NASD

CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2004

Balance Sheet:	NASD
Assets	
Cash and cash equivalents	42,702
Investments, available-for-sale	1,001,113
Investments, held-to-maturity	-
Receivables, net	24,076
Receivable from related parties	9,085
Deferred tax assets	-
Other current assets	7,471
Total current assets	1,084,447
Investment in Subsidiaries	842,345
Held-to-maturity investments	-
Total property and equipment, net	92,060
Noncurrent deferred tax assets	-
Line of credit receivable from related party	25,000
Goodwill	-
Intangible assets, net	2,345
Other assets	7,978
Total assets	2,054,175
Liabilities and members' equity	
Accounts payable and accrued Expenses	14,521
SEC fee payable	67,946
Accrued personnel costs	35,843
Deferred revenue	-
Deposits and renewals	-
Capital lease obligation	737
Due to custodial agent	17,696
Payable to related party	618,770
Other current liabilities	8,914
Total current liabilities	764,427
Accrued pension and other postretirement benefit costs	11,565
Long-term debt	-
Non-current deferred tax liabilities	-
Non-current capital lease obligation	868
Deferred revenue	-
Warrants to purchase Nasdaq stock from NASD	3,836
Other liabilities	12,451
Total liabilities	793,147
Minority interest	-
Members' equity	1,261,028
Total liabilities and members' equity	2,054,175

NASD

CONSOLIDATING INCOME STATEMENT
YEAR ENDED DECEMBER 31, 2004

Revenues:	**NASD**
Market services	-
Issuer services	-
Regulatory Fees	-
User Fees	2,792
Transparency services	14,736
Contract Service Fees	2,562
Dispute Resolution Fees	-
Other Fees	7,441
Total Operating Revenues	27,531
Activity Assessment	-
Fines	-
Total Revenues	27,531
Cost of Revenues	-
Net Revenue	**27,531**
Expenses:	
Compensation and benefits	88,202
Professional and contract services	41,801
Computer operations and data Communications	13,081
Depreciation and amortization	11,971
Occupancy	277
General and administrative	12,452
Total expenses	**167,784**
Net operating income	**(140,253)**
Other income (expense)	
Interest and dividend income	33,352
Interest expense	(87)
Net realized investment gains	22,872
Gain on Nasdaq warrants	3,909
Minority interest benefit	-
Income before income taxes, cumulative effect, and discontinued operations	**(80,207)**
Provision for income taxes	-
Income from continuing operations	**(80,207)**
Income from discontinued operations (net of tax expense of $5,596)	-
Cumulative effect of a change in accounting principle, net of tax	-
Net (loss) income	**(80,207)**

NASD

CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2004

Balance Sheet:	NASD	NIEF	SDIC	SDRP	ODR	NADR	Parent Eliminations	Total NASD Parent	Nasdaq	NAHO	Elims	Consolidated
Assets												
Cash and cash equivalents	42,702	-	435	131	2,230	20,150	-	65,648	58,186	-	-	123,834
Investments, available-for-sale	1,001,113	10,177	4,728	-	68,475	132,453	-	1,216,946	174,913	-	-	1,391,859
Investments, held-to-maturity	-	-	-	-	-	-	-	-	28,600	-	-	28,600
Receivables, net	24,076	6,022	306	-	4,429	12,753	-	47,586	104,258	-	(14)	151,830
Receivable from related parties	9,085	-	-	1	24,995	617,365	(623,263)	28,183	3,165	23	(26,425)	4,946
Deferred tax assets	-	-	-	-	-	-	-	-	24,209	-	-	24,209
Other current assets	7,471	-	49	-	203	467	-	8,190	12,866	-	-	21,056
Total current assets	1,084,447	16,199	5,518	132	100,332	783,188	(623,263)	1,366,553	406,197	23	(26,439)	1,746,334
Investment in Subsidiaries	842,345	-	-	-	-	-	(703,980)	138,365	-	-	(138,365)	-
Held-to-maturity investments	-	-	-	-	-	-	-	-	2,008	-	-	2,008
Total property and equipment, net	92,060	-	-	-	1,490	46,455	-	140,005	173,840	2	1	313,845
Noncurrent deferred tax assets	-	-	-	-	-	-	-	-	48,765	-	-	48,765
Line of credit receivable from related party	25,000	-	-	-	-	-	-	25,000	-	-	-	25,000
Goodwill	-	-	-	-	-	-	-	-	141,381	-	-	141,381
Intangible assets, net	2,345	-	-	-	62	1,062	-	3,469	40,791	-	-	44,260
Other assets	7,978	-	-	-	-	23,309	-	31,287	1,838	-	-	33,125
Total assets	2,054,175	16,199	5,518	132	101,884	854,014	(1,327,243)	1,704,679	814,820	25	(164,803)	2,354,718
Liabilities and members' equity												
Accounts payable and accrued												
Expenses	14,521	-	27	-	1,651	12,518	(7)	28,710	40,180	-	(3,864)	65,026
SEC fee payable	67,946	-	-	-	-	329	-	68,275	-	2	1	68,275
Accrued personnel costs	35,843	-	-	-	4,717	46,108	-	86,668	49,383	-	9,507	145,557
Deferred revenue	-	-	-	-	29,285	48,701	-	77,986	59,537	-	-	137,523
Deposits and renewals	-	-	-	-	-	60,602	-	60,602	2,430	-	-	63,032
Capital lease obligation	737	-	-	-	-	-	-	737	-	-	-	737
Due to custodial agent	17,696	-	-	-	-	-	-	17,696	-	-	-	17,696
Payable to related party	618,770	285	-	5	12,274	-	(631,335)	(1)	16,705	46	(16,300)	450
Other current liabilities	8,914	-	224	-	502	20,561	-	30,201	40,081	(39)	(201)	70,043
Total current liabilities	764,427	285	251	5	48,429	188,819	(631,342)	370,874	208,316	9	(10,857)	568,339
Accrued pension and other												
postretirement benefit costs	11,565	-	-	-	3,326	21,942	-	36,833	25,671	-	(4,710)	57,794
Long-term debt	-	-	-	-	-	-	-	-	265,000	-	-	265,000
Non-current deferred tax liabilities	-	-	-	-	-	-	-	-	29,514	-	-	29,514
Non-current capital lease obligation	868	-	-	-	-	-	-	868	-	-	-	868
Deferred revenue	-	-	-	-	855	16,385	-	17,240	89,821	(2)	2	107,061
Warrants to purchase Nasdaq stock from NASD	3,836	-	-	-	-	-	-	3,836	-	-	-	3,836
Other liabilities	12,451	-	-	-	68	1,484	-	14,003	39,935	-	(4,595)	49,343
Total liabilities	793,147	285	251	5	52,678	228,630	(631,342)	443,654	658,257	7	(20,160)	1,081,755
Minority interest	-	-	-	-	-	-	-	-	11,938	-	-	11,938
Members' equity	1,261,028	15,914	5,267	127	49,206	625,384	(695,901)	1,261,025	144,625	18	(144,643)	1,261,025
Total liabilities and members' equity	2,054,175	16,199	5,518	132	101,884	854,014	(1,327,243)	1,704,679	814,820	25	(164,803)	2,354,718
	-	-	-	-	-	-	-	-	-	-	-	-

NASD	National Association of Securities Dealers, Inc.
NIEF	NASD Investor Education Foundation
SDIC	Securities Dealers Insurance Company, Ltd.
SDRP	Securities Dealers Risk Purchasing Group, Inc.
ODR	NASD Dispute Resolution, Inc.
NADR	NASD Regulation, inc.
NAHO	NASD Holding, Inc.

NASD

CONSOLIDATING INCOME STATEMENT
YEAR ENDED DECEMBER 31, 2004

Revenues:	NASD	NIEF	SDIC	SDRP	ODR	NADR	Parent Eliminations	Total NASD Parent	Nasdaq	NAHO	Eliminations	Consolidated
Market services	-	-	-	-	-	-	-	-	334,517	-	(1,977)	332,540
Issuer services	-	-	-	-	-	-	-	-	205,821	-	(4,362)	201,458
Regulatory Fees	-	-	-	-	-	222,844	-	222,844	-	-	-	222,844
User Fees	2,792	-	-	-	-	134,485	-	137,277	-	-	-	137,277
Transparency services	14,736	-	-	-	-	-		14,736	-			14,736
Contract Service Fees	2,562	-	-	-	-	55,515	-	58,077	-	-	(53,384)	4,693
Dispute Resolution Fees	-	-	-	-	80,181	-	-	80,181	-	-	-	80,181
Other Fees	7,441	-	35	-	1,045	390	-	8,911	103	-	(6,692)	2,321
Total Operating Revenues	27,531	-	35	-	81,226	413,234	-	522,026	540,441	-	(66,415)	996,050
Activity Assessment	-	-	-	-	-	230,853	-	230,853	-	-	-	230,853
Fines	-	6,000	-	-	-	108,414	-	114,414	-	-	-	114,414
Total Revenues	27,531	6,000	35	-	81,226	752,501	-	867,293	540,441	-	(66,415)	1,341,317
Cost of Revenues	-	-	-	-	-	(230,853)	-	(230,853)	(55,845)	-	-	(286,698)
Net Revenue	**27,531**	**6,000**	**35**	**-**	**81,226**	**521,648**	**-**	**636,440**	**484,596**	**-**	**(66,415)**	**1,054,619**
Expenses:												
Compensation and benefits	88,202	-	-	-	22,376	196,252	-	306,830	148,155	-	842	455,827
Professional and contract services	41,801	146	72	-	18,337	58,102	-	118,458	23,709	-	(3,984)	138,182
Computer operations and data Communications	13,081	-	-	-	450	11,258	-	24,789	98,903	-	(249)	123,443
Depreciation and amortization	11,971	-	-	-	432	27,128	-	39,531	76,336	-	-	115,867
Occupancy	277	-	-	-	6,133	23,941	-	30,351	28,730	-	-	59,081
General and administrative	12,452	117	71	-	8,572	22,811	-	44,023	100,580	-	(40,250)	104,354
Total expenses	**167,784**	**263**	**143**	**-**	**56,300**	**339,492**	**-**	**563,982**	**476,413**	**-**	**(43,641)**	**996,754**
Net operating income	**(140,253)**	**5,737**	**(108)**	**-**	**24,926**	**182,156**	**-**	**72,458**	**8,183**	**-**	**(22,774)**	**57,865**
Other income (expense)												
Interest and dividend income	33,352	143	-	1	1,093	8,094	-	42,683	5,854	-	(13,188)	35,348
Interest expense	(87)	-	-	-	(173)	(29)	-	(289)	(11,484)	-	-	(11,773)
Net realized investment gains	22,872	37	-	-	-	2,775	-	25,684	-	-	-	25,684
Gain on Nasdaq warrants	3,909	-	-	-	-	-	-	3,909	-	-	-	3,909
Minority interest benefit	-	-	-	-	-	-	-	-	-	-	(5,149)	(5,149)
Income before income taxes, cumulative effect, and discontinued operations	**(80,207)**	**5,917**	**(108)**	**1**	**25,846**	**192,996**	**-**	**144,445**	**2,553**	**-**	**(41,111)**	**105,884**
Provision for income taxes	-	-	-	-	-	-	-	-	(749)	-	-	(749)
Income from continuing operations	**(80,207)**	**5,917**	**(108)**	**1**	**25,846**	**192,996**	**-**	**144,445**	**1,804**	**-**	**(41,111)**	**105,135**
Income from discontinued operations (net of tax expense of $5,596)	-	-	-	-	-	-	-	-	9,558	10,140	-	19,699
Cumulative effect of a change in accounting principle, net of tax	-	-	-	-	(29,809)	(28,533)	-	(58,342)	-	-	-	(58,342)
Net (loss) income	**(80,207)**	**5,917**	**(108)**	**1**	**(3,963)**	**164,463**	**-**	**86,103**	**11,362**	**10,140**	**(41,111)**	**66,492**

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NASD™

2004 ANNUAL FINANCIAL REPORT

CONTENTS

NASD
MANAGEMENT REPORT ON FINANCIAL OPERATIONS

OVERVIEW

NASD is the leading private-sector provider of financial regulatory services, dedicated to investor protection and market integrity through effective and efficient regulation. NASD touches virtually every aspect of the securities business—from registering all industry participants, to examining securities firms, enforcing both NASD rules and the federal securities laws, and administering the largest dispute resolution forum for investors and firms.

The following discussion and analysis of financial condition and results of operations should be read in connection with the consolidated financial statements and notes thereto included elsewhere in this Annual Financial Report. The 2004 consolidated financial statements reflect the combined activity of NASD and its consolidated subsidiaries, The Nasdaq Stock Market, Inc. (NASDAQ); NASD Regulation, Inc. (NASDR); NASD Dispute Resolution, Inc. (NASD DR); NASD Investor Education Foundation (NIEF); and New NASD Holding, Inc. (NASD Holding), which held NASD's Class B interest in The American Stock Exchange LLC (Amex). On December 31, 2004, NASD completed the sale of its Class B ownership interest in Amex to the Amex Membership Corporation. Amex results have been reported as a discontinued operation in the consolidated financial statements. (References to NASD and its consolidated subsidiaries throughout are collectively referred to as "the Company.")

The Company views its business as consisting of two segments as defined by Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures About Segments of an Enterprise and Related Information." These segments, NASD and NASDAQ, are managed and operated as separate, stand-alone companies, each with its own corporate governance. NASD consists of regulatory operations, and is a self-regulatory organization (SRO). NASDAQ consists of the operations of The NASDAQ Stock Market.

While this report reflects the consolidated operations of the Company, the primary focus is on the NASD segment, including NASDR and NASD DR. This focus is consistent with the steps the Company has taken to divest itself of ownership and operation of securities markets and is intended to highlight discussion of areas that will remain with NASD upon completion of the NASDAQ separation.

For the year ended December 31, 2004, the Company's consolidated net income was $66.5 million compared with a net loss of $57.7 million in 2003. Included in the 2004 results is a cumulative effect of a change in accounting principle of $58.3 million and income from discontinued operations of $19.7 million. Income from continuing operations was $105.1 million in 2004 compared with $50.0 million in 2003.

2004 YEAR-IN-REVIEW

2004 marked another successful year for NASD in its goal to solidify its leadership position as the preeminent U.S. private sector regulator in the financial services industry. NASD completed the sale of Amex to the Amex Membership Corporation, further separating itself from ownership and operation of stock exchanges. NASD and NASDAQ made significant strides toward further reducing NASD's ownership of NASDAQ common stock and worked closely on other steps to better position both organizations for operation once the Securities and Exchange Commission (SEC) approves NASDAQ's Exchange Registration. In February 2005, NASDAQ completed an underwritten secondary offering including 16.6 million shares of common stock previously owned by NASD. As a result of this transaction, NASD's economic ownership interest in NASDAQ has been reduced to 33.7 percent.

2004 highlights for NASD in fulfilling its mission of investor protection and market integrity:

- Filed 1,396 enforcement actions, barring or suspending 833 individuals, and levying and collecting more than $103.9 million in disciplinary fines.
- Dramatically increased transparency in the corporate debt market through the dissemination of transaction information on corporate bonds reported through NASD's Trade Reporting and Compliance Engine (TRACE) to 22,000 bonds, or more than 98 percent of the investment grade market. NASD brought full transparency to the corporate bond market in February of 2005.
- Dispute Resolution closed the year with 8,201 claims filed in arbitration and 1,217 mediation cases in agreement. The forum also closed 9,209 cases, an all-time record. NASD opened seven new hearing locations across the United States. By March 2005, Dispute Resolution had established at least one hearing location in each of the 50 states.
- Funded the newly created NIEF with an initial endowment of $10.0 million in March of 2004. NIEF will provide grants for educational programs and materials for the investing public.
- NASD, together with the SEC, settled a major mutual fund sales practice case against First Command Financial Planning, Inc. (First Command), a Texas-based firm that specialized in selling expensive systematic investment plans to military personnel. First Command paid a $12.0 million fine, and NASD directed its portion of the fine to be paid directly to the NIEF to support educational programs, materials, and research to help equip members of the military community with the knowledge and skills necessary to make informed investment decisions.
- In the area of rule writing, NASD moved forward with a number of important investor-focused proposals that touched on nearly every aspect of the securities industry, including variable annuity suitability and other recommendation requirements; requirements for securities firms to establish emergency preparedness plans; and new rules to ensure that firms effectively monitor the activities of their employees, especially those who manage office locations and also conduct their own securities business. NASD also put in place a required annual certification by chief executive officers of securities firms that the firm has processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures.

RESULTS OF OPERATIONS

REVENUES

The following table sets forth consolidated revenues by segment and revenue category:

NASD CONSOLIDATED NET REVENUES BY SEGMENT

	YEARS ENDED DECEMBER 31,							
	2004				2003			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in millions)							
Market services	$ –	$ 334.5	$ (2.0)	$ 332.5	$ –	$ 383.7	$ (0.1)	$ 383.6
Issuer services	–	205.8	(4.3)	201.5	–	204.2	–	204.2
Regulatory fees	222.8	–	–	222.8	174.2	–	–	174.2
User fees	137.3	–	–	137.3	128.4	–	–	128.4
Transparency services	14.7	–	–	14.7	21.1	–	–	21.1
Contract service fees	58.1	–	(53.4)	4.7	63.1	–	(60.5)	2.6
Dispute resolution fees	80.2	–	–	80.2	75.5	–	–	75.5
Other fees	8.9	0.1	(6.7)	2.3	9.7	1.9	(7.0)	4.6
Total operating revenues	522.0	540.4	(66.4)	996.0	472.0	589.8	(67.6)	994.2
Activity assessment	230.9	–	–	230.9	365.8	–	–	365.8
Fines	114.4	–	–	114.4	33.3	–	–	33.3
Total revenues	867.3	540.4	(66.4)	1,341.3	871.1	589.8	(67.6)	1,393.3
Cost of revenues	(230.9)	(55.8)	–	(286.7)	(365.8)	–	–	(365.8)
Net revenue	$ 636.4	$ 484.6	$ (66.4)	$ 1,054.6	$ 505.3	$ 589.8	$ (67.6)	$ 1,027.5

NASD

NASD net revenues were $636.4 million in 2004 compared with $505.3 million in 2003, an increase of $131.1 million or 25.9 percent.

REGULATORY FEES include the transaction-based trading activity fee, as well as assessments based on member firm gross income and number of personnel. Regulatory fees totaled $222.8 million in 2004 compared with $174.2 million in 2003, an increase of $48.6 million or 27.9 percent. Regulatory fees are used to fund NASD's member regulatory activities, including the regulation of members through examinations, processing of membership applications, financial monitoring, policymaking, rulemaking, and enforcement activities. To ensure adequate funding levels for member regulatory programs, the rates charged for trading activity fee services were increased in September of 2003. Based on the increased rate structure and higher trading volumes in 2004, trading activity fees totaled $110.0 million in 2004 as compared with $70.9 million in 2003. Further contributing to the increase in regulatory fees were personnel assessments, which totaled $33.3 million in 2004 as compared with $20.5 million in 2003. The increase in personnel assessments between years was driven by a planned three-year phase-in approved by the SEC in 2002. In November 2004, the trading activity fee rates were also reduced as part of this three-year phase in of regulatory fee pricing changes. These revenue changes have been instituted to better align NASD's regulatory fees with its functions, efforts, and costs.

USER FEES include fees charged for initial and annual registrations, qualifications exams, fees associated with NASD sponsored meetings and conferences, and charges associated with the review of underwriting arrangements in corporate filings. User fees totaled $137.3 million in 2004 compared with $128.4 million in 2003, an increase of $8.9 million or 6.9 percent. This increase was primarily attributable to an increase in the number of corporate filings and increase in the average size of filings reviewed. As a result, corporate financing revenues increased $5.9 million or 58.1 percent over 2003 levels. Further contributing to higher user fee revenues were an increase in the number of advertising filings reviewed and an increase in the number of conferences held by NASD's education and training area. In 2004, in connection with the implementation of Emerging Issues Task Force (EITF) No. 00-21, "Revenue Arrangements with Multiple Deliverables," NASD has separated first year registration fees into their initial and annual components and has begun to defer and amortize the initial fee component over an estimated customer relationship period. See the Cumulative Effect of a Change in Accounting Principle section for further discussion.

TRANSPARENCY SERVICES represent fees charged for services offered through TRACE and NASD's Alternative Display Facility (ADF). Transparency services revenues were $14.7 million in 2004 compared with $21.1 million in 2003, a decrease of $6.4 million or 30.3 percent. This decrease was due to the loss of ADF's largest customer in February of 2004, which led to a decline in ADF market data fees from $7.8 million in 2003 to $1.7 million in 2004. TRACE, which began operation in 2002, represents fees charged on secondary market transactions in eligible fixed income securities reported to NASD, as well as TRACE system related fees, and TRACE market data fees. While TRACE average daily volumes were down slightly in 2004, the number of terminals receiving corporate debt information increased, yielding consistent revenue performance for TRACE between years.

CONTRACT SERVICES FEES represent amounts charged for regulatory services provided primarily to NASDAQ and Amex, as well as other exchanges such as the International Stock Exchange and the Chicago Climate Exchange, associated with surveillance, monitoring, legal, and enforcement activities. Contract services fees totaled $58.1 million in 2004 compared with $63.1 million in 2003, a decrease of $5.0 million or 7.9 percent. This decrease was driven by lower depreciation charges and lower spending on NASDAQ initiatives, as well as a reduction in fees charged to NASDAQ due to a shift in the allocation of regulation resources between market and member regulation. Overall NASDAQ contract service fees declined from $61.8 million in 2003 to $45.6 million in 2004. Offsetting declines in NASDAQ contract service fees were new billings under the Amex Regulatory Services (RSA) agreement, which took effect in June 2004. Amex regulatory billings totaled $6.6 million in 2004.

DISPUTE RESOLUTION FEES totaled $80.2 million in 2004 compared with $75.5 million in 2003. Dispute resolution closed 9,209 cases in 2004, an all time record, as compared with 7,278 in 2003. In 2004, in connection with the implementation of EITF No. 00-21, NASD changed its accounting for dispute resolution fees collected on open cases. See the Cumulative Effect of a Change in Accounting Principle section for further discussion. Also included within dispute resolution fees are mediation fees, SRO annual fees for forum services, neutral training fees, and other fees totaling $2.1 million and $1.7 million for the years ended December 31, 2004 and 2003, respectively. These fees are recognized either as the cash is received or when the service is provided.

OTHER FEES totaled $8.9 million in 2004 as compared with $9.7 million in 2003. This slight decline is due to a decrease in amounts received from NASDAQ related to separation of NASDAQ and Amex shared technology applications. In 2002, a Master Agreement was signed between NASD, NASDAQ, and Amex whereby NASD and NASDAQ each agreed to reimburse Amex up to $14.5 million for costs incurred in the separation of technology applications. NASDAQ paid NASD $4.6 million in 2004 and $5.9 million in 2003 under this program. NASD then contributed those amounts, along with NASD's matching portion, to Amex in the form of a capital contribution. As of December 31, 2004, this program was fully funded and no further contributions are pending from either NASD or NASDAQ. Payments from NASDAQ to NASD under this program are included in the intercompany eliminations in the consolidating adjustments column.

ACTIVITY ASSESSMENT FEE AND COST OF REVENUES represent amounts incurred by NASD and owed to the SEC pursuant to Section 31 of the Securities and Exchange Act of 1934. Activity assessment fees totaled $230.9 million in 2004 as compared with

$365.8 million in 2003. This decline is due mainly to a reduction in Section 31 rates charged by the SEC in 2004. In August 2004, the SEC adopted new rules under Section 31 and provided additional guidance as to how the SEC charges SROs for these fees. As a result of the clarifications in the new rules, NASD has begun reporting amounts owed under Section 31 on a gross basis in the consolidated financial statements in accordance with EITF No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent." Balances for 2003 have also been reclassified to conform to current year presentation.

FINES represent amounts billed as sanctions for rule violations, which NASD does not view to be part of operating revenues. Fines totaled $103.9 million cash collected and $114.4 million in total in 2004 compared with $33.3 million collected in 2003, an increase of $81.1 million or 243.5 percent. In 2004, NASD levied numerous large sanctions for issues ranging from improper mutual fund sales and trading practices to excessive mark-ups.

NASDAQ

NASDAQ net revenues declined $105.2 million from $589.8 million in 2003 to $484.6 million in 2004, due mainly to a decline in NASDAQ's market share of transactions reported to NASDAQ's systems, the effect of price reductions, elimination of certain fees, and the implementation of the NASDAQ General Revenue Sharing Program.

CONSOLIDATING ADJUSTMENTS

Consolidating adjustments represent the elimination of intercompany charges at the Company level, primarily contract services fees charged to NASDAQ and Amex. Beginning in 2005, Amex contract services will no longer be eliminated as the sale of Amex to Amex Membership Corporation was completed on December 31, 2004.

TOTAL EXPENSES

The following table summarizes total operating expenses by segment and category:

NASD CONSOLIDATED EXPENSES BY SEGMENT

	YEARS ENDED DECEMBER 31,							
	2004				2003			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in millions)							
Compensation and benefits	$ 306.8	$ 148.2	$ (0.2)	$ 454.8	$ 267.8	$ 159.1	$ 0.2	$ 427.1
Professional and contract services	118.5	23.7	(3.0)	139.2	116.6	37.5	(0.7)	153.4
Computer operations and data communications	24.8	98.9	(0.3)	123.4	19.1	125.6	–	144.7
Depreciation and amortization	39.5	76.3	0.1	115.9	47.3	90.0	–	137.3
Occupancy	30.4	28.7	–	59.1	30.1	31.2	–	61.3
General and administrative	44.0	100.6	(40.2)	104.4	37.3	110.9	(58.0)	90.2
Elimination of non-core products	–	–	–	–	–	97.9	–	97.9
NASDAQ Japan impairment gain	–	–	–	–	–	(5.0)	–	(5.0)
Total expenses	$ 564.0	$ 476.4	$ (43.6)	$ 996.8	$ 518.2	$ 647.2	$ (58.5)	$ 1,106.9

NASD

NASD total expenses were $564.0 million in 2004 compared with $518.2 million in 2003, an increase of $45.8 million in 2004 or 8.8 percent.

COMPENSATION AND BENEFITS increased $39.0 million or 14.6 percent from $267.8 million to $306.8 million due to an increase in the number of member regulation, enforcement, and dispute resolution personnel, as well as headcount increases to service the Amex RSA. Total NASD head count was 2,333 as of December 31, 2004 compared with 2,085 as of December 31, 2003. Also contributing to the expense increase were costs associated with the Company's defined benefit pension plans due to continued reductions in the interest rate environment.

PROFESSIONAL AND CONTRACT SERVICES remained relatively consistent between years at $118.5 million in 2004 compared to $116.6 million in 2003. Included within this overall consistent performance were increases in arbitrator payments and NASD conference expenses offset by a reduction in consulting services due to a continuing disciplined approach to the review and approval of new initiative spending.

COMPUTER OPERATIONS AND DATA COMMUNICATIONS totaled $24.8 million in 2004 compared to $19.1 million in 2003, an increase of $5.7 million or 29.8 percent. This increase was attributable to new communication lines established for ADF and TRACE in 2004, as well as additional operational costs associated with several server migrations.

DEPRECIATION AND AMORTIZATION totaled $39.5 million in 2004 compared with $47.3 million in 2003, a decline of $7.8 million or 16.5 percent. This decline was due primarily to several assets becoming fully depreciated in the prior year. NASD has also significantly curtailed its capital spending in recent years with the reduction in cost of technology equipment and efficient management of the existing technology environment.

OCCUPANCY expense remained consistent between years at $30.4 million in 2004 compared with $30.1 million in 2003.

GENERAL AND ADMINISTRATIVE expenses include the company's expenditures on matters such as travel, supplies, and marketing. General and administrative expenses totaled $44.0 million in 2004 compared with $37.3 million in 2003, an increase of $6.7 million or 18.0 percent. The majority of this increase relates to bad debt expense on outstanding fines receivable as of December 31, 2004, impairment recorded on software replaced in the current year, and a loss on disposal of fixed assets associated with the migration of NASD servers in 2004. Offsetting this increase was a decline in marketing expenses due to NASD's mutual fund breakpoint campaign, which took place during the fourth quarter of 2003. NASD recognized $3.9 million of expense in 2003 associated with this public awareness campaign.

NASDAQ

Overall, NASDAQ total expenses declined significantly from 2003 to 2004. Total expenses in 2004 were $476.4 million as compared with $647.2 million in 2003, a decrease of $170.8 million or 26.4 percent. This significant decline represents a series of large one-time charges taken by NASDAQ in 2003 in connection with its strategic review and elimination of non-core product lines combined with the ongoing effects of these cost reductions in 2004. In 2003, NASDAQ incurred $97.9 million in charges associated with the elimination of non-core product lines. In 2004, the cost savings from these actions were realized. In addition, NASDAQ continued its cost cutting measures, eliminating an additional 172 positions and reducing its overall headcount from 956 on December 31, 2003 to 786 on December 31, 2004.

CONSOLIDATING ADJUSTMENTS

Consolidating adjustments represent the elimination of intercompany charges at the Company level, primarily contract services fees charged by NASD to NASDAQ and Amex. Beginning in 2005, Amex contract services will no longer be eliminated, as the sale of Amex to Amex Membership Corporation was completed on December 31, 2004.

OTHER INCOME (EXPENSE)

The following table summarizes total other income (expense) by segment and category:

NASD CONSOLIDATED OTHER INCOME (EXPENSE) BY SEGMENT

	YEARS ENDED DECEMBER 31, 2004				2003			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in millions)							
Interest and dividend income	$ 42.7	$ 5.9	$ (13.2)	$ 35.4	$ 42.0	$ 9.5	$ (8.1)	$ 43.4
Interest expense	(0.3)	(11.5)	–	(11.8)	(0.1)	(18.6)	–	(18.7)
Net realized investment gains	25.7	–	–	25.7	24.6	–	(0.3)	24.3
Gain on Nasdaq warrants	3.9	–	–	3.9	16.1	–	–	16.1
Net losses from equity investees	–	–	–	–	–	–	(4.1)	(4.1)
Minority interest benefit (expense)	–	–	(5.1)	(5.1)	–	–	47.2	47.2
Total other income (expense)	$ 72.0	$ (5.6)	$ (18.3)	$ 48.1	$ 82.6	$ (9.1)	$ 34.7	$ 108.2

NASD

NASD total other income was $72.0 million in 2004 compared with $82.6 million in 2003, a decline of $10.6 million or 12.8 percent. This decline between years is primarily attributable to a reduction in the gain recognized on the change in value of warrants to purchase NASDAQ stock from NASD. These warrants are carried at fair value with changes in the fair value recorded in income. The fair value of these warrants is calculated using a Black-Scholes valuation model. The decline in gain recognized between years is reflective of the passage of time and expiration of additional warrant tranches.

NASDAQ

NASDAQ realized a decline in other expense between periods due mainly to the redemption of outstanding debt in the third quarter of 2003. In 2003, NASDAQ redeemed the $150.0 million outstanding principal amount of senior notes due in 2007.

CONSOLIDATING ADJUSTMENTS

Consolidating adjustments represent mainly the intercompany elimination of dividends on NASDAQ preferred stock recognized by NASD, as well as NASD's sharing of income and losses in NASDAQ with minority interest partners. Minority interest expense (benefit) increased from a benefit of $47.2 million in 2003 to an expense of $5.1 million in 2004, reflective of the minority interest partners' share of NASDAQ's net loss in 2003 and net income in 2004.

PROVISION FOR INCOME TAXES

As NASD is a tax-exempt organization under the provisions of the Internal Revenue Code Section 501(c)(6), tax expenses reflected in the Company's consolidated financial statements represent the tax expense of NASDAQ. NASDAQ recorded a tax provision from continuing operations in 2004, with an effective tax rate of 29.3 percent, and a tax benefit from continuing operations in 2003, with an effective tax rate of 32.0 percent. The change from a tax benefit in 2003 to a tax provision in 2004 is related to the net loss reported by NASDAQ in 2003 versus net income reported for 2004.

DISCONTINUED OPERATIONS

Discontinued operations in the Company's consolidated statements reflect charges taken by both NASD Holding and NASDAQ. See the table below for a breakdown by company by year.

	YEARS ENDED DECEMBER 31,	
	2004	2003
	(in millions)	
Discontinued Operations:		
NASD Holding	$ 10.1	$ (47.4)
NASDAQ	9.6	(60.3)
Total	$ 19.7	$ (107.7)

NASD

NASD Holding's net loss from discontinued operations represents the operations of Amex for the period, net of intercompany eliminations and taxes, as well as the estimated loss at disposal recorded as of December 31, 2004, and 2003. On October 31, 2003, NASD agreed in principle to sell its ownership interest in Amex to the Amex Membership Corporation. On December 31, 2004, NASD completed the sale of Amex to the members of Amex Membership Corporation. See Note 16, "Discontinued Operations," to the consolidated financial statements for further discussion.

NASDAQ

NASDAQ's net loss from discontinued operations in 2004 and 2003 represents amounts associated with the disposal of NASDAQ Europe and IndigoMarkets Ltd. As a result of its strategic review, NASDAQ supported the closing of the market operated by NASDAQ Europe. These operations were wound down pursuant to a transition plan approved by the Belgian Banking and Finance Commission. As NASDAQ Europe was winding down its market operations, NASDAQ reached an agreement to transfer all of NASDAQ's shares in NASDAQ Europe to one of the original investors in NASDAQ Europe. The transfer of shares was completed in December 2003. NASDAQ made a similar decision to discontinue operations in IndigoMarkets Ltd. In 2004, NASDAQ released a reserve previously held to satisfy any potential claims against NASDAQ associated with the wind-down of NASDAQ Europe. See Note 16, "Discontinued Operations," to the consolidated financial statements for further discussion.

CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE

In June 2003, the Emerging Issues Task Force finalized EITF No. 00-21, which became effective for NASD's consolidated financial statements on January 1, 2004. This accounting pronouncement requires revenue arrangements be reviewed to determine (a) how the arrangement consideration should be measured, (b) whether the arrangement should be divided into separate units of accounting, and (c) how the arrangement consideration should be allocated among the separate units of accounting. Once each element of a revenue arrangement has been identified, EITF No. 00-21 requires companies to recognize the revenue for such element in accordance with existing accounting principles generally accepted in the United States. EITF No. 00-21 does not address when the criteria for revenue recognition are met or provide guidance on the appropriate revenue recognition convention for a given unit of accounting. NASD performed a comprehensive review of all revenue arrangements and concluded that this new accounting pronouncement was applicable to NASD's registration and dispute resolution fees.

As a result of this implementation, NASD changed its method of accounting for revenue recognition for the initial fee component of first year registration fees and amounts collected on open dispute resolution cases. As part of this implementation, NASD has begun deferring and amortizing these elements over an estimated customer relationship period. With this change, NASD recognized a one-time cumulative effect of a change in accounting principle as of January 1, 2004 of a combined $(58.3) million. The impact to 2004 revenues for registrations and dispute resolution fees was not significant.

LIQUIDITY AND CAPITAL RESOURCES

Consistent with the Company's operation of its business segments as separate stand-alone companies each with its own corporate governance, NASD and NASDAQ separately manage their liquidity and capital resources. Each segment's Board has approved its respective investment policies for internally and externally managed portfolios.

NASD

NASD's investment policy has been developed based on best practices as applied to its investment objectives. The NASD Investment Committee, whose members have extensive background and experience in the investment community, provides overall guidance and advice in determining the appropriate policy, guidelines, and allocation for these investments. NASD engages an investment consultant to support the Investment Committee in the areas of policy and guidelines, and to monitor the performance of the portfolio and investment managers, including periodic selection and evaluation of asset managers.

The goal of NASD's investment policy is to generate long-term returns to be used to support NASD operations for the benefit of investors and members, to preserve the real purchasing power of those funds for future contingencies, and to maintain financial balance sheet strength. Portfolio returns may be used for funding current operating budget needs, maintaining real purchasing power for future contingencies, or for other strategic or operational purposes. NASD's targeted investment portfolio allocations are 50 to 65 percent equities, 20 to 30 percent fixed income, and 15 to 20 percent alternative investments.

NASDAQ

The NASDAQ Board of Directors separately reviews and approves the investment policy for NASDAQ and its subsidiaries. The goal of NASDAQ's investment policy is to maintain adequate liquidity at all times, to fund current budgeted operating and capital requirements and to maximize returns. All securities must meet credit rating standards as established by the policy. The investment duration must not exceed 18 months. Beginning October 2003, the policy prohibits the purchasing of equity securities.

CASH FLOWS

Both NASD and NASDAQ rely on cash flows from operations to provide working capital for current and future operations. The Company's net cash provided by operating activities was $156.2 million and $241.1 million for 2004 and 2003, respectively. Net cash used in investing and financing activities by the company in 2004 and 2003 was a combined $365.1 million and $240.3 million, respectively.

See table below for total cash flows by segment between years:

	YEARS ENDED DECEMBER 31,					
	2004			2003		
	NASD	NASDAQ	Total	NASD	NASDAQ	Total
	(in millions)					
Operating:						
Continuing	$ 46.5	$ 107.5	$ 154.0	$158.5	$145.8	$304.3
Discontinued operations	(7.4)	9.6	2.2	(22.7)	(40.5)	(63.2)
Total operating	39.1	117.1	156.2	135.8	105.3	241.1
Investing	(163.6)	(201.3)	(364.9)	(83.1)	(0.2)	(83.3)
Financing	6.3	(6.5)	(0.2)	0.6	(157.6)	(157.0)
Total	$ (118.2)	$ (90.7)	$ (208.9)	$ 53.3	$ (52.5)	$ 0.8

NASD

During 2004, NASD generated net cashflows from continuing operations of $46.5 million due primarily to net income for the year offset by a reduction in the SEC fee payable of $83.9 million, which is due to the rate change by the SEC of the Section 31 assessment by 50.0 percent. NASD incurred investing cash outflows of $163.6 million in 2004, associated with changes in fund managers and the purchase of additional securities as part of the implementation of NASD's new investment policy, which was approved by the NASD Board in early 2004. Also included in investing cash outflows were capital expenditures of $28.5 million in 2004 related primarily to the acquisition of storage, servers, and backup equipment associated with the upgrade of NASD's disaster recovery environment, as well as capitalized software development costs and minor building enhancements. In 2003, capital expenditures were $19.2 million. Financing cash flows were $6.3 million in 2004.

NASD has been able to generate sufficient funds from operations to meet working capital requirements. NASD has a $50.0 million line of credit available through November 2005, had it temporarily needed liquidity to meet its current obligations. The Company believes that the liquidity provided by existing cash and cash equivalents, investments, and cash generated from operations will provide sufficient capital to meet current and future operating requirements.

NASD working capital was $995.7 million at December 31, 2004, compared with $961.6 million at December 31, 2003.

NASDAQ

Cash flows from continuing operations activities totaled $107.5 million in 2004 and $145.8 million in 2003. The decrease in operating cash flows was primarily due to payments for the elimination of non-core product lines, initiatives, and severance. Net cash used in investing and financing activities was $207.8 million in 2004 and $157.8 million in 2003. Capital expenditures for 2004 were $26.0 million compared with $31.6 million in 2003. In 2003, NASDAQ redeemed $150.0 million in Senior Notes, which are included in financing activities.

CONTRACTUAL OBLIGATIONS AND CONTINGENT COMMITMENTS

The Company has contractual obligations to make future payments under several contracts. A combined summary of those contractual obligations is provided below.

CONTRACTUAL OBLIGATIONS AND CONTINGENT COMMITMENTS

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(in millions)		
Long-term debt by contract maturity (NASDAQ)	$ 265.0	$ –	$ 241.5	$ 5.0	$ 18.5
Minimum rental commitments under non-cancelable operating leases, net	396.8	57.8	72.2	50.7	216.1
Minimum rental commitments under capitalized leases	1.6	0.7	0.9	–	–
Other long-term obligations	204.1	52.6	54.7	45.7	51.1
Total	$ 867.5	$ 111.1	$ 369.3	$ 101.4	$ 285.7

Long-term debt represents NASDAQ's $25.0 million senior note payable and NASDAQ's $240.0 million convertible subordinated notes. Principal payments on the $25.0 million note are scheduled to begin in 2007 and continue in equal monthly installments until maturity in 2012. The $240.0 million convertible subordinated notes become due in May of 2006. See Note 9, "Long Term Debt," to the consolidated financial statements for further discussion.

Minimum rental commitments under non-cancelable operating leases represent totals of NASD and NASDAQ. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs. Of the amounts presented, NASD operating lease commitments totaled $153.7 million and NASDAQ commitments were $243.1 million. Commitments under capitalized leases are solely attributable to NASD.

Other long-term obligations reflect NASD's information and technology services agreement with EDS, NASDAQ's global services agreement with MCI, and contracts between Brut and SunGard for on-line processing, hosting, and other related services.

NASDAQ RESTRUCTURING

NASD and NASDAQ are currently awaiting the SEC's decision on Exchange Registration for NASDAQ. Upon Exchange Registration, NASD will no longer exert voting control over NASDAQ and, as such, NASD expects that it will cease to consolidate NASDAQ. The following discussion details steps taken to date in the disposition of NASDAQ and the impact on the consolidated operations of the Company.

Previous NASD transactions in NASDAQ stock include Phase I and Phase II sales of NASDAQ common shares and warrants in 2000 and 2001. On May 3, 2001, NASD further decreased its ownership through a two-part transaction, which resulted in the issuance of convertible debt by NASDAQ to the private equity firm of Hellman & Friedman, and the subsequent repurchase of shares by NASDAQ from NASD.

In March 2002, NASD sold 33.8 million shares of NASDAQ common stock to NASDAQ, reducing its ownership of NASDAQ to 55 percent prior to the exercise of warrants. Assuming the full exercise of all warrants purchased in Phase I and II of the NASDAQ restructuring, this transaction effectively reduced NASD's ownership of NASDAQ common shares to zero on a fully diluted basis. In exchange for the shares sold, NASDAQ paid NASD $305.2 million in cash, issued 1,338,402 shares of Series A Cumulative Preferred Stock, and one share of Series B Preferred Stock.

With its 54.7 percent ownership and one share of Series B Preferred Stock, NASD continues to exert voting control over NASDAQ and therefore continues to consolidate NASDAQ's operations under accounting principles generally accepted in the United States. NASDAQ applied for registration as an exchange with the SEC in March 2001. If Exchange Registration is approved, warrant holders will have the right to direct the voting of the shares of NASDAQ common stock underlying the unexercised and unexpired warrants. At that time, NASD will no longer exert voting control and will cease to consolidate NASDAQ's operations in the Company's consolidated financial statements.

The table below summarizes the effect of all NASD and NASDAQ transactions in NASDAQ stock during the period June 2000 to December 2004.

EFFECT OF NASDAQ RESTRUCTURING ACTIVITIES (DOLLARS IN MILLIONS)

	NASD Ownership %	Fully Diluted %	NASDAQ Shares Owned by NASD	Increase in Consolidated Equity	(Increase) Decrease in Minority Interests	Increase in Liabilities	Consolidated Cash Proceeds
Year Ended 12/31/99—after stock split	100.0%	100.0%	100,000,000	$ –	$ –	$ –	$ –
Cumulative Activity '00 & '01	(31.0)%	(74.7)%	(23,005,129)	(247.5)	(140.6)	(368.6)	756.7
Year Ended 12/31/01	69.0%	25.3%	76,994,871	(247.5)	(140.6)	(368.6)	756.7
NASDAQ Share Buyback— March 2002 ***	(13.5)%	(25.3)%	(33,768,895)	(122.9)	122.9	–	–
Other NASDAQ & Warrant Exercises	(0.3)%	–	(20,830)	(1.0)	(1.2)	–	2.2
Ending Balance/Cumulative Impact-Year Ended 12/31/02	55.2%	–	43,205,146	(371.4)	(18.9)	(368.6)	758.9
Warrant Exercises & Expirations	–	13.7%	(15,000)	–	–	–	0.2
Other NASDAQ	(0.2)%	–	–	(0.8)	(0.7)	–	1.5
Ending Balance/Cumulative Impact-Year Ended 12/31/03	55.0%	13.7%	43,190,146	(372.2)	(19.6)	(368.6)	760.6
Warrant Exercises & Expirations	–	13.7%	(6,750)	–	–	–	0.1
Other NASDAQ	(0.3)%	(0.1)	–	(1.3)	(1.0)	–	2.3
Ending Balance/Cumulative Impact-Year Ended 12/31/04	54.7%	27.3%	43,183,396	(373.5)	(20.6)	(368.6)	763.0
Secondary Offering—February 2005	(21.0)%	(21.0)%	(16,586,980)	(135.2)	(5.5)	–	140.7
Year-Ended 12/31/04—Proforma	33.7%	6.3%	26,596,416	$ (508.7)	$ (26.1)	$ (368.6)	$ 903.7
Cash Proceeds—NASD *							$ 871.8
Cash Proceeds—NASDAQ **							31.9
Total Cash Proceeds							$ 903.7

* Reflects the effect of two NASDAQ buybacks of its shares from NASD amounting to $240.0 million (the Hellman & Friedman transaction in 2001) and $305.2 million (the March 2002 transaction).

** Reflects the $240.0 million as a pass through and the $305.2 million as a payment to NASD out of proceeds received during Phase I and II.

*** In connection with the March 2002 share buyback NASD also received 1,338,402 shares of Series A Cumulative Preferred Stock and one share of Series B Preferred Stock.

Warrants to purchase NASDAQ common shares are exercisable in four annual tranches. As of December 31, 2004, the first two warrant tranches have expired with only 42,580 warrants having been purchased through the exercise of warrants. The third warrant tranche is set to expire on June 27, 2005 and the final warrant tranche is due to expire on June 27, 2006. Exercise prices for the third and fourth warrant tranches are $15 and $16 per share, respectively.

On September 30, 2004, NASD waived a portion of the dividend on the Series A Cumulative Preferred Stock for the third quarter of 2004 of $2.5 million and accepted an aggregate amount of $1.0 million (calculated based on an annual rate of 3.0 percent) as payment in full of the dividend for this period. On November 29, 2004, NASD entered into an exchange agreement with NASDAQ pursuant to which NASD exchanged 1,338,402 shares of NASDAQ's Series A Cumulative Preferred Stock, for 1,338,402 shares of newly issued Series C Cumulative Preferred Stock. The Series C Cumulative Preferred Stock accrues quarterly dividends at an annual rate of 3.0 percent for all periods until July 1, 2006 and at an annual rate of 10.6 percent for periods thereafter. NASD also may be entitled to an additional payment in certain circumstances, which may not exceed $16.3 million in aggregate depending on the amount of time the Series C Cumulative Preferred Stock is outstanding and the market price of NASDAQ's common stock at the time NASDAQ redeems the Series C Cumulative Preferred Stock. Shares of Series C Cumulative Preferred Stock do not have voting rights, except for the right as a class to elect two new directors to the Board of Directors any time distributions on the Series C Cumulative Preferred Stock are in arrears for four consecutive quarters and as otherwise required by Delaware law.

On February 15, 2005, NASDAQ completed an underwritten secondary offering of 16,586,980 shares of common stock owned by NASD and an additional 3,246,536 shares of common stock owned by certain selling stockholders who purchased the shares in NASDAQ's private placements in 2000 and 2001. NASDAQ, its officers, or other employees did not sell any shares in the secondary offering. NASD received net proceeds of $140.7 million and recognized a gain on the sale of subsidiary stock of $135.1 million. As of February 15, 2005, NASD owned 33.7 percent of NASDAQ's common stock, 100.0 percent of NASDAQ Series C Cumulative Preferred Stock, and 100.0 percent of NASDAQ Series B Preferred Stock. Due to the voting rights of the Series B Preferred Stock, NASD will continue to consolidate NASDAQ.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Market risk represents the risks of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates, and equity prices. As of December 31, 2004, investments in the Company's consolidated financial statements consisted of equities, U.S. Treasury securities, obligations of U.S. Government-sponsored enterprises, and other financial instruments.

The Company's primary market risk is with respect to its investment portfolio and is associated with fluctuations in the equities markets, as well as fluctuations in interest rates and the effects that both types of fluctuations may have on its investment portfolio and outstanding debt.

NASDAQ's investment portfolio is held primarily in investments with maturities averaging less than one year and NASDAQ's debt obligations generally specify a fixed interest rate. Therefore, NASDAQ does not believe that a 100 basis-point fluctuation in market interest rates will have a material effect on the carrying value of the investment portfolio or earnings or cash flows.

NASD's investment portfolio also contains fixed income securities. However, NASD's fixed income securities have a longer maturity than NASDAQ's, with a duration, or weighted average maturity of cash flows, of approximately 3.0 years as of December 31, 2004. Duration is a measure of the sensitivity of a fixed income portfolio to a change in interest rates: for every 100 basis point change in interest rates, a portfolio with a duration of 3.0 years is expected to change inversely by 3.0 percent. NASD believes that any decline in the value of its fixed income securities due to a 100 basis point increase in interest rates should be largely offset by the portfolio's yield of approximately 3.8 percent.

NASD maintains a portion of its portfolio in equity securities, which have been more sensitive to market fluctuations. NASD reviews its investment portfolio for other-than-temporary declines on a quarterly basis. Based on these reviews, NASD recorded impairment charges for other-than-temporary declines of $3.1 million and $0.1 million in 2004 and 2003, respectively. NASD management believes that other-than-temporary fluctuations in market indices could have a significant impact on NASD's investment portfolio and earnings and cash flows.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the Company's financial statements in conformity with generally accepted accounting principles requires management to adopt accounting principles and make estimates and judgments to develop amounts reported in the financial statements and accompanying notes.

The Company periodically reviews the application of its accounting policies and evaluates the appropriateness of the estimates that are required to prepare the financial statements. The Company believes its estimates and judgments are reasonable; however, actual results and the timing of recognition of such amounts could differ from those estimates.

The Company's significant accounting policies are described in Note 2, "Summary of Significant Accounting Policies," to the consolidated financial statements. The following provides information about the Company's critical accounting policies, which are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. At the consolidated level, the Company has determined that the critical accounting policies are those that cover investments, revenue recognition, software costs, impairment of long-lived assets, and pension benefits.

INVESTMENTS

Under 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 value, with any 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 is adjusted for amortization of premiums and accretion of discounts. Fair value is determined based on quoted market prices when available, or if quoted market prices are not available, on discounted expected cash flows using market rates commensurate with the credit quality and maturity of the investment. Realized gains and losses on sales of securities are included in earnings using the average cost method. Amounts due to or from the custodial agent relate to security trades executed prior to the balance sheet date but not yet settled.

The Company reviews its investments quarterly to determine whether a decline in fair value below cost basis is other-than-temporary. If the decline in the fair value is judged to be other-than-temporary, the cost basis of the investment is written down to fair value, the amount of the write-down is charged to earnings, and a new cost basis for the security is established.

REVENUE RECOGNITION AND COST OF REVENUE

Market services include the NASDAQ Market Center and NASDAQ market services subscriptions revenues. NASDAQ Market Center revenues are variable, based on service volumes, and recognized as transactions occur. NASDAQ market services subscriptions revenues are based on the number of presentation devices in service and quotes delivered through those devices. NASDAQ market services subscriptions revenues are recognized in the month that information is provided and are recorded net of amounts due under revenue sharing arrangements with market participants. Pursuant to EITF No. 99-19, "Reporting Revenues Gross vs. Net," execution revenues from transactions executed through Brut are recorded on a gross basis in revenues. Expenses, such as the liquidity rebate payments, are recorded in cost of revenues as Brut acts as principal. NASDAQ's other execution revenues will continue to be reported net of the liquidity rebate as NASDAQ does not act as principal.

Issuer services consist primarily of annual listing fees, initial listing (IL) fees and listing of additional shares (LAS) fees on The NASDAQ Stock Market. Annual listing service revenues are recognized ratably over the following 12-month period. IL and LAS fees are recognized on a straight-line basis over estimated customer relationship periods. NASDAQ receives license fees for its trademark licenses related to the QQQ and other financial products linked to NASDAQ indices issued in the U.S. and abroad. These revenues are recognized as earned.

Regulatory fees represent fees to fund NASD's member regulatory activities, including the supervision and regulation of members through examinations, processing of membership applications, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. Regulatory fees are recorded net of any member rebates. Regulatory fees include a trading activity fee, gross income assessment, personnel assessment, and branch office assessment. The trading activity fee is assessed on the sell side of all member transactions in all covered securities regardless of where the trade is executed and is assessed directly to the firm responsible for clearing the transaction on behalf of the member firm. The trading activity fee is recognized as the transaction occurs. Gross income assessments, personnel assessments, and branch office assessments represent annual fees charged to member firms and representatives and are recognized ratably over the annual period to which they relate.

User fees consist of fees charged for initial and annual registrations, qualification exams, fees associated with NASD sponsored meetings and conferences, and charges related to the review of advertisements and corporate filings. Registration fees include both an initial and annual fee charged to all NASD-registered representatives. The initial fee is recognized over the estimated customer relationship period and the annual fee over the related annual period. Qualification fees consist of examination and continuing education fees, which are recognized as the exam is given or continuing education program is held. Advertising represents fees charged for the review of NASD member firms' communications to ensure that they are fair, balanced, and not misleading. Advertising fees are recognized as revenue as the review is completed. Corporate financing consists of fees charged by NASD for reviewing proposed public offerings and are recognized as the review is completed.

Dispute resolution fees consist of fees earned during the arbitration and mediation processes. Fees on open cases are recognized as revenue over the average life of a case. Upon closing of a case, a final billing is prepared and any unpaid fees are recognized as revenue at that time. Also included in dispute resolution fees are mediation fees, SRO annual fees for forum services, neutral training fees, and other fees, which are recognized either when the cash is received or when the service is provided.

Transparency services for NASD represent fees charged through NASD's TRACE and ADF. TRACE represents fees charged on secondary market transactions in eligible fixed income securities reported to NASD, TRACE system-related fees, and TRACE market data fees. ADF is a facility for posting quotes, and reporting and comparing trades. TRACE and ADF fees are recognized as the transactions occur.

Contract service fees represent amounts charged by NASDR for regulatory services provided under contractual arrangements and are recognized as revenue as the regulatory service is provided.

NASD, as an SRO, pays certain fees and assessments to the SEC pursuant to Section 31 of the Securities and Exchange Act of 1934. These fees are designed to cover costs incurred by the government in the supervision and regulation of securities markets and securities professionals and are based on a percentage of the total dollar value of securities sold in The NASDAQ Stock Market, the ADF, and the over-the-counter (OTC) Bulletin Board. NASD remits these fees to the U.S. Treasury semiannually in March and September. In 2004, the SEC adopted new rules under Section 31 and provided SROs additional guidance as to how the SEC charges SROs for these fees, which affected NASD's accounting treatment for such fees in its consolidated financial statements.

NASD recovers the cost of the SEC's fees and assessments through an activity assessment billed to securities firms based on the total dollar value of securities sold in The NASDAQ Stock Market, the ADF, and the OTC Bulletin Board. The assessments billed to securities firms are recognized when the transactions occur. Beginning in 2004, NASD reported the activity assessment on a gross basis within revenues in accordance with EITF No. 99-19. Amounts due to the SEC are reported as a cost of revenue. The effect of this change had no impact on NASD's consolidated net income.

Fines represent sanctions for rule violations. Commencing in 2004, fines are recognized when the fine is assessed.

SOFTWARE COSTS

Significant purchased application software, and operational software that is an integral part of computer hardware, are capitalized and amortized using the straight-line method over their estimated useful lives, generally two to seven years. All other purchased software is charged to expense as incurred. In accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," the Company capitalizes internal computer software development costs incurred during the application development stage. Computer software costs incurred prior to or subsequent to the application development stage are charged to expense as incurred.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company reviews its long-lived assets for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In the event that facts and circumstances indicate that long-lived assets or other assets may be impaired, an evaluation of recoverability would be performed. If an evaluation were required, the estimated future undiscounted cash flows associated with the asset would be compared to the asset's carrying amount to determine if a write-down is required. If impairment were indicated, the Company would prepare a discounted cash flow analysis to determine the amount of the impairment.

PENSION BENEFITS

The Company provides three non-contributory defined benefit pension plans for the benefit of eligible employees of its subsidiaries. The non-contributory defined benefit plan consists of a funded Employee Retirement Plan and two unfunded Supplemental Executive Retirement Plans. Several statistical and other factors, which attempt to anticipate future events, are used in calculating the expense and liability related to the plans. Key factors include assumptions about the expected rates of return on plan assets and discount rates as determined by the Company, within certain guidelines. The Company considers market conditions, including changes in investment returns and interest rates, in making these assumptions. The Company determines the long-term rate of return based on analysis of historical and projected returns as prepared by the Company's actuary and external investment consultant. The discount rate used in the calculations is tracked to changes in Moody's Aa bond ratings. The Company's Pension Plan Committee approves both the expected long-term rate of return and the discount rate assumptions.

Unrecognized actuarial gains and losses are being recognized over time in accordance with SFAS No. 87, "Employers Accounting for Pensions." Unrecognized actuarial gains and losses arise from several factors including experience and assumption changes in the obligations, and from the difference between expected returns and actual returns on plan assets.

The actuarial assumptions used by the Company in determining its pension benefits may differ materially from actual results due to changing market conditions and economic conditions, as well as early withdrawals by terminating plan participants. While the Company believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may materially affect the Company's financial position or results of operations.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123(R)), which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123(R) supersedes Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." Generally the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires NASDAQ to expense, in the consolidated statements of income, all share-based payments to employees, including grants of employee stock options, based on their fair values. This cost will be recognized over the vesting period of the grants. Pro forma disclosure will no longer be an alternative. NASDAQ cannot predict the impact of adoption of SFAS No. 123(R) because the impact will depend on the levels of share-based payments granted in the future. However, had NASDAQ adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in Note 12, "NASDAQ Stock Compensation, Stock Awards, and Capital Stock," to the consolidated financial statements. In April 2005, the SEC announced the adoption of a new rule allowing companies to implement SFAS No. 123(R) at the beginning of their next fiscal year that begins after June 15, 2005.

In March 2004, the Emerging Issues Task Force issued EITF No. 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," which provides new guidance for assessing impairment losses on debt and equity investments. Additionally, EITF No. 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB voted to delay the accounting provisions of EITF No. 03-1; however, the disclosure requirements remain effective and have been adopted for the Company's year ended December 31, 2004 financial statements and are included in Note 6 "Investments" to the consolidated financial statements. Once issued, the Company will evaluate the impact of adopting the accounting provisions of EITF No. 03-01.

CERTIFICATION FOR 2004 ANNUAL FINANCIAL REPORT

We, Robert R. Glauber and Todd T. Diganci, certify that:

1. We have reviewed this annual financial report of the National Association of Securities Dealers, Inc. (NASD);
2. The purpose of this report is principally to set forth management's report on financial operations with respect to NASD during the years ended December 31, 2004, together with the consolidated financial statements of NASD as of and for the year ended December 31, 2004 and 2003, and this report is not intended to comply with the substantive or form requirements for periodic reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations promulgated thereunder (the "Exchange Act Rules and Regulations") required of issuers of securities subject to the periodic reporting requirements under Sections 12, 13 and 15 of the Exchange Act of 1934 and the related Exchange Act Rules and Regulations;
3. Based on our knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
4. Based on our knowledge, the financial statements and other financial information set forth under the caption "Management Report on Financial Operations", fairly present in all material respects the financial condition, results of operations and cash flows of NASD as of, and for, the periods presented in this report;
5. NASD has established disclosure controls and procedures to ensure that material information relating to NASD, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
6. NASD has carried out its evaluation of the effectiveness of the design and operation of NASD's disclosure controls and procedures as of December 31, 2004. Based upon that evaluation, we have concluded that the disclosure controls and procedures are effective;
7. We have disclosed, based on NASD's most recent evaluation of internal control over financial reporting, to NASD's auditors and the Audit Committee of NASD's Board of Directors:
   a) Any significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect NASD's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in NASD's internal control over financial reporting.

Date: May 17, 2005

Robert R. Glauber

Robert R. Glauber
Chairman and CEO

Todd T. Diganci
Executive Vice President and CFO

AUDIT COMMITTEE REPORT

In accordance with its written Charter adopted by the Board of Governors, the Audit Committee of the Board of Governors assists the Board in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing, and financial reporting practices of NASD. Each member of the Committee is an independent director as defined by SEC Rule 10A-3 under The Securities and Exchange Act of 1934, Listing Standards Relating to Audit Committees. In addition, the Audit Committee and Board of Governors have determined that James E. Burton and Charles A. Bowsher are audit committee financial experts, as defined by the SEC. The Charter gives the Audit Committee responsibility for monitoring the independence of the independent auditors and recommending the appointment of the independent auditors for approval by the Board of Governors, and makes clear that the independent auditors are accountable to the Audit Committee and the Board of Governors, as representatives of the members and the public. In all respects, the Charter complies with standards applicable to publicly owned companies. In addition, the Charter and the By-laws of NASD make the Director of Internal Audit directly responsible to the Audit Committee. (The Charter for the NASD Audit Committee is available on the Internet at the following URL: *http://www.nasd.com/auditcommittee.*)

During 2004, the Committee met seven times, with the Committee members having a 94% attendance rate.

In discharging its oversight responsibility, the Audit Committee reviewed the assessments of audit risk and the audit plans of both the independent and internal auditors. The Audit Committee also discussed with management, the internal auditors, and the independent auditors the quality and adequacy of NASD's internal controls and the internal audit organization, responsibilities, budget, and staffing.

The Audit Committee obtained a written statement from the independent auditors describing all relationships with NASD. The Audit Committee discussed those relationships and satisfied itself that none of the relationships were incompatible with the auditors' independence. The Committee has reviewed and approved all services performed by NASD's independent auditors, Ernst and Young LLP, and the associated fees, before initiation of each engagement. Such services and fees are summarized in the following table:

INDEPENDENT PUBLIC ACCOUNTANT (IPA) FEES

	NASD (6)		NASDAQ (5)		Amex (6)		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
Audit services (1)	$ 656,440	$ 571,197	$ 2,307,100	$ 1,857,159	$ 258,000	$ 241,500	$ 3,221,540	$ 2,669,856
Audit-related services (2)	447,784	329,251	278,314	191,200	8,456	49,275	734,554	569,725
Tax services (3)	17,188	36,441	100,000	435,325	–	–	117,188	471,766
Other services (4)	–	–	–	6,900	–	–	–	6,900
Total	$ 1,121,412	$ 936,889	$ 2,685,414	$ 2,490,584	$ 266,456	$ 290,775	$ 4,073,282	$ 3,718,247

(1) Audit services for NASD and Amex represent fees for the year-end financial statement audits. Audit services for NASDAQ represent fees associated with the audit, inclusive of international entities, of NASDAQ's annual financial statements, the review of NASDAQ's quarterly reports on Form 10-Q, and accounting consultations on matters addressed during the audit or interim review. In addition, NASDAQ audit fees for 2004 include attestation procedures in connection with the internal control reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

(2) Audit-related services in 2004 and 2003 for NASD reflect fees associated with special purpose audits and agreed-upon procedures such as IARD, CRD, employee benefit plans, as well as audit related services associated with the planned disposition of Amex and separation from NASDAQ. Also included in NASD audit-related services are advisory fees associated with the initial phases of NASD's implementation of the principles embodied in Section 404. NASDAQ audit-related fees represent assurance and employee benefit plan audits. NASDAQ audit-related services also include internal control reviews including reviewing Section 404 internal control program design.

(3) Tax services represent fees related to tax compliance, advice, and planning.

(4) For 2003, other services for NASDAQ represent client advisory services and products.

(5) NASDAQ IPA services and fees are separately reviewed and approved by the NASDAQ Audit Committee. The NASD Audit Committee has oversight of the NASDAQ Audit Committee, but does not review actions taken with respect to the approval of IPA fees. NASDAQ fees exclude services provided to non-profit entities of The Nasdaq Stock Market, Inc., services provided in relation to NASDAQ's role as the Securities Information Processor under the Unlisted Trading Privileges Plan and the audit of the NASDAQ-100 Trust, Series 1, the trust for the NASDAQ-100 Index Tracking Stock, also known as QQQ. NASDAQ also incurred fees payable to Deloitte & Touché, LLP (Deloitte & Touché) for fiscal year ended 2004, totaling $226,750. On September 7, 2004, NASDAQ completed its acquisition of Toll Associates LLC and affiliated entities from SunGard Data Systems Inc., which includes Brut, LLC. These fees represent audit fees on the consolidated financial statements of Toll Associates as of December 31, 2004 and for the period September 7, 2004 through December 31, 2004. Deloitte & Touché was the independent registered public accounting firm for Toll Associates before the acquisition and, given their historical knowledge, the NASDAQ Audit Committee chose to continue the relationship through the remainder of 2004.

(6) NASD and Amex fees for 2004 are based on fees approved by NASD's Audit Committee as of April 20, 2005. The 2004 audit services and audit-related services include estimates to complete the current work in process. Fees included in 2003 were generally paid between July 1, 2003 and June 30, 2004. NASD 2003 fees have been updated from the prior year report to reflect final amounts paid for the 2003 approved services.

The Audit Committee discussed and reviewed with the independent auditors all communications required by generally accepted auditing standards and, with and without management present, discussed the results of the independent auditors' examination of the financial statements. Based on those discussions, the Audit Committee recommended to the Board of Governors that NASD's audited financial statements be included in the Annual Report for the year ended December 31, 2004.

Members of the Audit Committee:

James E. Burton, Chair
John W. Bachmann
M. LaRae Bakerink
Charles A. Bowsher
Joel Seligman

May 9, 2005

REPORT OF INDEPENDENT AUDITORS

BOARD OF GOVERNORS

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

We have audited the accompanying consolidated balance sheets of the National Association of Securities Dealers, Inc. (NASD) as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in members' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the consolidated financial statements of Toll Associates LLC, a partially owned subsidiary, which statements reflect 10.3% of consolidated total assets at December 31, 2004 and 4.6% of total consolidated revenues for the year then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Toll Associates LLC, is based solely on the report of other auditors.

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 financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, and the report of other auditors, provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NASD at December 31, 2004 and 2003, 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 5 to the consolidated financial statements, in 2004 the Company changed its method of accounting for certain registration and arbitration revenues.

Ernst + Young LLP

McLean, Virginia

April 29, 2005

NASD
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS)

	DECEMBER 31, 2004	DECEMBER 31, 2003
Assets		
Current assets:		
Cash and cash equivalents	$ 123,834	$ 332,784
Investments:		
Available-for-sale, at fair value	1,391,859	1,309,307
Held-to-maturity, at amortized cost	28,600	23,765
Receivables, net	151,830	175,254
Receivables from related parties	4,946	–
Deferred tax assets	24,209	40,460
Other current assets	21,056	22,728
Current assets—discontinued operations	–	120,511
Total current assets	1,746,334	2,024,809
Held-to-maturity investments, at amortized cost	2,008	4,506
Property and equipment:		
Land, buildings, and improvements	172,350	169,216
Data processing equipment and software	369,239	529,522
Furniture, equipment and leasehold improvements	264,442	305,073
	806,031	1,003,811
Less accumulated depreciation and amortization	(492,186)	(605,661)
Total property and equipment, net	313,845	398,150
Non-current deferred tax assets	48,765	109,479
Note receivable from Amex	25,000	–
Goodwill	141,381	–
Intangible assets, net	44,260	5,322
Other assets	33,125	34,235
Non-current assets—discontinued operations	–	32,785
Total assets	$ 2,354,718	$ 2,609,286

See accompanying notes.

NASD
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS)

	DECEMBER 31, 2004	DECEMBER 31, 2003
Liabilities and members' equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 65,026	$ 65,748
SEC fee payable	68,275	152,198
Accrued personnel and benefit costs	145,557	134,855
Deferred revenue	137,523	96,546
Deposits and renewals	63,032	67,220
Capital lease obligation	737	2,320
Due to custodial agent	17,696	124,973
Due to related parties	450	–
Other current liabilities	70,043	126,559
Current liabilities—discontinued operations	–	102,924
Total current liabilities	568,339	873,343
Accrued pension and other post retirement benefit costs	57,794	41,307
Long-term debt	265,000	265,000
Non-current deferred tax liabilities	29,514	78,317
Non-current capital lease obligation	868	1,654
Deferred revenue	107,061	84,703
Warrants to purchase NASDAQ stock from NASD	3,836	7,744
Other liabilities	49,343	46,990
Non-current liabilities—discontinued operations	–	41,280
Total liabilities	1,081,755	1,440,338
Minority interest	11,938	12,034
Commitments and contingencies		
Members' equity	1,194,043	1,120,191
Unrealized gain on available-for-sale investments	74,131	39,442
Foreign currency translation	988	875
Minimum pension liability	(8,137)	(3,594)
Total members' equity	1,261,025	1,156,914
Total liabilities and members' equity	$ 2,354,718	$ 2,609,286

See accompanying notes.

NASD
CONSOLIDATED STATEMENTS OF INCOME
(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2004	2003
Revenues		
Operating revenues:		
Market services	$ 332,540	$ 383,580
Issuer services	201,458	204,166
Regulatory fees, net of member rebates of $30,000 in 2004 and $25,000 in 2003	222,844	174,225
User fees	137,277	128,382
Dispute resolution fees	80,181	75,453
Transparency services	14,736	21,139
Contract service fees	4,693	2,570
Other	2,321	4,658
Total operating revenues	996,050	994,173
Activity assessment	230,853	365,803
Fines	114,414	33,329
Total revenues	1,341,317	1,393,305
Cost of revenues:		
SEC activity remittance	(230,853)	(365,803)
Other	(55,845)	–
Total cost of revenues	(286,698)	(365,803)
Net Revenues	1,054,619	1,027,502
Expenses		
Compensation and benefits	454,827	427,094
Professional and contract services	139,182	153,376
Computer operations and data communications	123,443	144,712
Depreciation and amortization	115,867	137,300
Occupancy	59,081	61,308
General and administrative	104,354	90,197
Elimination of non-core product lines, initiatives, and severance	–	97,910
NASDAQ Japan impairment gain	–	(5,000)
Total expenses	996,754	1,106,897
Net revenues less expenses	57,865	(79,395)
Other income (expense)		
Interest and dividend income	35,348	43,355
Interest expense	(11,773)	(18,702)
Net realized investment gains	25,684	24,327
Gain on NASDAQ warrants	3,909	16,080
Net losses from equity investees	–	(4,102)
Minority interest (expense) benefit	(5,149)	47,203
Income before income taxes, discontinued operations, and cumulative effect of change in accounting principle	105,884	28,766
(Provision) benefit for income taxes	(749)	21,240
Income from continuing operations	105,135	50,006
Income (loss) from discontinued operations (net of tax expense (benefit) of $5,596 in 2004 and ($12,494) in 2003)	19,698	(107,720)
Cumulative effect of change in accounting principle	(58,342)	–
Net income (loss)	$ 66,491	$ (57,714)
Pro forma net income (loss) assuming the accounting change is applied retroactively	$ 124,833	$ (60,840)

See accompanying notes.

NASD
CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY
(DOLLARS IN THOUSANDS)

	Members' Equity	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2003	$ 1,173,487	$ 1,069	$ 1,174,556
Net loss	(57,714)		(57,714)
Unrealized gain on available-for-sale investments, net of tax of $340, net of minority interests of $340	–	34,068	34,068
Foreign currency translation, net of minority interests of $856	–	1,092	1,092
Minimum pension liability, net of tax of $191, net of minority interests of ($135)	–	494	494
Comprehensive loss	–	–	(22,060)
Increase in equity attributable to the minority interest in preferred stock dividends	3,781	–	3,781
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of $684	791	–	791
Decrease in equity attributable to amortization of restricted stock awards by NASDAQ, net of minority interest of $44	(154)	–	(154)
Balance, December 31, 2003	1,120,191	36,723	1,156,914
Net income	66,491		66,491
Unrealized gain on available-for-sale investments, net of tax of $599 net of minority interests of $(409)	–	34,689	34,689
Foreign currency translation, net of minority interests of $99	–	113	113
Minimum pension liability, net of tax of $293, net of minority interests of $(201)	–	(4,543)	(4,543)
Comprehensive income	–	–	96,750
Increase in equity attributable to the minority interest in the loss on exchange and accretion of NASDAQ preferred stock	2,191	–	2,191
Increase in equity attributable to the minority interest in preferred stock dividends and distributions to NASD for the NASDAQ insurance agency	3,894	–	3,894
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of $1,121	1,154	–	1,154
Increase in equity attributable to amortization of restricted stock awards by NASDAQ, net of minority interest of $100	122	–	122
Balance, December 31, 2004	$ 1,194,043	$ 66,982	$ 1,261,025

See accompanying notes.

NASD
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2004	2003
Reconciliation of net income (loss) to cash provided by operating activities		
Net income (loss)	$ 66,491	$ (57,714)
Net income (loss) from discontinued operations	19,698	(107,720)
Income from continuing operations	$ 46,793	$ 50,006
Adjustments to reconcile net loss to cash provided by operating activities:		
Cumulative effect of change in accounting principle	58,342	–
Depreciation and amortization	115,867	137,300
Gain on NASDAQ warrants	(3,909)	(16,080)
Amortization of restricted stock and other stock-based compensation	541	(50)
Net realized gains on investments	(28,773)	(25,358)
Investment impairment charges	3,089	1,031
Elimination of non-core product lines, initiatives, and severance	–	33,923
Loss on assets held-for-sale	7,369	–
Loss on disposal of fixed assets	3,664	1,394
Asset impairment charges	1,506	–
Deferred taxes	26,142	(1,123)
NASDAQ Japan impairment gain	–	(5,000)
Losses from equity investees	–	4,102
Bad debt expense	7,502	6,291
Minority interest expense (benefit)	5,149	(47,203)
Other net non-cash income items	6,003	12,823
Net change in operating assets and liabilities, net of acquisitions and dispositions:		
Receivables, net	35,162	24,846
Receivables from related parties	(2,885)	–
Other current assets	1,854	4,201
Other assets	1,306	15,468
Accounts payable and accrued expenses	(14,970)	(26,774)
Accrued personnel and benefit costs	8,504	23,463
Deferred revenue	4,993	(21,657)
Deposits and renewals	(4,188)	(1,203)
SEC fee payable	(83,923)	70,460
Other current liabilities	(54,531)	40,558
Accrued pension and other post-retirement costs	11,026	8,117
Other liabilities	2,353	14,734
Net cash provided by continuing operations	153,986	304,269
Cash provided by (used in) discontinued operations	2,178	(63,213)
Net cash provided by operating activities	$ 156,164	$ 241,056

See accompanying notes.

NASD
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2004	2003
Cash flow from investing activities		
Proceeds from redemptions of available-for-sale investments	$ 4,266,970	$ 3,993,568
Purchases of available-for-sale investments	(4,396,417)	(4,023,883)
Proceeds from maturities of held-to-maturity investments	26,828	18,600
Purchases of held-to-maturity investments	(29,058)	(18,453)
Acquisition of Toll Associates, LLC	(190,000)	–
Capital contribution to NASDAQ LIFFE joint venture	–	(2,500)
Purchases of property and equipment	(54,555)	(50,810)
Proceeds from sales of property and equipment	11,299	143
Net cash used in investing activities	(364,933)	(83,335)
Cash flow from financing activities		
Net proceeds from the purchase of NASDAQ shares	2,273	996
Debt repayment	–	(150,000)
Payments for treasury stock purchases by NASDAQ	(85)	(147)
Principal payments on capital leases	(2,369)	(7,815)
Net cash used in financing activities	(181)	(156,966)
(Decrease) increase in cash and cash equivalents	(208,950)	755
Cash and cash equivalents at beginning of year	332,784	332,029
Cash and cash equivalents at end of year	$ 123,834	$ 332,784
SUPPLEMENTAL DISCLOSURES:		
Cash payments for interest	$ 11,772	$ 16,280
Cash refunds of taxes	$ (49,986)	$ (25,936)
SCHEDULE OF NONCASH INVESTING ACTIVITIES:		
Purchases of property and equipment under capital lease	$ –	$ 2,367

See accompanying notes.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND NATURE OF OPERATIONS

NASD

The National Association of Securities Dealers, Inc. (NASD), a Delaware corporation, is the majority owner of The Nasdaq Stock Market, Inc. (NASDAQ), and wholly owns the following significant subsidiaries: NASD Regulation, Inc. (NASDR), NASD Dispute Resolution, Inc. (NASD DR), New NASD Holding, Inc. (NASD Holding), and NASD Investor Education Foundation (NIEF); collectively referred to as the Company.

NASD regulates the activities of the U.S. securities industry and regulates NASDAQ, The American Stock Exchange LLC (Amex), and the over-the-counter (OTC) securities markets. NASDR carries out NASD's regulatory functions, including onsite examinations of securities firms, continuous automated surveillance of markets operated by NASDAQ and Amex, and disciplinary actions against firms and registered representatives. NASD DR provides arbitration and mediation services to assist in the resolution of monetary and business disputes between and among investors, securities firms, and registered representatives.

On February 13, 2004, NASD established NIEF, a non-profit membership organization incorporated in Delaware. NIEF provides investors with high quality, easily accessible information and tools to better understand investing and the markets. NASD is the sole member of NIEF.

On December 31, 2004, NASD sold its Class B interest in Amex to Amex Membership Corporation. See Note 16, "Discontinued Operations," for additional information.

NASDAQ

NASDAQ, the largest stock-based equity securities market in the United States, in terms of number of listed companies and traded share volume, uses a multiple market maker system to operate its market.

On September 7, 2004, NASDAQ completed its acquisition of Toll Associates LLC (Toll) and affiliated entities from SunGard Data Systems Inc. (SunGard). Toll is a holding company that owns a 99.8 percent interest in Brut, LLC (Brut), the owner and operator of the Brut ECN, a broker-dealer registered pursuant to the Securities Exchange Act of 1934. Toll also has a 100.0 percent interest in Brut Inc. (Brut Inc.), which owns the remaining 0.2 percent interest in Brut and serves as its manager pursuant to an operating agreement. Brut also owns Brut Europe Limited (Brut Europe), a wholly-owned subsidiary set up to generate a European subscriber base, which is currently inactive. See "Acquisition of Brut," of Note 3, "Significant Transactions," and Note 4, "Acquisition of Brut," for further discussion.

On October 31, 2003, Quadsan Enterprises, Inc. (Quadsan), previously a wholly-owned subsidiary of NASDAQ that provided investment management services to NASDAQ, was merged with and into NASDAQ. Prior to December 18, 2003, NASDAQ owned a 63.0 percent interest in NASDAQ Europe, which had previously operated an equity market licensed in Brussels, Belgium. On December 18, 2003, NASDAQ transferred its interest in NASDAQ Europe to a third party. Also, on September 30, 2003, NASDAQ Global sold its 55.5 percent interest in IndigoMarkets to its partner SSI Limited. See "Strategic Review," of Note 3, "Significant Transactions," for further discussion.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of NASD and majority owned subsidiaries. Investments, for which the Company has the ability to exercise significant influence, but not control, are accounted for using the equity method. All significant intercompany balances and transactions have been eliminated in consolidation.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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.

SEGMENTS

NASD operates in two primary business segments, NASD and NASDAQ, as defined by Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures About Segments of an Enterprise and Related Information." NASD's chief operating decision maker, as defined by SFAS No. 131, is our Chief Executive Officer. The Company uses net revenue less expenses to evaluate performance of its business segments.

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 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 value, with any 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 is adjusted for amortization of premiums and accretion of discounts. Fair value is determined based on quoted market prices when available, or if quoted market prices are not available, on discounted expected cash flows using market rates commensurate with the credit quality and maturity of the investment. Realized gains and losses on sales of securities are included in earnings using the average cost method. Amounts due to or from the custodial agent relate to security trades executed prior to the balance sheet date but not yet settled.

Available-for-sale investments also include investments in auction rate securities, which are either preferred stock or bonds with interest rates that reset periodically, typically less than every 90 days, based on a Dutch auction process. Given the longer-term maturities of these securities, they are classified as available-for-sale investments, rather than cash and cash equivalents.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company reviews its investments quarterly to determine whether a decline in fair value below cost basis is other-than-temporary. If the decline in the fair value is judged to be other-than-temporary, the cost basis of the investment is written down to fair value, the amount of the write-down is charged to earnings, and a new cost basis for the security is established.

DERIVATIVE INSTRUMENTS

The Company accounts for freestanding and embedded derivative instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS No. 133, as amended and interpreted, establishes accounting and reporting standards for derivative instruments and requires that all derivatives be recorded on the balance sheet at fair value. Additionally, the accounting for changes in fair value depends on whether the derivative instrument is designated and qualifies as part of a hedging relationship and, if so, the nature of the hedging activity. Changes in the fair value of derivatives that do not qualify for hedge treatment are recognized currently in earnings. NASD derivative instruments are not part of a hedging relationship, therefore changes in market value are recorded in earnings.

The Company places the majority of its investment funds with outside investment managers. The Company reviews its investment portfolio against the provisions of SFAS No. 133, as amended and interpreted, to identify any investment products that may have characteristics that qualify the investment as a derivative instrument. As of December 31, 2004 and 2003, the Company had investments in written options, future contracts, forward contracts and swaps, which the fair value of these derivative instruments was insignificant.

As discussed in Note 3, "Significant Transactions," NASD previously issued 10.8 million warrants for the purchase of 43.2 million shares of NASDAQ common stock. Beginning in July 2002, NASDAQ common stock began trading on the OTC Bulletin Board. Further, all transfer restrictions related to the common stock had expired. Therefore, beginning in July 2002, NASD began accounting for these warrants as derivative instruments. These warrants are carried at fair value with changes in the fair value recorded in income, which resulted in gains of $3.9 million and $16.1 million for the years ended December 31, 2004 and 2003, respectively. As of December 31, 2004, NASD recognized a cumulative gain on these warrants of $124.7 million. Fair value of these warrants was determined using a Black-Scholes valuation model using the following assumptions: a weighted-average expected life of 1.4 years and 2.1 years for 2004 and 2003, respectively, a weighted-average expected volatility of 30 percent, and a weighted-average risk free interest rate of 3.06 percent and 1.31 percent for 2004 and 2003, respectively. As of December 31, 2004 NASD held 43.2 million shares of NASDAQ common stock, of which 21.6 million underlie the outstanding warrants. As of December 31, 2003, NASD held 43.2 million shares of common stock, of which 32.4 million underlie the outstanding warrants.

RECEIVABLES, NET

The Company's receivables are primarily concentrated with NASD members, market data vendors, and NASDAQ-listed companies. 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. The reserve for bad debts is maintained at a level that management believes to be sufficient to absorb estimated losses in the accounts receivable portfolio. The reserve is increased by the provision for bad debts, which is charged against operating results and decreased by the amount of charge-offs, net of

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

recoveries. The amount charged against operating results is based on several factors, including a continuous assessment of the collectibility of each account. In circumstances where a specific customer's inability to meet its financial obligations is known (i.e., bankruptcy filings), the Company records a specific provision for bad debts against amounts due to reduce the receivable to the amount the Company reasonably believes will be collected. For all other customers, provisions for bad debts are made based on the length of time the receivable is past due and historical experience. For receivables past due 31-60 days, 61-90 days and over 90 days, the outstanding account balances are reserved for between 0.0 and 10.0 percent, 10.0 and 50.0 percent, and 50.0 and 100.0 percent of the outstanding account balances, respectively. If circumstances change (i.e., higher than expected defaults or an unexpected material adverse change in a major customer's ability to pay), the Company estimates of recoverability could be reduced by a material amount. Total reserves netted against receivables in the consolidated balance sheets were $8.3 million and $3.9 million at December 31, 2004 and 2003, respectively.

RELATED PARTY TRANSACTIONS

Related party receivables and payables are the result of various transactions between the Company and its affiliates. Also included in related party receivables and payables, as of December 31, 2004, are transactions with Amex, which were previously eliminated in consolidation. As of December 31, 2004, NASD had a note receivable from Amex of $25.0 million that matures on December 31, 2011. See Notes 3, "Significant Transactions," and 16, "Discontinued Operations," for additional information.

CONCENTRATION OF RISK

Financial instruments that potentially subject the Company to concentrations of risk consist primarily of cash and cash equivalents, available-for-sale and held-to-maturity investments, and accounts receivable. The Company does not require collateral on these financial instruments.

Cash and cash equivalents are maintained principally with financial institutions located in the United States that have high credit ratings. Risk on accounts receivable is reduced by the large number of entities comprising the Company's customer base and through ongoing evaluation of collectibility of amounts owed to the Company. NASD uses multiple outside investment managers to manage its investment portfolio and a custody agent, a publicly traded company located in New York, to hold and report on investments.

The Company is economically dependent on two suppliers, which provide telecommunications and information technology services to the Company. One of these two suppliers has recently emerged from bankruptcy. To the extent either of these suppliers is not able to perform, it could have an adverse effect on the Company's business.

The Company's business is transacted with multiple customers, with no individual customer exceeding 10 percent of total revenues.

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 value or the present value of future lease payments. Repairs and maintenance costs are expensed as incurred.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Depreciation and amortization are provided using the straight-line method over estimated useful lives ranging from 10 years to 40 years for buildings and improvements, two years to seven years for data processing equipment and software, and five 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. Depreciation and amortization expense for property and equipment, which includes amortization of capitalized software costs, totaled $106.5 million and $125.9 million for the years ended December 31, 2004 and 2003, respectively.

Property and equipment includes capital leases of $2.4 million and $8.8 million and accumulated amortization of $0.7 million and $4.8 million for the years ended December 31, 2004 and 2003, respectively. Amortization of assets under capital lease was $3.6 million and $6.7 million for the years ended December 31, 2004 and 2003, respectively, and is included within depreciation and amortization expense in the consolidated statements of income.

Property and equipment also includes an asset held-for-sale with a carrying value of $17.6 million as of December 31, 2004, related to an owned facility that is being actively marketed. See Note 15, "Real Estate Developments," for further discussion.

GOODWILL

Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of businesses acquired. As a result of the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," in the first quarter of fiscal year 2002, goodwill is no longer amortized, but instead will be tested for impairment at least annually. Goodwill is subject to annual impairment tests (during the fourth quarter) whereby goodwill is allocated to NASDAQ's reporting units and impairment is deemed to exist if the carrying value of a reporting unit exceeds its estimated fair value. For any business dispositions, goodwill is allocated to the business disposed of based on the ratio of the fair value of the business disposed of to the fair value of the reporting unit.

INTANGIBLE ASSETS, NET

Intangible assets, net, which primarily include technology software licenses and customer relationships, are amortized on a straight-line basis over its estimated average useful life. For intangible assets subject to amortization, the Company evaluates the recoverability of intangible assets and takes into account events or circumstances that warrant revised estimates of useful lives or that indicate impairment exists.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company reviews its long-lived assets for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In the event facts and circumstances indicate that long-lived assets or other assets may be impaired, an evaluation of recoverability would be performed. If an evaluation were required, the estimated future undiscounted cash flows associated with the asset would be compared to the asset's carrying amount to determine if a write-down is required. If impairment were indicated, the Company would prepare a discounted cash flow analysis to determine the amount of the impairment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NASDAQ recorded write-downs for property and equipment of $7.4 million related to long-lived assets held-for-sale in the fourth quarter of 2004. This charge is included in general and administrative expense in the consolidated statements of income. See Note 15, "Real Estate Developments," for further discussion.

In 2003, NASDAQ recognized a $12.3 million impairment charge on the video wall portion of the MarketSite Tower at its Times Square, New York location, based on a significant adverse change in the extent and manner in which the Tower portion of the MarketSite was used. In earlier years, the Tower portion of the MarketSite generated revenues from advertising. However, in the economic downturn that followed September 11, 2001 and the fall in the technology sector, the revenues from the Tower began to decline steeply and the Tower operated at a significant net loss. NASDAQ's new executive management team was put in place in May 2003 and tried to find alternatives and other strategic uses for the video wall on the MarketSite Tower. However, in the fourth quarter of 2003, it was determined that the Tower would never generate the originally forecasted amounts, as the modules that make up the sign are considered outdated and the Tower faces competition from newer advertising technology. NASDAQ obtained a quoted market price valuation from an independent third party and recognized the excess of the carrying amount over the fair value as an impairment charge. The impairment charge was included in the elimination of non-core product lines, initiatives, and severance in the consolidated statements of income.

DEFERRED REVENUE

Deferred revenue represents cash received and billed receivables for which services have not yet been provided. Included in deferred revenue are the unearned portion of registration fees, arbitration fees, member application fees, initial listing fees (IL), and listing of additional shares fees (LAS). The Company recognizes revenue from the upfront initial components of these fees on a straight-line basis over estimated customer relationship periods, determined based on historical experience, ranging from 15 months to 10 years. The estimated service periods for IL fees are six years, while LAS fees are recognized over a four-year service period. The Company recognizes revenue from the annual component of these fees over the annual contract period.

DEPOSITS AND RENEWALS

NASD-registered 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 (SROs). Total CRD related deposits and renewals were $48.9 million and $47.9 million as of December 31, 2004 and 2003, respectively.

In July 2004, NASD was approached by the District Attorney of the County of New York to administer the monies of a restitution fund collected in relation the A.S. Goldmen indictment. Total deposits related to this restitution fund were $11.7 million as of December 31, 2004.

In February 2002, NASD DR was approached by the District Attorney of the County of New York to administer a fund of monies collected as a result of dispositions in a case in which investors were harmed by actions taken by a firm, which was being prosecuted by the District Attorney's Office. This fund was set up to distribute these monies to the claimants in a fair and efficient way. The total deposits related to this fund were $16.5 million as of December 31, 2003. As of December 31, 2004 all amounts were distributed to the appropriate claimants.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION AND COST OF REVENUE

Operating Revenues

Market services include the NASDAQ Market Center and NASDAQ market services subscriptions revenues. NASDAQ Market Center revenues are variable, based on service volumes, and recognized as transactions occur. NASDAQ market services subscriptions revenues are based on the number of presentation devices in service and quotes delivered through those devices. NASDAQ market services subscriptions revenues are recognized in the month that information is provided and are recorded net of amounts due under revenue sharing arrangements with market participants. Pursuant to Emerging Issues Task Force (EITF) No. 99-19, "Reporting Revenues Gross as a Principal vs. Net as an Agent," execution revenues from transactions executed through Brut are recorded on a gross basis in revenues. Expenses, such as the liquidity rebate payments, are recorded in cost of revenues as Brut acts as principal. NASDAQ's other execution revenues will continue to be reported net of the liquidity rebate as NASDAQ does not act as principal.

Issuer services consist primarily of annual listing fees, IL fees and LAS fees on The NASDAQ Stock Market. Annual listing service revenues are recognized ratably over the following 12-month period. IL and LAS fees are recognized on a straight-line basis over estimated customer relationship periods, which are six and four years, respectively. NASDAQ receives license fees for its trademark licenses related to the QQQQ and other financial products linked to NASDAQ indices issued in the U.S. and abroad. These revenues are recognized as earned.

Regulatory fees represent fees to fund NASD's member regulatory activities, including the supervision and regulation of members through examinations, processing of membership applications, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. Regulatory fees are recorded net of any member rebates. Regulatory fees include a trading activity fee, gross income assessment, personnel assessment, and branch office assessment. The trading activity fee is assessed on the sell side of all member transactions in all covered securities regardless of where the trade is executed and is assessed directly to the firm responsible for clearing the transaction on behalf of the member firm. The trading activity fee is recognized as the transaction occurs. Gross income assessments, personnel assessments, and branch office assessments represent annual fees charged to member firms and representatives and are recognized ratably over the annual period for which they relate.

User fees consist of fees charged for initial and annual registrations, qualification exams, fees associated with NASD sponsored meetings and conferences, and charges related to the review of advertisements and corporate filings. Registration fees include both an initial and annual fee charged to all NASD-registered representatives. The initial fee is recognized over the estimated customer relationship period and the annual fee over the related annual period. Qualification fees consist of examination and continuing education fees, which are recognized as the exam is given or continuing education program is held. Advertising represents fees charged for the review of NASD member firms' communications to ensure that they are fair, balanced, and not misleading. Advertising fees are recognized as revenue as the review is completed. Corporate financing consists of fees charged by NASD for reviewing proposed public offerings and are recognized as the review is completed.

Dispute resolution fees consist of fees earned during the arbitration and mediation processes. Fees on open cases are recognized as revenue over the average life of a case. Upon closing of a case, a final billing is prepared and any unpaid fees are recognized as revenue at that time. Also included in dispute resolution fees are mediation fees, SRO annual fees for forum services, neutral training fees, and other fees totaling $2.1 million and $1.7 million for the years ended December 31, 2004 and 2003, respectively. These fees are recognized either when the cash is received or when the service is provided.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Transparency services represent fees charged through NASD's Trade Reporting and Compliance Engine (TRACE) and Alternative Display Facility (ADF). TRACE represents fees charged on secondary market transactions in eligible fixed income securities reported to NASD, TRACE system-related fees, and TRACE market data fees. ADF is a facility for posting quotes, and reporting and comparing trades. TRACE and ADF fees are recognized as the transactions occur.

Contract service fees represent amounts charged by NASDR for regulatory services provided under contractual arrangements and are recognized as revenue as the regulatory service is provided.

Activity Assessment

NASD, as a SRO, pays certain fees and assessments to the Securities and Exchange Commission (SEC) pursuant to Section 31 of the Securities and Exchange Act of 1934. These fees are designed to cover costs incurred by the government in the supervision and regulation of securities markets and securities professionals and are based on a percentage of the total dollar value of securities sold in The NASDAQ Stock Market, the ADF, and the OTC Bulletin Board. NASD remits these fees to the U.S. Treasury semiannually in March and September. In 2004, the SEC adopted new rules under Section 31 and provided SROs additional guidance as to how the SEC charges SROs for these fees, which affected NASD's accounting treatment for such fees in its consolidated financial statements.

NASD recovers the cost of the SEC's fees and assessments through an activity assessment billed to securities firms based on the total dollar value of securities sold in The NASDAQ Stock Market, the ADF, and the OTC Bulletin Board. The assessments billed to securities firms are recognized when the transactions occur. As a result of the new SEC rule, beginning in 2004, NASD reported the activity assessment on a gross basis within revenues in accordance with EITF No. 99-19. Amounts due to the SEC are reported as a cost of revenue. The effect of this change had no impact on NASD's consolidated net income.

Fines

Fines represent sanctions for rule violations. Commencing in 2004, fines are recognized when the fine is assessed. For the years ended December 31, 2004 and 2003, NASD collected fines of $103.9 million and $33.3 million, respectively.

SOFTWARE COSTS

Significant purchased application software, and operational software that is an integral part of computer hardware, are capitalized and amortized using the straight-line method over their estimated useful lives, generally two to seven years. All other purchased software is charged to expense as incurred. In accordance with Statement of Position (SOP) No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," the Company capitalizes internal computer software development costs incurred during the application development stage. Computer software costs incurred prior to or subsequent to the application development stage are charged to expense as incurred.

Unamortized, capitalized software development costs of $85.2 million and $98.8 million as of December 31, 2004 and 2003, respectively, are classified within data processing equipment and software in the consolidated balance sheets. Amortization of

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

costs capitalized under SOP No. 98-1 totaled $31.4 million and $28.3 million for 2004 and 2003, respectively, and is included in depreciation and amortization in the consolidated statements of income. Additions to capitalized software were $16.4 million and $14.9 million in 2004 and 2003, respectively.

SFAS No. 34, "Capitalization of Interest Cost," requires the capitalization of interest as part of the historical cost of acquiring assets, for all costs incurred to get the assets ready for their internal use. SOP No. 98-1 includes interest costs incurred while developing internal-use software as capitalizable costs under SFAS No. 34. The effect of capitalization of interest cost related to the development of internal-use software is not material when compared with the effect of expensing these interest costs as incurred. Therefore, all interest costs have been expensed when incurred.

ADVERTISING COSTS

The Company expenses advertising costs, which include media advertising and production costs. Advertising costs are recorded in the period in which the costs are incurred. Advertising costs totaled $14.6 million and $24.5 million for 2004 and 2003, respectively, and are included in general and administrative expense in the consolidated statements of income.

PENSION BENEFITS

The Company provides three non-contributory defined benefit pension plans for the benefit of eligible employees of its subsidiaries. The non-contributory defined benefit plans consists of a funded Employee Retirement Plan (ERP) and two unfunded Supplemental Executive Retirement Plans (SERP).

The Company accounts for its pension plans in accordance with SFAS No. 87, "Employers Accounting for Pensions." Unrecognized actuarial gains and losses arise from several factors, including experience and assumption changes in the obligations, and from the difference between expected returns and actual returns on plan assets.

STOCK COMPENSATION

NASD's consolidated subsidiary, NASDAQ, maintains a stock compensation plan for its employees. NASDAQ accounts for stock option grants in accordance with Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees." NASDAQ grants stock options with an exercise price equal to the fair market value of the stock at the date of the grant, and, accordingly, recognizes no compensation expense related to such grants.

In the first quarter of 2003, NASDAQ adopted SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure." SFAS No. 148 amends the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation." Pro forma net income includes the amortization of the fair value of stock options over the vesting period and the difference between the fair value and the purchase price of common shares purchased by employees under the employee stock purchase plan. The pro forma net income also includes a reduction in option expense due to the true-up of actual forfeitures. Pro forma income from continuing operations for the years ended December 31, 2004 and 2003, was $103.0 million and $42.9 million, respectively. See Note 12, "NASDAQ Stock Compensation, Stock Awards, and Capital Stock," for additional information.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), which is a revision of SFAS No. 123. SFAS No. 123(R) supersedes APB No. 25 and amends SFAS No. 95, "Statement of Cash Flows." SFAS No. 123(R). Generally the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires NASDAQ to expense in the consolidated statements of income all share-based payments to employees, including grants of employee stock options, based on their fair values. This cost will be recognized over the vesting period of the grants. Pro forma disclosure will no longer be an alternative. NASDAQ cannot predict the impact of adoption of SFAS No. 123(R) because the impact will depend on the levels of share-based payments granted in the future. However, had NASDAQ adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income summarized above and in Note 12 "NASDAQ Stock Compensation, Stock Awards, and Capital Stock" to the consolidated financial statements for further discussion. In April 2005, the SEC announced the adoption of a new rule allowing companies to implement SFAS No. 123(R) at the beginning of their next fiscal year that begins after June 15, 2005.

INCOME TAXES

NASD, NASDR, NASD DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). NIEF is a tax-exempt organization under IRC Section 501(c)(4). 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 are realized. If necessary, a valuation allowance is established to reduce deferred tax assets to the amount that is more likely than not to be realized.

ISSUANCE OF SUBSIDIARY STOCK

The Company recognizes gains and losses on issuances of subsidiary stock in members' equity.

FOREIGN CURRENCY TRANSLATION

Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment are translated to U.S. dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at average exchange rates during the year. Translation adjustments resulting from this process are charged or credited to the other comprehensive income component of members' equity.

MINORITY INTERESTS

Minority interests in the consolidated balance sheets represent the minority owners' share of equity of consolidated subsidiaries, principally NASDAQ, as of the balance sheet date. Minority interests in the consolidated statements of income represent the minority owners' share of the income or loss of consolidated subsidiaries.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECLASSIFICATIONS

Certain amounts for the prior year have been reclassified to conform to the 2004 presentation.

3. SIGNIFICANT TRANSACTIONS

NASD

Sale of Amex

On December 31, 2004, NASD sold its Class B interest in Amex to Amex Membership Corporation and NASD recognized a cumulative loss on this sale of approximately $224.7 million, of which $6.8 million was recognized in 2004, which is included within income (loss) from discontinued operations in the consolidated statements of income. In accordance with SFAS No. 144, Amex is reflected as a discontinued operation for all years presented. See Note 16, "Discontinued Operations," for additional information.

On December 31, 2004, NASD and Amex entered into an Amended and Restated Loan Agreement, which amended Amex's previous borrowings from NASD from $50.0 million to a $25.0 million note (New Note). If the New Note is not paid in full by the first anniversary date of the closing of the transaction, Amex will issue to NASD an Additional Note in an amount of up to $25.0 million (less any prepayments of the New Note). The New Note matures on October 31, 2011 and bears interest at a rate of 10.0 percent per annum (non-compounding) until December 31, 2005, and 5.0 percent per annum thereafter. For each the years ended December 31, 2004 and 2003, NASD recognized intercompany interest income of $0.9 million, which has been eliminated in consolidation.

On December 31, 2004, NASD and Amex entered into a Revolving Credit Facility, pursuant to which Amex will have the ability to borrow from NASD additional amounts, up to a maximum, at any one time, of $25.0 million at an interest rate of 5.0 percent. The maturity date for the Revolving Credit Facility is October 31, 2011. In February 2005, Amex borrowed $25.0 million under this Revolving Credit Facility.

On December 31, 2004, NASD and Amex entered into a Transition Services Agreement, pursuant to which NASD will provide certain administrative and other support services to Amex for a period of up to five years. The services to be provided by NASD include accounting, purchasing, internal audit, and other administrative services. Amex may terminate any of the services provided by NASD, other than internal audit services, upon 90 days' written notice. Amex may terminate the internal audit services at any time. For the years ended December 31, 2004 and 2003, NASD recognized $5.4 million and $7.3 million, respectively, of intercompany revenues related to administrative and other support services provided to Amex, which has been eliminated in consolidation.

On April 30, 2004, NASD and Amex signed a Regulatory Services Agreement, pursuant to which NASD provides certain regulatory services and develops certain regulatory technologies for Amex. If Amex requires additional services or technologies, beyond the initially agreed scope of work, Amex is generally required to give NASD the opportunity to perform such additional services. Further, NASD may extend financing to Amex for the costs of technology and related matters that may be required to be implemented by the SEC, but NASD will not extend financing for any fines or penalties imposed on Amex by the SEC. For the year

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

ended December 31, 2004, NASD recognized $6.6 million of intercompany revenue related to regulatory services provided to Amex, which has been eliminated in consolidation.

NASDAQ Restructuring

In 2000, NASD members approved a plan to broaden the ownership of NASDAQ to minimize potential conflicts of interest between NASDAQ and NASDR and allow NASDAQ to respond to current and future competitive challenges caused by technological advances and the increasing globalization of financial markets.

In connection with this plan, NASD issued 10.8 million warrants to purchase an aggregate of 43.2 million NASD-owned common shares of NASDAQ, generating net proceeds to NASD of $128.6 million. Each warrant sold by NASD entitles the holder to purchase voting trust certificates for four shares of NASDAQ common stock owned and held by NASD for prices ranging from $13.00 to $16.00 per share. Each warrant is exercisable for 12 months in each of four annual tranches, with one share of NASDAQ common stock available for purchase in each tranche. The first and second annual tranches expired on June 27, 2003, and June 25, 2004, respectively, resulting in 21.6 million shares of NASDAQ common stock reverting back to NASD, which represented the common stock underlying the expired warrants. The third tranche became exercisable on June 28, 2004, and expires on June 27, 2005. The fourth tranche becomes exercisable on June 28, 2005, and expires on June 27, 2006. For the years ended December 31, 2004 and 2003, 6,750 and 15,000 warrants were exercised and an equivalent number of voting trust certificates were issued from warrant exercises, yielding gross proceeds to NASD of $0.1 million and $0.2 million, respectively. As of December 31, 2004 NASD held 43.2 million shares of NASDAQ common stock, of which 21.6 million underlie the outstanding warrants. As of December 31, 2003, NASD held 43.2 million shares of common stock, of which 32.4 million underlie the outstanding warrants.

In March 2002, NASDAQ issued 1,338,402 shares of Series A Cumulative Preferred Stock and one share of Series B Preferred Stock to NASD. The Series A Cumulative Preferred Stock carried a 7.6 percent dividend rate for the year commencing March 2003 and carried a 10.6 percent dividend rate in all subsequent years. The Series B Preferred Stock does not pay dividends and entitles NASD to cast the number of votes that, together with all other votes that NASD is entitled to vote by virtue of ownership, proxies or voting trusts, enables NASD to cast one vote more than one-half of all votes entitled to be cast by stockholders. If NASDAQ's registration as an exchange (Exchange Registration) is approved by the SEC and becomes effective, the share of Series B Preferred Stock will lose its voting rights and will be redeemed by NASDAQ.

If NASDAQ obtains Exchange Registration, the shares of NASDAQ common stock underlying unexercised and unexpired warrant tranches, as well as the shares of NASDAQ voting trust certificates purchased through the exercise of warrants, will be voted by a voting trustee at the direction of NASD. If Exchange Registration is approved, the warrant holders will have the right to direct the voting trustee as to the voting of the shares of NASDAQ common stock underlying unexercised and unexpired warrant tranches. Additionally, NASD has determined, commencing upon Exchange Registration, to vote its shares of NASDAQ common stock (other than shares underlying then outstanding warrants) in the same proportion as the other common stockholders of NASDAQ.

On September 30, 2004, NASD waived a portion of the dividend on the Series A Cumulative Preferred Stock for the third quarter of 2004 of $2.5 million and accepted an aggregate amount of $1.0 million (calculated based on an annual rate of 3.0 percent) as payment in full of the dividend for this period. On November 29, 2004, NASD entered into an exchange agreement with NASDAQ pursuant to which NASD exchanged 1,338,402 shares of NASDAQ's Series A Cumulative Preferred Stock for 1,338,402 shares of

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

newly issued Series C Cumulative Preferred Stock. The Series C Cumulative Preferred Stock accrues quarterly dividends at an annual rate of 3.0 percent for all periods until July 1, 2006, and at an annual rate of 10.6 percent for periods thereafter. NASD also may be entitled to an additional payment in certain circumstances, which may not exceed $16.3 million in aggregate depending on the amount of time the Series C Cumulative Preferred Stock is outstanding and the market price of NASDAQ's common stock at the time NASDAQ redeems the Series C Cumulative Preferred Stock. Shares of Series C Cumulative Preferred Stock do not have voting rights, except for the right as a class to elect two new directors to the Board of Directors anytime distributions on the Series C Cumulative Preferred Stock are in arrears for four consecutive quarters and as otherwise required by Delaware law. In the event of a liquidation of NASDAQ, the holders of the Series C Cumulative Preferred Stock are entitled to have paid to them out of the assets of the NASDAQ available for distribution to stockholders before any distribution is made to or set apart for the holders of shares of NASDAQ common stock, Series B Preferred Stock, or other Junior Securities, an amount in cash per share equal to $100.00 per share plus all accrued and unpaid dividends thereon, whether or not declared, to the date of liquidation. These investments have been eliminated in consolidation.

NASDAQ recognized a loss of $3.9 million related to the exchange of the Series A Cumulative Preferred Stock with the Series C Cumulative Preferred Stock. This loss was due to the difference between the combined fair value of the Series C Cumulative Preferred Stock and additional dividend ($137.7 million) versus the redemption value ($133.8 million). The principal amount of the Series C Cumulative Preferred Stock will accrete through NASDAQ's retained earnings from its estimated current fair market value of $129.2 million on November 29, 2004 to its redemption value of $133.8 million over the five consecutive quarters beginning with the fourth quarter 2004. For the year ended December 31, 2004, $0.9 million was accreted through NASDAQ's retained earnings. As a result, NASD realized an increase in its consolidated members' equity of $2.2 million, representing the minority owners' portion of these transactions.

As a result of these conditions, NASD has a controlling interest in NASDAQ until Exchange Registration is effective. As of December 31, 2004, the Exchange Registration has not become effective. As of December 31, 2004, NASD owned 54.7 percent of NASDAQ common stock, 100 percent of NASDAQ Series B Preferred Stock, and 100 percent of NASDAQ Series C Cumulative Preferred Stock.

NASDAQ

2004 Cost Reductions

During 2004, in connection with taking certain actions to improve its operational efficiency, NASDAQ incurred expenses of approximately $62.6 million. The following table summarizes the cost reduction charges included in the consolidated statement of income for the year ended December 31, 2004:

	(in millions)
Real estate consolidation	$ 29.0
Reductions in force	9.4
Technology migration	24.2
Total cost reduction charges	$ 62.6

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

Real Estate Consolidation

During 2004, NASDAQ's management re-evaluated all of NASDAQ's owned and leased real estate and determined that NASDAQ could consolidate staff into fewer locations and save significant costs. In 2004, NASDAQ recorded real estate charges, primarily for sublease loss reserves, of $29.0 million (net of a $1.9 million reversal of a sublease reserve recorded in 2003), which is included in general and administrative expense in the consolidated statements of income. In 2003, NASDAQ also recorded real estate charges of $3.5 million. See Note 15, "Real Estate Developments," for further discussion.

Reductions in Force

During the year ended December 31, 2004, 172 NASDAQ positions were eliminated associated with staff reduction plans and NASDAQ recorded a charge of $9.4 million for severance and outplacement costs, which is included in compensation and benefits expense in the consolidated statements of income. NASDAQ paid approximately $4.9 million during the year ended December 31, 2004, for these severance and outplacement costs from the 2004 staff reduction plans. NASDAQ expects to pay the remainder of the severance and outplacement costs by the end of the first quarter of 2006. Total headcount decreased from 956 employees at December 31, 2003, to 786 employees at December 31, 2004.

Technology Migration

As a result of a continued review of its technology infrastructure, NASDAQ shortened the estimated useful life of certain assets and changed the lease terms on certain operating leases associated with its quoting platform and its trading and quoting network as it migrates to lower-cost operating environments, which resulted in incremental depreciation and amortization expense. The incremental depreciation and amortization expense associated with these assets and operating leases was $18.7 million for the year ended December 31, 2004.

In November 2004, NASDAQ purchased a technology platform held-for-sale and owned by Easdaq, for €1.9 million ($2.4 million). Additionally, in order to make use of the purchased technology platform, NASDAQ purchased a license for the use of certain software for $0.5 million. NASDAQ has a multi-year initiative to migrate the NASDAQ Market Center applications to lower-cost operating environments and processes. The purchased platform will provide a baseline of functionality for the NASDAQ Market Center. The migration will reduce NASDAQ's overall costs. As a result of the migration initiative, NASDAQ shortened the estimated useful life of its current application platform. Beginning in the fourth quarter of 2004, NASDAQ recorded incremental amortization expense of $2.9 million. NASDAQ expects to record an additional $19.8 million of incremental amortization expense through March 2007.

In October 2004, NASDAQ entered into an agreement for technology equipment and also renegotiated related operating leases with a major vendor. NASDAQ sold equipment with a net book value of $13.6 million and entered into a three-year lease agreement, which included new upgraded equipment. NASDAQ received $11.0 million in cash from the vendor and recognized a $2.6 million loss on this transaction, which is included in general and administrative expense in the consolidated statements of income. NASDAQ paid $1.6 million in 2004 and will pay $8.2 million, $0.4 million, and $0.4 million in 2005, 2006, and 2007, respectively, under the terms of the lease agreement. NASDAQ also upgraded related leased equipment and entered into a new

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

three-year operating lease and extended the terms of license and maintenance agreements. Under the terms of the operating lease and license and maintenance agreements, NASDAQ paid $11.2 million in 2004 and will pay $15.3 million, $9.0 million and $2.9 million in 2005, 2006, and 2007, respectively.

Acquisition of Brut

On September 7, 2004, NASDAQ announced the completion of its acquisition of Brut, the owner of the Brut ECN and affiliated entities, from SunGard for a total consideration of $190.0 million in cash, subject to certain post-closing adjustments. See Note 1, "Organization and Nature of Operations" for further discussion of the entities acquired. NASDAQ financed the purchase from available cash and investments. As a result of this acquisition, NASDAQ expects that its customers will benefit from enhanced execution quality, additional quote information and a deeper pool of liquidity in NASDAQ-listed securities and securities listed on other exchanges. NASDAQ's customers also benefit from the ability to access liquidity from multiple destinations outside the NASDAQ Market Center through the use of Brut's sophisticated order routing technology. See Note 4, "Acquisition of Brut," for further discussion.

In connection with the transaction, Brut and SunGard entered into a hosting and multi-year processing agreement for SunGard to provide real-time securities clearance and settlement system for certain NASDAQ trades. Brut also contracted with SunGard to host certain software on designated equipment at a SunGard facility for a transitional period. See Note 14, "Commitments and Contingencies," for further discussion.

Strategic Review

During the second quarter of 2003, NASDAQ announced the results of a strategic review of its operations designed to position NASDAQ for improved profitability and growth. This strategic review included the elimination of non-core product lines and initiatives and resulted in a reduction in NASDAQ's workforce. For the year ended December 31, 2003, a total pre-tax charge to earnings of $145.5 million was recorded. The net impact to NASDAQ was a total pre-tax charge of $143.5 million. The difference represented costs absorbed by minority shareholders of NASDAQ Europe. The charge recorded reflects the completion of the costs associated with NASDAQ's strategic review. As shown in the following table, the total charge of $145.5 million includes $97.9 million from continuing operations and $47.6 million from discontinued operations related to NASDAQ Europe and IndigoMarkets. See Note 16, "Discontinued Operations," for further discussion. The charge was primarily recorded to property and equipment, goodwill, intangible assets, net, other accrued liabilities, and accrued personnel costs in the consolidated balance sheets.

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

The following table summarizes the strategic review charges included in the consolidated statements of income for the year ended December 31, 2003:

	(in millions)
Continuing Operations:	
Non-Core Product Lines and Initiatives:	
Impairment of capitalized software and fixed assets	$ 21.1
Impairment of goodwill and intangible assets	8.2
Contract cancellations	11.4
Other exit costs	11.6
Total non-core product lines and initiatives	52.3
Severance and benefit costs	32.4
Loss on early extinguishment of debt	13.2
Total continuing operations strategic review charge	$ 97.9
Discontinued Operations:	
NASDAQ Europe:	
Impairment of technology platform	$ 29.4
Severance and benefit costs	2.5
Impairment of goodwill	8.1
Other exit costs including contract cancellations	8.2
Total NASDAQ Europe	48.2
Gain on disposition of IndigoMarkets	(0.6)
Total discontinued operations strategic review charge	$ 47.6
Total strategic review charge	$ 145.5

Non-core product lines and initiatives included in the strategic review were:

- Primex—Primex was an electronic auction system. NASDAQ ended its exclusive rights agreement with Primex Trading N.A., L.L.C. on December 31, 2003. NASDAQ decided to consolidate its trading services to a common functionality within the SuperMontage system and ceased offering Primex effective January 16, 2004.
- NASDAQ Tools—NASDAQ Tools was an order management system that ran on the NASDAQ Application Programming Interface using the NASDAQ Workstation II and was wound down throughout 2003. NASDAQ Tools was a previously wholly-owned subsidiary of NASDAQ and was merged with and into NASDAQ on July 31, 2002.
- NQLX—NQLX was a joint venture with LIFFE to create a market for single stock futures and other futures products. On July 24, 2003, NASDAQ redeemed its interest in the NQLX joint venture and transferred its ownership interest to LIFFE. LIFFE assumed financial and management responsibility for NQLX. This change did not have any impact on the operation of NQLX, but usage of the NASDAQ brand by the company ceased.

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

- BBX—BBX was a proposed platform for companies not eligible for The NASDAQ SmallCap Market to raise equity capital and increase the visibility of their stock. OTC Bulletin Board continues its existing operations.
- Liquidity Tracker—Liquidity Tracker was an automated order routing system designed to allow traders to direct orders to specific market makers based on recent trading activity. Liquidity Tracker ceased operations as of June 30, 2003.
- MarketSite Tower—MarketSite Tower is located at NASDAQ's Times Square, New York location. The video wall portion of the Tower was deemed impaired.

The charge related to the elimination of the above non-core products and initiatives was approximately $52.3 million for the year ended December 31, 2003. Included in the charge was the reduction of NASDAQ's investment in NQLX of $6.3 million due to the redemption of NASDAQ's interest in the NQLX joint venture, the impairment of goodwill of $4.1 million associated with NASDAQ Tools, the impairment of certain intangible assets of $4.1 million, impairment of various capitalized software and fixed assets of $21.1 million, contract cancellations of $11.4 million, and other costs of $5.3 million. Included in the $21.1 million impairment of various capitalized software and fixed assets is $12.3 million impairment associated with the MarketSite Tower. The remaining impairment of capitalized software and fixed assets relates to the eliminated products specifically NASDAQ Tools, Primex, BBX and Liquidity Tracker.

In addition, the charges from continuing operations recorded included severance costs of $32.4 million and the loss on early extinguishment of long-term debt of $13.2 million. The severance costs included $13.8 million related to the reductions in force of 329 employees. The remaining $18.6 million of severance costs relate to the fulfillment of employment contracts and obligations associated with the retirement and departure of certain members of senior management. Total headcount was 956 as of December 31, 2003 versus 1,227 (excluding 48 employees in discontinued operations) as of December 31, 2002. The extinguishment of debt costs relate to the redemption of $150.0 million in aggregate principal amount of NASDAQ's 5.83 percent senior notes due 2007. In conjunction with its strategic review, NASDAQ reassessed its capital needs and determined that it no longer needed the liquidity of the senior notes. See the Long-Term Debt below for further discussion.

The following table summarizes the strategic review accrual activity from December 31, 2003, through December 31, 2004. These accruals are recorded in other current liabilities and accrued personnel costs in the current liabilities section and in other liabilities in the non-current liabilities section of the consolidated balance sheets. NASDAQ funded the majority of these reserves, except for a $4.6 million contract payment that is due in January 2006 and other contractual sublease obligations that will continue through 2010.

	Severance for U.S. Employees	Products & Other	Total
		(in millions)	
Accrued liabilities associated with the strategic review as of December 31, 2003	$ 16.4	$ 10.7	$ 27.1
Cash payments	(9.2)	(9.6)	(18.8)
Other	(1.8)	(0.2)	(2.0)
Accrued liabilities associated with the strategic review as of December 31, 2004	$ 5.4	$ 0.9	$ 6.3

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

Discontinued operations included in the strategic review were:

- NASDAQ Europe—NASDAQ Europe was a pan-European stock market licensed in Belgium. See below for complete discussion of the wind-down and eventual transfer of shares of NASDAQ Europe.
- IndigoMarkets—IndigoMarkets was a joint venture with SSI Limited to develop international trading platforms. On September 30, 2003, NASDAQ Global sold its interest in the joint venture to SSI Limited and recognized a gain on the sale of approximately $0.6 million.

EUROPE

As a result of the strategic review, NASDAQ supported the closing of the market operated by NASDAQ Europe, in which NASDAQ owned a 63.0 percent interest through December 18, 2003. At an Extraordinary General Meeting held on June 26, 2003, the shareholders of NASDAQ Europe voted to discontinue operations of the market and, as a result, market operations were wound down pursuant to a Transition Plan approved by the Belgian Banking and Finance Commission.

As NASDAQ Europe was winding-down its market operations, NASDAQ reached an agreement to transfer all of NASDAQ's shares in NASDAQ Europe to one of that company's original investors; the cash consideration for the transaction was nominal. The transfer of NASDAQ's shares of NASDAQ Europe was completed on December 18, 2003. The entity ceased using the NASDAQ Europe name after the transaction and is now known as Easdaq. As part of the transaction, NASDAQ Europe's new owner committed to seek to restructure that company's obligations and, in that context, to request from certain major creditors releases of any claims they might have against NASDAQ Europe's former directors, officers, and shareholders (if such claims are related to NASDAQ's prior ownership interest in NASDAQ Europe).

At the time of the transfer, NASDAQ Europe had $15.1 million of external debt, accrued interest, and other liabilities. NASDAQ recorded liabilities of $15.1 million that management believed was sufficient to satisfy any potential claims against NASDAQ. NASDAQ and Easdaq entered into an agreement dated as of October 27, 2004, providing in relevant part that Easdaq was to reach agreements with certain of its creditors to settle these creditors' existing claims against Easdaq. On November 9, 2004, NASDAQ was provided evidence that these claims (related to NASDAQ's prior ownership interest in NASDAQ Europe) of certain Easdaq's creditors were satisfied or otherwise settled without any liability for NASDAQ. NASDAQ was the third-party beneficiary of these creditor agreements and in the fourth quarter of 2004 released the $15.1 million reserve it maintained in connection with such claims and liabilities. The release of the reserve was recorded as income from discontinued operations on the consolidated statements of income.

Also, as part of NASDAQ's strategic review, during the third quarter of 2003, NASDAQ supported NASDAQ Europe's position in favor of the decision of the shareholders of NASDAQ Deutschland, a German exchange in which NASDAQ Europe had a 50.0 percent interest, to suspend that company's trading operations effective August 29, 2003. NASDAQ Europe transferred all of its shares in NASDAQ Deutschland to one of the other shareholders, BWB Holding AG, as of August 29, 2003. All shareholders of NASDAQ Deutschland agreed to release and discharge each other from certain claims that they may have had against each other in connection with certain agreements related to the operations and control of NASDAQ Deutschland.

The charge related to the orderly wind-down and liquidation of market operations in Belgium and Germany was approximately $48.2 million (excluding the minority interest benefit of $2.0 million) for the year ended December 31, 2003. The $48.2 million

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

charge includes the $29.4 million impairment of certain technology platforms held-for-sale and owned by NASDAQ Europe, the impairment of goodwill of $8.1 million (NASDAQ Europe and NASDAQ Deutschland), severance costs of $2.5 million, and other costs of $8.2 million including contract cancellations. During the third quarter of 2003, the losses incurred by NASDAQ Europe exceeded the minority shareholders' interests. Therefore, once the minority shareholders reached this point, NASDAQ absorbed 100.0 percent of NASDAQ Europe's losses and strategic review charges.

Long-Term Debt

On September 30, 2003, NASDAQ redeemed $150.0 million of its senior notes. In conjunction with its strategic review, NASDAQ reassessed its capital needs and determined that it no longer needed the liquidity of the senior notes. NASDAQ paid the holders of the senior notes $150.0 million in outstanding principal amount, accrued interest of $1.2 million and an aggregate make-whole payment of approximately $12.6 million (representing the net present value of future payments). The repayment amounts reflected the terms of the senior notes, except that the parties agreed to a reduced make-whole amount equal to the excess of the discounted value of the remaining scheduled payments, discounted at a factor equal to 100 basis points over the yield to maturity of U.S. Treasury securities having a maturity equal to the remaining average life of the redeemed amount. This represented a renegotiation of the 50 basis points over the yield to maturity required by the terms of the senior notes. NASDAQ recorded a $13.2 million pre-tax charge in the third quarter of 2003 related to the redemption of the senior notes. This charge included the make-whole payment and capitalized costs related to the issuance of the senior notes. NASDAQ used funds from available cash and investments to finance the redemption.

NASDAQ Member Revenue Sharing

Effective June 1, 2002, NASDAQ terminated its market data revenue sharing program for securities listed on The NASDAQ Stock Market, as a result of the SEC's decision to abrogate certain market participant tape sharing pilot programs. The SEC's action was in response to concerns about the effect of market data rebates on the accuracy of market data and the regulatory functions of SROs. The SEC's action allows NASDAQ and competing exchanges to retain tape revenue. However, NASDAQ continues to share market data revenue with the exchanges that participate in the UTP Plan based on their respective share of volume and trades of securities listed on The NASDAQ Stock Market. In addition, NASDAQ continues to share tape revenue with NASDAQ market participants who report trades in the NYSE and the Amex-listed securities through NASDAQ.

In August 2003, NASDAQ implemented the NASDAQ General Revenue Sharing Program, which, like the General Revenue Sharing Program of The National Stock Exchange, a regional stock exchange, shares operating revenue from multiple business lines in addition to tape fee revenue. The new discretionary program shares operating revenue, which is interpreted to mean net revenue after expenses from all services that derive revenue from member trading and trade-reporting activity in NASDAQ-listed securities. As such, the program is designed to provide an incentive for quoting market participants to send orders and report trades to the NASDAQ Market Center. NASDAQ did not share any revenues during 2003 under the General Revenue Sharing Program. For the year ended December 31, 2004, NASDAQ shared approximately $20.1 million under this new program, which is shown net within market services revenues.

3. SIGNIFICANT TRANSACTIONS (CONTINUED)

NASDAQ Japan

During the second quarter of 2002, NASDAQ recognized an other-than-temporary impairment charge on its equity investment in NASDAQ Japan. NASDAQ recognized this impairment as a result of the depressed level of market activity in Japan, combined with the suspension of NASDAQ Japan's hybrid trading system due to the inability to gain exchange approval of market rules and industry participation. These conditions led management to conclude that NASDAQ Japan would not be profitable in the foreseeable future. As a result, NASDAQ Japan's financial liabilities to NASDAQ were not expected to be repaid and were recognized as a loss. NASDAQ Japan entered into liquidation status in late November 2002, and was completely dissolved by the end of May 2003.

The net impact of the other-than-temporary impairment on NASDAQ's pre-tax income was $15.2 million. This represented a complete write-down of the investment, outstanding and unfunded loans (an additional $6.0 million was loaned and $7.0 million was committed), foreign exchange translation losses and other receivables, partially offset by a re-valuation of certain variable NASDAQ Japan stock based awards of approximately $7.9 million.

During the second quarter of 2003, NASDAQ reversed $5.0 million of the reserves related to NASDAQ Japan due to favorable contract negotiations and lower legal costs resulting from the complete liquidation of NASDAQ Japan.

QQQ Lists on NASDAQ

On December 1, 2004, the NASDAQ-100 Index Tracking Stock (NASDAQ symbol: QQQQ) transferred its listing to NASDAQ from Amex. NASDAQ and Amex reached a mutual decision to transfer the QQQ earlier than the contractual date of June 2005.

4. ACQUISITION OF BRUT

As previously discussed, on September 7, 2004, NASDAQ announced the completion of its acquisition of Brut and related entities, including Toll, from SunGard for a total consideration of $190.0 million in cash, subject to certain post-closing adjustments. In addition, NASDAQ incurred direct costs of $3.1 million associated with the acquisition. NASDAQ accounted for the acquisition under the purchase method of accounting. Brut and related affiliates are included within the NASDAQ segment.

4. ACQUISITION OF BRUT (CONTINUED)

NASDAQ had not finalized the allocation of the purchase price as of December 31, 2004. NASDAQ expects future adjustments related to taxes and settlement of post-closing adjustments. An estimation of the purchase price allocation was prepared and included as part of these financial statements. The initial purchase price was allocated as follows:

	(in thousands)
Net assets acquired:	
Accounts receivable, net	$ 19,240
Deferred tax asset	486
Other current assets	182
Property and equipment, net	3,433
Intangible assets	5
Other assets	20
Accounts payable and accrued expenses	(14,248)
Accrued personnel costs	(2,198)
Non-current deferred tax liability	(523)
Accumulated other comprehensive loss	(127)
Total net assets	6,270
Goodwill	141,730
Intangible assets	42,000
Estimated purchase price	$ 190,000

During the fourth quarter of 2004, NASDAQ adjusted the initial allocation of the purchase price. Goodwill decreased from $141.7 million to $141.4 million primarily due to a decrease in severance liability. NASDAQ does not expect future adjustments to the purchase price to be significant. NASDAQ expects to deduct $2.7 million of goodwill for income tax purposes for the year ended December 31, 2004.

The following table presents details of the identifiable intangible assets acquired in the Brut acquisition:

	Amount	Estimated Average Useful Life
	(in thousands)	*(in years)*
Identifiable intangible assets:		
Technology	$ 15,700	10.0
Customer relationships	26,300	10.0
Total	$ 42,000	

Both the goodwill and intangible assets related to the acquisition of Brut are included on the books and records of Brut in the NASDAQ segment.

4. ACQUISITION OF BRUT (CONTINUED)

The unaudited pro forma combined historical results for the years ended December 31, 2004 and 2003, as if NASDAQ had acquired Toll and related entities at the beginning of fiscal 2004 and 2003, are estimated to be:

	YEARS ENDED DECEMBER 31,	
	2004	2003
	(in thousands)	
Total Revenues	$ 1,464,543	$ 1,509,672
Net Revenues	1,066,979	1,044,532
Income from continuing operations	104,627	48,363

The pro forma results include amortization of the intangibles presented above and the elimination of intercompany transactions had NASDAQ and Toll acted as a combined company. The pro forma results are not necessarily indicative of what actually would have occurred if the acquisition had been completed as of the beginning of each fiscal period presented, nor are they necessarily indicative of future consolidated results.

The integration of Brut's services into NASDAQ is designed to be seamless to both NASDAQ and Brut customers. Brut continues to operate under the Brut name as a broker-dealer; however, it will operate as part of The NASDAQ Stock Market. Brut is subject to the SEC's Uniform Net Capital Rule (the "Rule"), which requires the maintenance of minimum net capital. Brut has elected to use the basic method permitted by the Rule to determine its net capital, which requires Brut maintain minimum net capital equal to the greater of $100,000 or 6.67 percent of aggregate indebtedness, as defined. The rule also requires that aggregate indebtedness not exceed 15 times net capital. At December 31, 2004, Brut had net capital of $8.1 million, which was $6.4 million in excess of its required net capital of $1.7 million.

Brut results are included as of September 7, 2004, in the consolidated statements of income.

5. DEFERRED REVENUE

NASD

In June 2003, the EITF finalized Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," which became effective for NASD's consolidated financial statements on January 1, 2004. This accounting pronouncement requires revenue arrangements be reviewed to determine (a) how the arrangement consideration should be measured, (b) whether the arrangement should be divided into separate units of accounting, and (c) how the arrangement consideration should be allocated among the separate units of accounting. Once each element of a revenue arrangement has been identified, EITF No. 00-21 requires companies to recognize the revenue for such element in accordance with existing accounting principles generally accepted in the United States (GAAP). EITF No. 00-21 does not address when the criteria for revenue recognition are met or provide guidance on the appropriate revenue recognition convention for a given unit of accounting. NASD performed a comprehensive review of all revenue arrangements and concluded that this new accounting pronouncement was applicable to NASD's registration fees and arbitration fees.

As a result of this review, NASD changed its method of accounting for revenue recognition for these fees. The first year's registration fee consists of two elements, an upfront initial fee and an annual fee. NASD has segregated the initial and annual

5. DEFERRED REVENUE (CONTINUED)

components of this fee using the residual value approach within EITF No. 00-21 and will defer and amortize the initial fee element over an estimated customer relationship period of 10 years for firms and three and a half years for individual representatives. Fees received on open arbitration cases also include multiple elements. These fees will be deferred and amortized over the average life of an arbitration case, or 15 months. Registration fees are included within user fees and arbitration fees are included within dispute resolution fees in the consolidated statements of income.

NASD recognized a one-time cumulative effect of change in accounting principle as of January 1, 2004, of $58.3 million. The adjustment to 2004 net income for the cumulative change to prior years' results consists of the following:

	(in thousands)
Registration	$ (28,533)
Arbitration	(29,809)
Cumulative effect of change in accounting principle	$ (58,342)

In 2004, NASD recognized an aggregate of $40.4 million in revenue that was deferred as part of the cumulative effect adjustment as of January 1, 2004. Following is a summary of amounts included in NASD's current and non-current deferred revenue as of December 31, 2004, and the years over which those amounts will be recognized:

	Registration	Arbitration	Annual and Other	Total
		(in thousands)		
Fiscal year ended:				
2005	$ 10,879	$ 29,285	$ 37,822	$ 77,986
2006	7,486	854	–	8,340
2007	4,240	–	–	4,240
2008	1,492	–	–	1,492
2009 and thereafter	3,168	–	–	3,168
	$ 27,265	$ 30,139	$ 37,822	$ 95,226

Following is a summary of activity in NASD current and non-current deferred revenue for the year ended December 31, 2004 for all revenue arrangements. The additions reflect the fees charged during the year while the amortization reflects the revenues recognized during the year based on the accounting methodology described above.

	Registration	Arbitration	Annual and Other	Total
		(in thousands)		
Balance as of January 1, 2004	$ 28,461	$ 29,809	$ 36,879	$ 95,149
Additions	12,101	52,240	48,862	113,203
Amortization	(13,297)	(51,910)	(47,919)	(113,126)
Balance as of December 31, 2004	$ 27,265	$ 30,139	$ 37,822	$ 95,226

5. DEFERRED REVENUE (CONTINUED)

As of December 31, 2003, NASD had deferred revenues of $36.8 million, which is included within current deferred revenues in the consolidated balance sheets. During the fourth quarter of each year, NASD completes its annual renewal process for all registered representatives and member firm branch offices. These renewals relate to the following fiscal year, the period over which they are recognized into income. For the year ended December 31, 2003, NASD recognized revenues of $29.9 million and $6.7 million, which are in registration fees and member regulatory fees in the consolidated statements of income, respectively.

NASDAQ

NASDAQ's deferred revenue, which was not impacted by the issuance of EITF No. 00-21, as of December 31, 2004, will be recognized in the following years:

	Initial	LAS	Annual and Other	Total
		(in thousands)		
Fiscal year ended:				
2005	$ 27,306	$ 32,231	$ –	$ 59,537
2006	17,101	21,873	–	38,974
2007	12,075	15,603	–	27,678
2008	9,407	5,351	–	14,758
2009 and thereafter	8,411	–	–	8,411
	$ 74,300	$ 75,058	$ –	$ 149,358

NASDAQ's deferred revenue for the years ended December 31, 2004 and 2003, is reflected in the following tables. The additions reflect revenues charged during the year, while the amortization reflects revenues recognized during the year in accordance with GAAP.

	Initial	LAS	Annual and Other	Total
		(in thousands)		
Balance at January 1, 2004	$ 78,485	$ 65,957	$ –	$ 144,442
Additions	26,905	45,846	97,446	170,197
Amortization	(31,090)	(36,745)	(97,446)	(165,281)
Balance at December 31, 2004	$ 74,300	$ 75,058	$ –	$ 149,358

	Initial	LAS	Annual and Other	Total
		(in thousands)		
Balance at January 1, 2003	$ 93,857	$ 72,841	$ –	$ 166,698
Additions	16,886	30,206	97,964	145,056
Amortization	(32,258)	(37,090)	(97,964)	(167,312)
Balance at December 31, 2003	$ 78,485	$ 65,957	$ –	$ 144,442

6. INVESTMENTS

AVAILABLE-FOR-SALE INVESTMENTS

Investments principally consist of U.S. Treasury securities, obligations of government-sponsored enterprises, U.S. corporate debt securities, equity securities, and other financial instruments. Following is a summary of investments classified as available-for-sale, which are carried at fair value as of December 31, 2004:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(in millions)			
U.S. Treasury securities	$ 30.3	$ 0.5	$ –	$ 30.8
Debt securities issued by government-sponsored enterprises	64.7	–	0.8	63.9
Obligations of states and political subdivisions	55.3	0.2	0.9	54.6
Debt securities issued by foreign governments	4.7	0.1	–	4.8
Asset-backed securities	31.7	0.2	0.2	31.7
U.S. corporate debt securities	80.3	0.9	0.4	80.8
Other debt securities	30.9	0.6	0.6	30.9
Auction rate securities	219.2	–	–	219.2
Total debt securities	517.1	2.5	2.9	516.7
Mutual/commingled funds	572.1	40.2	1.3	611.0
Equity securities	229.6	37.3	2.7	264.2
Total	$ 1,318.8	$ 80.0	$ 6.9	$ 1,391.9

Unrealized gains (losses) from available-for-sale securities recorded in members' equity also include the Company's share of available-for-sale securities unrealized gains (losses) of equity investees.

Following is a summary of investments classified as available-for-sale, which are carried at fair value as of December 31, 2003:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(in millions)			
U.S. Treasury securities	$ 113.8	$ 1.1	$ 0.4	$ 114.5
Debt securities issued by government-sponsored enterprises	105.5	0.2	0.3	105.4
Obligations of states and political subdivisions	20.0	0.3	–	20.3
Debt securities issued by foreign governments	6.2	0.2	–	6.4
Asset-backed securities	187.0	1.6	1.0	187.6
U.S. corporate debt securities	221.9	6.4	0.6	227.7
Other debt securities	84.8	1.8	2.8	83.8
Auction rate securities	257.5	–	–	257.5
Total debt securities	996.7	11.6	5.1	1,003.2
Mutual/commingled funds	160.0	10.3	2.3	168.0
Equity securities	113.5	26.0	1.4	138.1
Total	$ 1,270.2	$ 47.9	$ 8.8	$ 1,309.3

6. INVESTMENTS (CONTINUED)

Following is a summary, by contractual maturity, of investments classified as available-for-sale as of December 31, 2004:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
Due in one year or less	$ 121.7	$ 0.1	$ 0.9	$ 120.9
Due after one through five years	158.0	1.1	1.6	157.5
Due after five through 10 years	16.8	0.5	0.1	17.2
Due after 10 years	220.6	0.8	0.3	221.1
Total debt securities	517.1	2.5	2.9	516.7
Mutual/commingled funds	572.1	40.2	1.3	611.0
Equity securities	229.6	37.3	2.7	264.2
Total	$ 1,318.8	$ 80.0	$ 6.9	$ 1,391.9

The gross realized gains on sales in 2004 and 2003 totaled $62.6 million and $42.1 million, respectively, and the gross realized losses totaled $32.9 million and $16.7 million, respectively. Included within gross realized gains (losses) are reclassifications from unrealized gains (losses) after taxes on available-for-sale securities of $39.9 million and $4.6 million in 2004 and 2003, respectively. These reclassifications represent the recognition of amounts previously recorded as unrealized gain (loss) as of the end of the previous year.

HELD-TO-MATURITY INVESTMENTS

As of December 31, 2004 and 2003, all held-to-maturity investments were U.S. Treasury securities and obligations of government-sponsored enterprises. The cost of the securities was $30.6 million and had gross unrealized losses of $0.4 million and a total estimated fair value of $30.2 million at December 31, 2004. Of the $0.4 million of gross unrealized losses, 98.9 percent have been in an unrealized loss position for less than 12 months and are deemed to be temporary. At December 31, 2003, the cost of the securities was $28.3 million and had gross unrealized gains of $0.05 million and a total estimated fair value of $28.3 million.

As of December 31, 2004 and 2003, investments with a carrying value of approximately $30.6 million and $28.3 million were pledged as collateral for NASDAQ'S $25.0 million note payable. Collateral is limited to U.S. Government and Agency securities with a margined value of not less than 100.0 percent of the loan and is invested in accordance with the note agreement. See Note 9, "Long Term Debt," for further discussion.

All investments classified as held-to-maturity mature in 2005 and 2006 in the amounts of $28.6 million and $2.0 million, respectively.

OTHER THAN TEMPORARY DECLINES IN FAIR MARKET VALUE

For the year ended December 31, 2004, the Company recorded impairment charges of $3.1 million related to 12 publicly traded equity securities. For the year ended December 31, 2003, the Company recorded impairment charges of $1.0 million related to 8

6. INVESTMENTS (CONTINUED)

publicly traded equity securities. The impairment charges related to declines in the fair value of its investments that were judged to be other-than-temporary and are reflected in net realized investment gains (losses) in the consolidated statements of income.

The following table shows the fair value of available-for-sale investments with an unrealized loss position deemed to be temporary for less than 12 months and greater than 12 months as of December 31, 2004.

		Gross Unrealized Loss	
	Fair Value	Less than 12 Months	Greater than 12 Months
		(in millions)	
Debt securities issued by government-sponsored enterprises	$ 58.6	$ 0.8	$ –
Obligations of states and political subdivisions	51.4	0.9	–
Asset-backed securities	10.2	0.1	0.1
U.S. corporate debt securities	33.5	0.3	0.1
Other debt securities	18.8	0.3	0.3
Total debt securities	172.5	2.4	0.5
Mutual/commingled funds	122.7	1.3	–
Equity securities	51.0	2.7	–
Total	$ 346.2	$ 6.4	$ 0.5

The following table shows the fair value of available-for-sale investments with an unrealized loss position deemed to be temporary for less than 12 months and greater than 12 months as of December 31, 2003.

		Gross Unrealized Loss	
	Fair Value	Less than 12 Months	Greater than 12 Months
		(in millions)	
U.S. Treasury securities	$ 30.1	$ 0.4	$ –
Debt securities issued by government-sponsored enterprises	37.8	0.2	0.1
Asset-backed securities	18.3	0.2	0.8
U.S. corporate debt securities	58.0	0.5	0.1
Other debt securities	43.7	0.9	1.9
Total debt securities	187.9	2.2	2.9
Mutual/commingled funds	45.8	2.3	–
Equity securities	16.9	0.8	0.6
Total	$ 250.6	$ 5.3	$ 3.5

7. GOODWILL AND OTHER INTANGIBLE ASSETS

NASD

NASD had license agreements of $7.5 million and $7.4 million with accumulated amortization of $4.3 million and $2.8 million, respectively, as of December 31, 2004 and 2003, respectively. Licenses are amortized over a five-year estimated useful life. Amortization expense for the next four years commencing in 2005 is expected to be $1.6 million, $1.0 million, $0.5 million, and $0.1 million, respectively.

NASD had a SERP pension asset of $0.3 million and $0.5 million as of December 31, 2004 and 2003, respectively. Pension intangible assets were recorded as required by SFAS No. 87. Amounts are not amortized but are adjusted as part of the annual minimum pension liability assessment.

NASDAQ

As of December 31, 2004, NASDAQ had goodwill of $141.4 million related to the acquisition of Brut. The following table summarizes NASDAQ's intangible assets as of December 31, 2004:

	Gross Carrying Amount	Accumulated Amortization
	(in thousands)	
Technology	$ 15,700	$ (666)
Customer relationships	26,300	(935)
Pension intangible assets	318	–
Other	355	(281)
Intangible assets, net	$ 42,673	$ (1,882)

Both the technology and customer relationships intangible assets are being amortized over a 10-year estimated useful life ending in 2014. Amortization expense for the next five years commencing in 2005 is expected to be $4.8 million, $4.3 million, $4.2 million, $4.1 million, and $4.1 million, respectively. Pension intangible assets were recorded as required by SFAS No. 87. Amounts are not amortized but are adjusted as part of the annual minimum pension liability assessment.

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company considers cash and cash equivalents, receivables, investments, the note receivable from Amex, accounts payable and accrued expenses, due to custodial agent, short and long-term debt, and warrants to purchase NASDAQ stock from NASD to be its financial instruments. The carrying amounts reported in the balance sheets for these financial instruments equal or closely approximate their fair values due to the short-term nature of these assets and liabilities. The approximate fair value of NASDAQ's senior notes was estimated using a discounted cash flow analysis, based on NASDAQ's assumed incremental borrowing rates for similar types of debt arrangements. This analysis indicates that the fair value of NASDAQ's long-term debt as of December 31, 2004 and 2003, approximates its carrying amount.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. LONG TERM DEBT

NASD CREDIT FACILITY

In September 1999, NASD entered into an unsecured line of credit agreement. Under this agreement, NASD has the option to borrow up to $50.0 million at LIBOR plus 0.3 percent. As of December 31, 2004 and 2003, no amounts were outstanding under this line of credit. The line of credit agreement expires on November 30, 2005.

NASDAQ SENIOR NOTES

On September 30, 2003, NASDAQ redeemed its $150.0 million outstanding principal amount of the senior notes. Under the terms of the senior notes, NASDAQ paid the holders of the senior notes $150.0 million in outstanding principal amount, accrued interest of $1.2 million and an aggregate make-whole payment of approximately $12.6 million (representing the net present value of future payments). NASDAQ recorded a $13.2 million pre-tax charge in the third quarter of 2003 related to the redemption of the senior notes. This charge included the make-whole payment and capitalized costs related to the issuance of the senior notes. NASDAQ used funds from available cash and investments to finance the redemption. See Note 3, "Significant Transactions," for further discussion. Interest expensed and paid under the senior notes totaled approximately $6.5 million for the year ended December 31, 2003.

In May 1997, NASDAQ entered into a $25.0 million note payable with a financial institution (the Lender). Principal payments are scheduled to begin in 2007 and continue in equal monthly installments until maturity in 2012. The note requires monthly interest payments through May 2007 at an annual rate of 7.41 percent. After May 2007, NASDAQ will incur interest equal to the Lender's cost of funds rate, as defined in the agreement, plus 0.5 percent. Interest expensed and paid under the agreement totaled approximately $1.9 million for each of the years ended December 31, 2004 and 2003.

NASDAQ SUBORDINATED NOTES

On May 3, 2001, NASDAQ issued and sold $240.0 million in aggregate principal amount of 4.0 percent convertible subordinated notes due 2006 to Hellman & Friedman Capital Partners IV, L.P. and certain of its affiliated limited partnerships (collectively, Hellman & Friedman). Until NASDAQ is granted Exchange Registration, Hellman & Friedman may only exercise its conversion rights for a number of shares of common stock such that immediately following such conversion, NASD will continue to control greater than 50.0 percent of the combined voting power of NASDAQ. The annual 4.0 percent coupon will be payable in arrears and the Subordinated Notes are convertible at any time into an aggregate of 12.0 million shares of common stock at $20.00 per share, subject to adjustment, in general, for any stock split, dividend, combination, recapitalization, or other similar event. Interest expensed and paid under the agreement totaled approximately $9.6 million for each of the years ended December 31, 2004 and 2003.

In 2002, NASDAQ stockholders approved an amendment to NASDAQ's Restated Certificate of Incorporation (the Certificate of Incorporation) that provided for voting debt. As a result, the holders of the Subordinated Notes may vote on an as-converted basis on all matters on which holders of common stock have the right to vote, subject to the current 5.0 percent voting limitation in the Certificate of Incorporation. NASDAQ has granted Hellman & Friedman certain registration rights with respect to the shares of common stock underlying the Subordinated Notes.

9. LONG TERM DEBT (CONTINUED)

On an as-converted basis as of December 31, 2004, Hellman & Friedman owned an approximate 13.7 percent equity interest in NASDAQ as a result of its ownership of these Subordinated Notes and 500,000 shares of common stock purchased from NASDAQ in a separate transaction. Hellman & Friedman is permitted to designate one person reasonably acceptable to NASDAQ for nomination as a director of NASDAQ for so long as Hellman & Friedman owns Subordinated Notes and/or shares of common stock issued upon conversion thereof representing at least 50.0 percent of the shares of common stock issuable upon conversion of the Subordinated Notes initially purchased. Patrick Healy, a managing director of Hellman & Friedman, was designated by Hellman & Friedman and currently serves on the Board of Directors.

10. INCOME TAXES

The income tax (provision) benefit from continuing operations includes the following amounts, which relate to NASDAQ:

	YEARS ENDED DECEMBER 31,	
	2004	2003
	(in thousands)	
Current income tax benefit (provision):		
Federal	$ 24,741	$ 26,753
State	(208)	(11)
Foreign	(3,908)	(2,790)
Total current income tax benefit	20,625	23,952
Deferred income tax benefit (provision):		
Federal	(22,506)	(7,180)
State	(68)	4,468
Foreign	1,200	–
Total deferred income tax provision	(21,374)	(2,712)
Total (provision) benefit for income taxes	$ (749)	$ 21,240

10. INCOME TAXES (CONTINUED)

Reconciliations of the statutory U.S. federal income tax (benefit) provision from continuing operations, based on the U.S federal statutory rate, to the Company's actual income tax (benefit) provision from continuing operations for the years ended December 31, 2004 and 2003 are as follows:

	YEARS ENDED DECEMBER 31,	
	2004	2003
	(in thousands)	
Federal income tax (provision) benefit at the statutory rate	$ (894)	$ 23,223
State income tax (provision) benefit, net of federal effect	(179)	2,897
Change in valuation allowance—foreign losses	1,051	(1,468)
Foreign taxes	(872)	–
Tax preferred investments	601	681
Nondeductible expenses	(926)	(1,410)
Tax credits	–	1,711
Goodwill impairment	–	(1,431)
Prior year tax payable	496	(2,904)
Other	(26)	(59)
Actual income tax (provision) benefit	$ (749)	$ 21,240

The following represents the domestic and foreign components of income (loss) from continuing operations before income tax expense for the Company's taxable entities:

	YEARS ENDED DECEMBER 31,	
	2004	2003
	(in thousands)	
Domestic	$ (1,122)	$ (75,114)
Foreign	3,675	8,762
Income (loss) before income tax (expense) benefit	$ 2,553	$ (66,352)

10. INCOME TAXES (CONTINUED)

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

	DECEMBER 31, 2004	DECEMBER 31, 2003
	(in thousands)	
Deferred tax assets:		
Deferred fees	$ 33,217	$ 56,624
Foreign net operating loss	1,506	1,576
NASD Holding net operating and capital loss carryforwards	47,507	98,144
NASDAQ capital loss carryforward	22,703	23,802
State net operating loss	4,911	5,466
Technology costs	1,231	3,680
Compensation and benefits	12,365	8,252
Lease reserves	14,022	7,949
Strategic review charges	3,113	16,326
Other	3,135	14,502
Total deferred tax asset	143,710	236,321
Deferred tax liabilities:		
Depreciation	(2,591)	(8,269)
Investment in Amex	–	(37,400)
Software development costs	(26,923)	(31,843)
Other	(373)	(3,198)
Total deferred tax liabilities	(29,887)	(80,710)
Net deferred taxes before valuation allowance	113,823	155,611
Valuation allowance	(70,736)	(86,382)
Net deferred tax assets	$ 43,087	$ 69,229

The change in the valuation allowance from December 31, 2003, to December 31, 2004 is as follows:

	(in thousands)
Balance December 31, 2003	$ (86,382)
Utilization of prior year foreign net operating losses in the current Period	1,200
Foreign net operating loss carryforwards generated in 2004	(149)
State tax effect of prior year valuation allowance	626
Capital loss carryforwards expired in 2004	900
Capital loss carryforwards generated in 2004	(428)
Sale of Amex	13,497
Balance December 31, 2004	$ (70,736)

10. INCOME TAXES (CONTINUED)

Of the $4.9 million of state net operating losses and the $1.5 million of foreign net operating losses as of December 31, 2004, state losses of $4.9 million will expire through 2023, foreign losses of $0.4 million will expire 2007 through 2011, and foreign losses of $1.1 million have no expiration date.

As of December 31, 2004, NASDAQ had total capital loss carryforwards of $22.7 million, of which $15.8 million relate to discontinued operations. The capital loss carryforwards generated through discontinued operations will expire in 2008. Of the remaining $6.9 million of capital loss carryforwards, $0.7 million will expire 2006 through 2008, and $6.2 million will expire in 2009.

As of December 31, 2004 and 2003, NASD Holding had net operating loss carryforwards of $105.6 million and $76.0 million, respectively. These net operating loss carryforwards begin to expire in 2020. Under SFAS No. 109, to record a deferred tax asset without a valuation allowance, it must be more likely than not that the deferred tax asset will be realized. The Company does not believe the capital loss carryforward and net operating loss carryfoward will be realized. Therefore, a full valuation allowance has been recorded as of December 31, 2004 and 2003.

11. EMPLOYEE BENEFITS

As of December 31, 2004 and 2003, the Company provided two non-contributory defined benefit pension plans and one non-contributory post retirement benefit plan (Post Retirement Plan) for the benefit of eligible employees of its subsidiaries. The non-contributory defined benefit plans consists of a funded ERP plan and two unfunded SERP plans. The benefits are primarily based on years of service and the employees' average salary during the highest 60 consecutive months of employment. Beginning on January 1, 2004, the benefits for NASDAQ are primarily based on years of service and the employees' career-average salary during employment, subject to a phase-in period. The Post Retirement Plan represents a life insurance benefit available to eligible retired employees.

Until November 1, 2003, NASDAQ participated in the SERP plan maintained by NASD for certain senior executives. On November 1, 2003, NASDAQ formed its own SERP plan and transferred all amounts to this new plan.

The investment policy and strategy of the plan assets, as established by the NASD Pension Plan Committee, is to provide for preservation of principal, both in nominal and real terms, in order to meet the long-term spending needs of the Plan by investing assets per the target allocations stated below. Asset allocations are reviewed quarterly and adjusted, as appropriate, to remain within target allocations. The investment policy is reviewed on an annual basis, under the advisement of an investment consultant, to determine if the policy or asset allocation targets should be changed. The plan assets consisted of the following as of December 31:

	Target Allocation	2004	2003
Equity securities	45.0-75.0%	65.5%	74.0%
Debt securities and cash equivalents	10.0-40.0%	26.0	26.0
Other investment strategies	10.0-20.0%	8.5	–
Total		100.0%	100.0%

11. EMPLOYEE BENEFITS (CONTINUED)

The expected long-term rate of return for the plan's total assets is based on the expected return of each of the above categories, weighted based on the current target allocation for each class. Equity securities are expected to return 8.0 percent to 10.0 percent over the long-term, debt securities and cash equivalents are expected to return 4.0 percent to 6.0 percent, while other investment strategies are anticipated to yield 6.0 percent to 8.0 percent. Based on historical experience, the NASD Pension Plan Committee expects that the plan's asset managers overall will provide a modest (1.0 percent per annum) premium to their respective market benchmark indices.

The plan is measured at the beginning of each fiscal year. The Company expects to contribute $22.1 million to the ERP plan in 2005. In addition, the Company expects to make the following benefit payments to participants over the next ten fiscal years:

	ERP	SERP	Total
		(in thousands)	
Fiscal year ended			
2005	$ 6,647	$ 750	$ 7,397
2006	8,658	8,150	16,808
2007	10,949	8,002	18,951
2008	12,462	1,104	13,566
2009	14,458	1,127	15,585
2010 through 2014	102,894	14,122	117,016
	$ 156,068	$ 33,255	$ 189,323

11. EMPLOYEE BENEFITS (CONTINUED)

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

	2004	2003
	(in thousands)	
Change in benefit obligation		
Benefit obligation at beginning of year	$ 226,716	$ 195,734
Service cost	22,721	20,906
Interest cost	13,996	13,285
Amendments	–	(3,300)
Actuarial losses	584	7,626
Benefits paid	(24,447)	(29,162)
Loss due to change in discount rate	25,326	21,627
Change in retirement age assumption	5,474	–
Change in salary scale	(3,189)	–
Transfers of employees from Amex	4,744	–
Benefit obligation at end of year	$ 271,925	$ 226,716
Change in plan assets		
Fair value of plan assets at beginning of year	$ 101,416	$ 90,995
Transfers of employees from Amex	4,198	–
Actual return on plan assets	10,156	20,425
Company contributions	20,508	19,158
Benefits paid	(24,447)	(29,162)
Fair value of plan assets at end of year	111,831	101,416
Funded status of the plan (underfunded)	(160,094)	(125,300)
Unrecognized net actuarial loss	98,754	73,837
Unrecognized prior service cost	(6,361)	(6,229)
Unrecognized transition asset	(609)	(823)
Amount recognized to reflect minimum liability	(11,005)	(5,961)
Net accrued benefit cost	$ (79,315)	$ (64,476)

The net accrued pension cost as of December 31, 2004 and 2003, as reflected above, consists of the accrued benefit cost from the underfunded ERP plan and the unfunded SERP plans.

11. EMPLOYEE BENEFITS (CONTINUED)

The components of the accrued benefit cost for the Company's defined benefit pension plans and post retirement benefit plan as of December 31, 2004 and 2003, and the location of these amounts in the consolidated balance sheets, were as follows:

	DECEMBER 31, 2004	DECEMBER 31, 2003
	(in thousands)	
Current (included in accrued personnel and benefit costs):		
ERP	$ (21,398)	$ (18,624)
SERP	(750)	(4,926)
Total current	(22,148)	(23,550)
Noncurrent (included in accrued pension and other post retirement benefit costs):		
ERP	(27,846)	(22,828)
SERP	(29,321)	(18,098)
Post Retirement Plan	(627)	(381)
Total non-current	(57,794)	(41,307)
Accrued benefit costs	$ (79,942)	$ (64,857)

As of December 31, 2004 and 2003, the following is the funded status of each of NASD's defined benefit pension plans:

	DECEMBER 31, 2004	DECEMBER 31, 2003
	(in thousands)	
ERP		
Projected benefit obligations	$ 235,891	$ 198,237
Accumulated benefit obligations	146,093	120,110
Fair value of plan assets	111,831	101,416
SERP		
Projected benefit obligations	$ 36,034	$ 28,479
Accumulated benefit obligations	30,070	23,023
Fair value of plan assets	–	–

During 2004 and 2003, there were settlement losses of $0.2 million and $3.9 million, respectively, for employees included within the SERP due to early retirements.

11. EMPLOYEE BENEFITS (CONTINUED)

Pursuant to the provisions of SFAS No. 87, related to the SERP, intangible assets of $0.6 million and $1.2 million were recorded as of December 31, 2004 and 2003, respectively. In addition, as of December 31, 2004 and 2003, a minimum pension liability of $9.2 million (net of tax of $1.2 million) and $3.7 million (net of tax of $0.9 million), respectively, were recorded in the consolidated balance sheets.

	DECEMBER 31,	
	2004	2003
Weighted-average assumptions:		
Discount rate	5.75%	6.25%
Expected return on plan assets (1)	8.75	8.75
Rate of compensation increase	5.1	5.3

(1) In 2005, the Company's expected return on plan assets was reduced to 8.5 percent.

	YEARS ENDED DECEMBER 31,	
	2004	2003
	(in thousands)	
Components of net periodic benefit cost:		
Service cost	$ 22,721	$ 20,906
Interest cost	13,996	13,285
Expected return on plan assets	(8,753)	(7,609)
Amortization of unrecognized transition asset	(214)	(214)
Recognized net actuarial losses	4,119	2,786
Prior service cost recognized	149	5,474
Curtailment/settlement loss recognized	207	2,964
Benefit cost (included in compensation expense)	$ 32,225	$ 37,592

The Company also maintains voluntary savings plans for eligible employees of its subsidiaries. Employees are immediately eligible to make contributions to the plan and are also eligible for an employer contribution match at an amount equal to 100 percent of the first 4 percent of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from the Company. Savings plan expense for 2004 and 2003 was $12.5 million and $11.5 million, respectively, which is included within compensation expense in the consolidated statements of income. The expense included a discretionary match totaling $2.8 million for 2004 and $2.4 million for 2003.

In April 2004, the Company established a deferred compensation plan for certain eligible employees under the provision of Section 457(b) of the IRC. Eligible employees may make contributions to the plan and NASD may, at its discretion, make additional contributions to the plan. The assets of this plan are maintained within an irrevocable rabbi trust. NASD believes that this trust is a variable interest entity under FIN No. 46 (revised December 2003) and believes that it is the primary beneficiary of this trust. As of

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11. EMPLOYEE BENEFITS (CONTINUED)

December 31, 2004 approximately $0.5 million of investments and $0.5 million payables to plan participants are included in the available-for-sale investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing participant contributions to this plan. As of December 31, 2004, NASD made no additional contributions to this plan.

12. NASDAQ STOCK COMPENSATION, STOCK AWARDS, AND CAPITAL STOCK

Effective December 5, 2000, as amended on February 14, 2001 and January 23, 2002, NASDAQ adopted The Nasdaq Stock Market, Inc., Equity Incentive Plan (the Plan) under which nonqualified and qualified incentive stock options, restricted stock, restricted stock units, or other stock-based awards may be granted to employees, directors, officers, and consultants. A total of 24,500,000 shares are authorized under the Plan. At December 31, 2004, 7,550,992 shares were available for future grants under the Plan. In 2003, NASDAQ also issued stock options and restricted stock outside of the Plan.

In 2004, NASDAQ granted 6,068,800 stock options, 109,000 shares of restricted stock to employees and officers, and 49,014 shares of restricted stock to non-employee Board of Directors members pursuant to the Plan. During 2004, 824,202 stock options and 59,947 shares of restricted stock awards were forfeited.

In December 2001, the Board adopted a revised Non-Employee Directors Compensation Policy whereby beginning in 2002, all non-employee directors were awarded 5,000 stock options per year with an exercise price at fair market value, which may be exercised for up to 10 years while serving on the Board of Directors (in general, three years from termination of service on the Board of Directors). On January 23, 2002, a total of 65,000 stock options were awarded to non-employee directors pursuant to the policy. In November 2002, the Board approved a modification to the Non-Employee Directors Compensation Policy whereby all non-employee directors will receive a compensation package valued at $40,000. On April 28, 2004, the Board approved a modification to the Non-Employee Directors Compensation Policy whereby all non-employee directors would receive a base compensation package valued at $50,000. Each non-employee director may elect to receive the base compensation package in cash, payable in equal quarterly installments, shares of restricted stock or a combination thereof. The shares of restricted stock will vest two years from the date of grant and unvested shares are forfeited in certain circumstances upon termination of the director's service on the NASDAQ Board. During 2004, 49,014 shares of restricted stock were awarded to non-employee directors. Directors who serve as committee chairs or as members of the Audit Committee and the chairman of the board are entitled to additional compensation beyond the base compensation package; however, these additional amounts are paid in cash rather than restricted stock.

Restricted stock awards are awarded in the name of the employee or officer at fair market value on the date of the grant. In 2004, NASDAQ granted 109,000 shares of restricted stock to employees and officers with a weighted-average grant price of $7.45. Restricted stock awards contain restrictions on sales and transfers, are generally subject to a five-year vesting period, and are expensed over the vesting period. NASDAQ recognized $0.5 million in amortization expense related to restricted stock during the year ended December 31, 2004. For the year ended December 31, 2003, the number of restricted stock awards forfeited more than offset the yearly amortization expense to a $0.05 million benefit.

Stock options are granted with an exercise price equal to the fair market value of the stock on the date of the grant. NASDAQ accounts for stock option grants in accordance with APB No. 25, and, accordingly, recognizes no compensation expense related to such grants.

12. NASDAQ STOCK COMPENSATION, STOCK AWARDS, AND CAPITAL STOCK (CONTINUED)

Options granted generally vest over three years and expire 10 years from the date of grant. Beginning in 2004, the Board approved the issuance of Performance Accelerated Stock Options (PASO) and granted 4,919,000 PASOs during the year. The PASOs include a performance-based accelerated vesting feature based on NASDAQ achieving specific levels of performance in fiscal years 2004 and 2005. The vestings of the PASO awards are no longer than six years from the grant date. All options to date have been granted at fair market value on the date of grant. At December 31, 2004, options for 8,368,901 shares were vested (including grants outside of the Plan) and exercisable with a weighted-average exercise price of $11.92. At December 31, 2003, options for 7,550,589 shares were vested (including grants outside of the Plan) and exercisable with a weighted-average exercise price of $12.43. The weighted-average remaining contract life was 7.6 years and 7.5 years at December 31, 2004 and 2003, respectively.

Stock option activity, including shares from outside of the Plan, during the year ended December 31, 2004, is summarized below:

		PRICE PER SHARE	
	Shares	Range	Weighted Average
Balance, January 1, 2004	13,423,134	$ 5.28–19.70	$ 10.82
Granted	6,068,800	6.15–9.15	7.58
Exercised	310,296	5.28–8.50	5.39
Canceled	2,124,875	6.15–13.00	10.94
Balance, December 31, 2004	17,056,763	$ 5.28–19.70	$ 9.75

The following table presents the options outstanding as of December 31, 2004, by range of exercise prices:

Range of Exercise Prices	Outstanding as of December 31, 2004	Weighted Average Exercise Price
$ 5.28 – 7.34	2,564,000	$ 6.00
7.35 – 8.49	3,987,500	7.37
8.50 – 10.24	3,584,049	8.74
10.25 – 12.99	186,284	10.39
13.00 – 13.38	6,633,330	13.00
13.39 – 19.69	–	–
$19.70 – 20.00	101,600	19.70
	17,056,763	$ 9.75

12. NASDAQ STOCK COMPENSATION, STOCK AWARDS, AND CAPITAL STOCK (CONTINUED)

Stock option activity, including shares from outside of the Plan, during the year ended December 31, 2003, is summarized below:

		PRICE PER SHARE	
	Shares	Range	Weighted Average
Balance, January 1, 2003	10,917,403	$ 10.25–19.70	$ 12.91
Granted	5,398,410	5.28–9.05	7.41
Exercised	–	–	–
Canceled	2,892,679	6.30–19.70	12.33
Balance, December 31, 2003	13,423,134	$ 5.28–19.70	$ 10.82

NASDAQ has an employee stock purchase plan for all eligible employees. Under the plan, shares of common stock may be purchased at six-month intervals (each, an Offering Period) at 85.0 percent of the lower of the fair market value on the first or the last day of each Offering Period. Employees may purchase shares having a value not exceeding 10.0 percent of their annual compensation, subject to applicable annual Internal Revenue Service limitations. During 2004 and 2003, employees purchased an aggregate of 110,408 and 143,352 shares at a weighted-average price of $5.45 and $6.95 per share, respectively.

Pro forma information regarding net income and earnings per share is required under SFAS 148 and has been determined as if NASDAQ had accounted for all stock option grants based on a fair value method. The fair value of each stock option grant was estimated at the date of grant using the Black-Scholes valuation model assuming a weighted-average expected life of five years, weighted-average expected volatility of 30.0 percent and a weighted-average risk free interest rate of 3.43 percent and 2.94 percent for 2004 and 2003, respectively. The weighted-average fair value of options granted in 2004 and 2003 was $2.49 and $2.37, respectively.

Pro forma net income includes the amortization of the fair value of stock options over the vesting period and the difference between the fair value and the purchase price of common shares purchased by employees under the employee stock purchase plan. The pro forma net income also includes a reduction in option expense due to the true-up of actual forfeitures. The pro forma information for the years ended December 31, 2004 and 2003, is as follows:

	2004	*2003*
	(in thousands)	
Income from continuing operations	$ 105,135	$ 50,006
Compensation expense (net of minority interest of $1,784 in 2004 and $5,789 in 2003)	(2,152)	(7,143)
Pro forma income from continuing operations	$ 102,983	$ 42,863

13. 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 $39.9 million in 2004 and $41.4 million in 2003, and is included in occupancy expense in the consolidated statements of income.

Future minimum lease payments under non-cancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 2004:

	Gross Lease Commitment	Sublease Income	Net Lease Commitment
		(in thousands)	
Year ending December 31,			
2005	$ 59,762	$ 1,900	$ 57,862
2006	42,180	2,185	39,995
2007	34,423	2,224	32,199
2008	28,256	2,299	25,957
2009	27,004	2,266	24,738
Remaining years	231,307	15,221	216,086
Total minimum lease payments	$ 422,932	$ 26,095	$ 396,837

Future minimum lease payments under non-cancelable capital leases with initial or remaining terms of one year or more consisted of the following at December 31, 2004:

	(in thousands)
Year ending December 31,	
2005	$ 758
2006	809
2007	67
Total minimum lease payments	1,634
Less: imputed interest	(29)
Total present value of minimum lease payments	$ 1,605

In October 2004, NASDAQ entered into a lease agreement for technology equipment and also renegotiated related operating leases with a major vendor. NASDAQ also upgraded related leased equipment and entered into a new three-year operating lease and extended the terms of license and maintenance agreements. Under the terms of these leases and license and maintenance agreements, NASDAQ will pay a total of $36.2 million over the remaining lives of the leases and agreements. See Note 3, "Significant Transactions," for further discussion.

14. COMMITMENTS AND CONTINGENCIES

NASD

EDS

On April 1, 2003, NASD and EDS entered into a new service agreement (2003 EDS Agreement), which superseded an existing agreement with NASD. The new agreement included several modifications, including a more detailed statement of work, enhanced service levels, improved pricing, and an extended term. The 2003 EDS Agreement expires on December 31, 2012, representing an extension of 3.5 years. Under the 2003 EDS Agreement, NASD is obligated to pay EDS a minimum of $24.0 million for the first year, (prorated for a nine-month period during 2003 commencing on the effective date), which is reduced ratably to $16.0 million in the final year, for both applications development and maintenance services. NASD is also required to use EDS for all its production services needs. Furthermore, NASD cannot terminate the 2003 EDS Agreement until April 1, 2005, at which point the termination fee is based on a fixed fee schedule versus the formula-based approach in the initial agreement. As consideration for the 2003 EDS Agreement, NASD agreed to forgive a $35.3 million deposit with EDS related to the previous EDS agreement. This deposit is being amortized on a straight-line basis over the remaining term of the 2003 EDS Agreement. As of December 31, 2004 and 2003, NASD recorded other assets of $29.0 million and $32.6 million, respectively, representing the unamortized balance of the deposit with EDS. Amortization expense of $3.6 million and $2.7 million was recorded during the years ended December 31, 2004 and 2003, respectively, and is included within depreciation and amortization in the consolidated statements of income.

New York City

In 2001, NASD entered into a series of incentive agreements with the City of New York resulting in potential incentives aggregating $53.6 million on a net present value basis to NASD, NASDAQ, and Amex. The terms of this agreement require NASD, NASDAQ, and Amex together to maintain a set number of full-time employees within New York City annually until December 31, 2020. If the Company does not meet the required headcount, the Company will be required to pay back either all or a portion of the benefits recognized. In 2004, NASD amended this agreement to separate the benefits among NASD, NASDAQ, and Amex individually. As of December 31, 2004, the Company has met the headcount requirements as stipulated in the agreement.

New York State Grant

In April 2003, NASD received $3.0 million of a capital grant from the New York State Urban Development Corporation d/b/a Empire State Development Corporation (ESDC). The terms of this grant require NASD, NASDAQ, and Amex together to maintain a set number of full-time employees within New York City annually until January 1, 2009. If the required headcount as summarized in this grant are not maintained, NASD, NASDAQ, and Amex will be required to pay back to ESDC either all or a portion of the grant received. In 2004, NASD amended this agreement to separate the benefits among NASD, NASDAQ, and Amex individually. As of December 31, 2004, the Company has met the headcount requirements as stipulated in the agreement.

NASDAQ

Brut Agreements

Brut contracted with a subsidiary of SunGard, SunGard Financial, for SunGard Financial to provide Brut online processing, report services, and related services in connection with the clearance of trades. The term of the agreement is five years beginning in

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14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

September 2004 and is automatically renewed at yearly intervals thereafter until terminated by Brut or SunGard Financial. The annual service fee is $10.0 million in the first year, dropping to $8.0 million in the second year and $6.0 million in the third year of the agreement. The annual service fee is subject to price review in years four and five based on market rates, but will not be less than $4.0 million per year. Some additional fees may be assessed based on services needed or requested.

Brut also contracted with SunGard to host certain software on designated equipment at a SunGard facility for a transitional period beginning in September 2004. SunGard developed and operated the computer software programs that enable Brut to operate and provide order entry and execution over its ECN. Under the terms of the original agreement, which began in September 2004 through May 2005, Brut was obligated to pay SunGard approximately $0.1 million per month. On November 29, 2004, an amendment was signed which extended the original agreement through June 30, 2006. Beginning November 30, 2005, Brut may cancel the agreement with 30 days written notice to SunGard.

Brokerage Activities

Brut provides guarantees to securities clearinghouses and exchanges under their standard membership agreements, which require members to guarantee the performance of other members. If a member becomes unable to satisfy its obligations to the clearinghouses, other members would be required to meet its shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral as well as meet certain minimum financial standards. Brut's maximum potential liability under these arrangements cannot be quantified. However, NASDAQ believes that the potential for Brut to be required to make payments under these arrangements is unlikely. Accordingly, no contingent liability is recorded in the consolidated balance sheets for these arrangements.

NASDAQ Insurance Agency

In December 2002, NASDAQ purchased NASD's 50.0 percent interest in NASD Insurance Agency, LLC (subsequently renamed the NASDAQ Insurance Agency, LLC (NASDAQ Insurance Agency) or (NIA)) for $0.5 million. The payment was recorded as a distribution to NASD. The agency provides insurance brokerage services and specializes in the director and officer liability insurance market. NASDAQ accounts for its investment in the NASDAQ Insurance Agency under the equity method of accounting as of December 31, 2004. NASDAQ believes that the NASDAQ Insurance Agency was a Variable Interest Entity under FASB Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51," and its amendment entitled FIN No. 46 (revised December 2003), "Consolidation of Variable Interest Entities." However, NASDAQ does not believe that it is the primary beneficiary of the NIA and therefore did not consolidate the NIA in its results of operations.

On January 1, 2005, NASDAQ purchased the remaining 50.0 percent interest in the NASDAQ Insurance Agency from AIG NJV, Inc. for nominal consideration. On December 31, 2004, NASDAQ entered into a revolving promissory note with the NIA and loaned the agency $2.9 million, which is included in receivables from related parties on the consolidated balance sheets. See Note 18, "Subsequent Events," for further discussion.

MCI

On January 30, 2004, NASDAQ and MCI entered into a global services agreement (GSA), effective May 31, 2004, related to the data network that connects NASDAQ's market facilities to market participants. The GSA terminated the prior agreement between

14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

the two parties. The GSA, which expires on December 31, 2005, requires usage charges for certain GSA services to be at least $20.0 million during the period from June 1, 2004 to December 31, 2004, and $20.0 million in 2005. In 2004, NASDAQ met the minimum usage charges and fully expects to meet the minimum usage charges in 2005.

General Litigation

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, it has adequately provided for any liabilities or settlements arising from these proceedings. 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.

15. REAL ESTATE DEVELOPMENTS

NASD

In December 2003, NASD vacated office space in Rockville, Maryland. NASD was obligated under this lease agreement to pay $5.0 million over the life of the lease, which expires in July 2006. As of December 31, 2003, the estimated loss on the sublease was $3.6 million, which has been included within occupancy expense in the consolidated statements of income. As of December 31, 2003, the estimated loss was calculated using NASD's incremental borrowing rate of 1.75 percent, and an estimated two-year sublease, commencing in 2004 at estimated market rates. The estimated reserve was adjusted to reflect interest accretion and rental payments made during 2004. As of December 31, 2004, the estimated loss on the sublease was $2.5 million, which was based on NASD's incremental borrowing rate of 3.57 percent.

NASDAQ

New York

In 2001, NASDAQ recorded a sublease loss reserve of $21.5 million in anticipation of relocating its headquarters location from One Liberty Plaza to 1500 Broadway. NASDAQ signed a lease commencing May 1, 2002, at 1500 Broadway. Later in 2002, NASDAQ's management reconsidered its decision to relocate to 1500 Broadway and decided to maintain its headquarters at One Liberty Plaza. NASDAQ maintained the initial reserve recorded in 2001 (including interest accretion) for the sublease loss at 1500 Broadway. At December 31, 2003, the estimated loss on the sublease was approximately $20.5 million. In 2004, NASDAQ signed subleases for all of its space at 1500 Broadway. At December 31, 2004, NASDAQ updated the sublease loss estimate based on current assumptions and known sublease incomes and recorded an additional loss of $1.2 million to general and administrative expense in the consolidated statements of income. The additional loss was primarily due to a change in the assumption of sublease term commencement dates. As of December 31, 2004, the estimated sublease loss reserve was approximately $18.0 million. The estimated reserve was adjusted throughout the year to reflect interest accretion, rental payments made during 2004, and depreciation on leasehold improvements. The estimated loss was calculated using a 7.5 percent net discount rate and estimated 21-year sublease terms commencing in 2004 and 2005 at estimated market rates.

In 2001, NASDAQ also signed a lease for expansion space on one of the floors it occupied at One Liberty Plaza, which was to commence on October 1, 2004. NASDAQ's management does not intend to occupy this space and began marketing the expansion

15. REAL ESTATE DEVELOPMENTS (CONTINUED)

space for sublease during the third quarter of 2004. NASDAQ is obligated under the terms of the expansion space lease to pay $33.9 million over the remaining life of the lease and recorded a sublease loss reserve of $12.8 million, which is included in general and administrative expense in the consolidated statements of income. In addition, in the fourth quarter of 2004, NASDAQ's management decided that it no longer needed the space it currently occupied on the expansion floor and recorded an additional estimated sublease loss reserve of $4.8 million for the remaining space. This charge is also included in general and administrative expense in the consolidated statements of income. NASDAQ is obligated under the terms of this lease to pay $12.6 million over the remaining useful life of the lease. Both estimated losses for One Liberty Plaza were calculated using a 7.5 percent net discount rate and estimated 17-year sublease term commencing in January 2006 at estimated market rates.

New Jersey

As a part of NASDAQ's strategic review, NASDAQ vacated the space NASDAQ Tools occupied at 15 Exchange Place, Jersey City, New Jersey. As of December 31, 2003 NASDAQ was obligated under the terms of this lease to pay $2.8 million over the remaining life of the lease and recorded a sublease loss reserve of $1.2 million, which was included in the elimination of non-core product lines, initiatives, and severance in the consolidated statements of income. As of December 31, 2004, NASDAQ updated the sublease loss reserve based on current assumptions and recorded an additional loss of $0.2 million to general and administrative expense in the consolidated statements of income. The estimated loss was calculated using a 7.5 percent net discount rate and estimated six-year sublease term commencing in the beginning of 2005 at estimated market rates. NASDAQ is currently actively marketing the space and has signed a sublease agreement for approximately 50.0 percent of the space. As of December 31, 2004, the sublease loss reserve was approximately $0.8 million. The estimated loss was adjusted throughout the year to reflect interest accretion and rental payments made during 2004.

Maryland

During 2003, NASDAQ decided to vacate part of the space it occupies at 9600 Blackwell in Rockville, Maryland, and recorded a sublease loss reserve of $2.3 million, which was included in general and administrative expense in the consolidated statements of income. NASDAQ's management re-evaluated its decision to vacate the space at 9600 Blackwell and decided instead to sell the building it owns and occupies at 9513 Key West Avenue in Rockville, Maryland. Based on NASDAQ management's revised decision, NASDAQ released the sublease loss reserve recorded for 9600 Blackwell, which totaled $1.9 million, net of rental payments, on September 30, 2004 this is recorded in general and administrative expense in the consolidated statements of income.

NASDAQ began actively marketing the 9513 Key West building for sale in the fourth quarter of 2004 and expects the building to be sold within a year. During the fourth quarter of 2004, NASDAQ recognized a $7.4 million loss, which is included in general and administrative expense in the consolidated statement of income on the write-down of the building's carrying amount to fair market value less cost to sell. Fair value was determined using a quoted market price from an independent third party.

Connecticut

In 2004, NASDAQ also evaluated its real estate needs in Trumbull, Connecticut. NASDAQ currently owns and occupies a building located at 80 Merritt Boulevard and leases and occupies another building at 35 Nutmeg Drive. NASDAQ's management

15. REAL ESTATE DEVELOPMENTS (CONTINUED)

determined that based on staff reductions, all employees in Trumbull will consolidate into NASDAQ's building at 80 Merritt Boulevard. Although NASDAQ's lease at 35 Nutmeg Drive terminates in July 2008, NASDAQ plans on moving all employees from 35 Nutmeg Drive to 80 Merritt Boulevard by the end of 2005. As a result, NASDAQ expects to record a charge of approximately $2.5 million in the fourth quarter of 2005 when it completely vacates 35 Nutmeg Drive for its remaining lease obligation. In order to accommodate all employees in the Merritt building, two data center spaces will be converted into office space. The data centers will cease being used by the end of the first quarter of 2005, and, accordingly, NASDAQ began accelerating the data centers' fixed assets and leasehold improvements over the new estimated useful life. NASDAQ recorded $4.5 million of accelerated depreciation for the data center assets for the year ended December 31, 2004, and will record an additional $2.2 million in the first quarter of 2005.

16. DISCONTINUED OPERATIONS

AMEX

On December 31, 2004, NASD sold its Class B interest in Amex to Amex Membership Corporation. NASD recognized a cumulative loss on this sale of approximately $224.7 million, of which $6.8 million was recognized in 2004. In accordance with SFAS No. 144, Amex is reflected as a discontinued operation for all years presented. As of December 31, 2003, the assets and liabilities of Amex are segregated on the consolidated balance sheets and the net operations of Amex have been reported within discontinued operations on the consolidated statements of income for 2004 and 2003. Amex was previously reported by NASD as a separate segment under the provisions of SFAS No. 131.

The following table presents the combined carrying amounts of the major classes of assets and liabilities of Amex:

	DECEMBER 31, 2004	DECEMBER 31, 2003
	(in millions)	
Current assets:		
Cash and cash equivalents	$ –	$ 23.6
Available-for-sale investments	–	45.1
Receivables, net	–	45.2
Other current assets	–	6.6
Total current assets of discontinued operations	–	120.5
Total non-current assets of discontinued operations	–	32.8
Total assets of discontinued operations	–	153.3
Current liabilities:		
Accounts payable and accrued expenses	–	26.4
Other current liabilities	–	76.5
Total current liabilities of discontinued operations	–	102.9
Accrued pension and other post retirement benefits	–	30.9
Other liabilities	–	10.4
Total non-current liabilities of discontinued operations	–	41.3
Total liabilities of discontinued operations	$ –	$ 144.2

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16. DISCONTINUED OPERATIONS (CONTINUED)

For the year ended December 31, 2004, NASD recorded net income from discontinued operations related to Amex of $10.1 million. For the years ended December 31, 2003 and 2002, NASD recorded a net (loss) from discontinued operations related to Amex of $(47.4) million and $(121.2) million, respectively. Included in the net income (loss) from discontinued operations is the loss at disposal recorded as of December 31, 2004, 2003, and 2002 of $6.8 million, $83.3 million, and $134.6 million, respectively, representing the adjustment of the carrying value of Amex long-lived assets to the fair value less costs to sell, and the accrual of contractual obligations related to amounts paid by NASD for certain remaining commitments and contingencies, employee severance costs, and other liabilities. As of December 31, 2004, NASD had accrued liabilities of $7.5 million related to legal and employee costs incurred as part of the sale agreement, which are included in other current liabilities in the consolidated balance sheets.

The following table presents condensed results of operations for Amex.

	YEARS ENDED DECEMBER 31,	
	2004	2003
	(in thousands)	
Revenues	$ 218,258	$ 235,689
Income (loss) from discontinued operations	$ 10,139	$ (47,385)

NASDAQ EUROPE AND INDIGOMARKETS

On September 30, 2003, NASDAQ Global sold its interest in IndigoMarkets to its partner, SSI Limited, and recognized a gain of approximately $0.6 million on the sale. In addition, on December 18, 2003, NASDAQ transferred its interest in NASDAQ Europe to one of that company's original investors for nominal cash consideration. In the fourth quarter of 2004, NASDAQ recognized a gain on the release of a reserve for potential claims against NASDAQ that management established at the time of the transfer of NASDAQ's shares of NASDAQ Europe. In the fourth quarter of 2004, Easdaq reached agreements with certain of its creditors to settle these creditors' existing claims against Easdaq. NASDAQ was the third-party beneficiary of these creditor agreements and released the $15.1 million reserve management established. See Note 3, "Significant Transactions," for further discussion.

In accordance with SFAS No. 144, both NASDAQ Europe and IndigoMarkets are reflected as discontinued operations for all years presented. As discontinued operations, the revenues, costs and expenses, and cash flows of NASDAQ Europe and IndigoMarkets have been excluded from the respective captions in the consolidated statements of income and consolidated statements of cash flows, and have been presented separately as "income (loss) from discontinued operations, net of tax" and as "cash provided by (used in) discontinued operations." There were no assets and liabilities of NASDAQ Europe and IndigoMarkets at December 31, 2004 and 2003.

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2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. DISCONTINUED OPERATIONS (CONTINUED)

The following table presents condensed results of operations for NASDAQ Europe and IndigoMarkets.

	YEARS ENDED DECEMBER 31, 2004	YEARS ENDED DECEMBER 31, 2003
	(in thousands)	
Revenues	$ –	$ 10,632
Pre-tax income (loss)	15,154	(63,998)
(Provision) benefit for income taxes	(5,596)	3,663
Income (loss) from discontinued operations	$ 9,558	$ (60,335)

17. BUSINESS SEGMENT INFORMATION

As described in Note 2, "Summary of Significant Accounting Policies," NASD operates in two primary business segments, NASD and NASDAQ. NASD includes NASD, NASDR, and NASD DR. NASDAQ represents a separate identifiable organization. Transactions between segments are accounted for at fair value as if the transactions were to third parties. All inter-segment transactions have been eliminated in consolidation.

SEGMENT INCOME OR LOSS

NASD's accounting policies for segments are the same as those described in Note 2, "Summary of Significant Accounting Policies." Management evaluates segment performance based on net revenue less expenses operating income (loss). Consolidating adjustments represent the elimination of intercompany transactions. In 2003, the consolidating adjustments also include the discontinued operations related to Amex.

	2004			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in thousands)			
Revenues	$ 867,293	$ 540,441	$ (66,417)	$ 1,341,317
Cost of revenues	(230,853)	(55,845)	–	(286,698)
Net revenues	636,440	484,596	(66,417)	1,054,619
Total expenses	563,982	476,413	(43,641)	996,754
Net revenue less expenses	72,458	8,183	(22,776)	57,865
Total assets	1,704,679	814,820	(164,781)	2,354,718
Depreciation and amortization	39,531	76,336	–	115,867
Interest and dividend income	42,682	5,854	(13,188)	35,348
Purchases of property and equipment	$ 28,526	$ 26,029	$ –	$ 54,555

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. BUSINESS SEGMENT INFORMATION (CONTINUED)

	2003			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in thousands)			
Revenues	$ 871,100	$ 589,845	$ (67,640)	$ 1,393,305
Cost of revenues	(365,803)	–	–	(365,803)
Net revenues	505,297	589,845	(67,640)	1,027,502
Total expenses	518,208	647,159	(58,470)	1,106,897
Net revenue less expenses	(12,911)	(57,314)	(9,170)	(79,395)
Total assets	1,701,673	851,254	56,359	2,609,286
Depreciation and amortization	47,317	89,983	–	137,300
Interest and dividend income	41,998	9,517	(8,160)	43,355
Purchases of property and equipment	$ 19,215	$ 31,595	$ –	$ 50,810

GEOGRAPHIC DATA

The following table presents revenues and property and equipment, net by geographic area for 2004 and 2003. Revenues are classified based upon the location of the customer. Property and equipment information is based on the physical location of the assets.

	Revenues	Property and equipment, net
	(in thousands)	
2004:		
United States	$ 1,292,446	$ 313,088
All other countries	48,871	757
Total	$ 1,341,317	$ 313,845
2003:		
United States	$ 1,337,437	$ 397,879
All other countries	55,868	271
Total	$ 1,393,305	$ 398,150

INTER-SEGMENT TRANSACTIONS

Summarized below are significant inter-segment transactions between NASD and NASDAQ.

NASD
2004 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. BUSINESS SEGMENT INFORMATION (CONTINUED)

Surveillance and Other Regulatory Services

NASDR incurs costs associated with monitoring, legal, and enforcement activities related to the regulation of NASDAQ. These costs are charged to NASDAQ based upon NASD management's estimated percentage of costs incurred by each NASDR department that are attributable directly to The NASDAQ Stock Market surveillance. Inter-segment charges between NASDR and NASDAQ for surveillance and other regulatory services were $45.6 million and $61.8 million for the years ended December 31, 2004 and 2003, respectively.

On June 28, 2000, NASDAQ and NASDR signed a Regulatory Services Agreement to which NASDR or its subsidiaries would provide services to NASDAQ and its subsidiaries commencing upon the effectiveness of Exchange Registration. Pursuant to the terms of the Regulatory Services Agreement, the services provided will be the same type and scope as are currently provided by NASDR to NASDAQ for a term of 10 years. Each regulatory service is to be provided for a minimum of five years, after which time the parties may determine to terminate the provision by NASDR of a particular service. The termination of a particular service will generally be based upon a review of pricing and the need for such service.

Administrative and Technology Support Services

During 2003, NASD provided certain administrative, corporate, and infrastructure services to NASDAQ. NASD charges these expenses and other operating costs based on allocation of direct costs incurred by NASD. Support services provided to NASDAQ in 2003 were $1.2 million.

In January 2002, NASD and NASDAQ entered into a Separation and Common Services Agreement (New Separation Agreement), which replaced an interim Separation and Common Services Agreement (Interim Separation Agreement). The services to be provided to NASDAQ by NASD under the New Separation Agreement are limited to certain finance, technology infrastructure, facilities sharing, and legal services. Under the New Separation Agreement, NASDAQ pays NASD the costs of the services provided, including incidental expenses associated with such services.

18. SUBSEQUENT EVENTS

On January 1, 2005, NASDAQ purchased the remaining 50.0 percent interest in the NASDAQ Insurance Agency from AIG NJV, Inc. for nominal consideration. The purchase is not expected to have any impact on the operations of the agency. Beginning January 1, 2005, NASDAQ will consolidate the Insurance Agency in its consolidated results.

NASDAQ applied for and was granted a common stock listing on The NASDAQ National Market, and commenced trading on The National Market under the symbol NDAQ on February 10, 2005.

On February 15, 2005, NASDAQ completed an underwritten secondary offering of 16,586,980 shares of common stock owned by NASD and an additional 3,246,536 shares of common stock owned by certain selling stockholders who purchased the shares in NASDAQ's private placements in 2000 and 2001. NASDAQ, its officers, or other employees did not sell any shares in the secondary offering. NASD received net proceeds of $140.7 million and recognized a gain on the sale of subsidiary stock of $135.2 million. As of February 15, 2005, NASD owned 33.7 percent of NASDAQ's common stock, 100.0 percent of NASDAQ Series C Cumulative

18. SUBSEQUENT EVENTS (CONTINUED)

Preferred Stock, and 100.0 percent of NASDAQ Series B Preferred Stock. Due to the voting rights of the Series B Preferred Stock, NASD will continue to consolidate NASDAQ.

In February 2005, Amex borrowed $25.0 million under its Revolving Credit Facility with NASD.

In March 2005, NASD censured and fined Citibank Global Markets, American Express, and Chase Investment Services over $21.0 million for suitability and supervisory violations relating to mutual fund sales practices between January 2002 and July 2003. These cases are part of a larger, ongoing investigation into mutual fund sales practices.

On April 22, 2005, NASDAQ announced that it entered into a definitive agreement with Instinet Group, Incorporated (Instinet) to acquire Instinet (the Acquisition) and that it concurrently entered into a definitive agreement to sell Instinet's Institutional Broker division to an affiliate of Silver Lake Partners II, L.P. (SLP). Instinet also entered into a definitive agreement to sell its Lynch, Jones & Ryan subsidiary to Bank of New York prior to consummation of the NASDAQ transaction. As a result of these transactions, NASDAQ will ultimately acquire only Instinet's Electronic Communication Network (INET).

Instinet stockholders will receive approximately $1.878 billion in cash, comprised of approximately $934.5 million from NASDAQ, approximately $207.5 million from SLP, and the balance from INET's available cash, including approximately $174.0 million from Bank of New York.

Completion of the Acquisition is subject to the completion of Instinet's sale of Lynch, Jones & Ryan, and customary closing conditions, including the approval of the Acquisition by Instinet's shareholders, as well as regulatory approvals, including approval of the SEC and approval under the Hart-Scott Rodino Antitrust Improvements Act of 1976. The proposed sale of Instinet's Institutional brokerage business to an affiliate of SLP is subject to terms and conditions including, among other things, the closing of the Acquisition, and closing conditions and regulatory approvals that are similar to the closing conditions contained in the Agreement discussed above.

NASDAQ expects the Acquisition to be dilutive to NASDAQ's stockholders for up to 12 months and anticipates this transaction will be accretive to stockholders thereafter.

To finance the transaction, NASDAQ has obtained the following:

- $750.0 million commitment for six-year senior term debt along with a $50.0 million five-year revolving line of credit, with JP Morgan and Merrill Lynch acting as joint lead arrangers and joint bookrunners.
- $205.0 million in convertible notes issued to affiliates of SLP ($145.0 million) and Hellman & Friedman ($60.0 million) on April 22, 2005. The notes carry a coupon of 3.75 percent and will be convertible into NASDAQ common stock at a price of $14.50 per share. SLP and Hellman & Friedman also received 1.56 million and 0.65 million warrants, respectively, to purchase NASDAQ common stock at a price of $14.50. The warrants cannot be exercised on or before April 22, 2006 and expire on the third anniversary of the Acquisition closing date.

In order to facilitate the transaction, Hellman & Friedman also restructured the terms of NASDAQ's existing Subordinated Notes, extending the maturity date to October 2012, lowering the interest coupon rate to 3.75 percent from 4.0 percent and lowering the Subordinated Notes' conversion price to $14.50 from $20.00. Hellman & Friedman also received an additional 2.75 million

18. SUBSEQUENT EVENTS (CONTINUED)

warrants to purchase NASDAQ common stock at a price of $14.50 per share. These warrants also cannot be exercised on or before April 22, 2006 and expire on the third anniversary of the Acquisition closing date.

In the event the Acquisition does not occur, the convertible notes issued on April 22, 2005 will be redeemed at par and the warrants will expire worthless. In addition, the terms of the Subordinated Notes will revert back to the original terms, with limited exceptions.

On April 21, 2005, NASD and NASDAQ entered into a Stock Repurchase and Waiver Agreement whereby NASD consented to the financing described acquisition of Instinet Group above. In exchange for the waiver, NASDAQ repurchased 384,932 shares of its Series C Cumulative Preferred Stock owned by NASD for $40.0 million and Additional Redemption Amounts (as defined in the Certificate of Designations, Preferences and Rights of the Series C Cumulative Preferred Stock) due on these repurchased shares.

In connection with the sale of Amex to Amex Membership Corporation on December 31, 2004, all current and former employees (and their respective beneficiaries) of Amex (other than former employees who worked for NASD after leaving Amex) ceased to participate in the employee benefit plans sponsored or maintained by NASD, except the NASD Employee Retirement Plan maintained by NASD. On March 31, 2005, NASD and Amex instructed the trustee of the NASD Employee Retirement Plan to transfer to the trustee of Amex's newly established plans 80.0 percent of the plan's estimated assets related to the Amex employees, or $51.9 million. The distribution of the remaining 20.0 percent will take place upon final review and certification by the actuarial advisors of NASD and Amex.

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