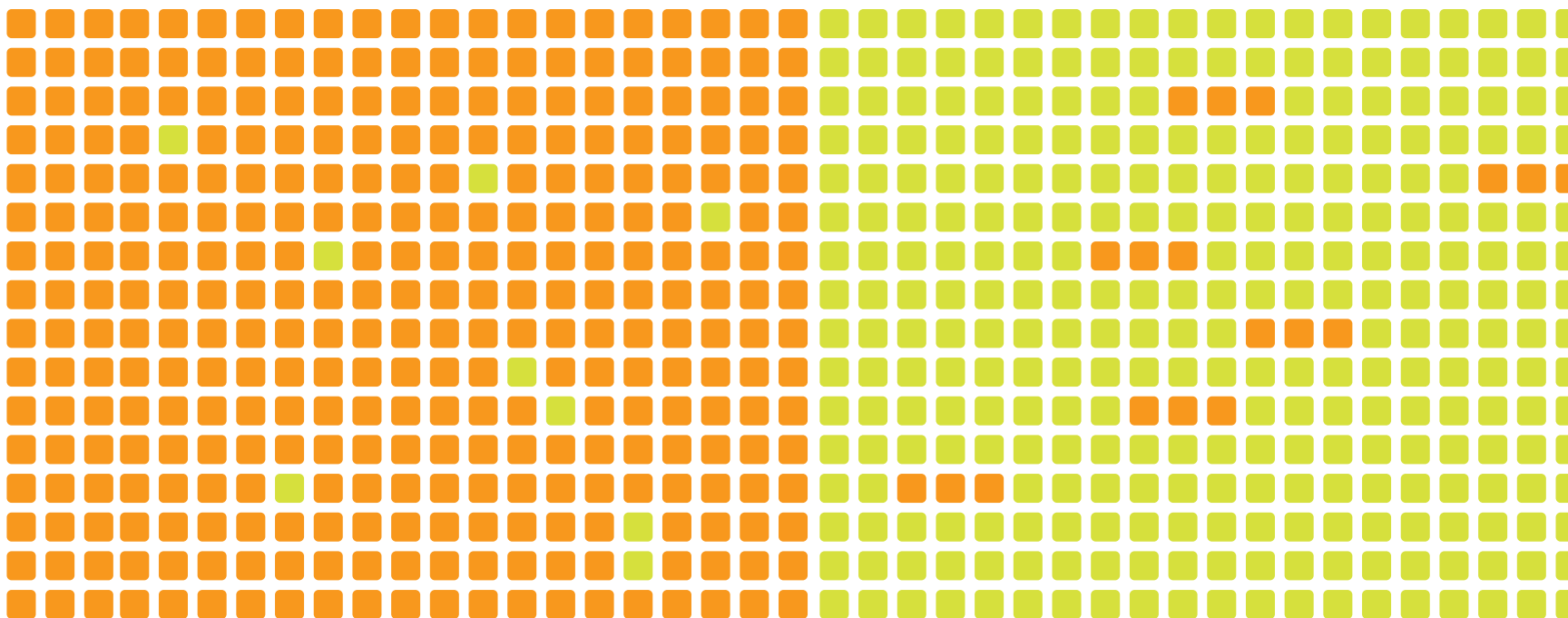




Better Information | Better Regulation



2005 YEAR IN REVIEW

The focus of NASD is keeping the markets fair for investors.

NASD is the leading independent, private-sector regulator of every U.S. broker-dealer and securities firm doing business with the investing public. It regulates trading on NASDAQ, the American Stock Exchange, OTC equities, the corporate bond market and the International Securities Exchange.

In operation since 1938, NASD provides market integrity and investor protection through effective rules, regulations and ethical standards; examinations and enforcement; education and information.



Robert R. Glauber

Robert R. Glauber

Chairman and Chief Executive Officer

This is NASD's last annual report under my leadership. Next year, you will see in this space a letter from Mary Schapiro. Mary is our vice chairman and my natural successor, having run our core regulatory activities for 10 years. She will take control of an organization that has been through a challenging period and emerges much changed and much strengthened.

That change is most evident to the public and to securities firms in the increased level of regulatory intensity and vigilance. As one example, NASD's Department of Enforcement turned in a record year in 2005 with about 1,400 cases filed and just over \$134 million in fines collected.

In the face of the fallout from the Bubble-era abuses, this heightened regulatory vigilance has been both necessary and appropriate. It has been necessary to protect investors and renew their confidence in the markets. It has been appropriate to reaffirm and enhance the mandate of private-sector regulation in the face of critics who believe that industry-based oversight cannot be legitimate.

While NASD's regulatory programs have increased, we have worked hard to control their costs and the burdens they place on the firms we regulate. Most importantly, we have now completed the transformation of NASD into an organization focused only on regulation, unencumbered and undistracted by the ownership of markets. We sold our ownership in the American Stock Exchange in 2004. Early this year, the SEC approved NASDAQ's becoming a wholly separate exchange, and we have embarked on the final round of selling the last vestiges of our ownership in NASDAQ.

To control costs and burdens, we have built Examiner University, the training program for NASD compliance inspectors, and we offer firms an increasingly rich menu of compliance tools. One example is an online database of information to assure that brokers have ready access to information necessary to give mutual fund investors the proper fee discounts—called breakpoints—when they buy large amounts of Class A mutual fund shares.

We have managed our operations efficiently, allowing us to provide firms with regulatory fee rebates of more than \$150 million since 2000. Our strong balance sheet, bolstered by the proceeds of selling our NASDAQ ownership, produces sufficient income to offset about \$75 million a year of our operating expenses. Absent this income, NASD would have to charge the firms we regulate that much more in fees and assessments.

The focus of NASD's regulation has expanded beyond writing rules and enforcing compliance. We believe investors, better educated and supplied with more complete market information, can provide the front line of their own protection. Our NASD Investor Education Foundation, started three years ago, now has a commitment of \$85 million from which to make research grants. I am particularly proud of the work the Foundation undertook in 2005 to provide education for U.S. military families.

And this year saw TRACE, our corporate bond disclosure system, complete its evolution to total market coverage. Trade and price information about every corporate bond, from investment grade to the most illiquid and thinly-traded, became available in real-time on TRACE in 2005.

In summary, NASD in 2005 solidified its position as the preeminent private-sector securities regulator and now stands ready and able to take on the challenges of 2006 and beyond.

It is an organization I am proud to have led.

Awareness | Fairness

Although we're thought of by some as an industry watchdog, our role and responsibilities are much more encompassing. NASD brings needed awareness to investors about investing, and needed guidance to securities firms on complying with regulations. All of this contributes to fairer financial markets and fewer problems.

When we talk about "better information," we mean greater transparency: a clearer, deeper and more understandable view of financial investments and investing. We also mean more accessible and usable knowledge. By "better regulation" we mean more efficient and effective oversight that promotes proper industry behavior and investor confidence.

In 2005, the country's capital markets, securities firms and investors at every level benefited from NASD-initiated improvements in information and regulation.

Given the increasing size and complexity of the financial markets, our mission has evolved by necessity beyond pure industry oversight—although this remains our first priority. For investors and the industry, NASD is not only an independent regulator and active enforcer, but also a leading educator, information and infrastructure provider, innovator and industry problem solver.

Everything that affects the fairness of the financial markets matters to us, which is why our activities are so extensive—and proactive. Our role and responsibilities reach beyond writing rules and enforcing regulations; to anticipating, preventing and preempting problems from happening or becoming crises. Central to success in this is giving investors the knowledge they need to invest more wisely, and giving securities firms the tools they need to comply more easily. In our experience, properly informed and educated investors are the best first line of defense in deterring investment fraud and abusive sales practices. Backed up at all times, of course, by NASD.

Carrying out our job requires balance and sensitivity: protecting investors' interests and maintaining a level playing field for all market participants, yet doing this efficiently, with the least intrusiveness on the day-to-day business of the country's securities firms.

Having a financially strong and stable business operation is key to doing our job well—from fielding highly trained examiners and advancing our technology, to hiring and retaining the best industry talent. It also allows us to minimize the economic demands we make on the industry. To these ends, we bolstered our balance sheet in 2005.

This year's review lays out each dimension of our activities: what we're focused on, what we accomplished in 2005 to date, and why it matters to firms and investors.



Investor protection. Market integrity.

91 million individuals, comprising 54 million U.S. households, owned mutual funds in 2005.

Source: Investment Company Institute

NASD is now singularly focused. With NASDAQ gaining exchange registration, our separation from that market will be completed this year, following our full separation from the American Stock Exchange in 2004. Why is this important? Because it frees us from the conflicts and politics that arise from both owning and regulating for-profit exchanges.

Action | Interaction

NASD takes vigorous action whenever necessary, responding forcefully but always fairly to address misconduct and protect investors. We also require that broker-dealer firms meet certain ethical standards—in addition to complying with NASD legal rules and regulations. These efforts continued in 2005, as did our interaction with securities firms to explore the impact of regulation, address urgent investor issues and find the most constructive solutions.

Our regulatory focus on variable annuities, 529 college savings plans and mutual funds intensified in 2005, especially taking rule-breakers and wrongdoers to task and holding them accountable in the sales of these products. Working with other regulators, we are now looking to close the regulatory gap in sales practices among different annuity products, and between mutual funds and college savings plans. Our goal is for investors to have an even regulatory playing field for these products.

NASD's examination and enforcement during the past year, in all the areas we oversee, was robust and wide-ranging: from taking action regarding abusive mutual fund sales practices to rooting out boiler-room fraud. On the heels of our efforts to protect military investors, we followed through in 2005 with enforcement actions to protect senior investors. Looking forward, we'll be focused on:

Curbing sales practice abuses in the distribution of annuities. Together with the Securities and Exchange Commission (SEC) and state regulators, we're working with industry representatives and consumer advocates to see whether more can be done to better protect investors in these products in terms of more effective supervision and compliance.

Vetting financial and investment seminars, especially those targeting retirees and the elderly, because they can involve high-pressure sales tactics through the lure of a free meal. These sales events are often run by broker-dealers we regulate, and other groups outside our jurisdiction, such as investment advisers. NASD has joined with the SEC and Florida securities regulators to make sure they're being run properly.

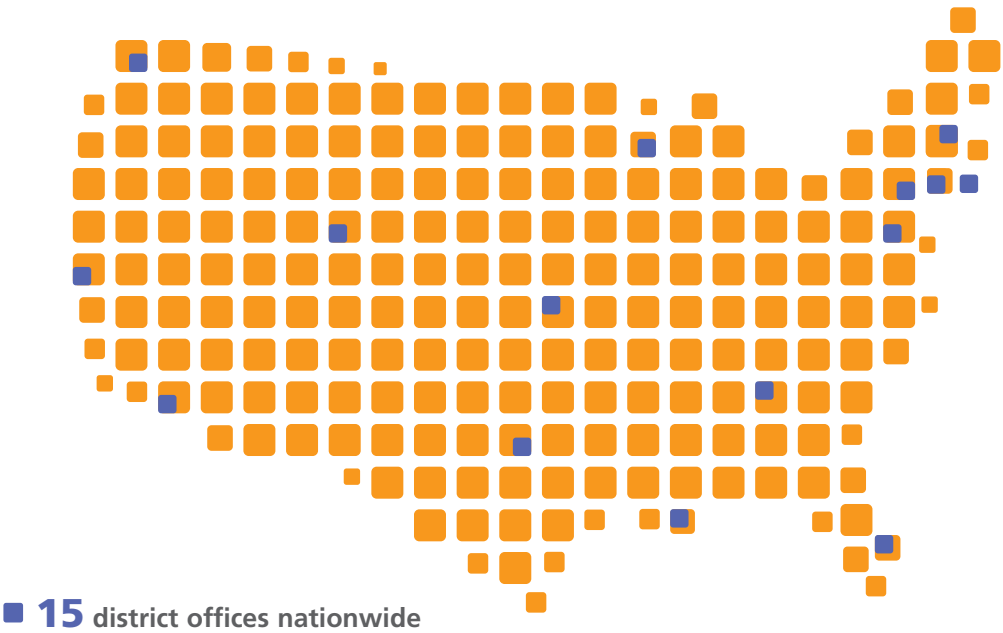
Key to staying vigilant and on top of these kinds of emerging issues is our day-to-day work in the field examining securities firms for compliance with our rules and federal securities laws. Here, we arrived at ways to work smarter:

NASD's Examiner University saw its first full year of operation. It's a one-year "graduate school" that trains all incoming NASD examiners in a uniform way, coast-to-coast, with an approach that makes them more knowledgeable and efficient, thus more productive and able to lessen the time they spend on-site examining firms for compliance.

NASD's Next Generation Examination Program advanced in 2005. When it's implemented, we'll be able to monitor firms remotely, in real-time, which will enable us to better focus exams by risk and tailor them to each firm.

NASD jurisdiction
in 2005:

Regulation by NASD is required by law for all securities firms selling financial products to the U.S. public. And, while securities firms don't control our process, they do have a meaningful and welcome voice in it.



655,832 Registered Representatives

5,111 Member Firms

Regulatory actions in 2005:

383 individuals barred

15 firms expelled

1,399 new disciplinary actions filed

357 individuals suspended

3 firms suspended

1,344 formal actions resolved

We also began requiring CEOs to regularly consult with their chief compliance officers (CCOs), and to certify that their firm has written processes in place to establish and maintain supervisory procedures.

While dealing with day-to-day demands, NASD is actively thinking about the next generation of regulation, and where it needs to go, since the traditional approach will no longer be enough. Clearly, regulation needs to become more fluid and innovative, especially in light of broker-dealers adopting new business models, and stock exchanges like the NYSE and NASDAQ consolidating or changing their structures.

NASD has more than fifty national and district committees, with representatives from the securities industry who provide important, informed input and insight. We also have a small firm advisory board; a network of district offices around the country that places us close to member firms; and a protocol to send rule proposals out for comment before submission to the SEC.

Information | Illumination

NASD is a primary and trustworthy source of information: a looking glass for investors to see more clearly and revealingly into the markets. We provide useful information and data about what they're buying, and enable them to think and act in a more enlightened way. For securities firms, the data we supply helps them explain and disclose in proper detail what they're selling, and stay in compliance with our rules. Two areas where we achieved great headway in 2005 were:

The Bond Market. TRACE, our Trade Reporting and Compliance Engine, now captures and disseminates in real-time all corporate bond information (www.bondinfo.com) in a ticker-like fashion—and offers an outstanding tutorial on bond investing. This data is available free to retail investors through virtually every major market data service and an increasing number of public Web sites. By helping investors make better-informed decisions about buying and selling bonds, TRACE makes the market more efficient—so investors can get a fair execution and a fair price.

Mutual Funds. More than 54 million households now own mutual funds. In 2005, we rolled out an enhanced data-fed version of our **Mutual Fund Expense Analyzer**. It's a free online tool investors can use to do instant side-by-side comparisons of the fees and expenses charged by different mutual funds and exchange traded funds, and to evaluate the impact on returns over time. This year, we also introduced the first **Mutual Fund Breakpoint Search Tool**, a free online service to help broker-dealers deliver the right sales charge discounts on load funds, and enable investors to research what discounts they're entitled to.

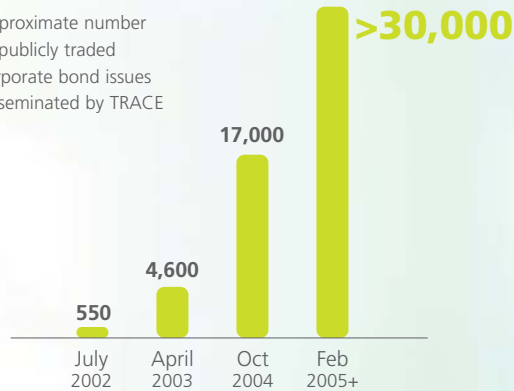
However, transparency goes further: it's also giving investors access to background data on brokers and investment firms:

NASD BrokerCheck. Our free, online system (available at www.nasdbrokercheck.com and by phone at 800.289.9999), gives investors an open book on investment professionals and their firms—from credentials and conduct to disciplinary history—to help them choose or keep tabs on those they invest with. It's the only tool of its kind available to investors.

TRACE

(Trade Reporting and Compliance Engine)

Approximate number
of publicly traded
corporate bond issues
disseminated by TRACE



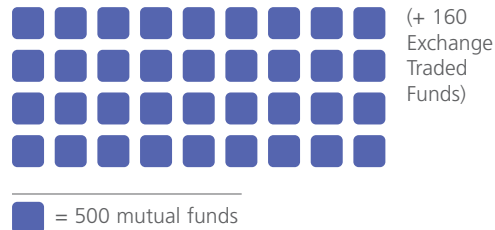
22,000
Average daily
transactions

Today, through **TRACE**, corporate bond trades are reported centrally to NASD and individual transaction pricing is made available immediately, in real-time—bringing valuable market information and transparency to investors. In 2005, NASD and Bloomberg jointly introduced new retail-oriented corporate bond indices to help investors gauge market direction and to provide performance benchmarks for individual bond holdings. This fulfills one of NASD's major goals: to get useful and reliable information to retail investors.

representing
\$18 billion
in volume

Mutual Fund Expense Analyzer

18,000 Mutual funds



NASD BrokerCheck: 2005

Information on over **655,000** current
registered individuals

194,190 reports generated

>4.2 million successful searches
for an individual or firm

Transparency is only good for investors and the marketplace if it's effective—when information is relevant, readily accessible and easy to digest. When it is, investors can invest more confidently and prudently, and brokers can work more productively with their clients.

Education | Application

Education is absolutely central to investor protection and market integrity. NASD serves a unique role among SROs (self-regulatory organizations) as an unbiased and centralized source of knowledge and education. Investors can apply our wide range of educational resources directly to investing, and firms can use them to comply with regulations and to conduct business properly with the public. Our extensive tools range from an online resources guide for firms to material on college savings plans to compliance webcasts.

The comprehensive learning available through NASD, especially online at *www.nasd.com*, takes the mystery and confusion out of most investing for individuals; from young professionals with 401(k)s but little or no investing experience, to senior citizens exploring bonds and annuities. We've drawn on our deep experience in the financial markets to enlighten investors on the many savings and investing options they have, and to lay out the risks and rewards of numerous investment products and the issues to consider around each one.

NASD's Investor Education Foundation is devoted exclusively to educating the American investing public through grant making and targeted research projects. It is funded by fines we collect, and gives us an added way to research and address truly important investor issues. We have contributed nearly \$32 million to the Foundation to date—\$15 million in 2005.

Earlier this year, the Foundation launched *SaveAndInvest.org* as part of a comprehensive campaign to deliver financial education, tools and training to members of the U.S. military and their spouses. The goal is straightforward: to help servicemembers and their families manage their money more confidently. Another priority is to better prepare older Americans to handle their finances in retirement. Established just three years ago, the Foundation is now the industry's leading educational resource—actively shaping and supporting innovative research and public service projects like these.

At the 5,100-plus firms that NASD regulates, more CEOs than ever worry about the pressures of meeting their regulatory obligations. The welcome news is that in 2005 we gave them new and better ways to manage their burden: namely, more—and more useful—information, education, training and technology. We also spent a good deal of time on the road talking with firms, listening and responding to their business concerns, and proving to be an extremely accessible regulator.

In 2005, NASD's *Investor Alert* series—a widely praised program started in 2001—helped to clue investors in to problem products and practices and other timely need-to-know topics, from stock scams to online identity theft.

>\$3.4 million was awarded by the NASD Investor Education Foundation in 2005 for programs and research targeting underserved segments of the investing population.

To date, the Foundation has granted more than \$4.5 million to non-profit organizations, colleges and universities to further the reach of investor education programs and research.



NASD's Liaison Program—announced in 2005—began its pilot phase in early 2006 in selected NASD District Offices. It's designed to help firms comply by giving them faster answers to NASD-related questions, and designating a specific point-of-contact to handle their queries. A full roll-out of the program will begin in June 2006 in three phases.

100,000
e-learning course
users at securities firms
in 2005

In 2005, with significant input from the industry, we introduced the Web-based E-Learning Exchange. It features a growing body of core compliance courses, including decision-based scenarios and mastery tests, so firms no longer need to create this training themselves. More than 100,000 users accessed our affordable online courses last year. We also introduced a series of no-cost, compliance-oriented webcasts—short, streaming videos outlining important points on hot-button topics from money laundering to ethical behavior. NASD also administers a continuing education program, and hosts regular conferences throughout the year on relevant regulatory developments.

When investors and brokerage firms are educated, everyone is inclined to do things right the first time, and this kind of preventive care is a major emphasis of our educational efforts and tools.

Extensive | Intensive

NASD's regulatory scope is far-reaching. We touch virtually every aspect of investing. From working to ensure that firms put the interests of investors first when creating and introducing new investment products; to registering, licensing and training their brokers; to running key business operations that help make the markets more transparent.

Our activities are not only extensive, they're intensive. In 2005, we actively oversaw more than 655,000 individual brokers and 5,100-plus brokerage firms across the United States. This demands tremendous capacity and specialized capabilities that other regulators simply don't have. Last year, our nationwide staff of 536 examiners completed more than 7,000 examinations. We also conducted over 6,200 reviews based on our automated surveillance of market activity covering more than 3,300 issues listed on NASDAQ, 8,200 OTC securities and all corporate and municipal bond transactions required to be reported. All of this resulted in nearly 1,400 enforcement actions filed by our team of 115 enforcement attorneys. In addition, we analyzed nearly 200 million pieces of order, quote and trade reporting information daily and provided regulatory services to two major options markets.

Our dispute resolution forum, now available in every U.S. state; San Juan, Puerto Rico; and London, England, is an invaluable resource for investors and the industry. Why? If investors aren't confident they can bring a claim to an unbiased forum and get a fair hearing, they'll be less confident about investing. We actively recruit and train quality arbitrators and mediators from diverse backgrounds. We're currently working to make our resolution processes even easier to understand and more efficient and transparent for everyone who uses them.

NASD is not only a standard bearer in the United States, but also a leading resource and role model for securities markets in other countries. In 2005, we expanded our international outreach, consulting with regulators and markets in Europe, Asia, Latin America and the Middle

6,074 New
arbitration
claims filed



9,043
Arbitration
cases closed



1,253 New
mediation
claims filed



1,675
Mediation
cases closed



Dispute Resolution: 2005

Arbitrations and mediations enable most investors to get compensated for wrongdoing by brokers in a faster, cheaper and more efficient way than going to court. In 2005, NASD Dispute Resolution saw 6,074 new arbitration claims and parties agreed to mediate 1,253 claims. During the year, we closed 9,043 arbitration cases and 1,675 mediation cases.

East. We also launched with Complanet a database listing regulated financial companies worldwide. And, together with the University of Reading in England, formed a European center for global capital market educational programs that revolve around regulation and compliance.

Stability | Capability

We ended the year on a sound note financially, giving us the strength and stability to regulate effectively, and to continue providing and expanding resources that investors and the industry rely on. Our financial health also means that NASD-regulated firms do not have to spend as much to support our operations.

By running NASD more effectively and efficiently, we kept costs down in 2005 and rebated \$50 million to the firms we regulate. Since 2000, we have been able to provide firms with total rebates in excess of \$150 million.

We also contributed \$15 million to our Investor Education Foundation to support new and needed public outreach programs. Like for-profit firms, we have to contend with expenses rising faster than revenues. To that end, we are aggressively pursuing ways to control our costs in 2006 and beyond. Succeeding at this will require, in part, a smarter approach to technology—a step we're taking in 2006 to maintain NASD's position as the most technologically advanced regulator.

As our obligations expand due to fresh government demands and new and more complex financial products, our need for an outstanding workforce is increasing. By being competitive and creating an exceptional working environment, we've been able to hire, keep and inspire the best possible talent to do everything we need to do.

We've also improved our reporting and adopted sophisticated metrics to better manage our business overall, including a Balanced Scorecard that helps us see and stay on top of strategic priorities. We have even implemented Sarbanes-Oxley Section 404, one of the first U.S. not-for-profit organizations to do so.

And, as discussed at the outset of this year's review, to meet our goal to become a completely independent private-sector regulator of markets, uncompromised by profit motives and other conflicts, we reduced our ownership stake in NASDAQ to 18.4 percent by the end of 2005, and will divest the rest of our holdings this year. Last year, proceeds from these transactions were aggregated into NASD's investment portfolio, which generated \$75 million in returns in 2005—returns that we are using to subsidize our ongoing operations.

While we're busy regulating, enforcing, informing and educating effectively outside, we're taking care to manage the business of NASD wisely inside.



2,432
NASD employees

Nearly **200 million** quotes,
orders and trades monitored daily
in 2005

89,653 securities-related
ads and sales communications
reviewed in 2005

NASD writes the rules that govern the industry's conduct. Examines firms for regulatory compliance and disciplines those that fail to comply. Reviews securities-related advertising and sales literature filed by firms, an average of more than 80,000 items annually. Regulates trading in equities, corporate and municipal bonds, securities futures and options. Licenses individuals and admits firms to the industry. Provides education and qualification examinations to industry professionals. Operates the largest securities dispute resolution forum in the world.

Integrity | Opportunity

The more integrity markets and the industry have—the more transparent and accessible they become—the greater the opportunity for them and for investors to prosper.

NASD exists to help ensure this integrity for investors, and part of that job requires making and enforcing rules. Without this, investors would go unprotected and lose the confidence so critical to the industry's existence.

Doing the right thing for investors is our mantra; a philosophy we live and breathe, and believe should guide all securities firms and their employees. We're able to do the right things, and to influence good behavior by firms, by focusing on the vital issues, conferring with the industry, formulating the best rules and ensuring active compliance with them.

Of course there are challenges. Among the most important:

- Investors are faced with an increasingly complex array of investment products, and with products that look the same on the surface but are subject to unequal regulation and protection;
- Different regulators have overlapping responsibilities;
- Firms' business models and stock exchange structures are changing, and capital markets are converging across the country and around the world.

All of these developments will influence the way securities firms, capital markets and investment products are regulated. All of them require serious attention.

Fortunately, NASD is on top of these issues, trends and flashpoints—and working to make sure investing remains as safe, fair and clear for investors as possible. We're adopting a necessarily bigger and broader perspective on the best and most innovative ways to regulate the evolving markets we're responsible for, and remaining a valued guide through these markets.

We're also redefining and communicating what greater value an SRO can deliver: a new and improved paradigm. In the meantime, NASD continues regulating effectively. We're making the markets more transparent, and making investors sharper so they can better protect themselves firsthand, stepping in to deal with wrongdoing whenever and wherever they need us.

Since we don't live in a perfect world, there has to be an NASD to keep the rest of the financial marketplace honest.

We consider ourselves privileged to play such an important role.



Forward thinking.

Nearly **70** years of
regulatory innovation

The focus of NASD's regulation goes beyond writing rules and enforcing compliance—to anticipating, preventing and preempting problems before they occur or become crises. Key to our success in this is developing innovative resources and information that can help investors make better financial decisions, and providing securities firms with the tools they need to comply more easily.

Vision | Leadership



ROBERT R. GLAUBER

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Joined NASD in 2000 as CEO and President; named Chairman and CEO in 2001. Member of the NASD Board of Governors since 1996. Former U.S. Treasury Under Secretary for Finance; Harvard Business School professor of finance; Harvard Kennedy School of Government lecturer; and Executive Director, President Reagan's Brady Commission on the 1987 stock market crash. Graduate of Harvard College and Harvard Business School. Member, Council on Foreign Relations.

MARY L. SCHAPIRO

VICE CHAIRMAN

PRESIDENT, REGULATORY POLICY AND OVERSIGHT

Joined NASD in 1996 as President of NASD Regulation and member of the Board of Governors; named Vice Chairman in 2002. Former Chairman of the Commodity Futures Trading Commission (CFTC), appointed by President Clinton. Appointed as a Commissioner of the SEC by President Reagan, reappointed by President Bush; named Acting Chairman by President Clinton. Graduate of Franklin & Marshall College and George Washington University Law School. Chairman of the Self-Regulation Committee of the International Organization of Securities Commissions (IOSCO).





DOUGLAS H. SHULMAN

VICE CHAIRMAN

PRESIDENT, MARKETS, SERVICES AND INFORMATION

Joined NASD in 2000; named Vice Chairman in 2006. Former co-founder and Executive Vice President of FoundryOne, Inc.; Vice President of Darby Overseas Investments, Ltd.; and Senior Policy Advisor and Chief of Staff for the National Commission on Restructuring the Internal Revenue Service (IRS). Graduate of Williams College; Harvard University's Kennedy School of Government; and Georgetown University Law Center.

MICHAEL D. JONES

SENIOR EXECUTIVE VICE PRESIDENT AND CHIEF ADMINISTRATIVE OFFICER

Joined NASD in 1996. Former Deputy Director and Counsel for the SEC's Office of Public Affairs, Policy Evaluation and Research; Communications Director and Press Secretary for Senator Bill Bradley; Public Affairs Counselor for international public relations firm Burson-Marsteller; Public Relations Director for the March of Dimes; and partner at law firm Hayes & White. Graduate of Boston College; Boston College Law School. President, Alliance for Investor Education.



TODD T. DIGANCI

EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

Joined NASD in 1995 as Controller; named Chief Financial Officer in 2000. Former Corporate Controller for the Host-Marriott operating group, overseeing 150 operations worldwide. Graduate of Drake University and Harvard University Business School's Advanced Management Program.

LINDA D. FIENBERG

PRESIDENT, DISPUTE RESOLUTION AND EXECUTIVE VICE PRESIDENT
AND CHIEF HEARING OFFICER, REGULATORY POLICY AND OVERSIGHT

Joined NASD in 1996. Former partner at law firm Covington & Burling; senior staff member at the SEC; Executive Assistant to two SEC chairmen and Associate General Counsel; member and reporter, NASD's 1996 Securities Arbitration Task Force Report. Graduate of Georgetown University Law Center; Wesleyan University; and Cornell University.



Financial Highlights

NASD's financial performance remained sound in 2005. Results exceeded expectations and were in line with those of prior years. Despite the heightened regulatory environment, NASD continued to regulate effectively while managing its rising operating expenses by utilizing net investment earnings derived from its investment portfolio. As a result, NASD achieved break-even operating cash flows, and strong net cash flows.

Based on this strong performance, NASD granted and distributed \$50 million in rebates to firms in 2005, as compared with \$30 million and \$25 million in 2004 and 2003, respectively. Since 2000, NASD has been able to provide firms with total rebates in excess of \$150 million.

In addition, NASD came closer to completing its separation from NASDAQ in 2005. Through a series of transactions, NASD reduced its ownership in NASDAQ common stock to 18.4 percent as of December 31, 2005, and to 9.4 percent as of May 3, 2006.

The financial information provided herein represents the results of operations of the NASD business segment excluding the operations of The Nasdaq Stock Market, Inc. (NASDAQ) for the years ended December 31, 2005 and 2004, and the loss on disposal of the American Stock Exchange, LLC (Amex) in 2004.

Refer to NASD's 2005 Annual Financial Report for NASD's 2005 Consolidated Financial Statements and Management Report on Financial Operations.

www.nasd.com/annual_report

FINANCIAL RESULTS

NASD's operating revenues were \$597.6 million in 2005, compared with \$602.3 in 2004, a decrease of \$4.7 million. Causing this decrease were declines in regulatory fees due to a rate reduction on the trading activity fee, and decreases in dispute resolution fees associated with lower case volumes. Expenses increased \$66.4 million to \$587.4 million in 2005, due primarily to additional headcount and benefits costs related to regulatory scope increases.

Operating cash flows, as measured by earnings before taxes, depreciation and amortization, realized gains (losses) on NASDAQ common stock and warrants, and fines, were \$10.2 million in 2005. NASD generated total proceeds of \$404.2 million on sales of NASDAQ common stock and exercises of warrants, and received \$40.0 million related to the partial redemption of NASDAQ preferred stock. As a result, net cash flows were \$454.4 million in 2005.

NASD FINANCIAL RESULTS (IN MILLIONS)

	YEARS ENDED DECEMBER 31,			
	2005		2004	
	Operating	Fines	Operating	Fines
Revenues ¹	\$ 597.6	\$ 148.5	\$ 602.3	\$ 114.4
Expenses ¹	587.4	16.1	521.0	5.7
Operating Cash Flow ²	10.2	132.4	81.3	108.7
Other Cash Flow ³	444.2	—	—	—
Net Cash Flow	\$ 454.4	\$ 132.4	\$ 81.3	\$ 108.7
Discretionary Member Rebate	\$ (25.0)	\$ —	\$ (10.0)	\$ —
Ownership of NASDAQ Common Stock, as of December 31	18.4%		54.7%	

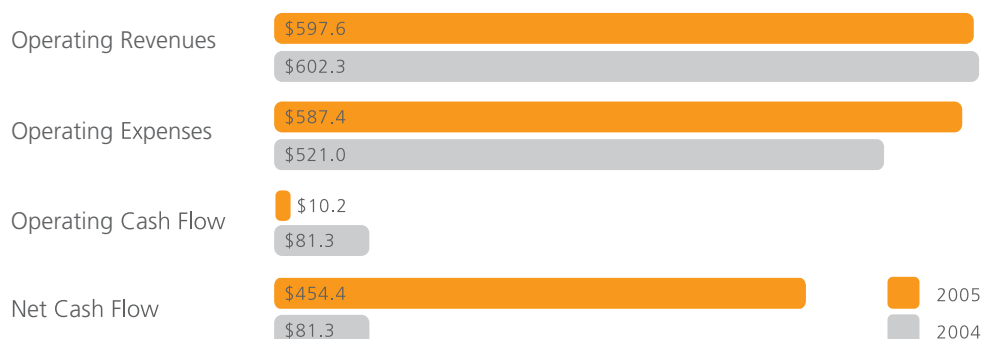
(1) Amounts are calculated on a non-GAAP basis. Refer to the operating revenues and operating expense tables for additional information.

(2) Operating cash flow is calculated on a non-GAAP basis, and represents earnings before gains on sales of NASDAQ common stock, mark-to-market adjustments on the NASDAQ warrants, and depreciation and amortization.

(3) Other cash flow includes proceeds from the sales of NASDAQ common stock, exercises of warrants, and partial paydown on the NASDAQ Preferred Stock.

FINANCIAL RESULTS (CONT.)

NASD FINANCIAL SUMMARY (IN MILLIONS)



OPERATING REVENUES

Regulatory fees were \$210.5 million in 2005, compared with \$232.8 million in 2004, a decline of \$22.3 million, due to a reduction in the rate for the trading activity fee. Regulatory fees include assessments based on the gross income and number of member-firm personnel, as well as the transactional-based trading activity fee, and exclude the discretionary member rebates. These fees are used to fund NASD's member regulatory activities, including the regulation of firms through examinations, financial monitoring, policy making, rule making and enforcement activities.

User fees increased \$8.0 million to \$145.3 million in 2005 from \$137.3 million in 2004, and include fees charged for initial and annual registrations, qualification exams, fees associated with NASD-sponsored meetings and conferences, processing of membership applications, and charges related to the review of advertisements and corporate filings.

Dispute resolution fees, which consist of fees earned during the arbitration and mediation processes, decreased \$7.3 million due to lower case volumes during the year.

Contract services represent amounts charged for regulatory services, including surveillance, monitoring, legal and enforcement activities primarily to NASDAQ and Amex, as well as other exchanges such as the International Stock Exchange and the Chicago Climate Exchange. Contract services were \$63.4 million in 2005, compared with \$58.1 million in 2004, an increase of \$5.3 million. This increase was due to a full year of regulatory services provided to Amex in 2005, as the Amex regulatory service agreement was signed in June 2004.

Investment earnings (net) represent interest, dividends, and realized gains and losses net of investment manager expenses on NASD's cash and investment portfolio. Investment earnings (net) increased \$10.7 million from the prior year due to increases in NASD's investment portfolio from the proceeds generated from the sales of NASDAQ common stock and exercises of warrants.

Transparency and other fees represent amounts charged for services offered through NASD's Trade Reporting and Compliance Engine (TRACE), Over-the-Counter (OTC) bulletin board and OTC equities, and the Alternative Display Facility (ADF). In October 2005, NASD completed the transfer of the OTC Equities market from NASDAQ, which was one of the conditions of NASDAQ's Exchange Registration.

NASD TOTAL OPERATING REVENUES BY YEAR (IN MILLIONS)

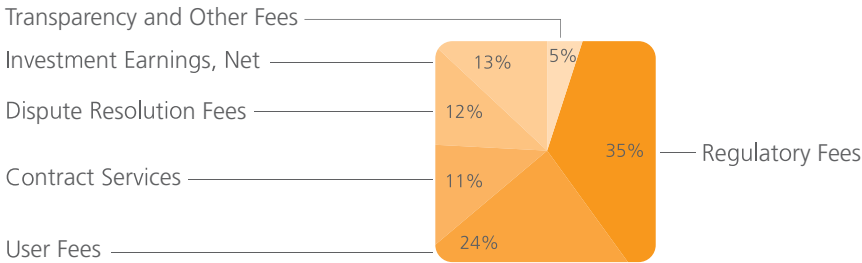
	YEARS ENDED DECEMBER 31,	
	2005	2004
Regulatory Fees ¹	\$ 210.5	\$ 232.8
User Fees	145.3	137.3
Dispute Resolution Fees	72.9	80.2
Contract Services	63.4	58.1
Investment Earnings, Net ²	75.6	64.9
Transparency and Other Fees	29.9	29.0
Total Operating Revenues	\$ 597.6	\$ 602.3

(1) Regulatory fees exclude discretionary rebates of \$25.0 million and \$10.0 million for the years ended December 31, 2005 and 2004, respectively.

(2) Represents interest, dividends and net realized gains less investment management fees.

OPERATING REVENUES (CONT.)

2005 NASD OPERATING REVENUES



OPERATING EXPENSES

Operating expenses increased by \$66.4 million, bringing total expenses for 2005 to \$587.4 million. This increase was primarily due to increased compensation and benefits from additional head-count, particularly in the market regulation and enforcement divisions. Contributing to this increase was a full year of compensation and benefits associated with over 100 employees that were transferred to NASD under the Amex regulatory contract.

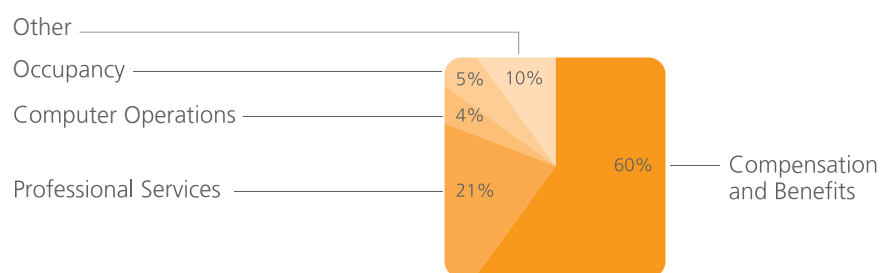
Professional services increased from the prior year due to costs associated with Sarbanes-Oxley Section 404 compliance and the Next Generation program. Other expenses increased due to a loss recognized on the Amex revolving credit facility and increased travel costs related to the NASD’s Examiner University program.

NASD OPERATING EXPENSES BY YEAR (IN MILLIONS)

	YEARS ENDED DECEMBER 31,	
	2005	2004
Compensation and Benefits	\$ 348.7	\$ 305.8
Professional Services	125.7	111.4
Computer Operations	23.8	24.5
Occupancy	28.3	30.4
Other	60.9	48.9
Operating Expenses ¹	\$ 587.4	\$ 521.0

(1) Operating expenses exclude (a) fine-related expenses from compensation and benefits, professional services, computer operations and other, (b) investment manager fees from professional services, and (c) depreciation and amortization. Other includes general and administrative expenses and intercompany expenses with NASDAQ.

2005 NASD OPERATING EXPENSES



BALANCE SHEET

NASD's total assets were \$2.4 billion as of December 31, 2005, and increased \$713.5 million from the prior year due to proceeds from sales of NASDAQ common stock, warrants, and from the partial redemption of NASDAQ preferred stock.

The goal of NASD's investment policy is to generate long-term returns to be used to support operations for the benefit of investors and members, preserve the real purchasing power of those funds and maintain financial balance sheet strength. NASD is guided by an Investment Committee comprised of industry members who have extensive background and experience in the investment community. In addition, an external investment consultant assists NASD and the Investment Committee in both policy making and performance monitoring.

Total liabilities increased \$363.2 million. During 2005, the SEC increased the Section 31 rates, which resulted in an increase in NASD's SEC payable year over year. In addition, the fair value of the outstanding NASDAQ warrants increased as the market price exceeded the exercise price. Members' equity increased \$350.3 million due to net income for the period combined with unrealized gains on investments.

NASD SUMMARY BALANCE SHEET (IN MILLIONS)

	DECEMBER 31,	
	2005	2004
Current Assets	\$ 2,084.0	\$ 1,366.6
Other Assets	334.2	338.1
Total Assets	2,418.2	1,704.7
Current Liabilities	667.9	356.8
Other Liabilities	139.0	86.9
Total Liabilities	806.9	443.7
Members' Equity	1,611.3	1,261.0
Total Liabilities and Members' Equity	\$ 2,418.2	\$ 1,704.7

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as of May 2, 2006

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