 17, 2000. As fast as we could expand our capacity, demand always threatened to exceed it — threatened to, but never did. During the entire year, our system provided availability during 99.2 percent of all our trading hours. At the same time, we renovated the entire Nasdaq network with every one of our member firms.

At the close of 1999, we signed a letter of intent with Primex Trading N.A., LLC, to incorporate its unique electronic trading platform exclusively on Nasdaq. The result, planned for 2000, is to offer listed companies and investors the best of both the dealer and auction markets. In the year ahead, we will introduce a new screen for our trading function — the Electronic Order Display Facility, nicknamed SuperMontage. This system will aggregate and display trading interest from all market participants, including the Electronic Communications Networks (ECNs). It will not only show best bid and offer (plus two price levels away) but also the depth of the market at each price level. The result for issuers: enhanced liquidity for their securities.

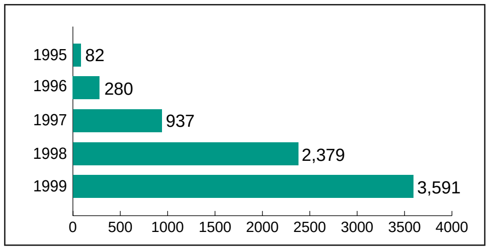


SuperMontage

“Amex is back!”

The Wall Street Journal, Feb. 22, 2000

AMEX



Total Index Share Volume
(in millions)

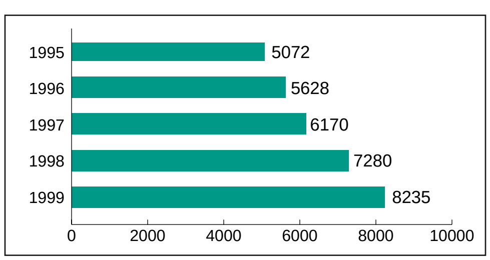
It was a record year for the resurgent, restructured American Stock Exchange.

- The Amex® Composite Index was up 27.3 percent, outpacing the Dow Jones Industrials, the S&P 500, and the Russell 3000.
- The Exchange brought in 118 new listings, the largest number in six years, and continuing a five-year trend of increases.
- Index Share assets more than doubled, for the fourth consecutive year, to $33.9 billion.
- Options volume set a new record — 129.7 million contracts, up 33 percent from 1998's record, and the largest percentage increase of any U.S. options exchange for the year.
- Created the most successful product launch in Amex history – The Nasdaq-100 Index Tracking Stock (QQQ), with a 1999 return of 82 percent.

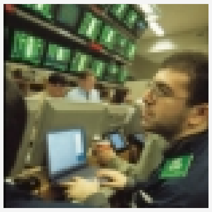
As befits an NASD organization, we continued our technological improvement, enlarging capacity to handle higher quote and transaction volume, implementing a new release of the Amex Equity Display book, and expanding the screen-based dimension of our trading. In turn, the NASD Board of Governors has earmarked $215 million from the impending public sale of The Nasdaq Stock Market for the Amex, to build on this recent success and achieve its long-term strategic goals.

"The Amex system of specialists and market makers is being copied now by every other options exchange in the country."

Penny Collins, Amex options specialist, Chase Manhattan



Total Equities Volume
(in millions)



The internal reorganization of the Amex into three business lines has brought strong performance from each:

Equities

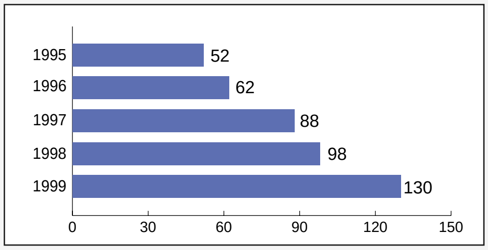
Mid- to small-cap companies have found improved liquidity and a higher level of attention at Amex. We offer them outstanding exposure, through americanstocks.com, a vigorous print and television advertising campaign, our investor relations program, and other visibility services. In addition, we work to help them broaden both their product lines and their customer base.

Index Shares

We are the undisputed leader in this market sector because we invented the product, and command a large staff of experts in product development, operations, regulation, and tax. We continue to explore and create new funds, converting mutual funds to exchange-traded fund status and expanding from equities to fixed income.

Options

The introduction of options multiple listing in 1999 meant that options order flow can go to any options exchange; for the year, Amex options had the largest increase in market share of any U.S. options market. We listed 342 new options during the year, bringing our total to over 1,200. Multiple listing also spiked quote traffic to nearly five times previous levels, but we managed it with expanded technological capacity.



Total Options Contracts
(in millions)

Investor Protection First

NASDR

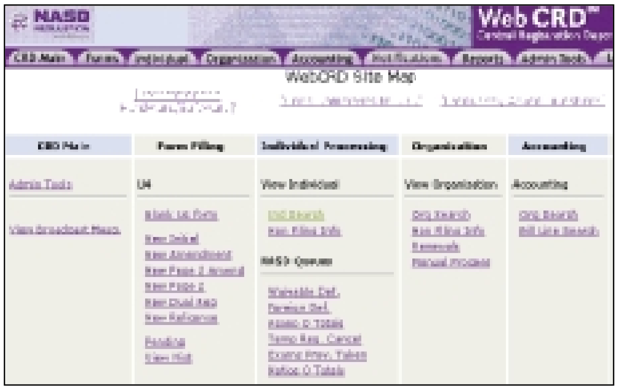
"In cooperation with state and federal authorities, we have cracked down on the microcap 'boiler rooms' of the industry and, we believe, eliminated the worst abuses as a national problem."

Barry Goldsmith, Executive Vice President for Enforcement, NASD Regulation, Inc.

NASD Regulation (NASDR℠) protects investors and strengthens market integrity through vigorous, even-handed, and cost-effective self-regulation. Its regulatory oversight extends to virtually all brokerage firms that conduct business in the United States. NASDR's diverse functions demonstrate the organization's dedication both to helping members meet their goals as self-regulators and to creating a safe environment for the investor in today's complex markets.

Through its nationwide network of 14 District Offices, NASDR assesses firm compliance with NASD and SEC rules. Now in development is an automated tool, INSITE, to streamline processes by integrating and analyzing data to enhance surveillance, improve field exam efficiency, and lessen burdens for members and examiners. Through its disciplinary process – which typically results in over 1,000 disciplinary actions a year – NASDR enforces against conduct that is illegal, unethical, or inconsistent with fair principles of trade.

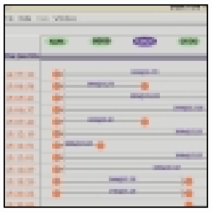
The Market Regulation arm of NASDR oversees and regulates trading on Nasdaq and the over-the-counter market. State-of-the-art technology reconstructs and dissects market activity using firms' trading data and quote information captured throughout the trading day. The recently established Order Audit Trail System (OATS℠) recreates the life cycle of orders to enhance surveillance of Nasdaq trading.

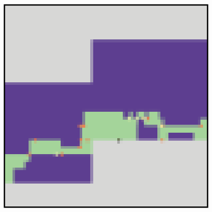


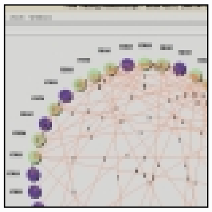
“We are bringing more and more of our regulatory responsibilities on-line, making the process more efficient and less distracting for the members.”

Carla Romano, Vice President and District Director, NASDR District 8, Chicago

NASDR estimates that nearly 2,000 industry volunteers contribute upward of 27,000 hours annually to the self-regulatory process.







NASDR also has major responsibilities for qualifications, testing, and licensing for the industry. NASDR administers mandatory qualification examinations to ensure levels of understanding and expertise. NASDR maintains qualification, employment, and disclosure histories of more than 600,000 registered securities employees of member firms through the Central Registration Depository (CRD℠) system. The new Internet-based CRD system, deployed in 1999, provides unparalleled registration and licensing capability. NASDR promotes the ongoing high quality of securities industry personnel through its Continuing Education Program. In 1999, NASDR launched The NASD Institute for Professional Development, which offers a certificate program in conjunction with the Wharton School, as well as other educational opportunities.

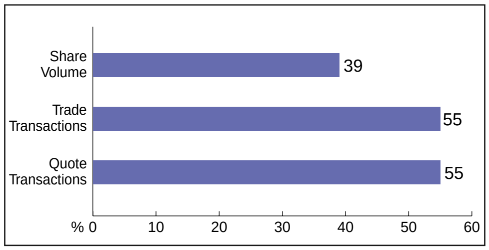
NASDR reviews member firms' communications with the public, including advertising, brochures, and research reports, to ensure that they are fair and accurate. NASDR also reviews members' underwriting arrangements to ensure fair and equitable underwriting compensation.

The Office of Dispute Resolution administers the largest securities arbitration and mediation forum in the world, with six offices offering services in 45 locations. Independent arbitrators and mediators are selected for service in cases by the parties from nationwide rosters.

The NASD Institute for Professional Development

A High-Tech Company in the Financial Markets

NASD TECH



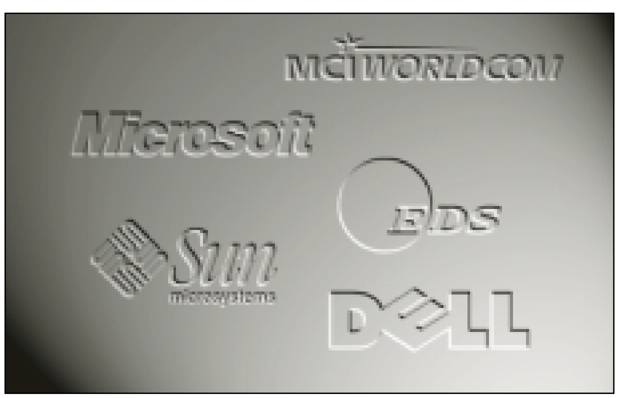
Nasdaq System Activity Growth
(Dec. 98 vs. Dec. 99)

One-third of all NASD employees are technology professionals. There is no more forceful demonstration of our reliance upon technology to serve investors, issuers, and members.

Technology is of course a highly visible element, whether it is the new SuperMontage screen or the new MarketSite, with its interactive and audiovisual miracles. Or, there is the Enterprise-Wide Network II, the renovation of the entire Nasdaq network with every member firm in 1999.

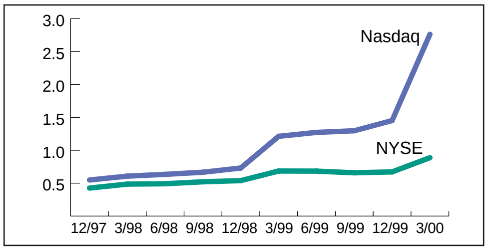
But sometimes, technology is most important when it isn't seen. We experienced no Y2K problems at NASD, but of course we dedicated thousands of hours to ensuring that neither we nor our members would encounter these issues. We made the transition to after-hours trading in 45 days, without a single hitch.

Technological excellence is more than bright people coaxing the best out of machines. It also requires attention to the professional needs of people, investing in their careers in an industry where employment turnover nationally runs more than one out of five persons. At Nasdaq, by contrast, focus on attracting and retaining the best in the industry reduced attrition in 1999 to 10 percent.



"The volume has been unbelievable. We had a ten year plan to deal with it. It lasted three years. In truth, what we have is continuous upgrades of software and hardware."

Charles McGibony, Computer Operator, Trumbull



Average Daily Trades
(year-to-date)

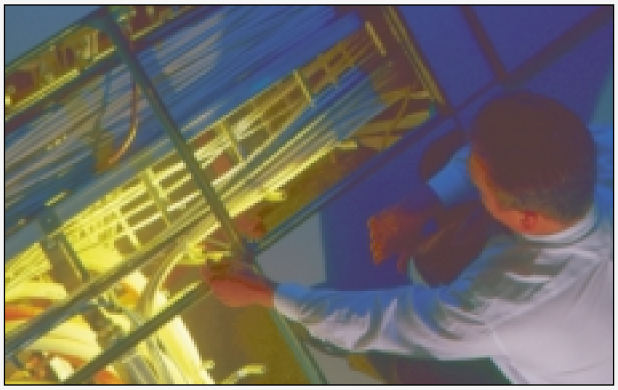
Industry Recognition of Nasdaq Technology in 1999

2 ComputerWorld/Smithsonian Award Nominations
CIO magazine “Top 100 Technology Companies of the Next Millenium”
ComputerWorld “Top 100 Technology Companies”
FutureBanker “Top Technology Deals of 1999”

When most members of the public think of the stock market, they think of the noisily chaotic scenes of an auction-based exchange. In fact, most securities markets — for bonds, Collateralized Mortgage Obligations, preferred stocks, and many others — are screen-based. The London and Frankfurt Stock Exchanges are among those that have recently converted to electronic trading.

In Trumbull, Connecticut, sixty miles north of New York City, sits The Nasdaq Technology Center. In our 4,300 square foot Command Center, customarily about a dozen individuals stroll among hundreds of large monitors fed by the enormous computing power in the neighboring Data Center. This system is linked to the servers at the more than 600 Market Maker firms and, in turn, to over 7,200 Nasdaq workstations and over 400,000 investors through Nasdaq market data providers. In a very real sense, this is The Nasdaq Stock Market. It is a powerful, secure private network not accessible to Internet hackers, and reliable more than 99 percent of the time. A complete backup system operates at Rockville, Maryland; it is capable of operating the entire system at any time — and does, in twice-a-year tests.

Once, the Tech Center was referred to as “the stock market of the future.” Now, of course, it is very much the stock market of the present.



MISSION To facilitate capital formation by creating the markets of choice – operated and regulated to achieve the most liquid, cost-efficient, technologically-advanced, and fair securities markets in the world – for the benefit and protection of investors.

ORIGIN The National Association of Securities Dealers, Inc. was organized under the 1938 Maloney Act amendments to the Securities Exchange Act of 1934 to address the U.S. securities industry's need for self-regulation.

The Maloney Act authorized the U.S. Securities and Exchange Commission to register voluntary national associations of broker/dealers for the purpose of regulating themselves under SEC oversight. Every U.S. securities firm transacting business with the public is currently required by law to be an NASD member.

NASD's founding mandate was to standardize the securities industry's principles and practices, to promote high standards of commercial honor, to advance just and equitable principles of trade for investor protection, to adopt and enforce fair practice, and to foster member observance of federal and state securities laws.

The NASD, taking direction from the SEC in 1963, adopted as another tenet of its self-regulatory mandate, the promotion of capital formation by developing, operating, and regulating fair and efficient securities markets. The Nasdaq Stock Market was founded in 1971 to fulfill this mandate.

PROFILE The NASD is the largest securities-industry self-regulatory organization in the world. It is the parent organization of The Nasdaq-Amex Market Group, Inc., which operates Nasdaq and The American Stock Exchange (Amex) together under one corporate umbrella. Through its regulatory subsidiary, NASD Regulation, Inc. (NASD Regulation), the NASD oversees the activities of the U.S. broker/dealer profession and regulates Nasdaq, Amex, and the over-the-counter securities markets.

The NASD sets the organization's strategic direction and policy agendas with a view toward the fulfillment of statutory and self-regulatory obligations. Nasdaq develops and operates marketplace systems and services and formulates market policies and listing criteria. Nasdaq and Amex operate separately under a dual market structure that sets the stage for the future, providing technological innovation, resources, and increased operating efficiency to provide benefits to investors, companies, and member firms of all sizes. NASD Regulation carries out NASD's regulatory functions, including on-site member firm examinations, automated market surveillance, and disciplinary actions against broker/dealers and their professionals, standard setting, advertising and underwriter compensation review, dispute resolution, registration, and continuing education.

“The membership’s vote on the creation of The Nasdaq Stock Market as a separate company comes after a long and careful process of preparation characterized by sensitivity to a wide variety of member concerns.”

M. LaRae Bakerink
First Vice President and Chief Compliance Officer
Pacific American Securities LLC

Frank G. Zarb, Chairman
Chairman and Chief Executive Officer
NASD, Inc. and The Nasdaq Stock Market, Inc.
Washington, DC

William C. Alsover, Jr.
Chairman
Centennial Securities Company, Inc.
Grand Rapids, MI

M. LaRae Bakerink
First Vice President and Chief Compliance Officer
Pacific American Securities LLC
San Diego, CA

H. Furlong Baldwin
Chairman, President, and Chief Executive Officer
Mercantile Bankshares Corporation
Baltimore, MD

Frank E. Baxter
Chairman and Chief Executive Officer
Jefferies Group, Inc.
Los Angeles, CA

Alfred R. Berkeley, III
President
The Nasdaq Stock Market, Inc.
Washington, DC

Anthony J. Boglioli
President
Whitehall Brokerage Services, Ltd.
New York, NY

Brian T. Borders
President
Association of Publicly Traded Companies
Washington, DC

Michael W. Brown
Retired Chief Financial Officer
Microsoft Corporation
Redmond, WA

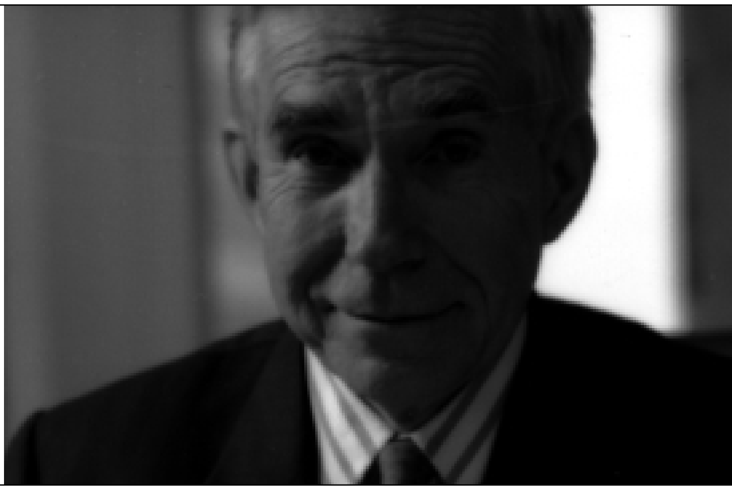
Elaine L. Chao
Distinguished Fellow
The Heritage Foundation
Washington, DC

Nicholas C. Cochran
Vice President
American Investors Company
Dublin, CA

Alan L. Davidson
President
Zeus Securities, Inc.
Jericho, NY

Kenneth M. Duberstein
Chairman and Chief Executive Officer
The Duberstein Group, Inc.
Washington, DC

Robert R. Glauber
Lecturer
Harvard University
John F. Kennedy School of Government
Cambridge, MA



"In 1999, NASD redoubled its efforts — already at a high level — to meet the needs of members of every size. I have no question that we improved the organization for all of us."

Frank E. Baxter
Chairman and Chief Executive Officer
Jefferies Group, Inc.

Eugene M. Isenberg
Chairman and Chief Executive Officer
Nabors Industries, Inc.
Houston, TX

Harry P. Kamen
Retired Chairman and
Chief Executive Officer
Metropolitan Life Insurance Company
New York, NY

Richard G. Ketchum
President
NASD, Inc.
Washington, DC

Donald J. Kirk
Executive-in-Residence
Columbia University Graduate School
of Business
New York, NY

John D. Markese
President
American Association of Individual
Investors
Chicago, IL

Donald B. Marron
Chairman and Chief Executive Officer
PaineWebber Group Inc.
New York, NY

Paul H. O'Neill
Chairman
ALCOA, Inc.
Pittsburgh, PA

Kenneth D. Pasternak
President and Chief Executive Officer
Knight Trading Group
Jersey City, NJ

David S. Pottruck
President and Co-Chief
Executive Officer
The Charles Schwab Corporation
San Francisco, CA

James S. Riepe
Vice Chairman
T. Rowe Price Associates, Inc.
Baltimore, MD

Todd A. Robinson
Chairman and Chief Executive Officer
LPL Financial Services
Boston, MA

Arthur Rock
Principal
Arthur Rock & Co.
San Francisco, CA

Richard C. Romano
President
Romano Brothers & Co.
Evanston, IL

"NASD has handled its responsibilities in the capital formation process and in the regulatory process with admirable balance and judgment. It would have been easy to stumble in such a year — and we didn't."

Robert R. Glauber
Lecturer, John F. Kennedy School of Government
Harvard University

James F. Rothenberg
President
Capital Research and Management Company
Los Angeles, CA

Mary L. Schapiro
President
NASD Regulation, Inc.
Washington, DC

Howard Schultz
Chairman and Chief Global Strategist
Starbucks Coffee Company
Seattle, WA

Sharon P. Smith
Dean, College of Business Administration
Fordham University
Bronx, NY

Salvatore F. Sodano
Chairman and Chief Executive Officer
The American Stock Exchange LLC
Chief Operating Officer
NASD, Inc.
New York, NY

Arvind Sodhani
Vice President and Treasurer
Intel Corporation
Santa Clara, CA

NASD

Member firms	5,482
Member firm branch offices	80,035
Registered representatives	620,387

The Nasdaq Stock Market

Annual share volume	272,604,906,000
Annual dollar volume	$11,013,192,009,000
Average daily share volume	1,081,765,000
Average daily dollar volume	$43,703,142,892
Market capitalization	$5,204,620,335,000
Companies listed	4,829
Issues listed	5,210
Market makers	472
Non-U.S. securities and American Depository Receipts (ADRs)	462
International share volume (non-U.S. and ADRs)	15,522,500,000
International dollar volume (non-U.S. and ADRs)	$384,966,900,000
Initial public offerings	485
Value of initial public offerings	$50,425,220,000
Secondary public offerings	281
Value of secondary public offerings	$53,454,930,000

The American Stock Exchange

Members

Regular	661
Registered options principals	203

Equities

Annual share volume	8,228,275,628
Annual dollar volume	$945,948,257,065
Average daily share volume	32,522,829
Average daily dollar volume	$3,738,925,917
Market capitalization	TK
Companies listed	769
Issues listed	898
Specialist units	22
Non-U.S. securities and ADRs	63
International share volume (non-U.S. and ADRs)	750,509,607
International dollar volume (non-U.S. and ADRs)	$4,337,971,083
Initial public offerings	11
Value of initial public offerings	$44,300,000
Secondary public offerings	13
Value of secondary public offerings	$59,600,000

Options

Equity options contracts	126,821,276
Index options contracts	2,840,913

Index Share Volume

SPDRs	1,463,913,500
MidCap SPDRs	182,912,500
Select Sector SPDRs	295,996,000
DIAMONDS	201,743,900
WEBS	216,331,700
Nasdaq-100 Index Tracking Stock	1,229,761,000
Total Index Share volume	3,590,658,600

Index Share Assets Summary

SPDR Trust	$19.8 billion
MidCap SPDR Trust	$2.3 billion
Select Sector SPDRs	$2.6 billion
DIAMONDS Trust	$1.3 billion
WEBS	$1.9 billion
Nasdaq-100 Trust	$5.9 billion

NASD Regulation

Compliance

Routine examinations conducted	2,833
Terminations for cause completed	2,803
Other cause examinations completed	1,334
Customer complaints reviewed	6,671

Disciplinary Actions

New disciplinary actions filed	1,175
Formal actions resolved	1,354
Firms expelled	10
Individual registrations revoked	74
Individuals barred from this industry	477
Firms suspended from membership	4
Individuals suspended	268

Advertising

Total items reviewed from filings, spot checks, and investigations	73,315

Corporate Financing

Underwriting arrangements reviewed	1,507
Public offerings reviewed ($ billion)	$945.5

Arbitration

Cases filed	5,608
Cases closed	4,767
Disputes resolved between parties without arbitration	3,331
Industry cases arbitrated	288
Customer cases arbitrated	1,148
Cases decided in favor of customers	697

Mediation

Cases brought	931
Cases closed	1,067
Cases settled	814
Total mediations	857

Qualifications

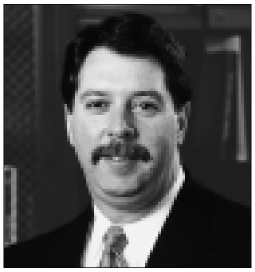
Registered representative and principal examinations administered	353,778

Continuing Education

Training sessions delivered (under the auspices of the Security Industry/Regulatory Council on Continuing Education)	137,657

1999
FINANCIAL INFORMATION

CONSOLIDATED FINANCIAL STATEMENTS



Salvatore F. Sodano

NASD Chief Operating Officer
1999 Chief Financial Officer, and
American Stock Exchange
Chairman and CEO

The 1999 financial results reflect the best outcome achieved in the history of the National Association of Securities Dealers, Inc. (NASD). Driven by the strong performance and activity of the securities markets, consolidated revenues reached an all time high of $1,177 million, approximately $437 million, or 59 percent, ahead of last year's total of $740 million. On a comparable basis[1], 1999 revenues exceeded last year by 27 percent. Net income increased by approximately 224 percent to $154 million; up 86 percent on a comparable basis.

This unprecedented growth was largely fueled by the sharp increase in trading volumes for The Nasdaq Stock Market (Nasdaq) and The American Stock Exchange (Amex). Specifically, average daily share volume for Nasdaq totaled 1,082 million shares per day representing a 35 percent growth over 1998. Transaction growth was even higher at 108 percent, illustrating the burgeoning presence in the market of the individual investor. Amex equity and options volume increased by 12 percent and 33 percent respectively over the prior year. Market information services revenue increased by approximately $42 million or 18 percent due to an increase in the population of professional, retail, institutional and non-professional users, as well as a significant increase in the amount of non-professional quote inquiries. Nasdaq issuer services rose over $26 million, or 19 percent, as a result of a large increase in the number and size of initial public offerings and additional shares listings over 1998.

Looking to regulatory operations, assessments based on members' business volumes grew slightly by $5 million or 5 percent. Registration and qualification fee revenues increased by $37 million or 43 percent from growth in the volume of registrations particularly with disclosure, amendments and qualification exams as the population of registered representatives grew by approximately 5 percent to accomodate an increase in industry activity. Regulatory transaction fees increased by over $17 million or 45 percent as a direct result of the increase in average daily share and trading volume. The funds provided by these sources enabled the NASD to complete regulatory initiatives aimed at responding to the SEC's 21(a) report requirements and aggressively address other emerging regulatory issues.

In light of the financial benefits experienced due to the growth in market volume, the NASD made a concentrated effort to reduce member costs and pass savings along to the industry and investors. Significant fee reductions, volume discounts and rebates were enacted on transaction and market data fees. These actions saved the industry approximately $70 million in 1999.

Operating expenses, before capitalization of software development costs net of amortization, equaled $991 million or a 20 percent increase over the prior year. A key focus of the NASD's efforts in 1999 was devoted to major system development and maintenance projects, including the Year 2000 program, Amex corporate systems development and integration, global initiatives and system environment costs incurred to accommodate the growth in share volume. Other important technology initiatives that were initiated or completed in 1999 include implementation of Web CRD, design of The Nasdaq Order Display Window, implementation of extended trading hours and design and launch of a pilot for INSITE, a program intended to improve the process of conducting routine cycle examinations. Regulatory resources were supplemented to continue to implement regulatory improvements in response to the undertakings emanating from the SEC's 21(a) report issued in 1996. At the end of 1999, the NASD had fulfilled its $100 million commitment to the SEC to devote incremental resources to enhance the NASD's market surveillance systems and to increase staffing for member examinations, surveillance, enforcement and internal audit. Although the commitment has been met, the NASD continues to invest heavily in this area to strongly position itself to respond to emerging regulatory issues.

1999 was also a landmark year for setting the stage for sweeping changes at the NASD. In July, the NASD Board of Governors approved, in concept, the separation of Nasdaq from the NASD. In January 2000, the Board approved a restructuring plan to separate Nasdaq from the NASD by selling approximately 78 percent of its ownership interests in a two-phase private placement. This monumental change from a member-owned to a shareholder-owned structure, a process called demutualization, is expected to better position Nasdaq to respond to major market challenges caused by technological advances and the increasing globalization of financial markets. Additionally, the NASD is building the foundation to create the first global stock exchange through the launching of Nasdaq-Japan and Nasdaq-Europe.

1 Comparable basis includes twelve months of Amex operating results in 1998 (acquired 10/30/98) and excludes the capitalization of software development costs net of amortization introduced as a new accounting standard in 1999. Unless stated otherwise, all financial comparisons are shown on a new comparable basis.

The NASD continues to make progress towards integrating the operations of Amex. The NASD committed to spend funds to meet its $110 million obligation to upgrade the technology and facilities supporting Amex's market trading and administrative systems, as well as its $30 million obligation to promote Amex brand identity through public relations and advertising programs. The financial success of this alliance is evidenced through realization of a 1999 cost savings of $37 million as a result of reduction or elimination of redundant administrative processes and services. A significant portion of these savings was passed on to the industry in the form of reductions in transaction fees on options and equities.

During 1999, the NASD completed the deployment of a new communications infrastructure to link Nasdaq's computerized market facilities to the market participants. This network was developed and is managed by MCI WorldCom. The NASD has agreed to provide a minimum revenue guarantee of $300 million through the year 2003, which costs will be covered directly from market participants. This custom intranet is able to handle a 4 billion share day, and is scalable up to 8 billion shares. The system handled more than one billion shares on 125 separate days during the year.

The NASD continues to examine ways to lower its costs and rationalize the nature and sources of its revenues to fund its operations. Begun in 1998, the NASD continued in 1999 its Enterprise Review initiative, which is focused on identifying cost reductions through consolidation of shared services and leveraging opportunities with vendors, as well as pursuing revenue enhancement opportunities linked to value-added services. In 1999, the NASD reached its target of identifying and implementing $50 million in margin impact from this program. As part of this effort, the NASD negotiated and finalized an agreement with EDS Corporation to establish an alliance, NasTech, through which EDS provides state-of-the-art technology services to the NASD's regulatory and administrative operations. This alliance is expected to bring to the NASD strategic technology capabilities as well as significant cost efficiencies.

Capital spending on property and equipment totaled a record $197 million in 1999. Spending on technology and related facilities accounted for the largest portion, totaling $113 million, as the NASD continued to respond to the rapid growth in Nasdaq market volumes and associated surveillance and regulatory systems. Furthermore, the NASD neared completion on two major capital commitments. By the end of the year 2000, the NASD plans to expend $70 million to complete the construction of a 250,000 square foot office facility in suburban Rockville, Maryland in order to consolidate the Washington, D.C. area operations. Approximately $22 million was expended in 1999 related to the construction of the building. It is anticipated that this consolidation will save $19 million in occupancy costs over a period of 10 years. Additionally, construction progressed on the new MarketSite and broadcast facility located in the New Times Square in New York City. The first stage of the MarketSite, the world's largest outdoor video screen was lit on schedule in time to welcome in the new millennium. Other features to be completed in early 2000 include office, conference, and retail space, in addition to a public interactive exhibit and a new broadcast facility. During 1999, approximately $31 million was incurred on this project.

Working capital remains solid at $266 million and members' equity increased 34 percent to $608 million at the end of 1999. These levels well position the NASD to meet the challenges of staying ahead of the curve in a fast-changing global exchange environment.

YEAR 2000

The Year 2000 issue is the result of computer programs using two digits rather than four to define a given year. Computer programs that process dates having two-digit years may recognize "00" as 1900 rather than the year 2000. These shortcomings in date processing may cause miscalculations or even system failures affecting various activities and operations of the NASD. Year 2000 computer problems may arise after January 1, 2000. Although the NASD has not experienced any significant Year 2000 problems to date, the NASD has been monitoring and will continue to monitor, the compliance of its internal systems. As of December 31, 1999, the NASD spent approximately $53.0 million in its Year 2000 remediation efforts. It is not expected that material expenditures will be incurred in the future related to the Year 2000.

Management is responsible for the preparation, integrity, and objectivity of the consolidated financial statements of the National Association of Securities Dealers, Inc. (NASD). This responsibility includes the selection of accounting procedures and practices, which are in accordance with generally accepted accounting principles. The consolidated financial statements have been prepared in conformity with these procedures and practices applied on a consistent basis. These consolidated financial statements reflect informed judgments and estimates, that management believes to be reasonable, in the determination of certain data used in the accounting and reporting process.

The NASD maintains an effective system of internal accounting controls that is periodically modified and improved to correspond with changes in the NASD's operations. This system of internal controls is designed to provide assurance that the assets of the NASD are safeguarded against loss from unauthorized use or disposition and that the books and records, from which the consolidated financial statements were prepared, properly reflect the financial transactions of the NASD. Important elements of the internal control system include capital and operating budgets, which are subjected to continuous review and reporting throughout the year; an organizational structure providing segregation of responsibilities; established policies and procedures; careful selection and training of qualified personnel; and an internal audit program developed and carried out by the NASD's Internal Review Department. The Internal Review Department is directly responsible to the Audit Committee of the Board of Governors of the NASD. It is management's opinion that the system of internal control as of December 31, 1999, is effective in providing reasonable assurance that the consolidated financial statements are free of material misstatement.

The Board of Governors of the NASD establishes charters for its Audit and Finance Committees, as applicable. The Audit Committee reviews the following: the adequacy and effectiveness of the NASD's internal controls; significant financial reporting issues and practices, including new or changed accounting principles and disclosures; the scope and results of the annual audit of the NASD's financial statements by the independent auditors; and monitors the independence and performance of the independent auditors. The Audit Committee consists exclusively of non-employee governors, a majority of whom are non-industry governors, including at least two public governors.

The Finance Committee oversees the financial operations and condition of the NASD through review and discussion of current financial results; reviews annual operating and capital budgets and material modifications thereto; and reviews all other financial matters related to the operation and financial position of the NASD. The Finance Committee, with the exception of the Chairman and CEO of the NASD, consists of non-employee governors, a majority of whom are non-industry members.

The NASD's independent auditors, Ernst & Young, have conducted an audit in accordance with generally accepted auditing standards of the consolidated financial statements of NASD for the years ended December 31, 1999 and 1998. Representatives of Ernst & Young have met with NASD management and with members of the Audit Committee of the Board of Governors with and without management present to discuss the results of their audits and other accounting, auditing and financial matters.

December 31 (Dollars in thousands)	1999	1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 161,040	$146,584
Investments:		
Available-for-sale, at fair value	475,757	377,108
Held-to-maturity, at amortized cost	10,697	11,582
Receivables, net	151,544	99,195
Other current assets	23,291	22,215
Total current assets	822,329	656,684
Investments:		
Held-to-maturity, at amortized cost	17,720	16,588
Property and equipment:		
Land, buildings and improvements	126,040	97,169
Data processing equipment and software	371,825	252,204
Furniture, equipment and leasehold improvements	227,268	151,925
	725,133	501,298
Less accumulated depreciation	(329,907)	(254,163)
Total property and equipment, net	395,226	247,135
Investments in warrants, at cost	33,480	—
Other assets	30,022	12,934
Total assets	$1,298,777	$933,341
LIABILITIES AND MEMBERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 155,018	$122,810
Accrued personnel costs	118,149	90,476
Net SEC fees	113,578	62,304
Deferred revenue	45,023	34,226
Short-term borrowings	35,000	-
Deposits and renewals	29,399	32,177
Other accrued liabilities	28,824	30,500
Due to banks	20,484	8,843
Total current liabilities	545,475	381,336
Long-term debt	25,000	25,000
Accrued pension costs	20,410	20,066
Accrued other postretirement benefit costs	21,910	20,303
Deferred revenue, investments in warrants, at cost	33,480	-
Other liabilities	44,709	34,399
Total long-term liabilities	145,509	99,768
Total liabilities	690,984	481,104
Members' equity	600,362	446,546
Unrealized gains on available for sale investments, net of tax	7,431	5,691
Total members' equity	607,793	452,237
Total liabilities and members' equity	$1,298,777	$933,341

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

December 31 (Dollars in thousands, except per share amounts)	1999	1998
REVENUE		
Transaction service revenues	$ 305,154	$141,410
Market information revenues	276,478	166,008
Issuer service revenues	177,219	139,699
Registration and qualification fees	123,525	80,051
Member assessments	100,640	92,128
Regulatory service fees and fines	93,536	49,195
Interest and other	50,592	33,401
Arbitration fees	30,767	21,488
Corporate financing fees	18,813	16,143
Total revenue	1,176,724	739,523
EXPENSES		
Compensation and benefits	372,243	281,596
Professional and contract services	236,926	127,923
Depreciation and amortization	78,351	60,600
Marketing and advertising	69,602	47,619
Computer operations and data communications	64,085	56,403
Other	39,428	24,041
Occupancy	38,675	25,577
Travel, meetings and training	29,797	23,599
Publications, supplies and postage	27,390	24,198
Total expenses	956,497	671,556
Income before provision for income taxes	220,227	67,967
Provision for income taxes	66,411	20,462
Net income	$ 153,816	$ 47,505

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Members' Equity

	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 1997	$399,041	$ —	$399,041
Net income	47,505	—	47,505
Unrealized gains on available-for-sale investments, net of tax of $1,088	—	5,691	5,691
Comprehensive income			53,196
Balance, December 31, 1998	446,546	5,691	452,237
Net income	153,816	—	153,816
Unrealized gains on available-for-sale investments, net of tax of ($149)	—	1,740	1,740
Comprehensive income			155,556
Balance, December 31, 1999	$600,362	$7,431	$607,793

December 31 (Dollars in thousands)	1999	1998
CASH FLOW FROM OPERATING ACTIVITIES		
Cash received from customers	$1,084,068	$ 725,134
Cash paid to suppliers and employees	(834,039)	(585,061)
Income taxes paid	(49,992)	(24,131)
Interest received, net	47,956	31,523
Other	(7,855)	(34,506)
Cash provided by operating activities	240,138	112,959
CASH FLOW FROM INVESTING ACTIVITIES		
Net cash from business acquisition	—	71,372
Proceeds from redemptions of available-for-sale investments investments	535,684	239,173
Purchases of available-for-sale investments	(632,592)	(284,712)
Proceeds from maturities of held-to-maturity investments	30,743	56,124
Purchases of held-to-maturity investments	(30,990)	(50,127)
Purchases of property and equipment, net	(226,442)	(64,105)
Cash used in investing activities	(323,597)	(32,275)
CASH FLOW FROM FINANCING ACTIVITIES		
Increase in due to banks	11,641	338
Net SEC fees	51,274	13,506
Proceeds from acquisition of debt	35,000	—
Cash provided by financing activities	97,915	13,844
Increase in cash and cash equivalents	14,456	94,528
Cash and cash equivalents at beginning of year	146,584	52,056
Cash and cash equivalents at end of year	$ 161,040	$ 146,584
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net income	$ 153,816	$ 47,505
Depreciation and amortization	78,351	60,600
(Increase) decrease in receivables, net	(52,349)	5,650
Increase in other current assets	(1,077)	(22,215)
Increase in other assets	(17,088)	(9,051)
Increase in accounts payable and accrued expenses	32,208	10,362
Increase in accrued personnel costs	27,673	6,903
Increase in deferred revenue	10,797	13,362
(Decrease) increase in other accrued liabilities	(1,676)	3,623
Increase in accrued other post-retirement costs	1,607	697
Increase (decrease) in accrued pension costs	344	(5,980)
(Decrease) increase in deposits and renewals	(2,778)	4,743
Increase (decrease) in other liabilities	10,310	(3,240)
Cash provided by operating activities	$ 240,138	$ 112,959

See accompanying notes to consolidated financial statements.

1 ORGANIZATION AND NATURE OF OPERATIONS

The National Association of Securities Dealers, Inc. (NASD) is the parent company of the following significant subsidiaries: The Nasdaq Stock Market, Inc. (Nasdaq), The American Stock Exchange LLC (Amex), NASD Regulation, Inc. (NASDR) and The Nasdaq-Amex Market Group Inc. (Market Group); collectively referred to as the Company.

Nasdaq uses a multiple market maker system to operate an electronic, screen-based equity market. Nasdaq's principal business products are price discovery and trading services, listing of issues, and the sale of related data and information. Amex uses a specialist system to operate a floor-based exchange. The majority of Nasdaq and Amex business is transacted with listed companies and firms in the broker/dealer industry within the U.S.

NASD oversees the activities of the U.S. broker/dealer profession and regulates Nasdaq, Amex and the over-the-counter securities markets. NASDR carries out the NASD's regulatory functions, including onsite examinations of member firms, continuous automated surveillance of markets operated by Nasdaq and Amex, and disciplinary actions against broker/dealers and their professionals.

2 SIGNIFICANT TRANSACTIONS

On April 8, 1998, the NASD and The American Stock Exchange, Inc. and its wholly-owned subsidiaries (Amex, Inc.) entered into a Transaction Agreement to acquire Amex. On October 30, 1998 (acquisition date), after obtaining necessary membership and regulatory approvals, the acquisition was consummated.

This acquisition has been accounted for using the purchase method of accounting, and accordingly, assets acquired and liabilities assumed have been recorded at their estimated fair values at the date of acquisition. Amex, Inc. transferred all of its assets and liabilities to Amex. In return, Amex, Inc. received a limited liability company interest in Amex. The controlling limited liability company interest is owned by Market Group. The results of operations of Amex are included in the consolidated statements of income and members' equity from the acquisition date. Periods prior to the acquisition date are not included in the consolidated statements of income and members' equity.

The excess of the fair value of net assets acquired over consideration incurred is being recognized as income on a straight-line basis over 25 years. The deferred credit is included in other liabilities in the consolidated balance sheets and is $7,510 and $11,692 as of December 31, 1999 and 1998, respectively.

As a result of the acquisition and in connection with the integration of operations of Amex into the Company, the Company has accrued liabilities associated with the consolidation of facilities and employee costs resulting from the business combination. As of December 31, 1998, the liability was established to be $18,920. During 1999, the Company determined that it was necessary to increase the liability by $4,300 to account for the actual employee consolidation costs incurred. During 1999, Amex incurred $12,188 of employee and facilities consolidation costs, resulting in a remaining liability of $11,032 as of December 31, 1999.

(In thousands, except share amounts)

The following unaudited pro forma information presents the results of operations of the Company as if the acquisition had occurred at the beginning of the acquisition period.

Year ended	December 31, 1998
Revenues	$925,645
Net Income	75,955

These unaudited pro forma results have been prepared for comparative purposes only and include the effects of the allocation of the excess of the fair value of net assets acquired over consideration to noncurrent assets which results in no depreciation expense for property and equipment acquired. These unaudited pro forma results are not necessarily indicative of the results of operations which would have actually resulted had the acquisition been consummated in the past nor are they indicative of future results.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the NASD and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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.

Cash and Cash Equivalents

Cash and cash equivalents include demand cash and all non-restricted investments purchased with a remaining maturity of three months or less at the time of purchase.

Investments

Under Statement of Financial Accounting Standards (SFAS) No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” management determines the appropriate classification of investments at the time of purchase. Investments for which the Company does not have the intent or ability to hold to maturity are classified as “available-for-sale” and are carried at fair market value, with the unrealized gains and losses, net of tax, reported as a separate component of Members’ Equity. Investments for which the Company has the intent and ability to hold to maturity are classified as “held-to-maturity” and are carried at amortized cost. The amortized cost of debt securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts. Realized gains and losses on sales of securities are included in earnings using the specific identification method.

A decline in the market value of any available-for-sale or held-to-maturity security below cost, that is deemed to be other than temporary, results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established.

Receivables, Net

The Company's receivables are concentrated with NASD members, Amex member firms, and Nasdaq issuers. Receivables are shown net of reserves for uncollectible accounts. Reserves are calculated based on the age and source of the underlying receivable and are tied to past collections experience. Total reserves netted against receivables in the consolidated balance sheets were $11,083 and $8,293 at December 31, 1999 and 1998, respectively.

Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation. Equipment acquired under capital leases is recorded at the lower of fair market value or the present value of future lease payments. Depreciation and amortization are provided on the straight-line method. Estimated useful lives generally range from 10 years to 40 years for buildings and improvements, 2 years to 5 years for data processing equipment and software, and 5 years to 10 years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the lesser of the useful life of the improvement or the term of the applicable lease.

Investments in Affiliates

The Company carries its various investments in affiliates at cost and under the equity method of accounting depending upon its ability to influence the operation of the affiliate. Investments in affiliates are included in other assets in the consolidated balance sheets and amount to approximately $12,300 and $2,100 as of December 31, 1999 and 1998, respectively.

Net SEC Fees

Pursuant to the National Securities Markets Improvement Act of 1996, the Securities and Exchange Commission (SEC) is permitted to collect a fee based on a percentage of the total dollar value of securities sold in The Nasdaq and Amex markets. These fees are designed to cover costs incurred by the government in the supervision and regulation of securities markets and securities professionals. The Company charges these fees monthly to its members and remits them to the United States Treasury semiannually in March and September. The liability for net SEC fees represents amounts collected from members but not yet remitted to the United States Treasury.

Deferred Revenue

Deferred revenue represents cash received and billed receivables which are unearned, until services are provided.

Deposits and Renewals

NASD member firms make deposits into the Company's Central Registration Depository (CRD) system to pay for services including registration fees charged by states and other self regulatory organizations. Total CRD deposits included in deposits and renewals in the consolidated balance sheets totaled $18,071 and $18,102 as of December 31, 1999 and 1998, respectively. CRD renewals included in deposits and renewals in the consolidated balance sheets totaled $9,145 and $12,237 as of December 31, 1999 and 1998.

Pensions and Other Postretirement Benefits

The Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" in fiscal year 1998. The provisions of this Statement revise employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of expense for these plans.

Revenue Recognition

Market information fees are based on the number of presentation devices in service and quotes delivered through those devices and are recognized in the month that information is provided. Transaction service, regulatory service fees, and registration and qualification fees are variable based on service volumes and are recognized as transactions occur. Issuer annual fees and member assessments are recognized as revenue evenly over the course of the year. Issuer entry and additional shares fees are recognized when applications are approved for listing on The Nasdaq Stock Market or The American Stock Exchange.

Advertising Costs

The Company expenses advertising costs, which include media advertising and production cost, in the periods in which the costs are incurred. Media advertising and production costs included as marketing and advertising in the consolidated statements of income totaled $51,353 and $37,556 for 1999 and 1998, respectively.

Software Costs

Significant purchased application software, and operational software that is an integral part of computer hardware, are capitalized and amortized on the straight-line method over their estimated useful lives. All other purchased software is charged to expense as incurred.

The Company adopted SOP 98-1, “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use” effective January 1, 1999. The provisions of this SOP require certain costs incurred in connection with developing or obtaining internal use software to be capitalized. Prior to January 1, 1999, the Company expensed such costs as incurred. Under SOP 98-1, the Company, as of December 31, 1999 capitalized approximately $33,741 net of amortization of $1,140.

Income Taxes

NASD and NASDR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). All other consolidated subsidiaries of NASD are taxable entities. Deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company’s tax liability is included in the consolidated return of Market Group.

Comprehensive Income

The Company adopted SFAS No. 130, “Reporting Comprehensive Income” in fiscal year 1998. SFAS 130 establishes new rules for the reporting and display of comprehensive income and its components; however, the adoption of this Statement had no impact on the Company’s net income or members’ equity. SFAS 130 requires unrealized gains and losses on the Company’s available-for-sale securities to be included as other comprehensive income in the consolidated balance sheets.

Classifications

Certain amounts for the prior year have been reclassified to conform with the 1999 presentation.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (“SFAS”) No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 133 provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. In June 1999, FASB issued Statement of Financial Accounting Standards No. (“FAS 137”), “Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 137” which defers the date of adoption of SFAS 133 such that it is effective for fiscal years beginning after June 15, 2000. The Company believes that the adoption of SFAS 133 will not have a significant impact on its operating results or cash flows.

(In thousands, except share amounts)

4 INVESTMENTS

Investments consist of U.S. Treasury securities, obligations of U.S. Government sponsored enterprises, municipal bonds, equity securities and other financial instruments. Upon completion of management's reevaluation of the classification of the investment portfolio at December 31, 1998, a majority of the held-to-maturity investment portfolio was reclassified to available-for-sale in order to align the investment portfolio with management's current intentions. The amortized cost and fair value of the investments transferred amounted to $346,236 and $352,797, respectively.

Following is a summary of investments classified as available-for-sale which are carried at fair value as of December 31, 1999:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Due in one year or less	$240,719	$ 117	$(3,049)	$237,787
Due after one year through five years	168,671	472	(3,088)	166,055
Equity securities	57,997	14,916	(998)	71,915
	$467,387	$15,505	$(7,135)	$475,757

Following is a summary of investments classified as held-to-maturity which are carried at amortized cost as of December 31, 1999:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Due in one year or less	$10,697	$7	$ (178)	$10,526
Due after one year through five years	17,720	-	(439)	17,281
	$28,417	$7	$ (617)	$27,807

Following is a summary of investments classified as available-for-sale which are carried at fair value as of December 31, 1998:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Due in one year or less	$136,107	$ 586	$(1)	$ 136,692
Due after one year through five years	234,222	6,198	(4)	240,416
	$370,329	$6,784	$(5)	$ 377,108

Following is a summary of investments classified as held-to-maturity which are carried at amortized cost as of December 31, 1998:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Due in one year or less	$11,582	$ 30	—	$11,612
Due after one year through five years	16,588	311	—	16,899
	$28,170	$341	—	$28,511

When long-term debt was acquired in 1997, investments with a carrying amount of approximately $28,000 were pledged as collateral. As of December 31, 1999 and 1998, approximately $28,000 remains pledged as collateral under that agreement.

5 FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company considers cash and cash equivalents, accounts receivable, investments, investments in subsidiaries, accounts payable and accrued expenses, due to banks, and short and long-term borrowings to be its financial instruments. The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, investments, accounts payable and accrued expenses, due to banks, and short-term borrowings closely approximate their fair values. The approximate fair value of the Company's long-term borrowings was estimated using a discounted cash flow analysis, based on the Company's assumed incremental borrowing rates for similar types of borrowing arrangements. This analysis indicates that the fair value of the Company's long-term debt at December 31, 1999 and 1998 approximates its carrying amount. The fair value of its investments in subsidiaries is not determinable since these investments do not have quoted market prices.

6 SHORT AND LONG-TERM BORROWINGS

In May 1997, the Company entered into a $25,000 note payable (the Note) with a U.S. financial institution (the Lender). The Note requires monthly interest payments at a rate of 7.41 percent through May 2007. In May 2007, the Company will incur interest equal to the Lender's cost of funds rate, as defined in the agreement, plus .50 percent. Principal payments are scheduled to begin in 2007 and continue in equal monthly installments until maturity in 2012. Interest expensed and paid under the Note totaled approximately $1,878 for 1999 and 1998, respectively.

In September 1999, the Company entered into an unsecured line of credit agreement (the Agreement) with the Lender. Under the Agreement, the Company has the option to borrow up to $50,000 at LIBOR plus .30 percent (6.77 percent as of December 31, 1999). Proceeds received related to borrowings under the Agreement were used to fund operating costs. The terms of the Agreement extend through September 2000. As of December 31, 1999, the Company had $35,000 in outstanding borrowings under the agreement. Interest expensed and paid under the Agreement totaled $483 for 1999.

(In thousands, except share amounts)

7 INCOME TAXES

The income tax provision includes the following amounts:

Years ended December 31,	1999	1998
Current income taxes:		
Federal	$42,912	$18,675
State	10,549	3,979
Total current income taxes	53,461	22,654
Deferred income taxes:		
Federal	10,599	(1,754)
State	2,351	(438)
Total deferred income taxes	12,950	(2,192)
Total provision for income taxes	$66,411	$20,462
Income taxes paid during the year	$49,992	$24,131

Reconciliations of the statutory United States federal income tax rates to the effective tax rates for the Company's taxable entities are as follows:

Years ended December 31,	1999	1998
Federal	35.0%	35.2%
State	5.7	4.4
Other, net	.2	(.8)
Effective rate	40.9%	38.8%

Components of the Company's deferred tax assets and liabilities consisted of the following:

Years ended December 31,	1999	1998
Deferred tax assets:		
Deferred fees	$2,233	$1,627
Compensation and benefits	179	1,015
Bad debts	2,801	1,653
Other	6,652	3,920
Total deferred tax assets	11,865	8,215
Deferred tax liabilities:		
Depreciation	(9,966)	(11,262)
SOP 98-1	(5,184)	
Other	(11,167)	(1,138)
Total deferred tax liabilities	(26,317)	(12,400)
Net deferred tax liabilities	$(14,452)	$(4,185)

The Company's current deferred taxes assets and liabilities are included in the consolidated balance sheets as other current assets and other accrued liabilities. Non-current deferred tax liabilities are recorded in the consolidated balance sheets as other liabilities.

8 PENSION BENEFITS

The Company provides defined benefit pension and postretirement benefit plans to certain employees. The NASD maintains a noncontributory, defined-benefit pension plan, along with other arrangements, for the benefit of eligible employees of its subsidiaries other than Amex. The benefits are primarily based on years of service and the employees' average salary during the highest 60 consecutive months of employment. Amex maintains a contributory, defined-benefit pension plan for the benefit of eligible Amex employees. The benefits are primarily based on years of service and compensation levels. Amex also maintains postretirement benefit plans that provide medical and life insurance benefits for Amex retirees and eligible dependents. Amex employees become eligible for these benefits if they meet minimum age and service requirements and are eligible for retirement benefits.

(In thousands, except share amounts)

The following table sets forth the plans' funded status and amounts recognized in the balance sheets at December 31:

	Pension Benefits		Other Postretirement Benefits	
	1999	1998	1999	1998
Change in benefit obligation				
Benefit obligation at beginning of year	$162,032	$ 90,468	$ 20,303	$ —
Service cost	12,322	9,162	645	120
Interest cost	11,062	7,094	1,426	219
Participant contributions	—	200	—	—
Amendments	—	1,172	—	—
Actuarial (gains) losses	(2,236)	1,254	(1,255)	(49)
Acquisition	—	58,197	—	20,119
Benefits paid	(12,128)	(8,480)	(1,059)	(106)
Curtailment (gains) losses	(4,904)	—	595	—
(Gain) loss due to change in discount rate	(2,034)	2,965	—	—
Benefit obligation at end of year	$164,114	$162,032	$ 20,655	$ 20,303
Change in plan assets				
Fair value of plan assets at beginning of year	$165,172	$ 68,468	—	—
Actual return on plan assets	15,001	12,930	—	—
Acquisition	—	84,159		
Company contributions	8,260	7,849	$ 1,059	$106
Participant contributions	51	246	—	—
Benefits paid	(11,975)	(8,480)	(1,059)	(106)
Fair value of plan assets at end of year	$176,509	$165,172	$ —	$ —
Funded status of the plan (underfunded)	12,395	3,140	(20,655)	(20,303)
Unrecognized net actuarial gain	(3,975)	1,838	(1,255)	—
Unrecognized prior service cost	2,878	3,465	—	—
Unrecognized transition obligation/(asset)	(1,725)	(1,949)	—	—
Prepaid (accrued) benefit cost	$ 9,573	$ 6,494	$(21,910)	$(20,303)

The accrued pension liability as of December 31, 1999 and 1998 is $27,607 and $27,171, respectively, of which $7,197 and $7,105 is included in accounts payable and accrued expenses in the consolidated balance sheets.

For all plans with projected benefit obligation in excess of plan assets as of December 31, 1999 and 1998, the aggregate projected benefit obligation totaled $114,630 and $108,273, respectively. Plan assets for those plans totaled $93,500 and $77,749 as of December 31, 1999 and 1998.

	Pension Benefits		Other Postretirement Benefits	
	1999	1998	1999	1998
Weighted-average assumptions as of December 31				
Discount rate	8.0%	7.0%	8.0%	7.0%
Expected return on plan assets	9.0	9.0	—	—
Rate of increase (compensation or health care cost)	5.4	5.4		4.5

(In thousands, except share amounts)

The assumptions for the annual increase in the health care cost trend rate are as follows:

December 31,	1999	1998
Under age 65	7.8%	7.0%
Age 65 and over	7.0	6.4

The health care cost trend rate for 1999 and 1998 was assumed to decrease gradually to an estimated annual increase of 4.5 percent in the year 2003 and thereafter.

	Pension Benefits		Other Postretirement Benefits	
	1999	1998	1999	1998
Components of net periodic benefit cost				
Service cost	$12,322	$ 9,162	$ 645	$120
Interest cost	11,062	7,094	1,426	219
Expected return on plan assets	(13,824)	(7,108)	—	—
Amortization of unrecognized transition asset	(224)	(213)	—	—
Recognized net actuarial loss	160	92	—	—
Prior service cost recognized	587	357	—	—
Curtailment (gain) loss recognized	(4,904)	—	595	—
Benefit cost	$ 5,179	$ 9,384	$2,666	$ 339

Curtailment gains recognized were tied primarily to the transfer of employees to a third party under the Company's technology outsourcing agreement and to employee consolidation related to the acquisition of Amex in 1998.

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:

December 31,	1999	1998
Effect of a one-percentage point increase		
Year end benefit obligation	$2,463	$2,689
Total service costs and interest components	166	67

December 31,	1999	1998
Effect of a one-percentage point decrease		
Year end benefit obligation	$(2,024)	$(2,185)
Total service costs and interest components	(127)	(53)

NASD also maintains a voluntary savings plan for eligible employees of its subsidiaries. Employees are immediately eligible to make contributions to the plan and after one year of service are also eligible for an employer contribution match at an amount equal to 50 percent of the first 6 percent of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from the Company. Savings plan expense for 1999 and 1998 was $9,130 and $7,094, respectively. The expense included a discretionary match authorized by the Board of Governors of the NASD totaling $3,900 for 1999 and $3,300 for 1998.

(In thousands, except share amounts)

Amex also maintains a voluntary savings plan for Amex employees. Employees are eligible to make contributions to the plan after one month and after six months of service are also eligible for an employer contribution match at an amount equal to 25 percent of the first 6 percent of eligible employee contributions. Eligible plan participants may also receive a discretionary match from the Company equal to an additional 75 percent of the employee's contributions (up to the first 6 percent of the employee's compensation). Savings plan expense for the periods ended December 31, 1999 and 1998 was $2,016 and $134, respectively.

9 LEASES

The Company leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was $21,648 in 1999 and $14,280 in 1998.

Future minimum lease payments under noncancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 1999:

Year ending December 31:	
2000	$ 23,967
2001	20,381
2002	18,652
2003	13,952
2004	12,029
Remaining years	67,533
Total minimum lease payments	$156,514

10 COMMITMENTS AND CONTINGENCIES

In November 1997, the Company entered into an agreement with MCI WorldCom Inc. to replace the existing data network that connects The Nasdaq market facilities to market participants. The contract contains a minimum guarantee of $300,000 to be incurred through November 2003. Billings under the contract are $67,933 as of December 31, 1999. Data communication costs incurred under network agreements are directly charged to market participants and, therefore, are netted against these revenues. Management anticipates that the minimum guarantee under the contract will be achieved.

In November 1998, Nasdaq entered into a $36,800 agreement for the construction of The Nasdaq MarketSite complex to be located in Times Square, New York. The first stage of the MarketSite, a 10,800 square foot outdoor video screen was lit on December 28, 1999. Other features to be completed by Spring 2000 include office, conference and retail space, in addition to a public interactive exhibit and a new broadcast facility. During 1999, approximately $31,200 was incurred on this project.

In September 1998, Nasdaq entered into a partnership with OptiMark® to design and develop an anonymous order matching system (the OptiMark system) that will be integrated into The Nasdaq network in Trumbull, Connecticut. OptiMark is the creator and owner of the OptiMark system, an electronic trading process that, through the use of powerful supercomputers and patented algorithms, matches buying and selling profiles to achieve best available prices in the marketplace. Pursuant to the operating agreement between Nasdaq and OptiMark, Nasdaq has the obligation to provide the network over which OptiMark transactions will be transmitted, the development required to integrate the OptiMark system with the Nasdaq Workstation II® (NWII), and the facilities to support the system. Management estimates that through December 31, 1999, approximately $2,483 of costs were incurred related to development and maintenance of the system. Future costs to be incurred related to maintenance of the system are not expected to be material to the Company's operations.

In April 1999, Nasdaq signed a letter of intent to acquire Financial Systemware, Inc. (FSI) a company which develops and markets a set of software utilities which can be loaded on a NWII terminal to enhance the features and functionalities of the NWII software. This transaction, which is expected to be completed in the Spring of 2000, will be accounted for under the purchase method. Upon the closing of the transaction, Nasdaq will acquire 100 percent of FSI's issued and outstanding stock for $5,000 plus the book value of the net assets as of the closing date. The FSI principals, the sellers, will collectively be paid $25,000 over the next 5 years, of which $10,000 will be paid upon closing. Five cash payments of $3,000 will be paid over the five years following closing, contingent upon the continued employment and development efforts of the FSI principals.

The Transaction Agreement entered into by the Company related to the acquisition of Amex, Inc. included a Member Equity Program (Program) to support the value of Amex Members' seats. On October 30, 1998, the closing date, the NASD committed $30,000 to support seat prices with an additional $10,000 commitment effective on January 1, 1999. This fund can grow without a cap through buying, selling and leasing seats as well as a 5 percent return on the account. Under the Program, an elected Seat Committee will monitor the effectiveness of the Program at 18 months, 36 months, and 60 months from the acquisition date. At the time of the reviews, the Seat Committee will disburse portions of the initial commitment amount in one of the following ways: to owners of membership interests in Amex; as a reduction of Amex Exchange fees; and/or for investments in technology. Additionally, the Seat Committee may elect a roll-over option under which it would not disburse funds until the next review date. After five years, the undistributed amount will be eligible for distribution to the Amex Members, reduction of Amex fees or investments in technology as determined by a Membership vote. Every two years after that, the remainder will be eligible for distribution in the same manner until the commitment has been fully paid. The commitment will be funded from operations of the Company. As of December 31, 1999, no seats were purchased by the NASD under the Program.

Also as a condition of the acquisition, a Member Supplement Fund was established under which annual distributions may be made by Market Group based upon 15 percent of the amount, if any, that the net income of Amex exceeds established thresholds for the years 1999 through 2008. Funds will be distributed to owners of membership interests in Amex or paid for investments in technology as determined by a Member Supplement Fund Committee.

Any contingency payments to members made under the Member Equity Program or the Member Supplement Fund will be accounted for as contingent consideration through an adjustment of the original purchase price allocation and will be amortized over the remaining life of any remaining goodwill.

On October 30, 1998, the NASD and the Amex entered into a Technology Transfer and Development Agreement (the Technology Agreement) whereby $110 million will be disbursed over the next five years for the purpose of operating and upgrading Amex's trading market and administrative systems. To the extent that Amex's revenues are not sufficient to fund this $110 million program as scheduled, the NASD will spend or make available the difference through capital contributions, loans, or guarantees of loans. The costs incurred by the Company through December 31, 1999 to be applied against the $110 million commitment remain subject to the review and approval of the Amex Committee.

During the two-year period following the acquisition date of Amex, the NASD committed to spend $30,000 on a public relations and advertising program designed to promote Amex. The costs incurred by the Company through December 31, 1999 to be applied against the $30,000 commitment remain subject to the review and approval of the Amex Committee.

Securities Industry Automation Corporation (SIAC), an affiliated company, has a lease agreement for a data processing site. SIAC's performance under the terms of the lease, which has a remaining obligation of approximately $80,738 over the next seven years, has been guaranteed by the NYSE as majority owner of SIAC. Amex has agreed to indemnify the NYSE for a portion of losses, if any, sustained by the NYSE in the event of a default by SIAC. The Amex's share of potential losses ($13,725, or 17 percent, at December 31, 1999) is based upon its utilization of SIAC services for the preceding three years, and is adjusted annually.

On June 1, 1999, the NASD finalized a ten-year agreement (the Agreement) with EDS Corporation to establish an alliance, NasTech, through which EDS provides technology services to the NASD and NASDR. The NASD has an obligation to pay to EDS a minimum of $51,200 each year under the term of the Agreement except for 2009 which will be prorated through the ending date of the Agreement on May 31, 2009. Additionally, in the event that the NASD terminates the Agreement for convenience, it is subject to a termination fee to EDS. The termination fee is based upon a formula which considers total EDS billings and profit through the date of termination and remaining minimum payments after the date of termination. If the Agreement was terminated effective December 31, 1999, the NASD would have been obligated to pay EDS a termination fee of $63,152.

The Company may be subject to claims arising out of the conduct of its business. Currently, there are certain legal proceedings pending against the Company. Management believes, based upon the opinion of counsel, that any liabilities or settlements arising from these proceedings will not have a material effect on the consolidated financial position or results of operations of the Company. Management is not aware of any unasserted claims or assessments that would have a material adverse effect on the financial position and the results of operations of the Company.

11 WARRANTS

In connection with the OptiMark partnership, OptiMark agreed to issue to Nasdaq warrants to purchase up to an aggregate of 11,250,000 shares of its ($.01 par value) common stock. The warrants when issued are exercisable in several tranches upon the achievement of certain milestones, which are based primarily upon the average daily share volume of Nasdaq securities traded through the OptiMark system. The first milestone is the warrant commencement date, which occurred on October 11, 1999. On that date, the Company received two fully exercisable warrants from OptiMark to purchase 4,500,000 of its shares. The first 2,250,000 shares may be purchased at an exercise price of $5.00 per share. All remaining warrants provide for shares to be purchased at an exercise price of $7.00 per share. The warrants are exercisable through the earlier of (i) the last day that the System continues to be available on all NWII workstations and (ii) the fifth anniversary of the warrant commencement date, or October 11, 2004. As of October 11, 1999, these warrants have a combined value of $33,480 which is considered to be the cost of these warrants. The deferred revenue associated with these warrants will be amortized into income based on share volume traded through the OptiMark system.

12 BUSINESS SEGMENT INFORMATION

The NASD manages three primary business segments: NASDR, Nasdaq and Amex. These three segments provide substantially all of the Company's revenues. As described in the summary of significant accounting policies, these segments also represent separate identifiable organizations. Services provided by all other potential segments represent less than 10 percent of consolidated gross revenues. Accordingly, activities related to these entities, including those of the NASD parent, are included in the category "All Other." Revenues generated by entities in "All Other" consist mainly of interest income and assessments on registered representatives charged to cover regulatory and market policy functions.

NASDR — Carries out the regulatory functions of the Company, including on-site examinations of member firms, continuous automated surveillance of markets operated by Nasdaq and Amex, and disciplinary actions against broker/dealers and their professionals. Fees are assessed to cover particular services, both regulatory and non-regulatory, and member assessments are levied to cover examinations and related regulatory functions.

Nasdaq — Uses a multiple market maker system to operate an electronic, screen-based equity market. Nasdaq's principal business products are price discovery and trading services, listing of issues, and the sale of related data and information.

Amex — Uses a specialist system to operate a floor-based exchange. The majority of this business is transacted with listed companies and firms in the broker/dealer industry within the U.S.

SEGMENT INCOME OR LOSS

The NASD's accounting policies for segments are the same as those described in the summary of significant accounting policies. Management evaluates segment performance based on operating income or loss before income taxes. Transfers between segments are accounted for at cost.

1999 (In thousands)	**NASDR**	**Nasdaq**	**Amex**	**All Other**	**Consolidated**
Revenues, principally from external customers	$351,449	$578,628	$230,628	$ 16,019	$1,176,724
Total expenses	270,017	434,058	212,865	39,557	956,497
Operating income before income taxes	81,432	144,570	17,763	(23,538)	220,227
Income taxes	—	58,421	7,990	—	66,411
Total assets	282,003	573,041	164,751	278,982	1,298,777
Working capital	145,776	154,250	34,614	(68,483)	266,157
Capital expenditures	4,396	94,193	21,837	76,047	196,473

1998 (In thousands)	**NASDR**	**Nasdaq**	**Amex**	**All Other**	**Consolidated**
Revenues, principally from external customers	$257,395	$426,499	$ 39,716	$ 15,913	$ 739,523
Total expenses	235,579	365,534	47,894	22,549	671,556
Operating income (loss) before income taxes	21,816	60,965	(8,178)	(6,636)	67,967
Income taxes	—	26,010	(5,548)	—	20,462
Total assets	176,433	403,745	124,320	228,843	933,341
Working capital	77,487	120,831	48,465	16,983	263,766
Capital expenditures	3,682	33,605	909	29,876	68,072

13 REORGANIZATION

In July of 1999 the Board of Governors approved, in concept, the separation of Nasdaq from the NASD, which would result in, among other things, the NASD selling some or all of its investment in Nasdaq as well as the potential for an initial public offering of equity securities by Nasdaq in the future. Such changes are intended to allow Nasdaq to respond to major market challenges caused by technological advances and the increasing globalization of financial markets. On January 4, 2000, the NASD Board unanimously approved a restructuring to separate Nasdaq from the NASD and sell approximately 78 percent of its investment in a two-phase private placement. As part of the reorganization the NASD will effect a 50,000 for one stock split to create 100,000,000 shares.

Management is intending that the NASD, through a two-phase private placement (the Transaction), will sell ownership interests in its Market Group subsidiary to key stakeholders such as key market makers, Nasdaq-listed companies, institutional investors and NASD members. The Transaction will be effectuated through a sale of a combination of common stock and warrants. Market Group is currently the sole stockholder of Nasdaq. Prior to the Transaction, Amex will be transferred from Market Group to a newly-formed subsidiary of the NASD so that at the time of the Transaction, Nasdaq will be the sole asset of Market Group. Following completion of the Transaction, the NASD will hold NASD Regulation and Amex as its primary operating subsidiaries and will hold an approximately 22 percent interest in Market Group on a diluted basis assuming full exercise of warrants to be sold in the Transaction.

Management anticipates the Transaction to be completed during 2000, pending further approval by, among others, the Securities and Exchange Commission and NASD members.

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National Association of Securities Dealers, Inc.

We have audited the accompanying consolidated balance sheets of the National Association of Securities Dealers, Inc. as of December 31, 1999 and 1998, and the related consolidated statements of income, changes in members' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the National Association of Securities Dealers, Inc. at December 31, 1999 and 1998, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 3 to the consolidated financial statements, effective January 1, 1999, the Company adopted Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use."

Ernst + Young LLP

Washington, D.C.
January 21, 2000

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