Financial Industry Regulatory Authority

FINRA 2011 Year in Review and Annual Financial Report

1 Letter from the Chairman and Chief Executive Officer

5 Financial Summary

7 Table of Contents

FROM THE CHAIRMAN AND CEO

2011 was a year characterized by meaningful, measured progress toward realizing our vision for stronger investor protections and market integrity. We continued to push forward on a number of fronts to strengthen our efforts to detect fraud, assess risk at firms and bring new levels of transparency to the markets. As a result, we are better positioned to respond to the needs of investors and fast-changing markets. Following are highlights of our activities in 2011.

- We continued to transform our examination program to be more risk-based. Our primary goal is to focus on issues that cause real harm to investors and work to prevent problems, rather than just react to them. Last year, we took concrete steps to support this goal, including obtaining approval to fund a "risk-platform redesign" that will modernize the technology and business processes we use to conduct exams. When it launches, FINRA's redesigned exam platform will be critical to helping us collect broader and more granular data from firms so that we can better assess risk while reducing the amount of time examiners need to spend at the firm.
- We took important steps to enhance transparency for investors by implementing an initial series of changes to the BrokerCheck® system. Several of these changes addressed recommendations made by the Securities and Exchange Commission (SEC) in a Dodd-Frank Act-mandated January 2011 study on improving investor access to registration information on brokers and advisers.
- We made additional progress to increase market transparency last year by expanding our Trade Reporting and Compliance Engine® (TRACE®) to include securitized products. We also introduced benchmark pricing and aggregated data reports on FINRA's website to provide investors with greater insight into securitized products.
- In the area of market surveillance, we expanded the Order Audit Trail System (OATS™) last fall to include all National Market System (NMS) stocks. This was a major step in our efforts to improve our view of trading activity across markets.
- In early 2011, FINRA received SEC approval for and implemented the All-Public Panel Option Rule for customer arbitrations, which allows investors to choose all-public panels in all cases with three arbitrators. Providing this option was an important step toward enhancing confidence in our arbitration process.

Richard G. Ketchum
Chairman and
Chief Executive Officer

- We also constructed and launched FINRA's new data center and migrated our market regulation applications from an outside vendor to the new center. By shifting data operations in-house, we have mitigated our risk, and can better control and develop FINRA technology at a lower cost. Additionally, the organization is better positioned to accommodate future growth.

Together, these steps and others—presented in more detail below—will help us carry out our regulatory mandate more efficiently and effectively.

Sharpening Our Examination Focus on Risk

2011 was a substantive year for FINRA's examination program, as we strengthened our ability to identify high-risk firms, branch offices, brokers, activities and products through broader data collection and more comprehensive analysis. The exam program's continued transformation promises to provide greater flexibility in the way we conduct exams and deploy our resources.

In addition to initiating our risk-platform redesign, we increased the number of staff in district offices who are tasked with having an in-depth and ongoing understanding of specific firms, and responsible for monitoring firms' business and financial changes. This expansion has enhanced our ability to evaluate available regulatory information and better target examinations.

We also increased the number of branch office exams, conducting nearly 800 in 2011—nearly 300 more than 2010. With this new approach, our examiners spend more time on site at branch offices talking to staff responsible for oversight and supervision of the branches, and, depending on the firm, spend less time at the main office. Our goal in deploying more staff to branch offices is to make sure we are examining firms at the point of sale, where they interact directly with customers.

As part of our increased focus on risk, we sent out a risk control assessment survey to firms in February of this year. This was another important step toward our goal of better understanding firms' business activities, product and service mix, customer base and the nature of underlying risk controls. We'll use the information we gather from this survey—along with other data we collect from firms and vendors—to tailor our exams to the unique risks of individual firms.

We received valuable feedback from firms early in the process and, as a result, made adjustments to clarify certain survey questions. Each year going forward, we will continue to consider feedback from firms in order to improve the quality of the data we collect.

Also in 2011, we collaborated with the Municipal Securities Rulemaking Board (MSRB) to modernize the municipal examination program and allow FINRA to develop a more risk-based program to examine firms engaged in the municipal securities business. Before the rule change, MSRB rules required FINRA to examine every member of FINRA and the MSRB every two calendar years and for every MSRB rule. With the change, FINRA can now tailor exams to a firm's business and the risks that are involved.

Strengthening Enforcement and Fraud Detection

While our primary goal is to address problems early and prevent harm to investors, a strong enforcement program remains a cornerstone of FINRA's regulatory oversight. Last year, FINRA brought 1,488 disciplinary actions against registered individuals and firms, barring 329 individuals and suspending 475 others. FINRA's fines against firms and individuals totaled $71.9 million. In addition, we ordered firms and individuals to return approximately $19.4 million in restitution to investors.

The Office of Fraud Detection and Market Intelligence (OFDMI) also continued to grow as a real force in stopping fraudulent behavior in the financial services industry. In 2011, OFDMI referred more than 650 matters involving potential fraud to the SEC, law enforcement agencies or internal FINRA departments. Among the most substantive matters, we referred an insider trading case to the SEC within two days of Pearson PLC's November 21, 2011, announcement of plans to acquire Beijing-based Global Education & Technology Group Ltd. The SEC filed a civil complaint and obtained a temporary restraining order on December 5, 2011, freezing $2.7 million in illicit profits. We also referred to the FBI a $12 million Ponzi scheme involving a Staten Island mortgage company, which we uncovered through a tip provided to FINRA's Office of the Whistleblower.

In addition, we brought a number of cases involving structured products, including unsuitable sales of reverse convertible securities to retail customers, inadequate supervision of sales of structured products, inadequate supervision of accounts funded with loans from the broker-dealer firm's affiliated bank, and other violations related to the offer and sale of structured products.

We also took significant actions involving the sales of illiquid products. In the real estate investment trust (REIT) arena, we filed a complaint against David Lerner & Associates, charging the firm with misrepresentations, advertising and suitability violations concerning the sales of Apple REIT Ten—an illiquid, non-traded $2 billion REIT—and for targeting unsophisticated and elderly customers.

Other notable work in this area includes sanctions against 10 firms and 17 individuals in cases involving selling interests in private placement offerings in Medcap, Provident and DBSI. These actions resulted in almost $4 million in restitution to investors.

We also resolved a number of cases stemming from the credit crisis, most notably an action against Charles Schwab for violative sales of an ultra-short bond fund managed by a Schwab affiliate.

Responding to Rapidly Changing Markets

Last year, we reached several milestones in our plan to develop a comprehensive surveillance platform that views trading across multiple markets and financial products. As mentioned, we expanded OATS to include all NMS securities. The expansion of OATS is critical to the development of cross-market patterns, and we view it as a strong foundation for the consolidated audit trail (CAT) proposed by the SEC. We also prepared a blueprint, which we submitted to the SEC, that illustrates how OATS can be leveraged to become the foundation for the CAT at a much lower cost and within a shorter time frame than prior SEC estimates. Assuming the SEC adopts its proposed CAT rule in a manner that permits the use of OATS, we're ready to begin working closely with the exchanges to implement this blueprint.

We also made substantial progress in developing cross-market surveillance patterns that will canvass 80 percent of the equity markets. This was a result of the expansion of our surveillance responsibilities to NYSE markets, combined with our pre-existing responsibilities for NASDAQ markets. We plan to introduce these patterns in 2012. By consolidating market data into new cross-market surveillance patterns, we will be better able to identify problematic trading activity more quickly and stop improper conduct before it spreads.

During the year, we continued to work closely with other regulators on new standards designed to address extraordinary volatility issues like those that led to the "flash crash." This collaboration resulted in the implementation of single-stock circuit breakers and clearly erroneous pilots—which are currently in effect. FINRA and the exchanges also proposed new standards for market-wide circuit breakers and a new limit up-limit down framework to replace the existing single-stock circuit breakers. In May of this year, the SEC approved these two proposals on a one-year pilot basis, which will be implemented on February 4, 2013. During the one-year pilot period, FINRA, the exchanges and the SEC will assess their operation and consider whether any modifications are appropriate.

Enhancing Market Transparency

Since TRACE was first introduced 10 years ago to track over-the-counter corporate bonds, we have seen the benefits of increased market transparency. Not only does TRACE help regulators identify manipulative activity, it provides investors and market participants with access to information that enables them to assess the quality and fairness of pricing and valuation. It's been an unequivocal success.

In 2011, we continued to take steps to increase market transparency and enhance our ability to supervise the market. In May, TRACE was expanded to include asset- and mortgage-backed securities, although we deferred public dissemination of these transactions until we had fully evaluated the potential benefits as well as impact on market liquidity. In November, FINRA filed a proposal with the SEC to publicly disseminate transactions for the to-be-announced (TBA) segment of the asset-backed securities (ABS) market. We have found that this segment of the market is liquid and "fungible"—meaning that the price in one security can be used as a benchmark for prices in a similar security. Pending SEC approval, the change will mean even further transparency in the fixed income market. We will continue to evaluate other segments of the ABS market for dissemination in the future.

FINRA also made progress in our efforts to increase transparency for investors through improvements to BrokerCheck. As mentioned earlier, we implemented changes to address explicit recommendations contained in the SEC's January 2011 study on improved investor access to registration information on brokers and advisers. In May of this year, we unified BrokerCheck and IAPD search results, added a ZIP code search function and expanded the educational content on BrokerCheck—ahead of the July 2012 deadline set forth in the study.

As further recommended in the SEC's study, FINRA is now analyzing additional ways to facilitate and increase investor use of BrokerCheck. Toward that end, in February of this year, we issued *Regulatory Notice 12-10* seeking comments related to expanding the range of information we disclose in BrokerCheck, updating the way in which that information is presented and increasing investor awareness of BrokerCheck.

We received many valuable comments from both the public and industry groups, which we will consider as we develop recommendations for further enhancements. Our goal is to continually improve BrokerCheck to ensure that investors have access to a useful—and flexible—database that helps them make smart decisions about investment professionals.

Also in the area of increasing market transparency, we expanded the Nationwide Mortgage Licensing System (NMLS) under contract with the Conference of State Bank Supervisors (CSBS). We achieved all CSBS objectives for the NMLS Program, including the registration of all 300,000 federal mortgage loan officers.

Enhancing Financial Education and Investor Programs

This year, we continued to take steps to position FINRA as a leading advocate for investor education. In 2011, we issued 11 new *Investor Alerts* on topics ranging from gold scams to non-traded REITs. FINRA's investor education initiatives have been the subject of news articles in more than 130 national and local newspapers and periodicals across the country. More than 6,000 radio stations, reaching most major media markets, have broadcast interviews featuring FINRA executives discussing investor education topics.

The FINRA Investor Education Foundation stewarded 112 grant-supported projects to promote, study and improve financial and investor education; facilitated evaluation of the Smart Investing @ Your Library® and Financial Education in Your Community grant programs; and added 30 new grant projects to the portfolio during the year.

In support of First Lady Michelle Obama and Dr. Jill Biden's "Joining Forces" initiative, the Foundation announced in October 2011 that it would give 50,000 servicemembers and spouses free FICO® Scores—doubling the number of individuals receiving this important credit tool.

Partnering with Stanford University, the Foundation launched The Research Center on the Prevention of Financial Fraud in August 2011. During the year, the Foundation also partnered with researchers and thought-leaders in the field of higher education finance to address the growing challenge of college student debt.

Finally, the Foundation partnered with 40 organizations on 229 live events to deliver our Outsmarting Investment Fraud curriculum to almost 10,000 investors. In addition, we reached tens of thousands of investors through more than 760 telecasts on public television of the award-winning *Trick$ of the Trade* documentary, a key component of the Foundation's Investor Protection campaign.

Financials

In 2011, we made strategic investments in FINRA's business, including insourcing our data center operations, building out our cross-market surveillance capabilities and moving into lower-cost real estate facilities. Supported by FINRA's Board of Governors, these initiatives better position us to meet our regulatory mandates and reduce our operating expenses going forward.

However, the broader economic downturn continues to negatively impact FINRA's funding, resulting in a loss for fiscal year 2011. Since the financial crisis, revenue from regulatory fees is down 10 percent—by nearly $50 million—compared to 2008 levels. While this is due primarily to declining industry revenues and transaction volumes, FINRA's investment returns are also lower than prior years given a more conservative investment allocation policy and overall market returns. In light of our robust regulatory responsibilities but static funding levels, we have taken a hard look at spending across FINRA to be sure we are operating as effectively and efficiently as possible. This review was successful in trimming our operating spending in 2011; approximately $35 million of additional spending reductions are planned for 2012. Cumulative savings from this effort will reach nearly $60 million by the end of 2013 without compromising our regulatory mission.

Despite these efforts, the costs of meeting our regulatory obligations are expected to outpace our revenues during these challenging economic times. With input from the Small Firm Advisory Board and the FINRA Board of Governors, we have proposed to the SEC ways to modernize our existing fee structures and identify new revenue opportunities. Our goal in adjusting our fees is to ensure we are sufficiently capitalized to meet our regulatory responsibilities, which will only continue to grow, without unnecessarily burdening the industry.

FINANCIAL SUMMARY	Years Ended December 31,		
Key Results (In millions)	**2011** Actual	2010 Actual	2009 Actual
Net revenues	**$ 880.1**	$849.9	$ 755.6
Total expenses	**(994.9)**	(940.9)	(876.7)
Interest and dividend income	**25.0**	30.6	32.0
Net investments gains[1]	**19.0**	50.1	37.3
Equity (losses) earnings from other investments	**(12.5)**	65.2	86.6
Other	**(0.7)**	(0.3)	13.8
Net (loss) income	**$ (84.0)**	$ 54.6	$ 48.6

1 *Amounts are net of impairments of $44.8 million for 2009. No impairment was recorded for 2011 or 2010.*

Looking Forward

The work we do at FINRA is a powerful force behind maintaining the fairness of the U.S. securities markets and protecting investors everywhere. Yet, despite the important progress we have made, much work remains to be done. The steps outlined in this letter allow us—in a concrete way—to continue moving forward to effectively and efficiently regulate the securities industry. We are excited about the challenges going forward, and eager to explore what more we can do to position FINRA to better protect investors and successfully oversee today's ever-changing markets.

Richard G. Ketchum
Chairman and Chief Executive Officer

Contents

Management Report on Financial Operations	8
Management Report on Internal Control Over Financial Reporting	25
Certification of 2011 Annual Financial Report	26
Audit Committee Report	27
Investment Committee Report	29
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting	31
Report of Independent Registered Public Accounting Firm	32
FINRA 2011 Consolidated Financial Statements:	
Consolidated Balance Sheets	33
Consolidated Statements of Operations	35
Consolidated Statements of Changes in Equity	36
Consolidated Statements of Cash Flows	37
Notes to Consolidated Financial Statements	39

Management Report on Financial Operations

OVERVIEW

The Financial Industry Regulatory Authority, Inc.® (FINRA®) is the largest independent regulator of securities firms doing business with the public in the United States. As of December 31, 2011, FINRA oversaw nearly 4,500 brokerage firms, approximately 160,000 branch offices and almost 630,000 registered securities representatives. FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services.

With approximately 3,300 employees, FINRA augments and deepens the reach of the federal securities laws with detailed and enforceable ethical rules and a host of comprehensive regulatory oversight programs. FINRA regulates the population of both firms and individuals in the industry; regulates securities markets and provides market information; adopts and enforces rules to protect investors and the financial markets; examines broker-dealers for compliance with its own rules as well as federal securities laws and rules of the Municipal Securities Rulemaking Board; informs and educates the investing public; provides industry utilities and administers the largest dispute resolution forum for investors, registered firms and firm employees.

This Management Report should be read in connection with the consolidated financial statements and accompanying notes included elsewhere in this Annual Financial Report. The 2011 consolidated financial statements reflect the activities of FINRA and its consolidated subsidiaries, collectively referred to as “we,” “our,” “us,” “FINRA” or the “Company” throughout this Management Report. FINRA’s primary consolidated subsidiaries are FINRA Regulation, Inc., FINRA Dispute Resolution, Inc. and the FINRA Investor Education Foundation® (the Foundation), as of and for the years ended December 31, 2011, 2010 and 2009.

RESULTS OF OPERATIONS

The Company’s consolidated net (loss) income for 2011, 2010 and 2009 was $(84.0) million, $54.6 million and $48.6 million.

The Company’s consolidated net loss of $84.0 million for 2011 was driven primarily by non-recurring costs related to our new data center facilities in New York and Maryland, as well as increased integration costs to further FINRA’s cross market surveillance capabilities. Once completed, these strategic initiatives position FINRA to respond to industry changes while enhancing its regulatory responsibilities. Contributing to the net loss were the waning economic conditions that created a decrease in the Gross Income Assessment (GIA) due to the continued decline in industry revenues over the last three years. Additionally, trading portfolio returns and the performance of our other investments declined in 2011 compared to 2010. Although our overall investment portfolio returns were positive for 2011 at 2.0 percent, they were substantially below 2010 portfolio returns of 6.9 percent.

Management Report on Financial Operations (continued)

The following table sets forth our actual consolidated results of operations for the three years ended December 31, 2011.

	Years Ended December 31,		
	2011	2010	2009
		(in millions)	
Revenues			
Regulatory fees	$ 407.3	$ 428.6	$ 387.9
User fees	157.0	154.0	148.3
Contract services fees	129.0	111.1	57.1
Transparency services fees	56.0	48.6	47.6
Dispute resolution fees	48.0	54.2	56.7
Other	10.9	11.4	10.4
Total operating revenues	808.2	807.9	708.0
Fines	71.9	42.2	47.6
Activity assessment	346.9	295.2	341.4
Total revenues	1,227.0	1,145.3	1,097.0
Activity assessment cost of revenues	(346.9)	(295.4)	(341.4)
Net revenues	880.1	849.9	755.6
Expenses			
Compensation and benefits	577.2	540.3	493.9
Professional and contract services	208.0	205.4	183.3
Occupancy	64.2	58.6	57.2
Depreciation and amortization	47.9	48.9	49.5
Computer operations and data communications	36.7	29.5	27.4
General and administrative	60.9	58.2	65.4
Total expenses	994.9	940.9	876.7
Interest and dividend income	25.0	30.6	32.0
Operating loss	(89.8)	(60.4)	(89.1)
Net investment gains	19.0	50.1	37.3
Equity (losses) earnings from other investments	(12.5)	65.2	86.6
Other (expense) income	(0.7)	(0.3)	13.8
Net (loss) income	**$ (84.0)**	**$ 54.6**	**$ 48.6**

Net revenues for 2011 of $880.1 million increased by $30.2 million compared to 2010 net revenues of $849.9 million. The increase is due, in part, to an increase in the number and average dollar amount of fines along with higher contract services fees related to market regulation services under the NYSE Euronext Regulatory Services Agreement (NYSE RSA) effective June 14, 2010. These increases were offset by a decrease in the GIA due to the continued decline in industry revenues over the last three years.

Management Report on Financial Operations (continued)

Total expenses for 2011 of $994.9 million increased by $54.0 million from total 2010 expenses of $940.9 million. This increase was primarily driven by the new data center facilities in New York and Maryland, increased integration costs to further FINRA's cross market surveillance capabilities and the full-year effect of former NYSE employees and related costs brought into the organization as a result of the NYSE RSA, as shown in the table below:

Total expenses for the year ended December 31, 2011	$994.9
Total expenses for the year ended December 31, 2010	940.9
Increase in total expenses	54.0
Increase in expenses associated with strategic initiatives:	
Data center strategy (a)	16.1
Cross market surveillance and the NYSE RSA (b)	26.8
Total increase in expenses associated with strategic initiatives	42.9
Other	11.1
Increase in total expenses	$ 54.0

(a) Includes expenses related to the new data center facilities in New York and Maryland, as well as the termination fee related to the early termination of a portion of our technology services contract.

(b) Includes increased spending to further FINRA's cross market surveillance capabilities across the NYSE and The NASDAQ OMX Group, Inc., (NASDAQ) markets and the full-year effect of former NYSE employees and related costs brought into the organization as a result of the NYSE RSA, effective June 14, 2010.

Results of Operations, 2011 Versus 2010

Revenues

Operating revenues were $808.2 million in 2011, compared with $807.9 million in 2010 — an increase of $0.3 million, due to higher user, contract services and transparency services fees, offset by lower regulatory and dispute resolution fees.

Regulatory fees include assessments for the supervision and regulation of firms through examination, policy making, rulemaking and enforcement activities. The primary regulatory fees are the Trading Activity Fee (TAF), the GIA, the Personnel Assessment (PA) and the Branch Office Assessment (BOA). Regulatory fees were $407.3 million in 2011, compared with $428.6 million in 2010 — a decrease of $21.3 million, or 5.0 percent, due primarily to a GIA decrease of $16.7 million. The GIA is based on the higher of the current year's GIA or the average of the preceding three years' GIA. The decrease in the GIA is attributable to the continued decline in industry revenues over the last three years. Also contributing to the overall decrease in regulatory fees is a $4.1 million decline in TAF, primarily due to a decrease in trading volumes from 2010 to 2011. Additionally, we issued rebates to firms of $5.6 million in 2011 and $5.7 million in 2010. We recorded these rebates as a reduction of regulatory fees.

User fees include initial and annual registration fees, fees for qualification examinations, fees associated with FINRA-sponsored educational programs and conferences, processing of membership applications and charges related to the review of advertisements and corporate financing filings. User fees totaled $157.0 million in 2011, compared with $154.0 million for 2010 — an increase of $3.0 million, or 1.9 percent, due primarily to an increase in testing fees of $2.7 million driven by the addition of the Operations Professional (Series 99) exam in October 2011.

Contract services fees represent amounts charged for regulatory services provided primarily to NASDAQ, NYSE Euronext and other exchanges, as well as the Trade Reporting Facilities (TRFs), for services including surveillance reviews, investigations, examinations and the disciplinary process. Contract services fees also include fees for the mortgage licensing system FINRA developed and deployed to the State Regulatory Registry LLC (SRR), and the delivery of national and state mortgage exams. Contract services fees were $129.0 million in 2011, compared with $111.1 million in 2010 — an increase of $17.9 million, or 16.1 percent, driven primarily by increased fees for FINRA's provision of market regulation services offset by a decrease in mortgage exam fees. Regulatory fees increased as a result of services provided to NYSE Euronext under the NYSE RSA, effective June 14, 2010. Market regulation services under the NYSE RSA were provided over the full year in 2011 versus only six-and-a-half months in 2010. Mortgage exam fees decreased as the majority of existing mortgage originators took the exam in 2010.

Transparency services fees represent amounts charged for services offered through the Trade Reporting and Compliance Engine® (TRACE®), the Alternative Display Facility® (ADF®), the Over-the-Counter Bulletin Board (OTCBB®) and the OTC Reporting Facility™ (ORF™). Transparency services fees totaled $56.0 million in 2011, compared with $48.6 million in 2010 — an increase of $7.4 million, or 15.2 percent. This increase was driven by the introduction of trade reporting for securitized products during 2011, which contributed $6.6 million in revenue.

Dispute resolution fees are earned during the arbitration and mediation processes. Dispute resolution fees totaled $48.0 million in 2011, compared with $54.2 million in 2010 — a decrease of $6.2 million, or 11.4 percent. Driving this decrease was a reduction in the number of new cases filed, from 5,680 in 2010 to 4,729 in 2011, a decrease of 16.7 percent.

Other revenues were relatively flat in 2011 compared to 2010, with revenues of $10.9 million in 2011, compared with $11.4 million in 2010. Other revenues represent the recognition of deferred contribution revenue attributable to the Foundation's use of funds received from the Global Research Analyst Settlement (the GRA Settlement). FINRA recognizes the related revenue as the Foundation makes grant payments and incurs expenses against GRA Settlement funds pursuant to guidelines under the Securities and Exchange Commission's (SEC's) investor education plan. Grant payments and expenses incurred for 2011 and 2010 were $8.7 million and $9.4 million.

Fines represent amounts levied as sanctions for rule violations. We do not view fines as part of our operating revenues. Fine monies are not used to fund employee compensation; the use of fine monies is limited to capital expenditures and regulatory projects, which are reported to our Board of Governors (Board). Fine revenues totaled $71.9 million in 2011 and $42.2 million in 2010 — an increase of $29.7 million, or 70.4 percent. The number of fines increased from 643 in 2010 to 733 in 2011; in addition, the average fine increased from approximately $65,600 in 2010 to approximately $98,100 in 2011.

Activity assessment revenues represent amounts charged to firms to cover our obligation to the SEC under Section 31 of the Securities Exchange Act of 1934. Activity assessment cost of revenues represents the amounts owed and remitted to the SEC under this obligation. Activity assessment revenues were $346.9 million in 2011, compared to $295.2 million in 2010 — an increase of $51.7 million, or 17.5 percent. Activity assessment cost of revenues was $346.9 million in 2011, compared to $295.4 million in 2010 — an increase of $51.5 million, or 17.4 percent. A rate increase in January 2011 drove the increase in both activity assessment revenues and activity assessment cost of revenues.

Expenses

Total expenses were $994.9 million in 2011, compared to $940.9 million in 2010 — an increase of $54.0 million, or 5.7 percent. The increase was primarily driven by increased spending to further FINRA's cross market surveillance capabilities, expenses related to the new data center facilities in New York and Maryland, and the full-year effect of former NYSE employees and related costs brought into the organization as a result of the NYSE RSA, effective June 14, 2010. Six-and-a-half months of the NYSE expenses were included in 2010 operating results versus a full year in 2011.

Compensation and benefits expenses increased to $577.2 million in 2011, from $540.3 million in 2010 — an increase of $36.9 million, or 6.8 percent. This increase was mainly driven by the full-year effect of former NYSE employees as well as an increase in the number of employees due in part to hiring staff to manage and operate our New York and Maryland data center facilities and in-sourcing other technology-related services. The balance of the increase is attributed to annual merit and promotion increases. FINRA had approximately 3,300 and 3,000 employees as of December 31, 2011, and 2010.

Management Report on Financial Operations (continued)

Professional and contract services increased to $208.0 million in 2011, from $205.4 million in 2010 — an increase of $2.6 million, or 1.3 percent, primarily driven by increased technology-related spending offset by decreased mortgage license exam administration costs. Technology-related spending increased due to the development of new cross market surveillance patterns and the maintenance and development of products and programs in support of FINRA's market regulation function, including integration activities. Additionally, we paid a termination fee related to the early termination of a portion of our technology services contract. These increases were offset by a decrease in expenses related to our administration of national and state mortgage license exams, as the majority of existing mortgage originators took the exam in 2010.

All other operating expenses (computer operations and data communications, depreciation and amortization, occupancy and general and administrative) increased to $209.7 million in 2011, from $195.2 million in 2010 — an increase of $14.5 million, or 7.4 percent. This increase was primarily driven by the build out of the New York and Maryland data center facilities, increased rent expenses and increased travel and training expenses due to increased headcount.

Interest and Dividend Income

Interest and dividend income primarily reflects income earned on FINRA's operating cash accounts and investments. Interest and dividend income was $25.0 million in 2011, compared with $30.6 million in 2010 — a decrease of $5.6 million, or 18.3 percent. The continued decline in interest rates contributed to the decrease in the interest income earned.

Investment Gains

Net investment gains in the consolidated statements of operations represent net realized gains and losses on sales of available-for-sale and trading securities, gains and losses on redemptions of our private investments, mark-to-market holding gains and losses on our trading portfolio, and other-than-temporary impairments of our available-for-sale securities and other investments. Net investment gains were $19.0 million in 2011, compared with $50.1 million in 2010. The net investment gains in 2011 are driven primarily by the sale of securities within our trading portfolio. The gains in 2010 were primarily due to steady investment returns from our trading portfolio and the sale of private investments committed to under the legacy investment portfolio policy. All but one of our legacy portfolio private investments were sold during 2010.

Equity (Losses) Earnings from Other Investments

Equity (losses) earnings from other investments represent our share in the earnings and losses from our ownership interests in hedge funds and limited partnerships accounted for under the equity method. Equity losses were $12.5 million in 2011, compared to the equity earnings of $65.2 million in 2010. Our weighted ownership interest in the net assets of all equity method investees was 8.1 percent at December 31, 2011.

Other (Expense) Income

Other expenses represent income taxes on unrelated business income earned primarily from mortgage licensing and examination services. Taxes are assessed and paid in the year following the tax year. In 2011, other expenses were $0.7 million, compared with $0.3 million in 2010, primarily due to higher unrelated business income reported to us from our pass-through investments (*i.e.*, limited partnership investments) for the 2010 tax year compared to the 2009 tax year.

Results of Operations, 2010 Versus 2009

Revenues

Operating revenues were $807.9 million in 2010, compared with $708.0 million in 2009 — an increase of $99.9 million, or 14.1 percent, due to higher regulatory, user and contract services fees.

Management Report on Financial Operations (continued)

Regulatory fees were $428.6 million in 2010, compared with $387.9 million in 2009 — an increase of $40.7 million, or 10.5 percent, due primarily to GIA and PA increases of $27.8 million and $39.9 million. The increase in the GIA is attributable to the restructuring of the fee whereby the assessment is based on the higher of the current year's GIA or the average of the preceding three years' GIA. The PA increased due to a fee increase to better align our revenues with costs. The restructuring of both of these fees allowed FINRA to continue to effectively discharge its regulatory obligations in a fiscally prudent way, while reducing its vulnerability to another market downturn as experienced in 2009. These increases were offset by a $26.6 million decline in the TAF, primarily due to a decrease in trading volumes from 2009 to 2010. Additionally, we issued rebates to firms of $5.7 million in 2010 and $5.9 million in 2009. We recorded these rebates as a reduction of regulatory fees.

User fees totaled $154.0 million in 2010, compared with $148.3 million for 2009 — an increase of $5.7 million, or 3.8 percent, due primarily to a $4.9 million increase in continuing education fees resulting from an exam fee increase to better align revenue with costs.

Contract services fees were $111.1 million in 2010, compared with $57.1 million in 2009 — an increase of $54.0 million, or 94.6 percent, driven primarily by FINRA's provision of market regulation services to NYSE Euronext as a result of the NYSE RSA, effective June 14, 2010. Market regulation fees for services provided under the NYSE RSA totaled $31.2 million in 2010. Additionally, contract services fees increased $24.4 million due to the development and delivery of national and state mortgage exams.

Transparency services fees remained relatively consistent with the prior year, totaling $48.6 million in 2010, compared with $47.6 million in 2009.

Dispute resolution fees totaled $54.2 million in 2010, compared with $56.7 million in 2009 — a decrease of $2.5 million, or 4.4 percent. Driving this decrease was a reduction in the number of new cases filed, from 7,137 in 2009 to 5,680 in 2010, a decrease of 20.4 percent. This decrease was partially offset by an increase in forum fees, which are assessed as arbitration and mediation sessions actually occur.

Other revenues were relatively flat in 2010 compared to 2009, with revenues of $11.4 million in 2010, compared with $10.4 million in 2009, primarily due to the recognition of deferred contribution revenue attributable to the Foundation's use of funds received from the GRA Settlement. Grant payments and expenses incurred for 2010 and 2009 were $9.4 million and $7.4 million.

Fine revenues totaled $42.2 million in 2010 and $47.6 million in 2009 — a decrease of $5.4 million, or 11.3 percent. The number of fines remained flat, with 644 fines levied in 2009 compared to 643 in 2010; however, the average fine decreased from approximately $73,900 in 2009 to approximately $65,600 in 2010.

Activity assessment revenues were $295.2 million in 2010, compared to $341.4 million in 2009 — a decrease of $46.2 million, or 13.5 percent. Activity assessment cost of revenues was $295.4 million in 2010, compared to $341.4 million in 2009—a decrease of $46.0 million, or 13.5 percent. A year-over-year rate decrease, partially offset by an increase in the dollar volume of contracts traded, drove the decrease in both activity assessment revenues and activity assessment cost of revenues.

Expenses

Total expenses were $940.9 million in 2010, compared to $876.7 million in 2009 — an increase of $64.2 million, or 7.3 percent. The increase was primarily driven by increases in compensation and benefits expense and professional and contract services.

Compensation and benefits expenses increased to $540.3 million in 2010, from $493.9 million in 2009 — an increase of $46.4 million, or 9.4 percent. Of the increase, $18.8 million was driven by the NYSE RSA as former NYSE employees were brought into the organization, increasing the number of employees on FINRA's payroll and employee benefit costs. The balance of the increase is attributed to the full-year effect of employees hired during 2009 and throughout 2010 coupled with annual merit and promotion increases. FINRA had approximately 3,000 and 2,800 employees as of December 31, 2010, and 2009.

Professional and contract services increased to $205.4 million in 2010, from $183.3 million in 2009 — an increase of $22.1 million or 12.1 percent, primarily due to regulatory exam external testing service fees and technology maintenance costs. External testing service fees increased $11.9 million due to the introduction of national and state mortgage-related exams. The cost of running this program is covered through the contract fees charged to SRR. Technology maintenance expenses increased by $10.0 million due primarily to the maintenance of integrated former NASD and NYSE member regulation technology platforms, previously in the application-development stage.

All other operating expenses (computer operations and data communications, depreciation and amortization, occupancy and general and administrative) decreased to $195.2 million in 2010, from $199.5 million in 2009 — a decrease of $4.3 million, or 2.2 percent. This change was primarily driven by a $6.6 million decrease in marketing expenses related to the suspension of FINRA's advertising campaign, offset by a $2.0 million increase in Foundation grant payments and expenses incurred.

Interest and Dividend Income

Interest and dividend income was $30.6 million in 2010, compared with $32.0 million in 2009—a decrease of $1.4 million, or 4.4 percent.

Investment Gains

Net investment gains were $50.1 million in 2010, compared with $37.3 million in 2009. The net investment gains in 2010 are primarily due to the sale of private investments and steady investment returns from our trading portfolio. The gains in 2009 were driven primarily by the recovery of the securities markets. We recorded impairment charges for other-than-temporary declines of $44.8 million in 2009 related to our private investments, as it was deemed probable as of December 31, 2009, that all of our direct investments in private equity funds, committed to under the legacy investment portfolio policy, would be sold at an amount different from the net asset value of our ownership interest in partners' capital. We sold all but one of our remaining legacy portfolio private investments during 2010.

Equity (Losses) Earnings from Other Investments

Equity earnings were $65.2 million in 2010, compared with $86.6 million in 2009. Our weighted ownership interest in the net assets of all equity method investees was 4.9 percent at December 31, 2010. The equity earnings in 2010 are due primarily to our main private investment fund's performance. The equity earnings in 2009 were generated from our main private investment fund's performance, as well as our investments in hedge funds, the majority of which were liquidated in 2009 as part of our change in investment strategy.

Other (Expense) Income

In 2010, other expenses of $0.3 million represent income taxes on unrelated business income earned in 2010, primarily from mortgage licensing and examination services.

In 2009, other income primarily consisted of FINRA's share of unexpended GRA Settlement research funds, unrelated to the Foundation's restricted educational GRA Settlement funds. The unexpended funds, in the amount of $8.2 million, were originally set aside as part of the GRA Settlement to support independent research over a five-year period. A portion of the GRA Settlement research funds not distributed at the end of the five-year period were paid to FINRA to support its regulation and enforcement programs.

Other income in 2009 also included $5.6 million in income tax benefits from unrelated business loss carryforwards. We determined that these loss carryforwards would be used to offset taxable unrelated business income, primarily from mortgage licensing and exam services. Realization is dependent on generating sufficient taxable income prior to expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is the ongoing ability to fund asset growth and business operations and meet contractual obligations through unrestricted access to funding at reasonable market rates. Liquidity management involves forecasting funding requirements and maintaining sufficient working capital to meet business needs and accommodate fluctuations in asset and liability levels due to changes in business operations or unanticipated events. We primarily rely on operating cash flows to fund current and future operations.

FINRA's investment portfolio (the Portfolio) is governed by a policy based on the degree of risk deemed appropriate for FINRA assets by the Board as applied to its investment objectives. The FINRA Investment Committee (Investment Committee), whose members have extensive background and experience in the investment community, provides overall guidance and advice in determining the appropriate policy and allocation for the Portfolio. As of December 31, 2011, the Portfolio remains highly liquid, with 55 percent available in 30 days or less.

See the separate Investment Committee Report on page 29 of the 2011 Annual Financial Report for further discussion of liquidity and capital resources.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT RISK

Market risk represents the risk of changes in the value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates, equity prices and other factors. As of December 31, 2011, investments in the Company's consolidated financial statements consisted of 1) U.S. government (including state and local) securities; 2) agency mortgage-backed securities; 3) corporate and asset backed securities; 4) mutual and commingled funds; 5) other investments (including private investments); and 6) other financial instruments.

Our primary market risk relates to our investment portfolio. Our investments are impacted by fluctuations in the securities markets and by interest rate risk, currency risk and commodity risk, as well as other financial and nonfinancial risks.

We capture changes in the market value of our trading investments and changes in the net asset value of our equity method investments in the consolidated statements of operations. Temporary changes in the market value of available-for-sale investments are recorded through unrealized gain (loss) in other comprehensive income.

FINRA management believes that other-than-temporary fluctuations in market indices could have a significant impact on our available-for-sale investment portfolio, earnings and cash flows. We review our available-for-sale investment portfolio for other-than-temporary declines on an annual basis. Based on these reviews, we recognize impairment charges for other-than-temporary declines on our available-for-sale investments. No impairment charges related to our available-for-sale investments were recognized in 2011, 2010 or 2009.

We consider and evaluate year-end fair value estimates to assess potential impairment of our private investments. In reviewing this information, we evaluate current financial statements and subsequently compare our valuations to annual audited statements obtained from each fund. We also review the valuation policy of the funds as described in the funds' financial statements. Net asset value is used as a practical expedient to measure fair value, unless it is probable that an investment will be sold for a different amount. In these cases, fair value is measured based on recent observable transaction information for similar investments, the consideration of non-binding bids from potential buyers and third-party valuations. Based on our assessment, no impairment charges related to our private investments were recognized in 2011 or 2010. We recognized impairment charges for other-than-temporary declines of $44.8 million in 2009 related to our private investments.

As specified in our investment policy, we maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return. During 2009, we entered into a limited partnership agreement with HighVista II Limited Partnership, a broadly diversified multi-asset fund managed by HighVista Strategies LLC, that represents approximately 48 percent of our total invested assets, excluding cash, as of December 31, 2011. Our active trading portfolio as of December 31, 2011, is a fixed income portfolio managed by Wellington Management Company, LLP.

FINRA is exposed to credit risk from third parties, including NASDAQ, NYSE Euronext and FINRA-regulated firms. These parties may default on obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons.

CASH FLOWS

FINRA prepares its consolidated statement of cash flows using the indirect method, whereby net (loss) income is reconciled to cash flows from operations by adjusting for those items that do not result in actual cash receipts or payments during the period. These reconciling items include depreciation, net investment gains (losses), undistributed equity earnings and losses from other investments and bad debt expense. Net (loss) income is further adjusted for changes in the consolidated balance sheet for working capital from the beginning to the end of the period to arrive at the cash inflows and payments related to items such as accounts receivable, prepaid expenses, accounts payable and deferred revenue. See the table below for a summary of cash flows:

	Years Ended December 31,		
	2011	2010	2009
	(in millions)		
Operating	$ 8.4	$ (36.5)	$(156.2)
Investing	5.0	233.0	311.7
Financing	(8.6)	(10.2)	(7.5)
Total	$ 4.8	$186.3	$ 148.0

FINRA generated a net cash inflow of $8.4 million from operating activities in 2011. FINRA had a net cash inflow from investing activities of $5.0 million due primarily to net sales of trading securities and redemptions of other investments, offset by equipment purchases related to our New York and Maryland data center facilities. Net cash used in financing activities of $8.6 million related to the Foundation's disbursement of GRA Settlement funds.

FINRA used $36.5 million of cash from operating activities in 2010. This was primarily due to payments related to SEC Section 31 fees. FINRA had a net cash inflow from investing activities of $233.0 million due primarily to net sales of trading securities and redemptions of other investments (private investments). We sold all but one of our remaining legacy portfolio private investments during 2010. Net cash used in financing activities of $10.2 million related to the Foundation's disbursement of GRA Settlement funds.

FINRA used $156.2 million of cash from operating activities in 2009. This was primarily used to purchase trading securities that would be sold in the near term. Other factors affecting the cash flow were an increase in accounts receivable coupled with payments of previously accrued expenses. FINRA had a net cash inflow from investing activities of $311.7 million due primarily to redemptions of available-for-sale and other investments (hedge funds) partially offset by purchases of other investments. Net cash used in financing activities of $7.5 million related to the Foundation's disbursement of GRA Settlement funds.

Overall, cash and cash equivalents, trading investments and available-for-sale investments totaled $1,142.3 million as of December 31, 2011, and $1,189.6 million as of December 31, 2010. The decrease of $47.3 million or 4.0 percent was driven primarily by cash used to fund our New York and Maryland data center facilities.

FINRA's working capital was $691.2 million as of December 31, 2011, and $762.1 million as of December 31, 2010. We believe 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.

CONTRACTUAL OBLIGATIONS AND CONTINGENT COMMITMENTS

FINRA has contractual obligations to make minimum rental commitments under non-cancelable operating leases and other obligations. The following table summarizes those contractual obligations:

	Total	Less than 1 Year	1 – 3 Years	3 – 5 Years	More than 5 Years
		(in millions)			
Minimum rental commitments under non-cancelable operating leases	$215.7	$29.3	$54.3	$47.4	$84.7
Commitments related to facility operations and security in New York, NY	12.6	12.6	—	—	—
Information and technology services agreement	15.0	15.0	—	—	—
Commitment to investment in limited partnership	5.7	5.7	—	—	—
Total	$249.0	$62.6	$54.3	$47.4	$84.7

The majority of the non-cancelable operating leases contain escalation clauses based on increases in rent, property taxes and building operating costs. Commitments related to operations in New York include facilities and security costs for FINRA personnel working in buildings subleased from NYSE as part of the acquired member regulation operations of NYSE. Information and technology services agreement commitments relate to our minimum annual spending requirements under an agreement with Hewlett-Packard (HP) Enterprise Services. Under that agreement, which expires on December 31, 2012, HP Enterprise Services provides us with systems support and maintenance services. Commitment to investment in limited partnership represents our remaining commitment to one legacy investment in a limited partnership. The general partner may call this commitment at any time from now until December 31, 2012. As such, we have presented the full remaining commitment as "Less than 1 Year."

EXECUTIVE COMPENSATION

Introduction

FINRA's compensation philosophy is a pay-for-performance model seeking to achieve pay levels in line with the competitive market while meeting the objectives of attracting, developing and retaining high-performing individuals who are capable of achieving our mission and to provide rewards commensurate with individual contributions and FINRA's overall performance.

The Management Compensation Committee (the Committee), composed of public members of the Board, is responsible for approving salary levels and incentive compensation targets for top-level executives. The Committee determines the incentive compensation awards based on actual performance. In determining salary and incentive compensation, management and the Committee consider operational, strategic and financial factors in addition to individual performance. The salary and incentive compensation recommendations for the CEO are reviewed and approved by the Board annually.

The Committee has the sole right and responsibility to hire and terminate a compensation consultant. In 2011, as in past years, the Committee engaged Mercer, Inc. (Mercer), an independent third-party compensation consultant, to prepare a compensation study, which included objective analysis of current compensation levels and benchmarking, using information from a comparable segment of the market for key executives. To ensure the independence of Mercer:

- throughout the year, Mercer reported directly and exclusively to the Committee;
- no Mercer employee is hired by FINRA;
- Mercer provides no other services, other than compensation consulting services, to FINRA;
- any interaction between Mercer and FINRA management is limited to discussions on behalf of the Committee and information that is presented to the Committee for approval; and
- fees paid to Mercer for compensation consulting services are reasonable and in line with industry standards.

Benchmarking

Defining the relevant employment market for competitive compensation benchmarking purposes is a significant challenge for us due to the scarcity of natural comparators, the uniqueness of functions performed, the need for specialized expertise in financial services and securities law and a constantly changing environment under heightened scrutiny.

As a general policy, FINRA has determined that its competitive compensation positioning should be considered against a broad section of financial services/capital market companies, as this sector is the most likely from which we recruit talent and talent is recruited from us. We also benchmark against general industry positions and law departments for jobs that are not unique to the financial services industry. FINRA recognizes that it does not provide fully competitive opportunities, particularly in the equity/long-term incentive area, when compared to certain global investment/securities firms.

In determining a benchmarking strategy for key executives, financial services organizations (broker-dealers, investment banks, Federal Reserve banks, commercial banks, insurance companies, exchanges and regulators) were determined to be the most relevant groups for comparison purposes. The Committee and Mercer engaged in substantial research and consideration of the functions and operations of several potential comparators as well as general competitive conditions. Ultimately, the Committee approved a benchmarking process that focused on the following sources:

- public comparison group comprised of a blend of financial services organizations engaged in brokerage or other related banking activities;
- public exchanges and regulators; and
- financial services industry survey data.

The Committee will routinely review the aforementioned sources in determining annual salary and incentive compensation.

Summary Compensation Table

The following table presents actual 2010 and 2011 compensation data in the year paid (all amounts are in dollars). The 2012 salary information represents the base annual salary at which the top ten executives as of June 28, 2012, are compensated. It does not represent 2012 year-to-date earnings. The 2012 incentive compensation amounts represent the actual payment in February 2012 based on 2011 performance. Other amounts, including deferred compensation and other benefits, are not presented for 2012 as these accumulate over the course of the year and final amounts are not determined until year-end. For the compensation details related to the full list of statutory officers and key employees, see FINRA's 2011 Form 990 tax returns.

Name and principal position		Salary (1)	Incentive compensation (2)	Other awards (3)	Deferred compensation (4)	Other benefits (5)	Total
Richard Ketchum	2012	1,000,000	1,250,000	—	*	*	2,250,000
Chairman and Chief Executive	2011	1,000,000	1,200,000	—	451,174	34,660	2,685,834
Officer	2010	1,000,000	1,250,000	—	321,305	38,049	2,609,354
Stephen Luparello	2012	600,000	690,000	—	*	*	1,290,000
Vice Chairman	2011	600,000	690,000	—	58,969	35,160	1,384,129
	2010	594,808	700,000	—	94,587	43,495	1,432,890
Todd Diganci	2012	500,000	680,000	—	*	*	1,180,000
EVP and Chief Financial Officer	2011	500,000	660,000	—	33,238	31,420	1,224,658
	2010	500,000	660,000	—	30,644	41,353	1,231,997
Linda Fienberg	2012	459,700	400,000	—	*	*	859,700
President, Dispute Resolution	2011	459,700	417,800	—	62,263	29,926	969,689
	2010	459,700	420,300	—	62,664	31,336	974,000
J. Bradley Bennett	2012	435,000	435,000	—	*	*	870,000
EVP, Enforcement	2011	416,827	—	75,000	90,050	12,507	594,384
	2010	—	—	—	—	—	—
Howard Schloss	2012	432,000	300,000	—	*	*	732,000
EVP, Corporate Communications	2011	432,000	325,000	—	31,493	41,521	830,014
	2010	432,000	393,000	—	157,340	45,044	1,027,384
Martin Colburn	2012	400,050	400,000	—	*	*	800,050
EVP and Chief Technology Officer	2011	400,050	430,000	—	110,762	31,886	972,698
	2010	400,050	454,043	—	159,027	38,929	1,052,049
Thomas Gira	2012	400,000	455,000	—	*	*	855,000
EVP, Market Regulation	2011	381,539	425,000	—	78,791	36,597	921,927
	2010	375,770	410,000	10,000	79,653	39,430	914,853
Grace Vogel	2012	375,000	475,000	—	*	*	850,000
EVP, Member Regulation	2011	370,000	500,000	—	118,856	31,754	1,020,610
	2010	370,000	525,000	—	258,719	33,263	1,186,982
Steven Joachim	2012	370,000	410,000	—	*	*	780,000
EVP, Transparency Services	2011	370,000	400,000	—	295,324	32,861	1,098,185
	2010	370,000	428,200	—	293,675	39,359	1,131,234

* 2012 deferred compensation and other benefits cannot be fully determined until the end of the calendar year and are therefore not included in the above table.

1 Salary is paid bi-weekly, one week in arrears. 2012 salary information represents the executives' current base annual rate of pay as of June 28, 2012.

2 Incentive compensation is paid after the close of the calendar year based on the prior year's performance. Payments are reflected in the table above in the year paid, consistent with FINRA's reporting in its Form 990 tax returns. Thus, the amount presented in 2012 was paid in February 2012, based on 2011 performance.

3 Other awards are presented in the year paid. Awards are typically discretionary and are attributed to specific individual performance events.

4 Deferred compensation includes earnings and accruals in supplemental executive retirement plans, which are not available to all employees. Mr. Ketchum, Mr. Bennett and Ms. Vogel participate in FINRA's supplemental defined contribution retirement plan. The remaining listed executives are participants in the supplemental defined benefit retirement plan, which is now closed to new participants. Deferred compensation also includes employer funded 401(k) matching contributions and the accrual of benefits in FINRA's employee retirement plans. The 401(k) and retirement plans are generally available to all employees.

5 Other benefits include taxable and non-taxable benefits such as employer paid health, life, and disability insurance, which are generally available to all employees. They also include parking, travel subsidies, tax gross-ups and other miscellaneous fringe benefits.

Components of Compensation

Direct Compensation

- Base salaries consist of job grade structures to provide for appropriate flexibility in hiring and retention. Actual salaries are based on job content, individual performance and relevant experience levels, and may fall above or below competitive levels.
- Incentive compensation is an additional "at-risk" compensation that is performance-based and determined in relation to individual achievements and FINRA's overall performance. The size of the actual award varies based on goal achievement, performance, grade level and degree of responsibility within the organization. If awarded, it is paid as a lump sum in the following year.
- Other awards are typically discretionary in nature and based on a specific performance event.

Indirect Compensation

- Supplemental retirement benefits are provided for top executives and are either defined benefit or defined contribution based on their start date. These plans are non-qualified and are based on salary and a portion of incentive compensation and officer level.
- Employee and family health, life and other insurance, pension and 401(k) deferral and matching programs, health club subsidies and other benefits are generally available to all employees. Additionally, certain executives receive miscellaneous taxable fringe benefits that may include parking, travel subsidies and similar minor items.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP). We are required to adopt accounting principles and make estimates and judgments to develop amounts reported in the consolidated financial statements and accompanying notes.

We periodically review the application of our accounting policies and evaluate the appropriateness of the estimates that are required to prepare the financial statements. We believe our estimates and judgments are reasonable; however, actual results and the timing of recognition of such amounts could differ from those estimates.

Our significant accounting policies are described in Note 2, "Summary of Significant Accounting Policies," and Note 6, "Fair Value Measurement," to the consolidated financial statements. The following provides information about our critical accounting policies, which are defined as those reflective of significant judgments and uncertainties that could result in materially different results under different assumptions and conditions. At the consolidated level, we have determined that the critical accounting policies are those that cover fair value measurement, investments, revenue recognition, and pension and other postretirement benefits.

FAIR VALUE MEASUREMENT

FINRA measures fair value according to a three-level hierarchy (*i.e.*, Level 1, 2 and 3 inputs, as defined below). The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities, and the lowest priority to unobservable inputs.

Accordingly, we classify and disclose assets and liabilities measured and reported at fair value in one of the following categories:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access as of the reporting date.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, through corroboration with observable data.

Level 3 Unobservable inputs, such as internally developed pricing models for the asset or liability due to little or no market activity for the asset or liability.

Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. In measuring fair value, FINRA obtains information from its custodian and investment fund managers who use various valuation approaches, including the use of counterparty pricing services and external or third-party pricing sources. Our valuation procedures support the consistency, timeliness and reliability of the valuation data provided.

INVESTMENTS

Debt and Marketable Equity Securities

We invest in debt and marketable equity securities that are classified as trading or available-for-sale and carried at fair value. Fair value is determined based on quoted market prices, when available, or on estimates provided by external pricing sources or dealers who make markets in such securities. At December 31, 2011, we had $718.2 million of trading and available-for-sale investments measured at fair value using either Level 1 or 2 inputs. We used Level 1 inputs — primarily quoted prices in active markets — to measure the fair value of $60.8 million of our investments. We used Level 2 inputs — primarily third-party pricing sources — to measure the fair value of $657.4 million of our investments. We use an internationally recognized pricing service as our primary pricing source, and we do not adjust prices received from third parties or obtain multiple prices when measuring the fair value of our investments. It is possible that different valuation techniques and models, other than those described above, could produce materially different estimates of fair value.

Other Investments

We have investments in hedge funds, which we have elected to account for under the equity method. We are also a limited partner in two private investment funds. We account for private investments under the cost or equity method based on our relative ownership interest in the partnership. The application of the equity method to our investments in hedge funds and private investment funds, including our related equity earnings, retains the investment company accounting applied by such funds.

Investment Impairment

FINRA periodically monitors and evaluates the realizability of its available-for-sale, equity method and cost method investments. When assessing realizability, including other-than-temporary declines in value, we consider such factors as:

- the extent of the decline in value;
- the duration of unrealized losses;
- the potential for recovery in the near term; and
- the probability that we will sell an equity method or cost method investment at an amount different from the net asset value of our ownership interest.

We also review the financial statements of our cost and equity method investments for potential indicators of impairment. If events and circumstances indicate that a decline in the value of these assets has occurred and is deemed other-than-temporary, the carrying value of the investment is reduced to its fair value and the impairment is charged to earnings. In assessing potential impairment, net asset value is used as a practical expedient to measure fair value, unless it is probable that an investment will be sold for a different amount. In these cases, fair value is measured based on recent observable transaction information for similar investments, the consideration of non-binding bids from potential buyers and third-party valuations.

REVENUE RECOGNITION

Multiple-Element Arrangements

On January 1, 2011, we adopted, on a prospective basis, the amendments proposed in Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements — a consensus of the Emerging Issues Task Force*.

ASU No. 2009-13 amends Accounting Standards Codification (ASC) Topic 605 to 1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and how the consideration in an arrangement should be allocated; and 2) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. Prior to our adoption of the guidance in ASU No. 2009-13, we used the residual method to allocate consideration in arrangements that included both an upfront initial registration and an ongoing service element. Upon adoption, we allocate consideration received under these types of arrangements using the relative selling price method based on the following hierarchy to determine the selling price: 1) vendor-specific objective evidence (VSOE); 2) third-party evidence of selling price; and 3) our best estimate of selling price. VSOE generally only exists when we sell the deliverable separately. The adoption of the guidance in ASU No. 2009-13 did not have a material impact on the Company's financial position or results of operations for the year ended December 31, 2011. Furthermore, the adoption of this guidance is not expected to have a material effect on our financial statements in future periods.

Our user fees include fees charged for initial and annual registrations. FINRA charges registration fees for all registered representatives and investment advisers. First-year registration and application fees consist of two deliverables that we account for as separate units of accounting: upfront registration delivered at inception and an ongoing service obligation for the remainder of that calendar year. We allocate arrangement consideration to upfront registrations based on our estimates of selling price. We estimate the selling prices of upfront registrations based on our internal cost structure, pricing practices and objectives, and historical prices. We allocate arrangement consideration to the remaining service obligation based on VSOE of the pricing for these services. Upfront registration revenue is recognized over the estimated service period for individual representatives and firms, while the remaining service obligation revenue is recognized ratably over the related remaining annual period. While the pricing model currently in use captures all critical variables, unforeseen changes due to external market forces may result in the revision to some of our inputs. These modifications may result in the allocation of consideration in future periods that differs from the allocation presently in use. Absent a significant change in the pricing inputs, future changes in the pricing model are not expected to materially impact our allocation of arrangement consideration.

Dispute resolution fees consist of fees earned during the arbitration and mediation processes. Certain arbitration fees, such as initial, counterclaim, cross claim and other filing fees, and surcharge fees, relate to the entire period covered by an arbitration case; as such, they are recognized as revenue over the average life of an arbitration case. Mediation filing fees are recognized over the average life of a mediation case. All other arbitration- and mediation-related fees, such as pre-hearing and hearing processing fees, adjournment fees, hearing session fees and mediation session fees, which are event-driven, are recognized as the service is provided. Dispute resolution fees also include arbitrator and mediator application and training fees that are recognized as the associated service is provided.

PENSION AND OTHER POSTRETIREMENT BENEFITS

FINRA provides two non-contributory defined benefit pension plans for the benefit of eligible employees. The non-contributory defined benefit plans consist of a qualified Employees Retirement Plan (ERP) and a non-qualified Supplemental Executive Retirement Plan (SERP). Both plans are now closed to new participants. We also provide an employer-funded defined contribution Retiree Medical Account Plan (RMA Plan) to assist our retirees with the cost of health care expenses during retirement. Under the RMA Plan, Retiree Medical Accounts are created for eligible employees and retirees, and fixed annual credits are applied to those accounts for each year of FINRA service beginning at age 40. In calculating the expense and liability related to all of the abovementioned plans, we use several statistical and other factors, which attempt to anticipate future events. Key factors include assumptions about the expected rates of return on plan assets and the discount rate as determined by FINRA, within certain guidelines, as well as assumptions regarding future salary increases, mortality, turnover, retirement ages and the medical expense trend rate. We consider market conditions, including changes in investment returns and interest rates, in making these assumptions. The discount rate used in the calculations is developed using a composite yield curve analysis based on a portfolio of high quality, non-callable marketable bonds. We determine the long-term rate of return based on analysis of historical and projected returns as prepared by our actuary and external investment consultant. FINRA's Pension/401(k) Plan Committee (the Pension Committee) reviews and advises FINRA management on both the expected long-term rate of return and the discount rate assumptions, which were 7.0 percent and 4.5 percent as of December 31, 2011.

The actuarial assumptions that we use in determining pension and other benefits may differ materially from actual results due to changing market and economic conditions, as well as early withdrawals by terminating plan participants. While we believe that the assumptions used are appropriate, differences in actual experience or changes in assumptions may materially affect our financial position or results of operations. A 25 basis-point increase (decrease) in the discount rate assumption as of December 31, 2011, would cause the projected benefit obligation for pension benefits to decrease (increase) by approximately $12.9 million. A 25 basis-point increase (decrease) in the discount rate assumption as of December 31, 2010, would have caused the 2011 pension benefits expense to decrease (increase) by approximately $1.5 million. Related to other benefits, a 25 basis-point increase (decrease) in the discount rate assumption would not have a material impact on the projected benefit obligation or expenses.

The decrease in the ERP discount rate assumption from 5.25 percent as of December 31, 2010, to 4.5 percent as of December 31, 2011, and the difference between actual and expected returns on ERP assets were the primary causes of the $61.0 million comprehensive loss related to our benefit plans as reflected in our consolidated statements of changes in equity.

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs*. The ASU amended ASC 820, *Fair Value Measurement*, to converge the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in ASC 820. In addition, the ASU requires additional fair value disclosures. The amendments are to be applied prospectively and are effective for annual periods beginning after December 15, 2011. We are currently evaluating the effect that the provisions of the ASU will have on our consolidated results of operations and financial position, but its adoption is not expected to have a material impact.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which amends ASC 220, *Comprehensive Income*. The ASU eliminates the option to present other comprehensive income (OCI) in the statement of changes in equity and instead requires net income, the components of OCI, and total comprehensive income to be presented in either one continuous statement or two separate but consecutive statements. The ASU will be effective for us for fiscal years ending after December 15, 2012, and will be applied retrospectively. The adoption of the provisions of the ASU is not expected to have a material impact on our consolidated results of operations and financial position as it only requires a change in the presentation of OCI in our consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles — Goodwill and Other (Topic 350): Testing Goodwill and Impairment*, which amends ASC 350, *Intangibles — Goodwill and Other*, related to goodwill impairment testing. The ASU allows an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If so, the entity is required to perform a two-step test to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. The ASU is effective for fiscal years beginning after December 15, 2011; however, early adoption is permitted. FINRA early adopted the ASU on December 31, 2011. Based on various quantitative and qualitative factors, we determined that it was not more likely than not that the fair value of our reporting unit was less than its carrying amount and no impairment of goodwill was recognized.

Management Report on Internal Control Over Financial Reporting

FINRA management is responsible for the preparation and integrity of the consolidated financial statements appearing in our annual report. The consolidated financial statements were prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP) and include amounts based on management's estimates and judgments. FINRA management is also responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. Internal control over financial reporting is a process designed by management to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with U.S. GAAP.

FINRA maintains a system of internal control that is designed to provide reasonable assurance as to the fair and reliable preparation and presentation of the consolidated financial statements, as well as to safeguard assets from unauthorized use or disposition that could have a material effect on the financial statements. FINRA's internal control over financial reporting includes written policies and procedures that 1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of FINRA's assets; 2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of FINRA are being made only in accordance with authorizations of FINRA's management and governors; and 3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of FINRA's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements due to error or fraud, including the possibility of the circumvention or overriding of controls. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision of the Chairman and Chief Executive Officer and the Chief Financial Officer, FINRA's management assessed the effectiveness of FINRA's internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework*. This evaluation included reviews of the documentation of controls, evaluations of the design effectiveness of controls, tests of the operating effectiveness of controls and a conclusion on management's evaluation. Based on this assessment, we assert that FINRA maintained effective internal control over financial reporting as of December 31, 2011.

FINRA's financial statements included in this annual report have been audited by Ernst & Young LLP, an independent registered public accounting firm. Ernst & Young LLP has also issued an attestation report on FINRA's internal control over financial reporting as of December 31, 2011.

June 28, 2012

Richard G. Ketchum
Chairman and Chief Executive Officer

Todd T. Diganci
Executive Vice President and Chief Financial Officer

Certification of 2011 Annual Financial Report

We, Richard G. Ketchum and Todd T. Diganci, certify that:

1. We have reviewed this annual financial report of the Financial Industry Regulatory Authority, Inc. (FINRA);
2. The purpose of this report is principally to set forth management's report on financial operations with respect to FINRA during the year ended December 31, 2011, together with the consolidated financial statements of FINRA as of December 31, 2011, and 2010, and for the years ended December 31, 2011, 2010 and 2009. 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, and the rules and regulations promulgated thereunder required of issuers of securities subject to the periodic reporting requirements under Sections 12, 13 and 15;
3. Based on our knowledge, this report does not contain any untrue statement of a material fact or omit statement of 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 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 FINRA as of, and for, the periods presented in this report;
5. FINRA has established disclosure controls and procedures to ensure that material information relating to FINRA, 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. FINRA has established internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
7. FINRA has carried out its evaluation of the effectiveness of the design and operation of FINRA's disclosure controls and procedures as of December 31, 2011. Based upon that evaluation, we have concluded that the disclosure controls and procedures are effective;
8. We have disclosed, based on FINRA's most recent evaluation of internal control over financial reporting, to FINRA's auditors and the Audit Committee of FINRA's Board of Governors:
   a) Any significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect FINRA'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 FINRA's internal control over financial reporting.

June 28, 2012

Richard G. Ketchum
Chairman and Chief Executive Officer

Todd T. Diganci
Executive Vice President and Chief Financial Officer

Audit Committee Report

In accordance with its written Charter adopted by the Board of Governors (Board), the Audit Committee of the Board assists the Board in fulfilling its responsibility for Board oversight of the quality and integrity of the accounting, auditing and financial reporting practices of FINRA. Each member of the Audit Committee is an independent director as defined by SEC Rule 10A-3 under The Securities Exchange Act of 1934, Listing Standards Relating to Audit Committees. In addition, the Audit Committee and Board 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 auditor and recommending the appointment of the independent auditor for approval by the Board, and makes clear that the independent auditor is accountable to the Audit Committee and the Board, as representatives of the members and the public. In addition, the Charter and the By-laws of FINRA make the Chief Audit Executive directly responsible to the Audit Committee. In all respects, the Charter complies with standards applicable to publicly-owned companies. (The Charter for the FINRA Audit Committee is available at: *www.finra.org/AboutFINRA/Leadership/Committees/index.htm*.)

During 2011, the Audit Committee met seven times, with the Audit Committee members having a 94.3 percent 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 had discussions with management, the internal auditors, and the independent auditor related to the quality and adequacy of FINRA's internal controls and the internal audit organization, responsibilities, budget and staffing.

The Audit Committee obtained a written statement from the independent auditor, Ernst & Young LLP (E&Y), describing all relationships with FINRA. The Audit Committee discussed those relationships and satisfied itself that none of the relationships were incompatible with the auditor's independence. The Audit Committee has reviewed and approved all services performed by E&Y for FINRA and the associated fees before initiation of each engagement. We have summarized such services and fees in the following table:

Independent Registered Public Accountant Fees

	FINRA (1)	
	2011	2010
Audit services (2)	$ 871,000	$ 868,000
Audit-related services (3)	317,100	261,750
Tax services (4)	159,000	154,000
All other services (5)	1,590	317,400
Total	$1,348,690	$1,601,150

(1) FINRA based its fees reported for 2011 on fees approved by FINRA's Audit Committee as of March 31, 2012. The 2011 audit services, audit-related services and tax services include estimates to complete the current work in process. FINRA has updated the 2010 fees from the prior year's report to reflect final amounts paid for the 2010 approved services.

(2) For 2011 and 2010, audit services represent the financial statement audit and the attestation on internal control.

(3) Audit-related services in 2011 and 2010 reflect fees associated with the special-purpose audit of the Investment Advisers Registration Depository, agreed-upon procedures over the Central Registration Depository, and the audit of the FINRA Investor Education Foundation and the Company's employee benefit plans. Audit-related services also include an internal controls review and assessment associated with the Company's new data center strategy. Audit-related services in 2010 also include an internal controls review and assessment of the Company's enterprise resource system.

(4) Tax services represent fees related to tax return preparation services in connection with the 2011 and 2010 Form 990s and related Form 990-Ts, as well as tax compliance, advice and planning.

Audit Committee Report (continued)

(5) All other services include enterprise risk management (ERM) services in facilitating management's development of an ERM roadmap, performance of an enterprise risk assessment and design of an ERM framework.

The Audit Committee discussed and reviewed with the independent auditor all communications required by PCAOB AU Section 380, *Communications With Audit Committees*. Further, the Committee has reviewed and discussed with management and with E&Y, with and without management present, the audited financial statements as of December 31, 2011; management's assessment of the effectiveness of FINRA's internal control over financial reporting; and E&Y's report on the financial statements and on FINRA's internal control over financial reporting. Based on those discussions, the Audit Committee recommended to the Board that FINRA's audited financial statements and related reports on internal control be included in the Annual Report for the year ended December 31, 2011.

Members of the Audit Committee:

James E. Burton, Chair
Charles A. Bowsher
John F. X. Dolan
W. Dennis Ferguson
Gary H. Stern

June 28, 2012

Investment Committee Report

Year Ended December 31, 2011

The FINRA investment portfolio* is a fund created to support FINRA in fulfilling its mission of protecting investors and maintaining market integrity by providing FINRA with supplemental financial resources. FINRA's investment policy strives to preserve principal, in real terms, while seeking to earn a long-term rate of return commensurate with the degree of risk deemed appropriate for FINRA assets by the Board of Governors. Distributions from the portfolio are subject to prior approval by the Board of Governors.

In total, FINRA's portfolio earned 2.0 percent in 2011. Including the impact of the sale of legacy investments, total return for the year was 1.8 percent. As of December 31, 2011, FINRA has divested all legacy assets from its portfolio with the exception of less than 1 percent in illiquid investments pending redemption. In a volatile year for the capital markets, equity market returns in the U.S. were muted, while overseas equity markets suffered negative returns. The chart below shows investment results for FINRA and for several common market benchmarks for 2011, for the three-year period since we repositioned the portfolio to its current strategy, as well as for the five-year period and since inception. At the end of the year, FINRA's investment portfolio totaled approximately $1.5 billion. Portfolio liquidity remains strong, with $833 million, or 55 percent, available in 30 days or less as of December 31, 2011.

		Annualized Returns		
	2011	3-Year	5-Year	Inception (2)
FINRA (1)	2.0%	7.7%	–0.2%	3.2%
Barclays US Aggregate	7.8%	6.8%	6.5%	5.4%
Citigroup Treasury Bill-3 Month	0.1%	0.1%	1.4%	2.0%
S&P 500	2.1%	14.1%	–0.3%	3.6%

(1) Total return percentages exclude accounting impairment charges and exclude the one-time sale of legacy private investments.

(2) Since inception as of 1/1/04.

The FINRA Board of Governors is responsible for FINRA's investments and approved the charter that guides the FINRA Investment Committee. The Investment Committee, which is composed of members of the Board of Governors and other investment professionals, advises the Board of Governors and provides guidance in determining the appropriate policy, guidelines and allocation for FINRA's investments. The FINRA Investment Office is responsible for management of the investments within the framework of the investment policy. FINRA engages investment consultants to support the Investment Office as needed. The Investment Committee met five times during 2011.

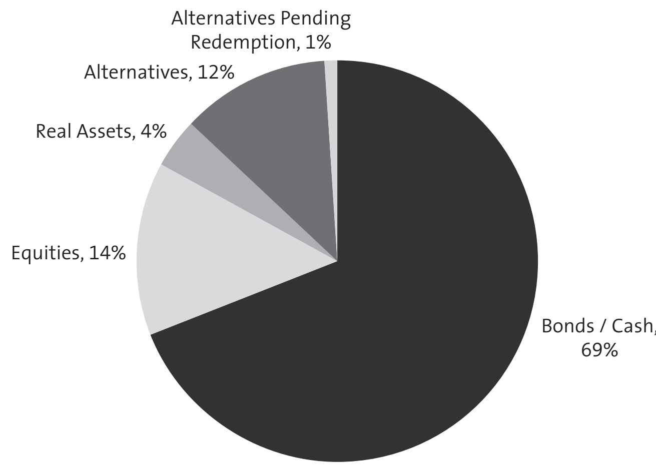
In April 2009, based on a comprehensive Investment Committee review of FINRA's investment policy, strategy and risk tolerance, the Board of Governors decided to shift FINRA's investment assets to a lower volatility strategy with the objective of a lower risk portfolio. The transition to the new policy was substantially completed in 2010. During 2009, FINRA entered into a limited partnership agreement with HighVista II Limited Partnership, a broadly diversified multi-asset fund managed by HighVista Strategies LLC, which uses risk controlled strategies to obtain market and non-correlated exposures. FINRA's fixed income portfolio is a diversified, high-quality investment grade portfolio managed by Wellington Management Company, LLP. With the new policy, FINRA continues to maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return. The Investment Committee reviews the policy annually and recommends changes subject to approval by the Board of Governors.

* For the purposes of this Investment Committee report, FINRA's investment portfolio includes investments net of their related receivables and payables on the consolidated balance sheet and excludes the Foundation's investments and Section 31 fees received but not yet remitted to the SEC.

Investment Committee Report (continued)

The chart below shows portfolio exposures as of December 31, 2011. Market exposures are 69 percent bonds/cash and 14 percent equities. Alternatives, at 12 percent, consist of non-correlated exposures.

Exposures as of December 31, 2011



FINRA has an Investments Conflicts of Interest policy that establishes the standards governing the separation of investment activities and decisions from FINRA's regulatory operations. As stated in the policy, FINRA's investment strategy limits the direct ownership of investment assets to debt securities, treasury futures and shares in a private investment fund not affiliated with a broker-dealer. Within the portion of the portfolio containing debt securities directly owned by FINRA, all securities within the banking and brokerage sectors are held within a blind trust, in order to prohibit any knowledge of or participation in the making of such investments by any FINRA regulatory personnel, and to avoid any appearance of a conflict of interest with FINRA's responsibilities.

All implementation decisions within the portfolio are made by third party providers, and with respect to internal activities, the oversight and management of the portfolio is performed by the Investment Committee and limited to essential staff only — defined as the CEO, Vice Chairman, CFO, Investment Office, Corporate General Counsel, Corporate Secretary and Internal Audit. With those exceptions, no individual in any examination or enforcement arm of the organization has any knowledge of the securities within our investment portfolio.

Members of the Investment Committee:

John J. Brennan, Chair
James E. Burton
William H. Heyman
Scott C. Malpass
Richard S. Pechter
Richard C. Romano
Gary H. Stern

June 28, 2012

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Governors

Financial Industry Regulatory Authority, Inc.

We have audited the Financial Industry Regulatory Authority, Inc.'s (FINRA) internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). FINRA's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and governors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, FINRA maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of FINRA as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in equity, and cash flows for each of the three years in the period ended December 31, 2011, and our report dated June 28, 2012 expressed an unqualified opinion thereon.

Ernst + Young LLP

McLean, Virginia
June 28, 2012

Report of Independent Registered Public Accounting Firm

Board of Governors

Financial Industry Regulatory Authority, Inc.

We have audited the accompanying consolidated balance sheets of the Financial Industry Regulatory Authority, Inc. (FINRA) as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in equity, and cash flows for each of the three years in the period ended December 31, 2011. 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 conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of FINRA at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), FINRA's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 28, 2012 expressed an unqualified opinion thereon.

Ernst + Young LLP

McLean, Virginia
June 28, 2012

FINRA Consolidated Balance Sheets

(In millions)

	December 31, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 424.1	$ 419.3
Investments:		
Trading, at fair value	667.6	716.5
Available-for-sale, at fair value	27.2	28.3
Foundation available-for-sale, at fair value	23.4	25.5
Receivables, net	96.1	96.3
Investments receivable	3.1	9.1
Other current assets	36.6	35.1
Total current assets	1,278.1	1,330.1
Property and equipment:		
Land, buildings and improvements	116.5	107.0
Data-processing equipment and software	267.1	221.1
Furniture, equipment and leasehold improvements	123.7	94.1
	507.3	422.2
Less accumulated depreciation and amortization	(337.6)	(305.9)
Total property and equipment, net	169.7	116.3
Goodwill and other intangible assets, net	31.0	32.0
Other investments	672.6	716.6
Other assets	21.9	36.3
Total assets	$2,173.3	$2,231.3

See accompanying notes.

FINRA Consolidated Balance Sheets (continued)

(In millions)

	December 31,	
	2011	2010
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 38.7	$ 42.0
Accrued personnel and benefit costs	140.9	130.8
Deferred revenue	52.4	54.6
Deferred contribution income	9.4	10.0
Deposits and renewals	65.2	59.4
Investments payable	162.8	174.9
Other current liabilities	6.6	8.0
SEC fee payable	110.9	88.3
Total current liabilities	586.9	568.0
Accrued pension and other postretirement benefit costs	234.0	147.4
Deferred revenue	22.9	27.6
Deferred contribution income	16.3	24.4
Other liabilities	26.3	30.0
Total liabilities	886.4	797.4
Equity	1,474.3	1,558.3
Unrealized gain on available-for-sale investments	3.1	5.1
Net unrecognized employee benefit plan amounts	(190.5)	(129.5)
Total equity	1,286.9	1,433.9
Total liabilities and equity	$2,173.3	$2,231.3

See accompanying notes.

FINRA Consolidated Statements of Operations

(In millions)

	Years Ended December 31,		
	2011	2010	2009
Revenues			
Operating revenues			
Regulatory fees, net of firm rebates of $5.6 in 2011, $5.7 in 2010 and $5.9 in 2009	$ 407.3	$ 428.6	$ 387.9
User fees	157.0	154.0	148.3
Contract services fees	129.0	111.1	57.1
Transparency services fees	56.0	48.6	47.6
Dispute resolution fees	48.0	54.2	56.7
Other	10.9	11.4	10.4
Total operating revenues	808.2	807.9	708.0
Fines	71.9	42.2	47.6
Activity assessment	346.9	295.2	341.4
Total revenues	1,227.0	1,145.3	1,097.0
Activity assessment cost of revenues	(346.9)	(295.4)	(341.4)
Net revenues	880.1	849.9	755.6
Expenses			
Compensation and benefits	577.2	540.3	493.9
Professional and contract services	208.0	205.4	183.3
Occupancy	64.2	58.6	57.2
Depreciation and amortization	47.9	48.9	49.5
Computer operations and data communications	36.7	29.5	27.4
General and administrative	60.9	58.2	65.4
Total expenses	994.9	940.9	876.7
Interest and dividend income	25.0	30.6	32.0
Operating loss	(89.8)	(60.4)	(89.1)
Other income (expense)			
Net investment gains	19.0	50.1	37.3
Equity (losses) earnings from other investments	(12.5)	65.2	86.6
Other (expense) income	(0.7)	(0.3)	13.8
Net (loss) income	$ (84.0)	$ 54.6	$ 48.6

See accompanying notes.

FINRA Consolidated Statements of Changes in Equity

(In millions)

		Accumulated Other Comprehensive Income (Loss)		
	Equity	Unrealized Gain (Loss) on Available-for-Sale Investments	Net Unrecognized Employee Benefit Plan Amounts	Total
Balance, January 1, 2009	$1,455.1	$ (0.1)	$(110.1)	$1,344.9
Net income	48.6	—	—	48.6
Change in unrealized loss on available-for-sale investments	—	14.5	—	14.5
Employee benefit plan adjustments	—	—	(40.0)	(40.0)
Comprehensive income				23.1
Balance, December 31, 2009	1,503.7	14.4	(150.1)	1,368.0
Net income	54.6	—	—	54.6
Change in unrealized gain on available-for-sale investments	—	(9.3)	—	(9.3)
Employee benefit plan adjustments	—	—	20.6	20.6
Comprehensive income				65.9
Balance, December 31, 2010	1,558.3	5.1	(129.5)	1,433.9
Net loss	(84.0)	—	—	(84.0)
Change in unrealized gain on available-for-sale investments	—	(2.0)	—	(2.0)
Employee benefit plan adjustments	—	—	(61.0)	(61.0)
Comprehensive loss				(147.0)
Balance, December 31, 2011	$1,474.3	$ 3.1	$(190.5)	$1,286.9

See accompanying notes.

FINRA Consolidated Statements of Cash Flows

(In millions)

	Years Ended December 31,		
	2011	2010	2009
Reconciliation of net (loss) income to cash provided by (used in) operating activities			
Net (loss) income	$(84.0)	$ 54.6	$ 48.6
Adjustments to reconcile net (loss) income to cash used in operating activities:			
Depreciation and amortization	47.9	48.9	49.5
Net investment gains	(19.0)	(50.1)	(37.3)
Undistributed equity losses and (earnings) from other investments	12.5	(63.8)	(86.6)
Bad debt expense	4.2	3.0	10.9
Other net non-cash income items	0.7	1.1	(14.0)
Net change in operating assets and liabilities, net of acquisitions and dispositions:			
Receivables, net	(4.0)	22.5	(37.5)
Net purchases of trading securities	—	—	(126.0)
Other current assets	(0.6)	(3.9)	2.9
Other assets	10.6	15.6	11.3
Accounts payable and accrued expenses	(3.3)	2.9	(0.2)
Accrued personnel and benefit costs	10.1	13.9	(34.8)
Deferred revenue	(6.9)	13.2	(5.6)
Deferred contribution income	(8.7)	(9.4)	(7.4)
Deposits and renewals	5.8	(7.5)	(1.5)
SEC fee payable	22.6	(61.3)	106.8
Other current liabilities	(1.4)	—	(11.5)
Accrued pension and other postretirement costs	25.6	(10.2)	(16.8)
Other liabilities	(3.7)	(6.0)	(7.0)
Net cash provided by (used in) operating activities	$ 8.4	$(36.5)	$(156.2)

See accompanying notes.

FINRA Consolidated Statements of Cash Flows (continued)

(In millions)

	Years Ended December 31,		
	2011	2010	2009
Cash flow from investing activities			
Net sales of trading securities	$ 66.2	$ 137.9	$ —
Proceeds from redemptions of available-for-sale investments	7.3	32.5	507.5
Purchases of available-for-sale investments	(8.4)	(13.1)	(38.6)
Return of capital and proceeds from redemptions from other investments	28.5	244.9	342.7
Purchases of other investments	—	(156.5)	(480.1)
Net purchases of property and equipment	(88.6)	(12.7)	(19.8)
Net cash provided by investing activities	5.0	233.0	311.7
Cash flow from financing activities			
Change in donor-restricted and other restricted cash	(8.6)	(9.8)	(6.9)
Other	—	(0.4)	(0.6)
Net cash used in financing activities	(8.6)	(10.2)	(7.5)
Increase in cash and cash equivalents	4.8	186.3	148.0
Cash and cash equivalents at beginning of year	419.3	233.0	85.0
Cash and cash equivalents at end of year	$424.1	$ 419.3	$ 233.0

See accompanying notes.

FINRA 2011 Notes to Consolidated Financial Statements

1. ORGANIZATION AND NATURE OF OPERATIONS

References to the terms “we,” “our,” “us,” “FINRA” or the “Company” used throughout these Notes to Consolidated Financial Statements refer to the Financial Industry Regulatory Authority, Inc. (FINRA), a Delaware corporation, and its wholly-owned subsidiaries. FINRA wholly owns the following significant subsidiaries: FINRA Regulation, Inc. (FINRA REG), FINRA Dispute Resolution, Inc. (FINRA DR) and FINRA Investor Education Foundation (the Foundation). The Foundation is a tax-exempt membership corporation incorporated in the State of Delaware, with FINRA as the sole member.

We are the largest independent regulator of securities firms doing business with the public in the United States. We regulate the activities of the U.S. securities industry and perform market regulation under contract for the New York Stock Exchange LLC (NYSE), NYSE Arca, Inc. (NYSE Arca), NYSE Amex LLC (NYSE Amex), The Nasdaq Stock Market LLC and other exchanges. We also regulate and operate the over-the-counter (OTC) securities markets. Our regulatory functions include onsite examinations of securities firms, continuous automated surveillance of markets operated by The NASDAQ OMX Group, Inc., and NYSE Euronext and disciplinary actions against firms and registered representatives. We provide arbitration and mediation services to assist in the resolution of monetary and business disputes between and among investors, securities firms and registered representatives. We also provide dispute resolution services for several exchanges through contracted agreements, thereby offering consistent procedures and the uniformity of a single forum for the resolution of securities-industry related disputes. The Foundation provides underserved Americans with the knowledge, skills and tools necessary for financial success throughout life. The Foundation funds innovative research and educational projects aimed at segments of the investing public who could benefit from additional resources.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of FINRA and its wholly-owned subsidiaries. We have eliminated all intercompany balances and transactions in consolidation.

USE OF ESTIMATES

The preparation of these consolidated financial statements requires management to make estimates and assumptions, including estimates of fair value and other-than-temporary impairment on investments, valuation of investments and assumptions related to our benefit plans, allowances for uncollectible accounts, and the estimated service periods related to our recognition of revenue, that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could materially differ from those estimates.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include demand cash, cash held in banks and all non-restricted, highly liquid investments with original maturities of 90 days or less when acquired.

INVESTMENTS

Debt and Marketable Equity Securities

At the time of purchase, we classify individual securities as trading, available-for-sale or held-to-maturity based on the type of security and our intent and ability to sell or to hold the securities. We have designated our investments in debt and marketable equity securities as either trading or available-for-sale. Trading securities are carried at fair value, with changes in fair value recorded as a component of net investment gains in the consolidated statements of operations. We present cash flows from purchases and sales of trading securities as either operating or investing activities based on the nature

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

and purpose for which the securities were acquired. Beginning in 2010, we presented net activity in trading securities within investing activities in the consolidated statement of cash flows based on our revised investment strategy and purpose for our trading portfolio. Prior to 2010, we presented net activity in trading securities as operating activities. We record available-for-sale securities at fair value and recognize temporary changes in fair value as unrealized gains (losses) as a separate component of equity in the consolidated balance sheets.

Fair value is determined based on quoted market prices, when available, or on estimates provided by external pricing sources or dealers who make markets in such securities. Realized gains and losses on sales of securities are included in earnings using the average cost method. Investment receivables or payables relate to security trades and other investment redemptions or purchases executed on or prior to the balance sheet date, but not yet settled, as we follow trade-date accounting.

Other Investments

FINRA has investments in hedge funds, which we have elected to account for under the equity method. We are also a limited partner in two private investment funds. We account for private investments under the cost or equity method based on our relative ownership interest in the partnership. The application of the equity method to our investments in hedge funds and private investment funds, including our related equity earnings, retains the investment company accounting applied by such funds.

Other-Than-Temporary Impairment

FINRA periodically monitors and evaluates the realizability of its available-for-sale, equity method and cost method investments. When assessing realizability, including other-than-temporary declines in value, we consider such factors as the extent of the decline in value, the duration of unrealized losses, the potential for recovery in the near term and the probability that we will sell an equity method or cost method investment at an amount different from the net asset value of our ownership interest. We also review the financial statements of our cost and equity method investments for potential indicators of impairment. If events and circumstances indicate that a decline in the value of these assets has occurred and is deemed other-than-temporary, the carrying value of the investment is reduced to its fair value and the impairment is charged to earnings.

RECEIVABLES, NET

The Company's receivables are primarily concentrated with FINRA registered firms, associated persons, NYSE Euronext, The NASDAQ OMX Group, Inc. and other exchanges. The financial statements present receivables net of an allowance for uncollectible accounts of $15.5 million and $14.4 million as of December 31, 2011, and 2010. We calculate the allowance based on the age, source of the underlying receivable and past collection experience. We maintain the allowance at a level that management believes to be sufficient to absorb estimated losses inherent in our accounts receivable portfolio. The allowance as of December 31, 2011, and 2010, primarily relates to fines, regulatory services and arbitration activities. The allowance is increased by the provision for bad debts, which is charged against operating results and decreased by the amount of charge-offs, net of recoveries. We base the amount charged against operating results on several factors, including a periodic assessment of the collectibility of each account. In circumstances where a specific firm's inability to meet its financial obligations is known (*e.g.*, bankruptcy filings), we record a specific provision for bad debts to reduce the receivable to the amount we reasonably believe will be collected.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROPERTY AND EQUIPMENT

FINRA records property and equipment at cost less accumulated depreciation. We expense repairs and maintenance costs as incurred. We calculate depreciation using the straight-line method over estimated useful lives ranging from 10 years to 40 years for buildings and improvements, two years to five years for data-processing equipment and software, and five years to 10 years for furniture and equipment. We amortize leasehold improvements using the straight-line method over the lesser of the useful life of the improvement or the term of the applicable lease, including any extension periods at our option. Depreciation and amortization expense for property and equipment, including amortization of capitalized software costs, totaled $35.3 million, $37.9 million and $38.6 million for 2011, 2010 and 2009.

SOFTWARE COSTS

FINRA 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. We capitalize significant purchased application software and operational software programs that are an integral part of computer hardware and amortize them using the straight-line method over their estimated useful life, generally three years. We expense all other purchased software as incurred.

The financial statements reflect unamortized, capitalized software development costs of $18.0 million and $18.7 million as of December 31, 2011, and 2010, within data-processing equipment and software in the consolidated balance sheets. Net additions to capitalized software were $12.1 million and $3.5 million in 2011 and 2010. Amortization of capitalized internal computer software costs totaled $12.9 million, $17.0 million and $17.6 million for 2011, 2010 and 2009, and is included in depreciation and amortization in the consolidated statements of operations.

GOODWILL AND INTANGIBLE ASSETS

FINRA's goodwill of $15.0 million as of December 31, 2011, and 2010, represents the excess of consideration paid in 2007 for the acquired member regulation operations of NYSE over the fair value of the net assets acquired. The acquisition of these assets provided FINRA with access to the membership of NYSE Regulation, Inc. (NYSE Regulation), as well as NYSE copyrights and proprietary software. Our acquired NYSE intangible assets apart from goodwill were recognized at fair value as of the date acquired. We evaluate goodwill for impairment annually at December 31. Based on our annual evaluation, we did not recognize any impairments of goodwill as of December 31, 2011, or 2010. Intangible assets with finite lives are amortized over their useful lives and tested for impairment when events or circumstances warrant. Intangible assets related to the acquired member regulation operations of NYSE totaled $7.8 million, net of accumulated amortization of $22.7 million as of December 31, 2011, and $11.4 million, net of accumulated amortization of $19.1 million as of December 31, 2010. We also have intangible assets related to software licenses, applications and patterns that are not related to the NYSE consolidation transaction in the amount of $8.2 million, net of accumulated amortization of $6.1 million as of December 31, 2011, and $5.6 million, net of accumulated amortization of $2.7 million as of December 31, 2010. *See* Note 3, "Acquisition of the Member Regulation Operations of NYSE" for additional information.

IMPAIRMENT OF LONG-LIVED ASSETS

We review our long-lived assets for impairment annually. In the event facts and circumstances indicate that long-lived assets or other assets may be impaired, we perform an evaluation of recoverability that compares the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount. If the evaluation failed the recoverability test, we would then prepare a discounted cash flow analysis to estimate fair value and the amount of any impairment. In 2011 and 2010, there were no indicators of long-lived asset impairment, and no impairment charges were recognized.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

DEFERRED REVENUE

Deferred revenue represents cash received for which we have not yet provided the related services. Included in deferred revenue is the unearned portion of registration fees, arbitration fees, mediation fees and application fees. We recognize revenue from the upfront initial components of these fees on a straight-line basis over estimated service periods. The estimated service periods for mediation fees, arbitration fees, registration fees and firm application fees, based on historical experience, is four months, 14 months, four years and 11 years, respectively.

GLOBAL RESEARCH ANALYST SETTLEMENT

On September 2, 2005, the Federal District Court for the Southern District of New York (the Court) issued an order (the Order) approving the Securities and Exchange Commission's (SEC's) new investor education plan, whereby all funds collected in connection with the Global Research Analyst Settlement (the GRA Settlement), less expenses previously approved by the Court, would be remitted to the Foundation. Pursuant to the final judgments against each of the defendants under the GRA Settlement, the Foundation received a total of $55.0 million.

As disclosed in Note 1, the Foundation is a consolidated subsidiary of FINRA. At the consolidated level, FINRA presents the amounts the Foundation received in relation to the Order, including interest and dividends earned on these funds, as deferred contribution income in the consolidated balance sheets, and recognizes the related revenue, net of interest and dividends earned on the funds, as the Foundation makes grant payments and incurs expenses pursuant to the guidelines in the Order. For the years ended December 31, 2011, 2010 and 2009, FINRA recognized revenue as the Foundation incurred grant payments and expenses against the GRA Settlement funds of $8.7 million, $9.4 million and $7.4 million.

Included in other current assets and other long-term assets in the consolidated balance sheets are funds from the GRA Settlement, including the interest earned on these funds. The GRA Settlement funds are included in other assets because their use is restricted to the Foundation. The Foundation invests the GRA Settlement funds in a U.S. Treasury money market fund in accordance with the terms of the GRA Settlement, which stipulates that funds received must be invested in money market funds or securities with maturities of less than six months and backed by the full faith and credit of the federal government. The current and long-term portions of the GRA Settlement funds as of December 31, 2011, were $9.1 million and $16.9 million. The current and long-term portions of the GRA Settlement funds as of December 31, 2010, were $9.9 million and $24.7 million.

Under the terms of the Order, to the extent that any of the GRA Settlement funds are not used by the Foundation within 10 years of the date of the Order, FINRA may be required to return any unused funds. Additionally, in the event of a proposed dissolution of the Foundation, the SEC shall file an application with the Court setting forth a plan for the disposition of any remaining GRA Settlement funds in the Foundation.

DEPOSIT AND RENEWAL LIABILITIES

FINRA's deposit and renewal liabilities primarily represent deposits into our Central Registration Depository (CRD®) system. FINRA-registered firms use these deposits to pay for services, including registration fees charged by states and other self-regulatory organizations (SROs).

OTHER LIABILITIES

FINRA's other liabilities include amounts associated with the Investment Advisers Registration Depository (IARD™) program.

FINRA administers the IARD program. IARD is an electronic filing system for investment advisers regulated by the SEC under the Investment Advisers Act of 1940, and by the states, represented by the North American Securities Administrators

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Association. The IARD system collects and maintains the registration and disclosure information for investment advisers and their associated persons. IARD fees received but not yet earned are included in deferred revenue in the consolidated balance sheets.

As administrator, FINRA is required to monitor the cumulative surplus of the IARD program in accordance with the agreement with the SEC dated July 23, 2009, as amended. The SEC will determine the distribution of the cumulative surplus attributable to filings by SEC-registered investment advisers upon termination of the agreement for the benefit of IARD filers. FINRA has applied the same principles of the agreement with the SEC to the cumulative surplus attributable to filings by state-registered investment advisers.

As of December 31, 2011, and 2010, FINRA recognized the cumulative surplus for the IARD program in its consolidated financial statements as follows:

	As of December 31,	
	2011	2010
	(in millions)	
Current deferred revenue	$ 0.2	$ 0.4
Non-current deferred revenue	0.4	0.6
Other long-term liabilities	13.4	19.1
Total	$14.0	$20.1

REVENUE RECOGNITION AND COST OF REVENUE

Multiple-Element Arrangements

On January 1, 2011, we adopted, on a prospective basis, the amendments proposed in Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements — a consensus of the Emerging Issues Task Force*.

ASU No. 2009-13 amends Accounting Standards Codification (ASC) Topic 605 to 1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and how the consideration in an arrangement should be allocated; and 2) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. Prior to our adoption of the guidance in ASU No. 2009-13, we used the residual method to allocate consideration in arrangements that included both an upfront initial registration and an ongoing service element. Upon adoption, we allocate consideration received under these types of arrangements using the relative selling price method based on the following hierarchy to determine the selling price: 1) vendor-specific objective evidence (VSOE); 2) third-party evidence of selling price; and 3) our best estimate of selling price. VSOE generally only exists when we sell the deliverable separately.

The adoption of the guidance in ASU No. 2009-13 did not have a material impact on the Company's financial position or results of operations for the year ended December 31, 2011. Furthermore, the adoption of this guidance is not expected to have a material effect on our financial statements in future periods.

Regulatory Fees

Regulatory fees include assessments for the supervision and regulation of firms through examination, policy making, rulemaking and enforcement activities. Regulatory fees are recorded net of any firm rebates. The primary regulatory fees are the Trading Activity Fee (TAF), Gross Income Assessment (GIA), Personnel Assessment (PA) and Branch Office Assessment (BOA). The TAF is calculated on the sell side of all transactions by firms in all covered securities regardless of where the trade is executed and is assessed directly on the firm responsible for clearing the transaction. Firms self-report

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

the TAF to us, and we recognize the income in the month the transactions occur. As the TAF is a self-reported revenue stream for us, subsequent adjustments by clearing firms may occur. We recognize these adjustments as revenue adjustments in the period they become known to us. The GIA, PA and BOA represent annual fees charged to firms and representatives. We recognize these fees ratably over the applicable annual period.

User Fees

User fees are charged for initial and annual registrations, qualification examinations, FINRA-sponsored educational programs and conferences, reviews of advertisements and corporate filings (corporate financing fees). FINRA charges registration fees for all registered representatives and investment advisers. First-year registration and application fees consist of two deliverables that we account for as separate units of accounting: upfront registration delivered at inception and an ongoing service obligation for the remainder of that calendar year. We allocate arrangement consideration to upfront registrations based on our estimates of selling price. We estimate the selling prices of upfront registrations based on our internal cost structure, pricing practices and objectives, and historical prices. We allocate arrangement consideration to the remaining service obligation based on VSOE of the pricing for these services. Upfront registration revenue is recognized over the estimated service period for individual representatives (four years) and firms (11 years), while the remaining service obligation revenue is recognized ratably over the related remaining annual period. While the pricing model currently in use captures all critical variables, unforeseen changes due to external market forces may result in the revision to some of our inputs. These modifications may result in the allocation of consideration in future periods that differs from the allocation presently in use. Absent a significant change in the pricing inputs, future changes in the pricing model are not expected to materially impact our allocation of arrangement consideration.

Qualification fees consist of examination and continuing education fees. We recognize qualification fees as we administer examinations or continuing education programs. FINRA-sponsored meeting and conference fees include fees paid by financial services industry participants for participating in our educational programs. We recognize these fees when the program or conference takes place. Advertising fees are charged for our review of firms' communications to ensure that they are fair, balanced and not misleading. We recognize advertising fees as revenue when our review is completed. Corporate financing fees are charged for our review of proposed public offerings. We recognize corporate financing fees when our review is completed.

Contract Services Fees

Contract services fees represent amounts charged for regulatory services provided primarily to The NASDAQ OMX Group, Inc., NYSE Euronext and other exchanges, as well as the Trade Reporting Facilities (TRFs), for services including surveillance reviews, investigations, examinations and the disciplinary process. Contract services fees also include fees for the mortgage licensing system FINRA developed and deployed to the State Regulatory Registry LLC (SRR). We recognize contract services fees as the services are provided.

Transparency Services Fees

Transparency services fees are charged for the use of the Trade Reporting and Compliance Engine (TRACE) and Alternative Display Facility (ADF). In addition, fees are charged for our OTC Reporting Facility (ORF) service for the reporting of trades in certain OTC equity securities on the OTC Bulletin Board (OTCBB) and dissemination of last sale reports. TRACE fees include market data fees as well as fees charged on secondary market transactions in eligible fixed income securities reported to us. ADF fees include market data fees as well as fees for posting quotes. OTCBB is a regulated quotation service in which fees are charged for a variety of services related to the display of real-time quotes in OTC equity securities that are eligible for quotation on the OTCBB. In addition, fees are earned for the sale of market data from the OTCBB and the ORF. We recognize transparency services fees as the transactions occur or when the market data is sold.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Dispute Resolution Fees

FINRA earns fees during the arbitration and mediation processes. Certain arbitration fees, such as initial, counterclaim, cross-claim and other filing fees, and surcharge fees relate to the entire period covered by an arbitration case, and as such are recognized as revenue over the average life of an arbitration case (14 months). Mediation filing fees are recognized over the average life of a mediation case (four months). All other arbitration- and mediation-related fees, such as pre-hearing and hearing processing fees, adjournment fees, hearing session fees and mediation session fees, which are event-driven, are recognized as the service is provided. Dispute resolution fees also include arbitrator and mediator application and training fees that are recognized as the associated service is provided.

Fines

Fines represent sanctions for rule violations, which FINRA recognizes upon issuance of a written consent or disciplinary decision. We do not view fines as part of our operating revenues. FINRA limits the use of fine monies to capital expenditures and regulatory projects, which are reported to our Board of Governors (Board).

Activity Assessment Revenues and Cost of Revenues

FINRA, as an SRO, pays certain fees and assessments to the SEC pursuant to Section 31 of the Securities Exchange Act of 1934. These fees are designed to recover costs incurred by the government for the supervision and regulation of securities markets and securities professionals, and are calculated based on the aggregate dollar amount of sales of covered securities transacted by or through any firm other than on a national securities exchange. Such covered transactions are reported to us through the ADF, the TRFs and the ORF. We remit these SEC fees to the U.S. Treasury semiannually, in March and September.

We recover the cost of the Section 31 fees and assessments through an activity assessment charged to clearing and self-clearing firms based on the aggregate dollar amount of sales of covered securities transacted by or through any firm other than on a national securities exchange. The assessments billed to securities firms are recognized when the transactions are reported. As of December 31, 2011, and 2010, we had $26.9 million and $24.3 million of SEC fee receivables presented within receivables, net in the accompanying consolidated balance sheets. FINRA, as the primary obligor to the SEC, reports the activity assessment on a gross basis within revenues. Amounts due to the SEC are reported as a cost of revenue. We report amounts pending remittance to the SEC in SEC fee payable in the accompanying consolidated balance sheets.

We rely on third-party providers and securities firms to report activity in a complete, accurate and timely manner for purposes of determining the activity assessment revenues and cost of revenues. As a result, subsequent adjustments may occur. We recognize any resulting activity assessment adjustments in the period they become known to us.

Interest and Dividend Income

FINRA recognizes interest income from cash, trading investments, available-for-sale investments and private investments as it is earned. Dividend income is recognized on the ex-dividend date.

Other (Expense) Income

FINRA received a share of additional unexpended GRA Settlement research funds, unrelated to the Foundation's restricted GRA Settlement educational funds. These unexpended funds were originally set aside as part of the GRA Settlement to support independent research over a five-year period. A portion of the GRA Settlement research funds not distributed at the end of the five-year period were paid to FINRA to support its regulation and enforcement programs. These unexpended independent research funds are included in other income in the consolidated statements of operations in 2009.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ADVERTISING COSTS

We expense advertising costs, which include media and production costs, in the period in which the costs are incurred. Advertising costs totaled $2.0 million, $2.9 million and $9.5 million for the years ending December 31, 2011, 2010 and 2009, and are included in general and administrative expense in the consolidated statements of operations.

PENSION AND OTHER POSTRETIREMENT BENEFITS

FINRA provides two non-contributory defined benefit pension plans for the benefit of eligible employees. The non-contributory defined benefit plans consist of a qualified Employees Retirement Plan (ERP) and a non-qualified Supplemental Executive Retirement Plan (SERP). Both plans are now closed to new participants. We also provide an employer-funded defined contribution Retiree Medical Account Plan (RMA Plan) to assist our retirees with the cost of health care expenses during retirement. Under the RMA Plan, Retiree Medical Accounts are created for eligible employees and retirees, and fixed annual credits are applied to those accounts for each year of FINRA service beginning at age 40. In calculating the expense and liability related to all of the abovementioned plans, we use several statistical and other factors, which attempt to anticipate future events. Key factors include assumptions about the expected rates of return on plan assets and the discount rate as determined by FINRA, within certain guidelines, as well as assumptions regarding future salary increases, mortality, turnover, retirement ages and the medical expense trend rate. We consider market conditions, including changes in investment returns and interest rates, in making these assumptions. The discount rate used in the calculations is developed using a composite yield curve analysis based on a portfolio of high-quality, non-callable, marketable bonds. We determine the long-term rate of return based on analysis of historical and projected returns as prepared by our actuary and external investment consultant. FINRA's Pension/401(k) Plan Committee (the Pension Committee) reviews and advises FINRA management on both the expected long-term rate of return and the discount rate assumptions.

Effective January 1, 2011, FINRA adopted a new defined contribution component to its voluntary contributory savings plan and participation in the ERP for all new hires ceased. The Company's contributions for this new component are based on the participant's age plus years of service, and vesting is on a graduated scale for up to six years. The investment options are the same as the current options in the savings plan. During 2011, current ERP participants were given a one-time option to participate in this new contribution component instead of the ERP. For ERP participants electing the new retirement contribution, their accrued benefit in the ERP was frozen, but future service with FINRA still allows for growth into vesting and eligibility for early retirement and/or early payment subsidies.

INCOME TAXES

FINRA, FINRA REG and FINRA DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). However, unrelated business income activities are taxed at normal corporate rates to the extent that they have taxable net income. New NASD Holding, Inc. (NAHO), a consolidated subsidiary of FINRA, is a taxable entity. We determine deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (*i.e.*, temporary differences). We measure these assets and liabilities at the enacted rates that we expect will be in effect when we will realize these differences. We also determine deferred tax assets based on the amount of net operating loss carryforwards. If necessary, we establish a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject us to concentrations of credit risk consist of cash and cash equivalents, trading investments, other investments and accounts receivable. We do not require collateral on these financial instruments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

We maintain cash and cash equivalents in excess of federally insured limits, principally with financial institutions located in the United States. Risk on accounts receivable is reduced by the number of entities comprising our member firm base and through ongoing evaluation of collectibility of amounts owed to us. We use outside investment managers to manage our investment portfolio and a custody agent, a publicly traded company headquartered in New York, to hold our trading securities.

As part of the investment policy established in April 2009, we maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return. Our investment portfolio, excluding Foundation investments, consists of investments in debt securities, private investments and illiquid investments pending redemption. During 2009, we entered into a limited partnership agreement such that one investment fund represents approximately 48 percent of our total invested assets, excluding cash, as of December 31, 2011. The Foundation's investment portfolio consists of mutual funds and a commingled fund.

We are dependent on a supplier that provides many of our infrastructure-related information technology services. To the extent this supplier is not able to perform, it could have an adverse effect on our business. The contract with this supplier expires in December 2012. We are in the process of transitioning the services provided by this supplier in anticipation of the expiration of this contract.

We transact business with multiple firms, with no individual firm providing in excess of 10 percent of total revenues.

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs*. The ASU amended ASC 820, *Fair Value Measurement*, to converge the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in ASC 820. In addition, the ASU requires additional fair value disclosures. The amendments are to be applied prospectively and are effective for annual periods beginning after December 15, 2011. We are currently evaluating the effect that the provisions of the ASU will have on our consolidated results of operations and financial position, but its adoption is not expected to have a material impact.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which amends ASC 220, *Comprehensive Income*. The ASU eliminates the option to present other comprehensive income (OCI) in the statement of changes in equity and instead requires net income, the components of OCI, and total comprehensive income to be presented in either one continuous statement or two separate but consecutive statements. The ASU will be effective for us for fiscal years ending after December 15, 2012, and will be applied retrospectively. The adoption of the provisions of the ASU is not expected to have a material impact on our consolidated results of operations and financial position as it only requires a change in the presentation of OCI in our consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill and Impairment*, which amends ASC 350, *Intangibles – Goodwill and Other*, related to goodwill impairment testing. The ASU allows an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If so, the entity is required to perform a two-step test to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. The ASU is effective for fiscal years beginning after December 15, 2011; however, early adoption is permitted. FINRA early adopted the ASU on December 31, 2011. Based on various quantitative and qualitative factors, we determined that it was not more likely than not that the fair value of our reporting unit was less than its carrying amount and no impairment of goodwill was recognized.

3. ACQUISITION OF THE MEMBER REGULATION OPERATIONS OF NYSE

On July 30, 2007, the National Association of Securities Dealers, Inc. (NASD) combined with the member regulation operations of NYSE to form FINRA. We accounted for the transaction as a business combination and allocated the total consideration paid to the estimated fair values of the tangible and intangible assets acquired and liabilities assumed on the acquisition date. The $15.0 million excess of the consideration paid over the fair value of the net assets we acquired was recorded as goodwill.

The separately identified intangible assets we acquired are as follows:

		2011			2010		
Description	Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
				(in millions)			
Membership lists	11 years	$10.3	$ (4.1)	$6.2	$10.3	$ (3.2)	$ 7.1
Copyrights	3 years	6.5	(6.5)	—	6.5	(6.5)	—
Executory contract-related	5 years	13.7	(12.1)	1.6	13.7	(9.4)	4.3
Total		$30.5	$(22.7)	$7.8	$30.5	$(19.1)	$11.4

As of December 31, 2011, estimated amortization expense for each of the next five years is as follows: 2012, $2.5 million; 2013, $0.9 million; 2014, $0.9 million; 2015, $0.9 million; and 2016, $0.9 million.

4. DEFERRED REVENUE

The following is a summary of amounts that we included in current and non-current deferred revenue as of December 31, 2011, and the years over which we will recognize those amounts:

	Registration	Arbitration	Annual and Other	Total
		(in millions)		
Year ending December 31,				
2012	$ 8.6	$5.4	$38.4	$ 52.4
2013	6.0	0.1	4.0	10.1
2014	3.7	—	4.0	7.7
2015	1.6	—	1.8	3.4
2016 and thereafter	1.7	—	—	1.7
	$21.6	$5.5	$48.2	$ 75.3

The following is a summary of activity in our current and non-current deferred revenue for the years ended December 31, 2011, and 2010, for all revenue arrangements. The additions reflect the fees charged during the period, while the amortization reflects the revenues recognized during the period:

	Registration	Arbitration	Annual and Other	Total
		(in millions)		
Balance as of January 1, 2011	$ 23.2	$ 6.7	$ 52.3	$ 82.2
Additions	9.0	10.5	306.0	325.5
Amortization	(10.6)	(11.7)	(310.1)	(332.4)
Balance as of December 31, 2011	$ 21.6	$ 5.5	$ 48.2	$ 75.3

4. DEFERRED REVENUE (CONTINUED)

	Registration	Arbitration	Annual and Other	Total
		(in millions)		
Balance as of January 1, 2010	$ 25.9	$ 8.2	$ 34.9	$ 69.0
Additions	8.7	12.3	341.6	362.6
Amortization	(11.4)	(13.8)	(324.2)	(349.4)
Balance as of December 31, 2010	$ 23.2	$ 6.7	$ 52.3	$ 82.2

5. INVESTMENTS

FINRA owns a diverse investment portfolio consisting of 1) U.S. government (including state and local) securities; 2) agency mortgage-backed securities; 3) corporate and asset-backed securities; 4) mutual and commingled funds; 5) other investments (including private investments); and 6) other financial instruments. We have classified our marketable investments as trading or available-for-sale based on their nature, and our intent and ability to sell or to hold the securities.

Our investment policy strives to preserve principal, in real terms, while seeking to maximize returns within acceptable levels of risk as deemed appropriate by the Board. We execute our investment strategy through separately managed accounts (SMAs) and direct investments. During 2011, our active trading portfolio was managed by an investment manager, who has the authority to buy and sell investments within FINRA-determined, pre-established multiple parameters.

FINRA's investment portfolio consisted of the following as of:

	December 31, 2011	December 31, 2010
	(in millions)	
Trading investments	$ 667.6	$ 716.5
Available-for-sale investments: FINRA	27.2	28.3
Available-for-sale investments: Foundation	23.4	25.5
Other investments:		
Equity method investments	672.3	716.3
Cost method investments	0.3	0.3
Total other investments	672.6	716.6
Total	$1,390.8	$1,486.9

Trading Investments

The total mark-to-market holding gain (loss) on trading securities held at December 31, 2011, and 2010, was $3.3 million and $(10.9) million.

Available-for-Sale Investments

FINRA's available-for-sale investments (excluding those of the Foundation) consisted of the following:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
As of December 31, 2011:				
Mutual funds	$24.9	$2.3	$(—)	$27.2
As of December 31, 2010:				
Mutual funds	$24.5	$3.8	$(—)	$28.3

5. INVESTMENTS (CONTINUED)

For 2011, 2010 and 2009, gross investment gains and losses recognized from our investments in mutual and commingled funds, including amounts reclassified from unrealized gains and losses in accumulated other comprehensive income, are as follows:

	2011	2010	2009
		(in millions)	
Gross investment gains recognized	$0.4	$11.0	$30.9
Gross investment losses recognized	—	—	2.6
Amounts reclassified from accumulated other comprehensive income	0.4	10.7	—

As of December 31, 2011, the Foundation had investments in mutual and commingled funds with a cost of $22.6 million and a fair value of $23.4 million. As of December 31, 2010, the Foundation had investments in mutual and commingled funds with a cost of $24.2 million and a fair value of $25.5 million. The Foundation's investments are available for use by the Foundation to fund future research and investor educational projects.

Other-Than-Temporary Declines in Fair Value

In 2011, 2010 and 2009, we did not record any impairment charges related to our mutual and commingled funds. As of December 31, 2011, and 2010, we did not identify any events or circumstances that would indicate the value of our mutual and commingled funds should be impaired. Impairment charges relate to other-than-temporary declines in the fair value of available-for-sale investments and are reflected in net investment gains (losses) in the consolidated statements of operations.

Temporary Declines in Fair Value

As of December 31, 2011, the Foundation had one commingled fund with a fair value of $3.4 million, reflecting unrealized losses of $0.2 million less than six months in duration. As of December 31, 2011, FINRA had no available-for-sale investments with aggregate unrealized losses. As of December 31, 2010, FINRA and the Foundation had no available-for-sale investments with aggregate unrealized losses.

Other Investments

As of December 31, 2011, FINRA had investments accounted for under the equity method of $672.3 million, comprising $666.3 million in one limited partnership and $6.0 million in hedge funds. These investments are included in other investments in the consolidated balance sheets. Our limited partnership investment represents a variable interest in an investment limited partnership. The purpose of the limited partnership is to maximize risk-adjusted returns over the long term by investing in a highly diversified asset allocation strategy. The nature of the limited partnership includes investments in equity, fixed income and alternative investments. As a limited partner, we do not have the power to direct the activities of the partnership that most significantly impact the partnership's business nor are we the party most closely associated with the partnership. Therefore, we are not the primary beneficiary and accordingly account for our interest under the equity method. Our equity in the earnings of the partnership is based on the partnership's reported net asset value. The partnership's net assets consist primarily of its investments accounted for at fair value; the majority of the partnership's fair value measurements are based on the estimates of the general partner. We recognized equity losses from this partnership of $10.1 million in 2011 and equity earnings of $58.4 million in 2010. During 2011, we did not make any contributions to this partnership. During 2010, we contributed $132.0 million to this partnership. Our maximum exposure to loss related to this partnership is limited to $666.3 million, the carrying amount of our investment, due to the legal structure and design of this partnership. We have no outstanding capital commitments, guarantees or any other liquidity arrangements with this partnership.

5. INVESTMENTS (CONTINUED)

We had an ownership interest in equity method investments with total net assets of $8.3 billion and total earnings from operations of $349.0 million as of and for the period ended December 31, 2011. Our weighted ownership interest in all equity method investees was 8.1 percent at December 31, 2011.

In 2011, we recognized equity losses from equity method investments of $12.5 million. We did not recognize any impairment charges on our cost or equity method investments for the year ended December 31, 2011.

As of December 31, 2010, FINRA had investments accounted for under the equity method of accounting of $716.3 million, comprising $676.4 million in one limited partnership and $39.9 million in hedge funds. We had an ownership interest in equity method investments with total net assets of $14.7 billion and total earnings from operations of $2.1 billion as of and for the year ended December 31, 2010. Our weighted ownership interest in all equity method investees was 4.9 percent at December 31, 2010.

In 2010, we recognized equity earnings from equity method investments of $65.2 million. We did not recognize any impairment charges on our cost or equity method investments for the year ended December 31, 2010.

In 2009, we recognized equity earnings from equity method investments of $86.6 million. We recorded impairment charges of $44.8 million related to our investment in 27 limited partnerships in 2009.

6. FAIR VALUE MEASUREMENT

The Company considers cash and cash equivalents, trading and available-for-sale investments, receivables, investments receivable and investments payable to be its financial instruments. The carrying amounts reported in the consolidated balance sheets for these financial instruments equal or closely approximate fair value.

U.S. GAAP defines fair value as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date (*i.e.*, an exit price).

U.S. GAAP prioritizes the level of market price observability used in measuring assets and liabilities at fair value. Market price observability is impacted by a number of factors, including the type of asset and liability and the specific characteristics of the assets and liabilities. Assets and liabilities with readily-available, actively-quoted prices or for which fair value can be measured from actively-quoted prices generally will have a higher degree of market price observability and less degree of judgment used in measuring fair value.

Assets and liabilities measured at fair value are classified into one of the following categories:

- Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access as of the measurement date.
- Level 2 — Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, through corroboration with observable data.
- Level 3 — Unobservable inputs, such as internally developed pricing models for the asset or liability due to little or no market activity for the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an asset or liability's level within the fair value hierarchy is based on the lowest level input that is significant to the fair value measurement. The assessment of significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

6. FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents information about our assets that are measured at fair value on a recurring basis as of December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized to determine fair value:

		Fair Value Measurement at December 31, 2011 Measured Using		
Description	Total carrying amount in balance sheet December 31, 2011	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		(in millions)		
Assets:				
Trading securities				
Fixed income				
Agency mortgage-backed securities	$180.0	$ —	$180.0	$—
Corporate debt securities				
Industrial	83.2	—	83.2	—
Utility	69.7	—	69.7	—
Consumer non-cyclical	56.0	—	56.0	—
Other financial institutions	50.4	—	50.4	—
Communication	46.3	—	46.3	—
Insurance	44.3	—	44.3	—
Banking and brokerage	41.4	—	41.4	—
Government securities	48.3	—	48.3	—
Asset-backed securities	34.4	—	34.4	—
Other securities	13.6	13.6	—	—
Available-for-sale securities				
Mutual funds	47.2	47.2	—	—
Commingled funds	3.4	—	3.4	—
Total Assets	$718.2	$60.8	$657.4	$—

6. FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents information about our assets that are measured at fair value on a recurring basis as of December 31, 2010, and indicates the fair value hierarchy of the valuation techniques utilized to determine fair value:

		Fair Value Measurement at December 31, 2010 Measured Using		
Description	Total carrying amount in balance sheet December 31, 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		(in millions)		
Assets:				
Trading securities				
Fixed income				
Agency mortgage-backed securities	$174.3	$ —	$174.3	$—
Corporate debt securities				
Industrial	74.4	—	74.4	—
Utility	69.9	—	69.9	—
Consumer non-cyclical	68.5	—	68.5	—
Banking and brokerage	67.9	—	67.9	—
Communication	56.0	—	56.0	—
Life insurance	50.8	—	50.8	—
Other financial institutions	50.2	—	50.2	—
Government securities	52.8	—	52.8	—
Asset-backed securities	39.2	—	39.2	—
Other securities	12.5	12.5	—	—
Available-for-sale securities				
Mutual funds	53.5	53.5	—	—
Commingled funds	0.3	—	0.3	—
Total Assets	$770.3	$66.0	$704.3	$—

Changes in the fair value of trading securities are recorded as a component of net investment gains in the consolidated statements of operations. Temporary changes in the fair value of available-for-sale securities are recognized as unrealized gains as a separate component of equity in the consolidated balance sheets.

For the years ended December 31, 2011, and 2010, there were no transfers between Level 1, Level 2 or Level 3 of the fair value hierarchy.

The following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis and the general classification of these instruments pursuant to the fair value hierarchy.

Trading Investments

We rely on pricing inputs from our custodian and investment fund managers to value our trading investments.

The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources include most government agency securities, investment-grade corporate bonds, less liquid listed equities, and state and municipal bonds. Accordingly, the valuation of

6. FAIR VALUE MEASUREMENT (CONTINUED)

these securities is categorized in Level 2 of the fair value hierarchy. Investment funds related to our defined contribution SERP for senior officers and deferred compensation plan for officers under the provisions of Section 457(b) of the IRC are valued using Level 1 inputs.

Available-for-Sale Investments

We value these investments based on quoted market or other observable prices for either identical or comparable funds in active markets and classify these funds within Level 1 or 2 of the fair value hierarchy.

7. INCOME TAXES

FINRA, FINRA REG and FINRA DR are tax-exempt organizations under IRC Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4).

Unrelated Business Income

Unrelated business income activities are taxed at normal corporate rates to the extent that they have taxable net income. Our unrelated business activities consist primarily of mortgage licensing services provided under our contract with SRR, certain external client exams and, in 2009 and prior, international consulting.

As of December 31, 2011, and 2010, FINRA had federal unrelated business loss carryforwards of $11.9 million and $15.4 million, primarily related to international consulting. The loss carryforwards are scheduled to expire beginning in 2024 through 2030.

In order 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. Prior to 2009, FINRA did not consider the realization of the deferred tax asset related to these loss carryforwards likely and, accordingly, had established a full valuation allowance for the deferred tax asset. However, based on the weight of positive evidence regarding the realizability of these loss carryforwards — specifically, our historical and sustained profitability on mortgage licensing services and external client exams — we reversed the valuation allowance in 2009 and recognized the full amount of the federal deferred tax asset of $7.2 million as of January 1, 2009.

As of December 31, 2011, and 2010, FINRA had a federal deferred tax asset of $4.0 million and $5.4 million, reflecting the benefit of $11.9 million and $15.4 million in loss carryforwards. Realization is dependent on generating sufficient taxable income prior to the expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. There are no other significant deferred tax assets or liabilities related to unrelated business income.

The federal and state 2011 and 2010 income tax provision of $0.7 million and $0.3 million and 2009 income tax benefit of $5.6 million primarily represent the net change in deferred tax assets related to unrelated business loss carryforwards during the year. We did not have any significant unrelated business income taxes currently payable or refundable in 2011 or 2010.

The income tax provision (benefit) is included in other (expense) income in the consolidated statements of operations in 2011, 2010 and 2009.

Other

As of December 31, 2011, and 2010, NAHO, a wholly-owned taxable subsidiary of FINRA, had net operating loss carryforwards of $105.6 million. These loss carryforwards will begin to expire in 2020. The amount of the federal deferred tax asset relating to these loss carryforwards as of December 31, 2011, and 2010, was $36.9 million; NAHO has no other deferred tax assets or liabilities. As management currently believes that it is more likely than not that these loss carryforwards will not be realized, a valuation allowance has been established for the full amount of the deferred tax asset.

7. INCOME TAXES (CONTINUED)

Uncertain Tax Positions

U.S. GAAP provides a two-step approach for evaluating tax positions. Recognition (step 1) occurs when an entity concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. In step 2 (measurement), the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, that is more likely than not to be realized upon ultimate settlement. During the years from 2008 to 2011, which represent the years management considers to be open for examination by taxing authorities, management did not identify the existence of any uncertain tax positions. Accordingly, all tax positions are recognized and measured at their full benefit in the consolidated balance sheets and statements of operations.

8. EMPLOYEE BENEFITS

Defined Benefit Pension Plans

As of December 31, 2011, and 2010, we provided two non-contributory defined benefit pension plans for the benefit of our eligible employees, consisting of a qualified ERP and a non-qualified SERP. The benefits are based primarily on years of service and employees' average compensation, as defined, during the highest 60 consecutive months of employment. Both plans are now closed to new participants.

We established an irrevocable rabbi trust equal to our SERP obligation, and included this trust in our consolidated financial statements. As of December 31, 2011, and 2010, $27.2 million and $28.3 million of investments are included in available-for-sale securities in the consolidated balance sheets, representing the amounts contributed by FINRA, plus earned income and market value gains, less distributions to retirees and market value losses.

The investment policy and strategy of the plan assets, as established by the Pension Committee, strive to provide for preservation of principal, both in nominal and real terms, in order to meet the long-term spending needs of the ERP by investing assets based on the target allocations stated below. The ERP assets are allocated among a diversified portfolio of equity investments, fixed income securities, alternative investments and cash equivalents with both domestic and international strategies. Derivatives are permitted on a limited scale for hedging or creation of market exposures. Direct debt and equity interests are prohibited in any broker-dealer, exchange, contract market, regulatory client, alternative or electronic trading system, and entities that derive a certain threshold of revenue from broker-dealer activities. Asset allocations are reviewed quarterly and adjusted, as appropriate, to remain within target allocations. The Pension Committee reviews the investment policy annually, under the guidance of an investment consultant, to determine whether a change in the policy or asset allocation targets is necessary. The ERP assets consisted of the following as of December 31:

	Target Allocation	2011	2010
Equity securities:			
U.S. equity	17.0%	17.6%	16.4%
Non-U.S. equity	15.0%	15.1%	14.7%
Global equity	12.0%	11.9%	12.1%
Debt securities	38.0%	38.3%	37.0%
Cash equivalents	2.0%	3.5%	1.6%
Alternative investments	11.0%	9.4%	13.5%
Real estate	5.0%	4.2%	4.7%
Total	100.0%	100.0%	100.0%

8. EMPLOYEE BENEFITS (CONTINUED)

The expected long-term rate of return for the plan's total assets is based on the expected returns of each of the above categories, weighted based on the current target allocation for each class. Based on historical experience, the Pension Committee expects that the ERP's asset managers overall will provide a modest premium to their respective market benchmark indexes. At least annually, the Pension Committee evaluates whether adjustments are needed based on historical returns to more accurately reflect expectations of future returns.

The following tables present information about the fair value of the Company's ERP assets at December 31, 2011, and 2010, by asset category, and indicate the fair value hierarchy of the valuation techniques utilized to determine fair value:

	Fair Value Measurement at December 31, 2011 Measured Using			
Description	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
		(in millions)		
Short-term investments in common/collective trusts (a)	$ —	$ 9.0	$ —	$ 9.0
Corporate stocks	7.2	—	—	7.2
Partnership/joint venture interests (b):				
Fixed income	—	—	7.2	7.2
Real estate	—	—	9.6	9.6
Common/Collective trusts — equity (c)	—	79.7	—	79.7
Private pension plan investment entities — fixed income (d)	—	47.4	—	47.4
Mutual funds:				
Equity	26.7	—	—	26.7
Fixed income	60.1	—	—	60.1
Total	94.0	136.1	16.8	246.9
Payables, net (1)				(0.1)
Total				$246.8

(1) Represents pending trades at December 31, 2011.

8. EMPLOYEE BENEFITS (CONTINUED)

Description	Fair Value Measurement at December 31, 2010 Measured Using Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
		(in millions)		
Short-term investments in common/collective trusts (a)	$ —	$ 10.1	$ —	$ 10.1
Corporate stocks	6.6	—	—	6.6
Partnership/joint venture interests — real estate (b)	—	—	7.9	7.9
Common/Collective trusts — equity (c)	—	69.1	—	69.1
Private pension plan investment entities (d):				
Equity	—	15.4	—	15.4
Fixed income	—	44.2	—	44.2
Mutual funds:				
Equity	25.3	—	—	25.3
Fixed income	46.4	—	—	46.4
Total	78.3	138.8	7.9	225.0
Receivables, net (2)				19.0
Total				$244.0

(2) Represents pending trades at December 31, 2010.

(a) Includes non-government fixed income securities, government obligations, money market instruments and repurchase agreements. Fair values have been estimated using the net asset value per unit of the trusts. Units of this investment are valued daily and a unit-holder's ability to transact a unit is not restricted.

(b) Includes an investment in a private equity fund and interests in two limited partnerships. Fair values have been estimated using the net asset value of the Plans' ownership interest of partner's capital.

The investment in the private equity fund, representing approximately 19 percent of the value of the investments in this category as of December 31, 2011, is nonredeemable. The term of the private investment is the later of August 11, 2018, or one year after the date on which all of its underlying investments have been disposed, but may be terminated earlier as set forth in the partnership agreement. The commitment to the fund is $5.3 million, of which $3.1 million and $2.8 million had been funded as of December 31, 2011, and 2010.

The first limited partnership is an open-ended partnership that invests in limited liability companies and limited partnerships established to act as real estate investment vehicles. Redemption may occur on a quarterly basis with notice of 30 days, provided there are liquid assets available. In the case of illiquid investments, partial payments will be made on a pro rata basis relative to the size of all other redeeming partners' investments.

In 2011, we entered into a second limited partnership whose investment objective is to maximize total returns by investing primarily in senior secured, floating rate loans of non-investment grade companies. Withdrawal may occur on a quarterly basis with a 90-day written notice prior to the withdrawal date. In the case of a complete withdrawal, ninety percent of the estimate of the amount due will be paid within 30 days after the withdrawal date.

(c) Includes both domestic and international equities. Fair values have been estimated using the net asset value per unit of the funds. Investment managers are not constrained by any particular investment style and may invest in either "growth" or "value" securities. Units of this investment are valued daily and a unit-holder's ability to transact in the trusts' units occurs daily.

(d) Includes global fixed income and international equities. Fair values have been estimated using the net asset value per unit of the funds. The net asset value of these investments is determined daily or at least twice a month while redemptions of shares are made often, based upon the closing net asset value. No redemption restrictions exist for these funds.

8. EMPLOYEE BENEFITS (CONTINUED)

The change in investments measured using Level 3 inputs to determine fair value is as follows:

		Fair Value Measurement Using Significant Unobservable Inputs (Level 3)	
	Total	Fund of hedge funds	Partnership/ joint venture interests
		(in millions)	
Beginning balance at December 31, 2009	$ 20.3	$ 18.7	$ 1.6
Actual return on plan assets:			
Relating to assets still held at the reporting date	—	—	—
Relating to assets sold during the period	0.3	0.3	—
Purchases	6.3	—	6.3
Sales	(19.0)	(19.0)	—
Balance at December 31, 2010	7.9	—	7.9
Actual return on plan assets:			
Relating to assets still held at the reporting date	1.4	—	1.4
Relating to assets sold during the period	—	—	—
Purchases	7.6	—	7.6
Sales	(0.1)	—	(0.1)
Ending balance at December 31, 2011	$ 16.8	$ —	$16.8

The valuation techniques and inputs used to measure fair value of the ERP assets are consistent with the Company's valuation procedures as disclosed in Note 6, "Fair Value Measurement." At times, the Company may engage external valuation experts to assist with the determination of the fair value of certain ERP assets. For alternative investments, net asset value is used as a practical expedient to measure fair value, unless it is probable that an investment will be sold for a different amount. In these cases, fair value is measured based on recent observable transaction information for similar investments, the consideration of non-binding bids from potential buyers and third party valuations.

Postretirement and Retiree Medical Benefit Plans

As of December 31, 2011, and 2010, the Company provided a non-contributory postretirement life insurance benefit plan for the benefit of eligible employees. The postretirement benefit plan provides a specified life insurance benefit to eligible retired employees. The postretirement benefit plan is closed with respect to new participants.

As of December 31, 2011, and 2010, the Company provided an employer-funded defined contribution RMA Plan to assist our retirees with the cost of health care expenses during retirement. Under the RMA Plan, Retiree Medical Accounts are created for eligible employees and retirees and fixed annual credits are applied to those accounts for each year of FINRA service beginning at age 40. Active employees may also accrue credits for a portion of their unused vacation and personal leave. The credits can be accessed only in retirement and may be used only toward paying a portion of monthly premiums under FINRA-sponsored retiree health plans.

8. EMPLOYEE BENEFITS (CONTINUED)

Plan Disclosures

The following tables disclose “Pension Benefits,” which include the ERP and SERP described above, and “Other Benefits,” which include the postretirement and RMA plans described above. The reconciliation of the projected benefit obligation, the change in the fair value of plan assets for the years ended December 31, 2011, and 2010, and the accumulated benefit obligation at December 31, 2011, and 2010, are as follows:

	Pension Benefits		Other Benefits	
	2011	2010	2011	2010
	(in millions)			
Change in benefit obligation				
Benefit obligation at beginning of year	$ 363.1	$ 338.6	$ 37.2	$ 32.0
Service cost	32.7	31.7	2.8	2.3
Interest cost	18.2	18.9	2.3	2.1
Actuarial (gains) losses	51.5	(11.2)	(0.5)	1.8
Benefits paid	(11.7)	(14.9)	(0.9)	(1.0)
Curtailment gain	(3.1)	—	—	—
Benefit obligation at end of year	$ 450.7	$ 363.1	$ 40.9	$ 37.2
Change in plan assets				
Fair value of plan assets at beginning of year	$ 244.0	$ 186.5	$ —	$ —
Actual return on plan assets	(2.2)	16.8	—	—
Company contributions	16.7	55.6	0.9	1.0
Benefits paid	(11.7)	(14.9)	(0.9)	(1.0)
Fair value of plan assets at end of year	$ 246.8	$ 244.0	$ —	$ —
Underfunded status of the plan	$(203.9)	$(119.1)	$(40.9)	$(37.2)
Accumulated benefit obligation (ABO)	$ 310.2	$ 247.7		

Our total accrued pension and other postretirement benefit liability in the consolidated balance sheet comprises the following:

	Pension Benefits		Other Benefits	
	2011	2010	2011	2010
	(in millions)			
Current	$ 9.5	$ 7.6	$ 1.3	$ 1.3
Noncurrent	194.4	111.5	39.6	35.9
Net amount at December 31	$203.9	$119.1	$40.9	$37.2

The current portion of pension and other benefits represents the net present actuarial value of benefits to be paid over the next 12 months in excess of plan assets and is included in accrued personnel and benefit costs in the consolidated balance sheet. There are no plan assets for the SERP and RMA Plan.

The Company does not expect any plan assets to be returned to it during the year ending December 31, 2012.

8. EMPLOYEE BENEFITS (CONTINUED)

The net amounts included in accumulated other comprehensive income (loss) are as follows:

	Pension Benefits		Other Benefits	
	2011	2010	2011	2010
	(in millions)			
Unrecognized net actuarial loss	$(172.5)	$(109.4)	$ (3.4)	$ (3.9)
Unrecognized prior service cost	(1.5)	(1.7)	(13.0)	(14.4)
Unrecognized net transition obligation	—	—	(0.1)	(0.1)
Net amount at December 31	$(174.0)	$(111.1)	$(16.5)	$(18.4)

The following amounts were included in other comprehensive income (loss) during 2011:

	Incurred but Not Recognized	Reclassification Adjustment for Prior Period Amounts Recognized
	(in millions)	
Actuarial gain (loss)		
Pension benefits	$(68.7)	$5.6
Other benefits	0.5	—
	(68.2)	5.6
Prior service cost		
Pension benefits	—	0.2
Other benefits	—	1.4
	—	1.6
	$(68.2)	$7.2

Estimated amounts to be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost during 2012 based on December 31, 2011, plan measurements are as follows:

	Pension Benefits	Other Benefits
	(in millions)	
Unrecognized prior service costs	$ 0.2	$1.4
Unrecognized actuarial losses	10.2	—

The weighted-average assumptions used to determine benefit obligations for the years ended December 31, 2011, and 2010, are as follows:

	Pension Benefits		Other Benefits	
	2011	2010	2011	2010
Discount rate	4.50%	5.25%	4.35%	5.68%
Rate of compensation increase	4.75%	4.74%	—	—

The weighted-average assumptions used to determine net periodic benefit cost for the year are as follows:

	Pension Benefits			Other Benefits		
	2011	2010	2009	2011	2010	2009
Discount rate	5.25%	5.75%	6.50%	5.68%	6.15%	6.50%
Rate of compensation increase	4.74%	4.92%	4.90%	—	—	—
Expected return on plan assets	7.75%	7.75%	7.75%	—	—	—

8. EMPLOYEE BENEFITS (CONTINUED)

The assumptions above are used to develop the benefit obligations at year-end and to develop the net periodic benefit cost for the subsequent year. Therefore, the assumptions used to determine benefit obligations were established at each year-end while the assumptions used to determine net periodic benefit cost for each year are established at the end of each previous year. The expected return on plan assets that will be used in the determination of 2012 net periodic benefit cost is 7.00 percent.

The net periodic benefit obligations and the net periodic benefit cost are based on actuarial assumptions that are reviewed on an annual basis. We revise these assumptions based on an annual evaluation of long-term trends, as well as market conditions, which may have an impact on the cost of providing retirement benefits.

The components of net periodic benefit cost included in the consolidated statements of operations are as follows:

	Pension Benefits			Other Benefits		
	2011	2010	2009	2011	2010	2009
			(in millions)			
Service cost	$ 32.7	$ 31.7	$ 24.6	$2.8	$2.3	$2.3
Interest cost	18.2	18.9	17.3	2.3	2.1	1.6
Expected return on plan assets	(18.1)	(14.3)	(10.0)	—	—	—
Recognized net actuarial losses	5.6	7.2	5.3	—	—	—
Prior service cost recognized	0.2	0.2	0.2	1.4	1.4	1.4
	$ 38.6	$ 43.7	$ 37.4	$6.5	$5.8	$5.3

The assumed health care cost trend rate to be used for the next year to measure the expected cost of other benefits is 10.2 percent, with a gradual decline to 4.9 percent by the year 2016. This estimated trend rate is subject to change. The assumed health care cost trend rate can have a significant effect on the amounts reported. However, a 1-percentage-point change in the assumed health care cost trend rate would not have a material impact on the benefit obligation or service and interest components of net periodic benefit cost.

We measure our plans as of the end of each fiscal year. In 2011, FINRA adopted a funding policy that would ensure its contributions to the ERP would be no less than the minimum required by the Employee Retirement Income Security Act of 1974 (ERISA). However, FINRA retains the right to make contributions above the minimum required at its discretion. FINRA intends to make discretionary contributions annually such that the plan is at least 100 percent funded on the Internal Revenue Service (IRS) Funding Target basis. Prior to this adoption, the ERP's funding policy targeted a funded ratio of the greater of the Funding Target or 100 percent of the ABO, the latter measure including a corridor between 95 percent and 110 percent of the ABO. In 2012, we expect to contribute $19.4 million to the ERP. We do not expect to make any contributions to the SERP in 2012. In addition, we expect to make the following benefit payments to participants during the next 10 years:

	Pension Benefits	Other Benefits
	(in millions)	
Year ending December 31,		
2012	$ 25.4	$ 2.2
2013	19.1	2.3
2014	22.8	2.7
2015	26.6	3.2
2016	27.9	3.8
2017 through 2021	232.1	30.6
Total	$353.9	$44.8

8. EMPLOYEE BENEFITS (CONTINUED)

All Other Benefit Plans

FINRA also maintains a voluntary contributory savings plan for eligible employees. Employees are immediately eligible to make elective contributions to the plan up to specified plan limits. Employees are also eligible to receive from FINRA a corresponding dollar-for-dollar matching contribution on any elective contribution made by the participant to the savings plan, up to a maximum of 4 percent of base compensation, with an additional discretionary match, effective January 1, 2010. Prior to January 1, 2010, the limit on amounts eligible for the basic dollar-for-dollar matching contribution was 6 percent. The plan also has a retiree medical match equal to 25 cents on the dollar for elective contributions in excess of 6 percent of compensation, up to an annual maximum match of $1,000. Savings plan expense for 2011, 2010 and 2009, was $17.8 million, $16.0 million and $17.4 million, and is included within compensation and benefits expense in the consolidated statements of operations. The savings plan expense includes a discretionary 1 percent match totaling $3.0 million and $2.7 million for 2011 and 2010, which is included within compensation and benefits expense in the consolidated statements of operations. The retiree medical match for 2011, 2010 and 2009 totaled $1.6 million, $1.4 million and $1.3 million and is included within compensation and benefits expense in the consolidated statements of operations.

Effective January 1, 2011, FINRA adopted a new defined contribution component to the savings plan and participation in the ERP for all new hires ceased. The Company's contributions for this new component are based on the participant's age plus years of service, and vesting is on a graduated scale for up to six years. The investment options are the same as the current options in the savings plan. During 2011, current ERP participants were given a one-time option to participate in this new contribution component instead of the ERP. For ERP participants electing the new retirement contribution, their accrued benefit in the ERP was frozen, but future service with FINRA still allows for growth into vesting and eligibility for early retirement and/or early payment subsidies. Expenses related to the new defined contribution component to the savings plan for 2011 were $0.9 million and are included within compensation and benefits expense in the consolidated statement of operations. The new defined contribution component to the savings plan also resulted in a decrease to the ERP's benefit obligation by approximately $3.1 million as of December 31, 2011.

FINRA maintains a deferred compensation plan for officers under the provisions of Section 457(b) of the IRC. Eligible employees may contribute to the plan and, at its discretion, FINRA may make additional contributions to the plan. FINRA placed the assets of this plan into an irrevocable rabbi trust that the Company consolidates. As of December 31, 2011, $7.8 million of investments and $7.8 million of amounts due to plan participants are included in trading investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing participant contributions to this plan and accrued earnings. As of December 31, 2010, $7.1 million of investments and $7.1 million of amounts due to plan participants are included in trading investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing participant contributions to this plan and accrued earnings. As of December 31, 2011, and 2010, FINRA made no additional contributions to this plan.

FINRA maintains a defined contribution SERP for the Company's senior officers. FINRA makes annual contributions based on salary and a portion of incentive compensation. Contributions and earnings vest upon the earlier of 1) the end of each third year of participation following such contribution; 2) attainment of age 62; 3) death; or 4) a disabled participant's termination of employment. As of December 31, 2011, $5.8 million of investments and $5.8 million of amounts due to plan participants are included in trading investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing FINRA's contributions to this plan plus accrued earnings. As of December 31, 2010, $5.5 million of investments and $5.5 million of amounts due to plan participants are included in trading investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing FINRA's contributions to this plan plus accrued earnings.

9. LEASES

FINRA leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in rent, property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was $29.6 million, $27.3 million and $27.3 million for the years ended December 31, 2011, 2010 and 2009, and is included in occupancy expense in the consolidated statements of operations.

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, 2011:

Year ending December 31,	*(in millions)*
2012	$ 29.3
2013	27.5
2014	26.8
2015	24.1
2016	23.3
Remaining years	84.7
Total minimum lease payments	$215.7

10. COMMITMENTS AND CONTINGENCIES

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 us. Management is not aware of any unasserted claims or assessments that would have a material adverse effect on our financial position and the results of operations. While the outcome of any pending or future litigation cannot be predicted, management does not believe that any such matter will have a material adverse effect on our business or financial position. As of December 31, 2011, there were no estimated losses accrued related to pending legal proceedings because we believe the loss from these matters is not probable and cannot be reasonably estimated. We believe any litigation contingency involves a chance of loss that is either remote or reasonably possible. Such pending legal matters involve unspecified claim amounts, in which the respective plaintiffs seek an indeterminate amount of damages. To the extent such matters present a reasonably possible chance of loss, we are not able to estimate the associated possible loss or range of loss. The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could require us to pay damages or make other expenditures or establish accruals in amounts that we could not estimate at December 31, 2011.

11. SUBSEQUENT EVENTS

Subsequent events have been evaluated through June 28, 2012, the date these financial statements became available to be issued.

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