moving into a new era of regulation

Year in Review
and Annual
Financial Report

2006

NASD is the leading private-sector regulator for all securities firms doing business with the U.S. public—over 5,000 firms employing nearly 660,000 registered representatives. Our role is to maintain market integrity and transparency, protect and educate individual investors, help firms comply with regulation, maintain a neutral arbitration forum and provide trade reporting and other industry utilities. NASD touches every important dimension of the capital markets and their most important and emerging issues. NASD's $82 million-endowed educational foundation, the largest of its kind in the nation, funds research and programs that help investors understand the complexities of the markets and investing. In 2007, NASD will integrate the member regulatory operations of the New York Stock Exchange and become a next-generation self-regulatory organization (SRO).

The landscape has changed for investors, firms and the capital markets, and we're evolving with it—to safeguard investors and expand U.S. market strength for generations to come.

Mary L. Schapiro
Chairman and
Chief Executive Officer

We're Evolving with the World's Capital Markets

The securities business has experienced remarkable growth over the seven decades we've been regulating it, but in the last few years, its evolution has been exponential. We recognized the need to evolve with it in an equally dramatic way. Our response was the far-reaching plan now unfolding—to combine with the member regulatory group of the New York Stock Exchange. The goal? To create a more effective, modern regulatory body, suited to the complexity and competitiveness of this century's capital markets. Our innovative, new self-regulatory organization (SRO) will be a well-funded, independent, not-for-profit source of oversight, insight and assistance.

It used to be easy to define our role. NASD wrote and enforced rules, conducted standardized exams, fielded investor complaints, imposed sanctions and handled broker licensing and registration. Our success was measured mainly on the numbers: total cases, amounts of fines and the like. Capital market structure and investment products were more straightforward. And, when problems arose, we responded.

Our central role—writing and enforcing industry rules—hasn't changed, but the landscape *has*. It's far more complicated now, and without its familiar boundaries. NASD has broader constituencies and much greater responsibilities to investors, the industry and markets. We're dealing with an aggressively expanding universe of investment instruments, and associated issues and risks that bewilder many investors. U.S. stock exchanges are trading publicly and markets are merging internationally—reshaped by globalization. We also have millions of under-informed and unprepared investors who need earnest, honest education and advocacy.

So our role has to be and *is* becoming larger, also more proactive, strategic and holistic; in engaging and educating investors, especially underserved segments of the public like the U.S. military—and vulnerable ones like senior citizens; in giving the industry valuable guidance, training and tools to better assist in compliance; in working with firms to pre-assess and counter risks in developing new products; and in understanding and working with regulators elsewhere in the world to effectively operate in—*and stay on top of*—this changing market environment.

This more enlightened approach is also critical to helping people invest intelligently and confidently.

GETTING THE BALANCE RIGHT

It's a constant balancing act to protect investors and preserve market integrity, while also giving securities firms the latitude to innovate. We're wholly committed to getting, *and keeping,* the balance right.

You'll see this commitment reflected everywhere. Foremost in how we led the initiative to streamline and bring greater flexibility and cost-consciousness to regulation by forming a single, umbrella SRO. You'll see it in our approach to small firms, whose business models and dynamics shouldn't be subject to "one-size-fits-all" treatment. You'll see it in our creative problem solving—through education, best practices and the creation of task forces.

This more enlightened approach is also critical to helping people invest intelligently and confidently. Just one example of this is our comprehensive outreach to the U.S. military through NASD's Investor Education Foundation, the largest of its kind in the country. Dozens of educational programs have been conducted by NASD staff on military bases around the country. We have trained military spouses as accredited financial counselors and, in return, they donate time to counsel military families. And last year, we launched *SaveAndInvest.org,* a Web site dedicated to informing military servicemembers about the basic principles of saving and investing. We have become—and are committed to being—a valued resource for all the armed services.

DELIVERING THE BENEFITS OF CONSOLIDATION

In 2006, I traveled across the country with senior NASD executives to encourage members to vote on the plan for regulatory consolidation with NYSE Member Regulation, and to discuss its merits. We visited 26 cities, and met with more than 800 firms face-to-face. You spoke up, and we listened, closely. You voiced your concerns and gave us tremendous direct feedback—the kind regulators rarely get. This input has shaped our agenda. It's a large part of what's driving us to simplify the rulebook, to put more focus on the impact of regulation on small firms, and to do our job in an increasingly thoughtful and less invasive way.

Since getting a resounding "yes" from the industry on the consolidation plan, we've begun integrating two of the world's leading regulatory organizations. This has its challenges, but I

You voiced your concerns and gave us tremendous direct feedback—the kind regulators rarely get. This input has shaped our agenda.

am confident that we'll reach our goals and achieve expected synergies. The benefits of one unified regulator are substantial and wide-ranging, with the most significant being:

An end to dual regulation. We're eliminating two sets of rules governing NYSE and NASD broker-dealer conduct, and along with them all the overlaps, conflicts and duplicative costs. Even the almost 5,000 broker-dealers that aren't members of the NYSE are affected and will benefit, because so many have clearing arrangements with NYSE-regulated firms.

Greater leverage. In addition to pooling NASD and NYSE regulatory expertise, having one approach and system instead of two means we can eliminate overlap here, as well, and leverage otherwise finite regulatory assets, from human resources to technology.

KEEPING OUR PROMISES

During our time on the road, we made clear our commitments to member firms. I want to reaffirm our intent to follow through on these promises to:

- Reassess rules for small firms, and look at how to make their regulatory burdens more manageable.
- Provide more advance notice for routine exams.
- Gauge risk more strategically.
- Reduce short- and long-term regulatory costs for *all* member firms.
- Increase and broaden industry participation in the self-regulatory process.
- Improve and enhance communication with member firms—and do it in plainer English.

We will also continue to:

Be good financial and technology stewards. We will continue to be careful, efficient and cost-conscious in how we manage the organization's financial assets. To this end, we have created a new investment office to oversee NASD's investment portfolio, the earnings from which enable us to keep member fees down. Our care extends, as well, to our technology platform, where we've greatly enhanced reliability, security and productivity.

My listening tour continues, and my ears, mind and door are open to every member firm.

Stay attentive and accessible. Prior to taking over as CEO in September of 2006, I went on a listening tour to sit down with CEOs of our member firms. I wanted to hear their issues, needs and viewpoints firsthand, and see how we could best work together in the cause of investor protection. It was revealing. I came back to NASD and shared what I learned—from the critiques to the compliments. Today, my listening tour continues, and my ears, mind and door are open to every member firm.

FOCUSING ON EMERGING ISSUES AND OPPORTUNITIES

As the capital markets continue to globalize, and new investment products and risks proliferate, our regulatory operations must keep pace. However, many products and vehicles—like fixed annuities, hedge funds and certain derivatives—fall outside our jurisdiction and are regulated differently. In our view, retail investors should have the *same* regulatory safeguards and protections, regardless of which vehicles and products they choose. We believe the country's regulatory regimes should work together to harmonize regulation for all financial products that look and behave in similar ways, whether they're securities, insurance, banking or investment advisory-related. Accomplishing this will require new types of partnerships, like NASD working in concert with state insurance commissioners. These are partnerships we're ready for, and invite.

When it comes to industry-wide issues, we need firms to be thinking more about emerging investor flashpoints. Foremost are those arising in the retirement space, where many baby boom households are financially ill-prepared for retirement. Studies reveal that half of those ages 55 to 59 have no savings at all, and two-thirds aren't saving enough to get securely through their "golden" years. Our aging population as a whole needs serious financial attention. Over the next 20 years, 75 million Americans will celebrate their 60th birthdays; that's 10,000 new 60-year-olds every day. Our industry can play a critical role in serving this segment of the American population, but the products must be well designed and properly sold.

Earlier, I referred to *advocacy.* This role as advocates of investing we've taken on is relatively new, but absolutely necessary. Why? Because most Americans simply can't make it to or through retirement on savings accounts alone: They *have* to invest. NASD can have

The old NASD you used to know is turning a major corner; in how we look at ourselves, how we regulate, and how we engage investors—and how we'll carry out our job in the future.

a profound impact on improving the population's widespread lack of knowledge about investing and personal financial management.

LOOKING AHEAD

The old NASD you used to know is turning a major corner; in how we look at ourselves, how we regulate, and how we engage investors—and how we'll carry out our job in the future. We're focusing our thoughts and actions on issues of urgency to investors and the industry. We're listening, and acting on what we hear. We're evolving, transforming and counting on your active involvement in our process.

We're also looking at a future that, while incredibly challenging, is incredibly exciting; rich with possibilities for investors, the capital markets and this industry. The securities business is essential to the success of the country, and to the ability of Americans to retire and live more secure and fulfilling lives in retirement. By uniting with NYSE Member Regulation, and working with other regulators and the investment community, we have the opportunity and the responsibility to help regulation evolve to preserve the preeminence of the U.S. capital markets while safeguarding the interests of investors.

Mary L. Schapiro

Mary L. Schapiro
Chairman and Chief Executive Officer

Key Facts about 2006

INVESTOR PROTECTION

The **NASD Investor Education Foundation** awarded $3.4 million in 2006 for programs and research targeting underserved segments of the investing population—such as the military community. To date, the Foundation has approved nearly $8.3 million in grants and an additional $10.2 million in direct investor education programming.

- NASD staff conducted 25 investor education forums to nearly 4,600 participants in 19 military duty stations worldwide; service and family members in all branches of the armed services.
- In 2006, NASD also created and presented a unique Military Spouse Fellowship Program to help military spouses earn Accredited Financial Counselor℠ status. Eighty-two percent have changed their own saving and investing habits since joining.

NASD BrokerCheck is a free online tool to help investors and the industry check the professional background of current and former NASD-registered securities firms and brokers.

- In 2006, NASD's BrokerCheck service produced more than 5.2 million search matches for existing brokers or firms, generated 189,000 reports and responded to 62,253 calls from investors.

NASD Jurisdiction

- 658,173 registered representatives
- 5,029 securities firms

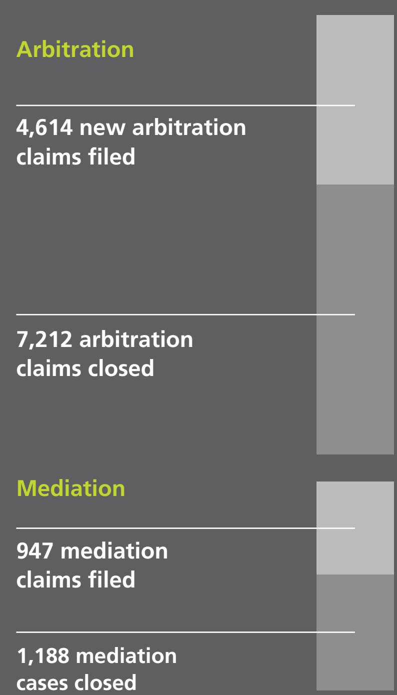
Regulatory Actions

Regulation by NASD is required by law for all securities firms selling financial products to the U.S. public.

- 394 individuals barred
- 352 individuals suspended
- 15 firms expelled
- 4 firms suspended
- 1,204 new disciplinary actions filed
- 1,147 formal actions resolved

Dispute Resolution

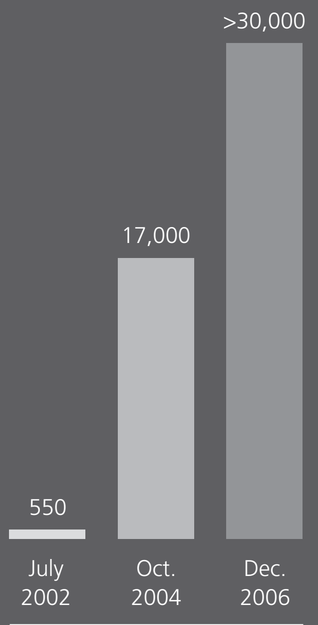
NASD operates the largest dispute resolution forum in the securities industry to assist in the resolution of monetary and business disputes between and among investors, securities firms and individual registered representatives.



TRACE

First introduced in 2002, TRACE (Trade Reporting and Compliance Engine) now disseminates more than 30,000 publicly traded bond issues. All NASD member firms have an obligation to report transactions in corporate bonds to TRACE under an SEC-approved set of rules.

- 19,822 average daily transactions representing nearly $17 billion in volume



Approximate number of publicly traded corporate bond issues disseminated by TRACE

Market Regulation

NASD regulates trading on NASDAQ, the American Stock Exchange, OTC Equities, the corporate bond market and the International Securities Exchange. In 2006, NASD monitored more than 401 million quotes, orders and trades each day.

MARKET INTEGRITY

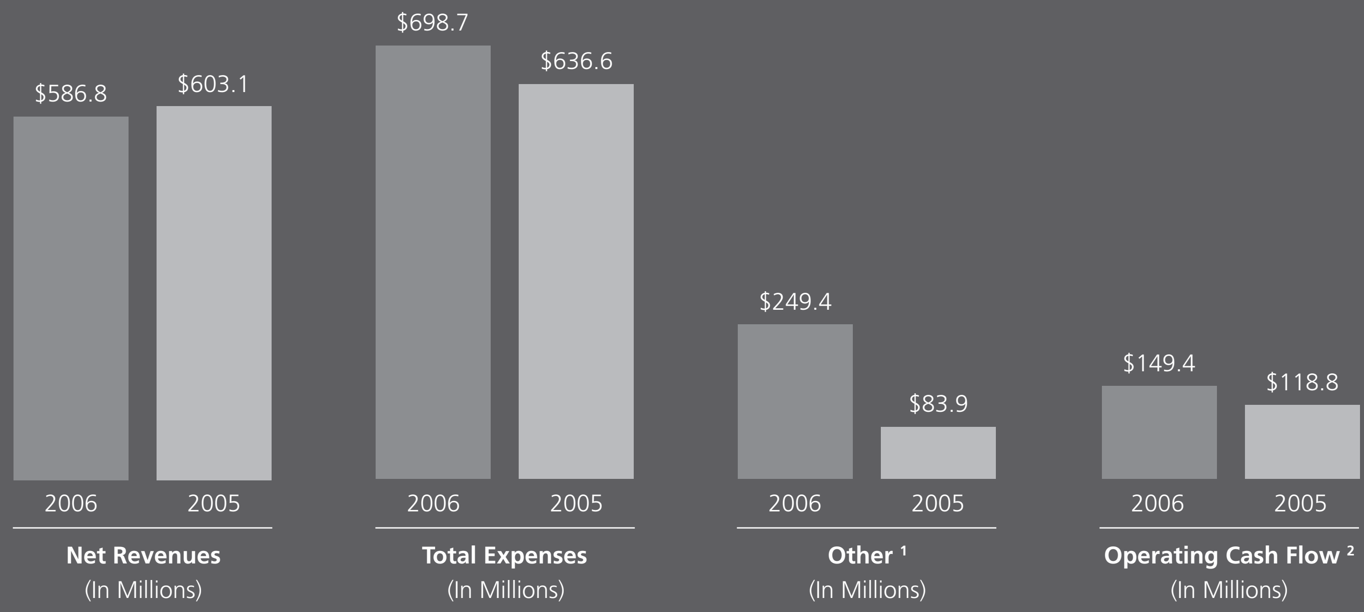
We have invested significant energy and resources into developing a wide range of **NASD Educational Programs** to assist the industry in meeting its compliance and regulatory obligations.

- In 2006, NASD introduced *What to Expect,* a webcast series aimed at taking the mystery out of key regulatory processes for compliance professionals, operations staff and branch managers. NASD also offers a no-cost webcast series for frontline staff, which received 82,585 views in 2006.
- NASD introduced a podcast series in 2006, covering compliance topics, updates and selected executive speeches. To date, 23 podcasts have been released.

NASD's Liaison Program designates a specific point of contact for all securities firms to make sure they get answers to their NASD-related questions.

- NASD completed a full rollout of its Liaison Program in 2006. By year-end, NASD Liaisons logged more than 13,000 calls and emails to and from member firms.
- During 2006, more than 70 percent of NASD member firms contacted their NASD Liaison directly with questions.

Financial Summary



1 "Other" includes interest and dividend income, realized investment gains, mark-to-market gain on trading securities and equity earnings from other investments

2 Represents operating cash flow from continuing operations

NASD TOTAL REVENUES BY YEAR (IN MILLIONS)

	YEARS ENDED DECEMBER 31,	
	2006	**2005**
Regulatory fees	$222.0	$ 185.4
User fees	158.7	145.3
Dispute resolution fees	55.7	72.9
Transparency service fees	43.6	22.8
Contract service fees	27.2	22.6
Other fees	4.4	7.2
Total operating revenues	511.6	456.2
Fines	75.0	148.5
Activity assessment	185.0	147.8
Total revenues	771.6	752.5
Cost of revenues	(184.8)	(149.4)
Net revenues	$586.8	$ 603.1

Management Report on Financial Operations

OVERVIEW

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

The following discussion and analysis of financial condition and results of operations should be read in connection with the consolidated financial statements and notes thereto, included elsewhere in this Annual Financial Report. The 2006 consolidated financial statements reflect the activities of NASD and its consolidated subsidiaries, primarily NASD Regulation, Inc. (NASDR), NASD Dispute Resolution, Inc. (NASD DR), and NASD Investor Education Foundation (the Foundation) as of and for the years ended December 31, 2006, and December 31, 2005, and NASD's ownership interest in the operations and cash flows of The Nasdaq Stock Market, Inc. (NASDAQ) prior to December 20, 2006, collectively referred to as "the Company."

2006 YEAR IN REVIEW

2006 was a landmark year for NASD, as we strengthened our financial position and took steps to expand our role, jointly with NYSE Regulation, Inc., as the leading private-sector provider of financial regulatory services.

In 2006, NASDAQ redeemed the remaining Series C Cumulative Preferred Stock from NASD, and NASD sold all remaining shares of NASDAQ's common stock. On December 20, 2006, NASDAQ redeemed the only outstanding share of Series D Preferred Stock, which previously provided NASD with voting control over NASDAQ. After the redemption, NASD ceased consolidating NASDAQ operations.

On November 28, 2006, NASD signed a non-binding term sheet with NYSE Group, Inc. (NYSE) to consolidate member regulation, related enforcement, and dispute resolution operations into a new self-regulatory organization (SRO) that will be the sole private-sector regulator for all 5,100 securities brokers and dealers doing business with the public in the United States. The new SRO, with nearly 3,000 staff, will bring together all of NASD and NYSE's member firm examination and related enforcement functions, arbitration and risk assessment, as well as other current responsibilities, including transparency facilities and market regulation by contract for NASDAQ, the American Stock Exchange (Amex), and the International Securities Exchange. On January 21, 2007, NASD announced that NASD member firms voted to approve the By-Law changes needed for the planned consolidation. The Company expects that the transaction will close during the second quarter of 2007.

For the years ended December 31, 2006, and December 31, 2005, the Company's consolidated net income was \$557.4 million and \$302.4 million, respectively. Included in net income for the years ended December 31, 2006, and December 31, 2005, was income from the discontinued operations of NASDAQ of \$419.8 million and \$252.0 million, respectively. Income from continuing NASD operations for the years ended December 31, 2006, and December 31, 2005, was \$137.7 million and \$50.4 million, respectively.

RESULTS OF OPERATIONS

REVENUES

The following table sets forth consolidated revenues by category for the years ended December 31, 2006, and December 31, 2005.

	YEARS ENDED DECEMBER 31,	
	2006	2005
	(in millions)	
Revenues		
Regulatory fees	$ 222.0	$ 185.4
User fees	158.7	145.3
Dispute resolution fees	55.7	72.9
Transparency services fees	43.6	22.8
Contract services fees	27.2	22.6
Other	4.4	7.2
Total operating revenues	511.6	456.2
Fines	75.0	148.5
Activity assessment	185.0	147.8
Total revenues	771.6	752.5
Activity assessment cost of revenues	(184.8)	(149.4)
Net revenues	$ 586.8	$ 603.1

NASD's operating revenues were $511.6 million in 2006, compared with $456.2 million in 2005—an increase of $55.4 million, or 12.1 percent, led mainly by higher regulatory, user and transparency services revenues offset by lower dispute resolution fees.

Regulatory fees fund NASD's member regulatory activities, including the supervision and regulation of members through examinations, financial monitoring, policy, rulemaking, interpretative, and enforcement activities. Regulatory fees include the transaction-based Trading Activity Fee, as well as assessments based on member firm gross revenue (Gross Income Assessment), registered representatives and branch offices. Regulatory fees were $222.0 million in 2006, compared with $185.4 million in 2005, an increase of $36.6 million, or 19.7 percent, due to increases in Trading Activity Fees, and an increase in the gross income (FOCUS revenues) used to bill the Gross Income Assessment. Trading Activity Fees increased by $14.8 million due to increased trading volumes across NASDAQ and Amex from 2005 to 2006. The Gross Income Assessment increased by $15.7 million over the prior year, driven by an increase in reported FOCUS revenues. In addition, Branch Office Assessment fees increased by $5.5 million over the prior year. With NASD's overall solid financial performance, NASD issued rebates to its membership of $50.0 million in both 2006 and 2005. NASD recorded these rebates as a reduction of Regulatory fees.

User fees include fees charged for initial and annual registrations, qualifications exams, fees associated with NASD-sponsored educational programs and conferences, processing of membership applications, and charges related to the review of advertisements and corporate financing filings. User fees were $158.7 million in 2006, compared with $145.3 million in 2005—an increase of $13.4 million, or 9.2 percent, due to an increase in continuing education volume as well as increases in branch office processing and Investment Adviser Registration Depository (IARD) fees.

Dispute resolution fees represent fees earned during the arbitration and mediation processes. Dispute resolution fees totaled $55.7 million in 2006 compared with $72.9 million in 2005—a decrease of $17.2 million, or 23.6 percent. Driving this decrease was a 24.0 percent decline in the number of new cases filed from 6,074 in 2005 to 4,614 in 2006, coupled with a 20.0 percent decrease in closed cases. Dispute resolution fees also include mediation fees, SRO annual fees, neutral training fees, and other fees, which together totaled $2.2 million and $2.1 million for the years ended December 31, 2006, and December 31, 2005, respectively. SRO annual fees relate to the maintenance of dispute resolution services, which include arbitration and mediation for SROs. Arbitrator training fees relate to NASD Dispute Resolution's comprehensive arbitrator and mediator application and training program.

Transparency services fees represent amounts charged for services offered through NASD's Trade Reporting and Compliance Engine (TRACE), NASD's Alternative Display Facility (ADF) and, beginning October 1, 2005, fees associated with the Over-the-Counter Bulletin Board (OTCBB) and other OTC Equities, including pink sheets, (together "OTC Equities") businesses. Transparency services fees were $43.6 million in 2006 compared with $22.8 million in 2005—an increase of $20.8 million, or 91.2 percent, due mainly to the full year of ownership of the OTCBB and OTC Equities businesses. On September 2, 2005, NASD executed the OTCBB and OTC Equities Revocation of Delegation and Asset Transfer and Services Agreement with NASDAQ related to the OTC Equities. Under the agreement, effective October 1, 2005, NASD assumed responsibility for the OTCBB and OTC Equities businesses from NASDAQ. NASD has included revenues generated from the OTCBB and OTC Equities businesses within transparency services fees effective with the transfer on October 1, 2005.

Contract services fees represent amounts charged for regulatory services provided primarily to NASDAQ, Amex, the Trade Reporting Facilities, and other exchanges for market watch, surveillance, monitoring, development, legal, and enforcement activities. Contract services fees were $27.2 million in 2006, compared with $22.6 million in 2005—an increase of $4.6 million, or 20.4 percent, due mainly to expanded regulatory services provided to Amex and new contracts for Trade Reporting Facilities and other regulatory bodies. Excluded from contract service fees are regulatory services fees charged to NASDAQ, totaling $33.1 million in 2006 and $40.9 million in 2005, as these amounts were eliminated against income from discontinued operations in consolidation. Beginning in 2007, NASD will no longer eliminate NASDAQ contract service fees, as NASD ceased consolidation of NASDAQ operations effective December 20, 2006.

Other revenues totaled $4.4 million in 2006 compared with $7.2 million in 2005—a decrease of $2.8 million, or 38.9 percent. The decrease is primarily due to the transition from NASD to Amex of the functions charged under Amex shared services. NASD provided certain in-house functions such as accounting resources and systems to Amex totaling $3.9 million from January 2005 through June 2005. In July 2005, Amex fully transitioned these functions from NASD.

Fines represent amounts billed as sanctions for rule violations. NASD does not view fines as part of its operating revenues. Fines revenues totaled $75.0 million in 2006 and $148.5 million in 2005—a decrease of $73.5 million, or 49.5 percent. Cash collections from fines were $84.9 million in 2006, compared with $134.3 million in 2005. The process that NASD has in place regarding the use of fines is designed to guard against potential conflicts in the organization's collection and use of fine monies. NASD's fine guidelines provide that:

1) All fine monies are collected and segregated from NASD revenues into a separate account;
2) Fine monies collected or anticipated are not included in NASD operating revenues and play no role in developing its operating budget;
3) Fine monies are not used to fund employee compensation;
4) The use of fine monies is limited to expenditures on regulatory capital purchases and strategic initiatives; and
5) NASD reports to its Board of Governors the projects and purposes for which it has used fine monies.

Activity assessment revenues represent amounts billed to NASD members to cover NASD's obligation to the Securities and Exchange Commission (SEC) under Section 31 of the Securities Exchange Act of 1934. Activity assessment cost of revenues represent the amounts owed and remitted to the SEC under this obligation. Activity assessment revenues were $185.0 million in 2006, compared to $147.8 million in 2005—an increase of $37.2 million, or 25.2 percent. Activity assessment cost of revenues was $184.8 million in 2006, compared to $149.4 million in 2005—an increase of $35.4 million, or 23.7 percent. An increase in the dollar volume of contracts traded, offset by a rate reduction late in 2005, drove the increase in both activity assessment revenues and activity assessment cost of revenues. NASD has reclassified Section 31 activity fees generated on NASDAQ markets from activity assessment revenues and activity assessment cost of revenues to income from discontinued operations.

EXPENSES

The following table sets forth consolidated operating expenses by category for the years ended December 31, 2006, and December 31, 2005.

	YEARS ENDED DECEMBER 31, 2006	YEARS ENDED DECEMBER 31, 2005
	(in millions)	
Operating expenses		
Compensation and benefits	$ 395.1	$ 351.6
Professional and contract services	148.4	134.4
Computer operations and data communications	26.2	24.3
Depreciation and amortization	36.1	37.6
Occupancy	30.3	28.3
General and administrative	62.6	60.4
Total operating expenses	$ 698.7	$ 636.6

NASD's total expenses were $698.7 million in 2006, compared to $636.6 million in 2005—an increase of $62.1 million, or 9.8 percent.

Compensation and benefits increased to $395.1 million in 2006 from $351.6 million in 2005, an increase of $43.5 million, or 12.4 percent. This was primarily due to employee benefit cost increases, higher incentive compensation, and annual merit and promotion increases. Increased employee benefit costs were primarily attributable to changes in the assumptions used to calculate the costs associated with the Company's defined benefit pension plans, as well as annual increases in health care premiums.

Professional and contract services increased to $148.4 million in 2006, from $134.4 million in 2005, an increase of $14.0 million or 10.4 percent, primarily due to the transfer of ownership of the OTCBB and OTC Equities businesses from NASDAQ to NASD in October 2005, and an increase in spending on technology related initiatives. Application maintenance charges increased by $15.3 million due mainly to the addition of the OTCBB and OTC Equities businesses and additional maintenance activities on NASD's PROCTOR testing program. Offsetting these increases were declines in Sarbanes-Oxley Section 404 implementation costs and other miscellaneous expenses. Excluded from professional and contract services are consolidating expense adjustments, totaling $16.3 million in 2006 and $7.7 million in 2005, which represent the elimination of charges associated with the operation of TRACE and the OTCBB and OTC Equities businesses by NASDAQ on behalf of NASD. NASD has eliminated these amounts against income from discontinued operations in consolidation. Beginning in 2007, NASD will no longer eliminate NASDAQ contract service fees and shared facilities expenses, as NASD ceased consolidation of NASDAQ operations effective December 20, 2006.

Computer operations and data communications expense, depreciation and amortization expense, occupancy, and general and administrative expense remained consistent with prior year expenditures totaling to $155.2 million in 2006 in comparison to $150.6 million in 2005, an increase of $4.6 million, or 3.1 percent.

INTEREST AND DIVIDEND INCOME

Interest and dividend income primarily reflects income earned on NASD's operating cash accounts, as well as interest income generated on NASD's investments in auction rate securities and fixed income securities. Interest and dividend income totaled $77.3 million in 2006, compared with $52.2 million in 2005, an increase of $25.1 million, or 48.1 percent, due mainly to income generated on additional proceeds received from the sale of NASDAQ common stock. Interest and dividend income excludes dividends on NASDAQ preferred stock of $0.7 million and $6.6 million for the years ended December 31, 2006 and 2005, respectively. NASD will not earn these dividends in future periods because NASDAQ redeemed the preferred stock in 2006.

OTHER INCOME, NET

The following table sets forth consolidated other income by category for the years ended December 31, 2006, and December 31, 2005.

	YEARS ENDED DECEMBER 31, 2006	2005
	(in millions)	
Other income, net		
Net realized investment gains	$ 57.8	$ 13.9
Net mark-to-market gain on trading securities	73.7	–
Equity earnings from other investments	40.6	17.8
Total other income, net	$ 172.1	$ 31.7

NASD utilizes returns on its investment portfolio to support its current operations. Included in "other income, net" in the consolidated income statements are net realized gains and losses on sales of available-for-sale and trading securities, mark-to-market adjustments on NASD's trading portfolio, and equity in earnings on NASD's equity method investments, totaling $172.1 million in 2006, compared with $31.7 million in 2005. This increase year-over-year is mainly due to the increased size of the portfolio from the investment of the proceeds generated on the disposition of NASDAQ common stock. Gains on the sale of NASDAQ common stock by NASD and mark-to-market gains on NASDAQ warrants have been reclassified to income from discontinued operations. These amounts, totaling $399.1 million in 2006 and $203.8 million in 2005, are one-time events related specifically to the entity being disposed, and will not continue in NASD operations in future years.

PROVISION FOR INCOME TAXES

NASD, NASDR, and NASD 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). The financial statements present taxes associated with NASDAQ's discontinued operations within "income from discontinued operations" in the consolidated statements of income.

DISCONTINUED OPERATIONS

On December 20, 2006, NASDAQ redeemed the one outstanding share of Series D Preferred stock from NASD, eliminating NASD's voting control over NASDAQ, and NASD ceased consolidation of NASDAQ operations. Discontinued operations in the Company's consolidated statements reflect the results of operations from NASDAQ through December 20, 2006, net of minority interests, and net of the elimination of activity between NASD and NASDAQ through the disposal date. Also included in income from discontinued operations are net gains on the sales of NASDAQ stock by NASD and mark-to-market adjustments on the warrants (to purchase NASDAQ stock) that expired on June 27, 2006. These amounts represent transactions specifically related to the entity being disposed, which will not be part of NASD operations going forward. Finally, amounts NASD processed and recorded through activity assessments and activity assessment cost of revenues under Section 31 of the Securities Exchange Act of 1934 have been adjusted to eliminate transactions that were generated through NASDAQ markets in 2006 and 2005, and will no longer continue in NASD operations in 2007.

The following table provides a summary presentation of net income from the discontinued operations for the years ended December 31:

	2006	2005
	(in millions)	
NASDAQ, net of tax and minority interest:		
Net income	$ 127.9	$ 61.7
Minority interest in NASDAQ	(124.0)	(43.5)
Subtotal	3.9	18.2
Consolidating adjustments:		
Intercompany eliminations	$ 16.8	$ 29.7
Gains on sales of NASDAQ stock	215.9	383.9
Warrants mark-to-market and expiration	183.2	(180.1)
Other	–	0.3
Subtotal	415.9	233.8
Income from discontinued operations	$ 419.8	$ 252.0

LIQUIDITY AND CAPITAL RESOURCES

NASD developed its investment policy based on best practices as applied to its investment objectives. The NASD 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, guidelines, and allocation for these investments. In July 2006, NASD established an internal investment office to support the Investment Committee. *See* separate Investment Committee Report contained elsewhere in the 2006 Annual Financial Report for further discussion of liquidity and capital resources.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT RISK

Market risk represents the risks of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates, equity prices, and other factors. As of December 31, 2006, investments in the Company's consolidated financial statements consist of auction rate securities, U.S. Treasury securities, obligations of government-sponsored enterprises, U.S. corporate debt securities, obligations of states and political subdivisions, debt securities issued by foreign governments, asset-backed securities, equity securities, mutual funds, commingled funds, exchange traded funds, hedge funds, hedge funds of funds, private investments, and other financial instruments.

The Company's primary market risk relates to its investment portfolio. The Company's investments are impacted by fluctuations in the equities markets, interest rates, and inflation.

NASD's investment portfolio contains fixed income securities that have a duration, or weighted-average maturity of cash flows, of approximately 3.7 years as of December 31, 2006. Duration is a measure of the sensitivity of a fixed income portfolio to a change in interest rates; i.e., for every 100-basis-point change in interest rates, a portfolio with a duration of 3.7 years is expected to change inversely by 3.7 percent. NASD believes that any decline in the value of its fixed income securities due to a 100-basis-point increase in interest rates should be largely offset by the portfolio's yield of approximately 5.3 percent.

NASD has foreign currency exposure on its available-for-sale, trading, and other investments. NASD captures changes in the market value of its trading and equity method investments from foreign currency fluctuations in the consolidated statements of income. Changes in the market value of available-for-sale investments are recorded through unrealized gain (loss) in other comprehensive income. Cost method investments are analyzed for other-than-temporary impairment.

NASD management believes that other-than-temporary fluctuations in market indices could have a significant impact on its investment portfolio, earnings, and cash flows. NASD reviews its investment portfolio for other-than-temporary declines on a quarterly basis. Based on these reviews, NASD recorded impairment charges for other-than-temporary declines of $31.2 million and $23.8 million in 2006 and 2005, respectively, primarily related to its investments in separately-managed accounts (SMAs). In

July 2006, NASD re-designated its investments in SMAs from available-for-sale (AFS) to trading. With the re-designation of NASD's investments in SMAs from AFS to trading, NASD captures fluctuations in the market value of those investments in the consolidated statements of income as mark-to-market gains and losses on trading securities. NASD relies on market value estimates for its investments in hedge funds, hedge funds of funds, and private investments. In relying on this information NASD reviews current financial statements and obtains annual audited statements from each fund. NASD also reviews valuation procedures for the funds and employs an investment consultant to assist in tracking portfolio performance.

NASD's investment policy allows for investments in derivative instruments, including options, interest rate swaps, and futures contracts. As of December 31, 2006 and 2005, NASD's investments in such instruments were not material to the consolidated financial statements.

NASD is exposed to credit risk from third parties, including NASDAQ, Amex and NASD members. These parties may default on obligations to NASD due to bankruptcy, lack of liquidity, operational failure, or other reasons. In addition, NASD has a revolving credit facility receivable from Amex for $25.0 million as of December 31, 2006. This revolving credit facility accrues interest at a fixed rate of 5.0 percent, and both interest and principal are due in October 2011. NASD performed a valuation of this revolving credit facility on the date of issuance, and estimated its fair market value to be $16.4 million, representing the net realizable value using a market rate of interest of 11.2 percent. Interest is recognized using the effective interest method. For the years ended December 31, 2006 and 2005, $2.0 million and $1.6 million, respectively, which represent interest on the note and accretion of the discount, are included in interest and dividend income in the consolidated statements of income. As of December 31, 2006, the estimated fair value of the receivable was $20.0 million.

CASH FLOWS

NASD primarily relies on operating cash flows, which include returns on its investment portfolio, to provide for current and future operations. See the table below for a summary of cash flows from continuing and discontinued operations:

	YEARS ENDED DECEMBER 31,					
	2006			2005		
	Continuing	Discontinued Operations	Total	Continuing	Discontinued Operations	Total
			(in millions)			
Operating	$ 149.4	$ 80.6	$ 230.0	$ 118.8	$ 41.3	$ 160.1
Investing	(729.8)	(931.5)	(1,661.3)	(517.5)	(567.9)	(1,085.4)
Financing	49.7	1,335.1	1,384.8	6.2	982.9	989.1
Total	$ (530.7)	$ 484.2	$ (46.5)	$ (392.5)	$ 456.3	$ 63.8

NASD generated cash inflows from operating activities of continuing operations of $149.4 million, compared with $118.8 million in the prior year. NASD incurred investing cash outflows from continuing operations of $729.8 million in 2006 and $517.5 million in 2005, investing the majority of the proceeds generated from the sales of NASDAQ common stock and exercise of warrants. Cash flows from financing activities of continuing operations were $49.7 million in 2006 and $6.2 million in 2005 due to contributions to the Foundation from external parties.

Overall cash and cash equivalents, trading investments, and available-for-sale investments totaled $2,049.8 million as of December 31, 2006, compared with $1,529.8 million as of December 31, 2005—an increase of $520.0 million, or 34.0 percent. This increase was primarily due to the receipt of $176.3 million associated with the sales of NASDAQ common stock, $166.7 million from the exercise of warrants, and $104.7 million from NASDAQ for the redemption of the Series C Cumulative Preferred Stock. Further contributing to this increase was income from continuing operations of $137.7 million offset by capital expenditures of $41.7 million.

NASD's working capital was $1,834.9 million as of December 31, 2006, and $1,306.8 million as of December 31, 2005. NASD has been able to generate sufficient funds from operations to meet working capital requirements. NASD has a line of credit of up to $50.0 million that has a variable interest rate; however, as of December 31, 2006 and 2005, no amounts were outstanding under this credit agreement. NASD believes that the liquidity provided by existing cash and cash equivalents, investments, and cash generated from operations would provide sufficient capital to meet current and future operating requirements.

CONTRACTUAL OBLIGATIONS AND CONTINGENT COMMITMENTS

NASD has contractual obligations to make future payments under investments in limited partnerships, 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)		
Commitments to investments in limited partnerships	$ 157.4	$ 49.2	$ 74.0	$ 27.6	$ 6.6
Minimum rental commitments under non-cancelable operating leases, net	193.5	17.2	35.0	35.3	106.0
Information and technology services agreement	111.0	21.0	39.0	35.0	16.0
Total	$ 461.9	$ 87.4	$ 148.0	$ 97.9	$ 128.6

Investments in limited partnerships represent the expected funding of NASD's total commitment to 16 investments in limited partnerships. The majority of the non-cancelable operating leases contain escalation clauses based on increases in property taxes and building operating costs. Information and technology services agreement commitments relate to NASD's agreement with EDS and the minimum annual spending requirements under that agreement. EDS provides application development and maintenance services to NASD under that agreement, which expires on December 31, 2012.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

INVESTMENTS

Investments in Debt and Marketable Equity Securities

NASD accounts for its investments in debt and marketable equity securities in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which requires that, at the time of purchase, individual securities be classified as trading, available-for-sale, or held-to-maturity based on the Company's intent and ability to hold these securities. Such designations are re-evaluated annually. NASD has designated its 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 realized gain (loss) in the consolidated statements of income. NASD records available-for-sale securities at fair value, and records changes in fair value as an unrealized gain (loss) as a component of equity in the consolidated balance sheets.

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

The Company regularly monitors and evaluates the realizable value of its securities portfolio. When assessing for other-than-temporary declines in value, the Company considers such factors as:

- intent and ability to hold,
- the extent of the decline in value,
- the duration for which the market value was less than cost,
- the performance of the investee's stock price in relation to the stock price of its competitors within the industry and the market in general,
- any information that has been released specific to the investee, and
- the outlook for the overall industry in which the investee operates.

The Company also reviews the financial statements of the investee to determine if the investee is experiencing financial difficulties. If events and circumstances indicate that a decline in the value of these assets has occurred, and NASD deems that the decline is other-than-temporary, it reduces the carrying value of the security to its fair value and charges the impairment to earnings.

Other Investments

NASD is a limited partner in several private investment funds. NASD accounts for investments in private investment limited partnerships under the cost or equity method in accordance with Emerging Issues Task Force (EITF) No. D-46, "Accounting for Limited Partnership Investments," which states the SEC staff's current position that such investments be accounted for pursuant to the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 78-9, "Accounting for Investments in Real Estate Ventures." NASD also has investments in hedge funds and hedge funds of funds. NASD accounts for these investments under the equity method consistent with common industry practice. NASD has retained the specialized accounting for its other investments pursuant to EITF Issue No. 85-12, "Retention of Specialized Accounting for Investments in Consolidation." NASD relies on market value estimates from fund managers to determine fair values for investments in private equity investments, hedge funds, and hedge funds of funds, and challenges those values through the review of audited and unaudited financial information. In addition, NASD performs certain other procedures related to the valuation of these funds, and assesses NASD's cost based investments for impairment.

REVENUE RECOGNITION AND COST OF REVENUE

Regulatory Fees

Regulatory fees represent fees to fund NASD's member regulatory activities, including the supervision and regulation of members through examinations, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. Regulatory fees are recorded net of any member rebates. Regulatory fees include the Trading Activity Fee, Gross Income Assessment, Personnel Assessment, and Branch Office Assessment. The Trading Activity Fee is assessed on the sell side of all member transactions in all covered securities regardless of where the trade is executed, and is assessed directly to the firm responsible for clearing the transaction on behalf of the member firm. The Trading Activity Fee is self-reported to NASD by the firms and is recognized as the transaction occurs. Due to the Trading Activity Fee being a self-reported revenue stream for NASD, subsequent adjustments by firms of their trading activity fee obligations may occur and are recognized as an adjustment to revenue in the period the adjustment becomes known to NASD. The Gross Income Assessment, Personnel Assessment, and Branch Office Assessment represent annual fees charged to member firms and representatives. NASD recognizes these fees ratably over the annual period to which they relate.

User Fees

User fees consist of fees charged for initial and annual registrations, qualification exams, NASD-sponsored educational programs and conferences, processing of membership applications, and reviews of advertisements and corporate filings. Registration fees include both initial and annual fees charged to all NASD-registered representatives. The initial fee is recognized over the estimated customer relationship period and the annual fee over the related annual period. Qualification fees consist of examination and continuing education fees. Qualification fees are recognized as examinations or continuing education programs are administered. Advertising fees represent fees charged for the review of NASD member firms' communications to ensure that they are fair, balanced, and not misleading. Advertising fees are recognized as revenue as the review is completed. Corporate financing fees consist of fees charged by NASD for reviewing proposed public offerings; thus, NASD recognizes these fees when it completes the review.

Dispute Resolution Fees

Dispute resolution fees consist of fees earned during the arbitration and mediation processes. Fees on open cases are recognized as revenue over the average life of a case. Upon the closing of a case, a final billing is prepared and any unpaid fees are recognized as revenue at that time. Dispute resolution fees also include mediation fees, SRO annual fees, neutral training fees, and other fees. SRO annual fees relate to the maintenance of dispute resolution services, including arbitration and mediation, for SROs. Arbitrator training fees relate to NASD DR's comprehensive arbitrator and mediator application and training program. These fees are recognized either when the cash is received or when the service is provided.

Transparency Services

Transparency services fees represent fees charged for the Corporate Debt, OTCBB, OTC Equities, and ADF businesses. Corporate Debt fees include market data fees as well as fees charged on secondary market transactions in eligible fixed income securities reported to NASD. ADF fees include market data fees as well as fees for posting quotes and for reporting and comparing trades. The OTC Equities, including OTCBB, provides an electronic screen-based quotation service for securities that, among other things, are not listed on The NASDAQ Stock Market or any U.S. national securities exchange. In addition, it displays real-time quotes, last-sale prices, and volume information in OTC equity securities. NASD recognizes transparency services fees as the transactions occur.

Contract Services Fees

Contract services fees represent amounts charged by NASDR for regulatory services provided under contractual arrangements. NASD recognizes this revenue as it provides the regulatory service.

Activity Assessment

NASD, as a self-regulatory organization (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 cover costs incurred by the government for supervising and regulating securities markets and securities professionals, and are based on a percentage of the total dollar value of securities sold through the ADF and the OTC securities markets. NASD remits these fees to the U.S. Treasury semiannually, in March and September.

NASD recovers the cost of the SEC's fees and assessments through an activity assessment billed to securities firms based on the total dollar value of securities sold through the ADF and the OTC securities markets. The assessments billed to securities firms are recognized when the transactions are reported. Prior to automation in December 2006, the activity assessments for certain transactions in the OTC securities markets were self-reported to NASD. Given the nature of these transactions, subsequent adjustments by firms of their self-reported transactions may occur and resulting activity assessments are recognized in the period reported to NASD. NASD, as the primary obligor to the SEC, reports the activity assessment on a gross basis within revenues in accordance with EITF No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent." NASD reports the amounts due to the SEC as an activity assessment cost of revenue.

Fines

Fines represent sanctions for rule violations. NASD recognizes fines upon assessment.

PENSION BENEFITS

As of December 31, 2006 and 2005, the Company provided two non-contributory defined benefit pension plans for the benefit of eligible employees of its subsidiaries. The non-contributory defined benefit plans consist of a funded Employee Retirement Plan and an unfunded Supplemental Executive Retirement Plan. Several statistical and other factors, which attempt to anticipate future events, are used in calculating the expenses and liability related to the plans. Key factors include assumptions about the expected rates of return on plan assets and discount rates as determined by the Company, within certain guidelines. The Company considers market conditions, including changes in investment returns and interest rates, in making these assumptions. The Company determines the long-term rate of return based on analysis of historical and projected returns as prepared by the Company's actuary and external investment consultant. The discount rate used in the calculations is tracked to changes in Moody's Aa bond ratings. The Company's Pension Plan Committee approves both the expected long-term rate of return and the discount rate assumptions.

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

On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS No. 158 requires the Company to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans and its post-retirement plan in the December 31, 2006 consolidated balance sheet, with a corresponding adjustment to accumulated other comprehensive income. The adjustment to accumulated other comprehensive income at adoption represents the net unrecognized actuarial losses, unrecognized prior service costs, and unrecognized transition asset, all of which were previously netted against the plan's funded status in the Company's consolidated balance sheets, pursuant to the provisions of SFAS No. 87, "Employers' Accounting for Pensions." NASD will subsequently recognize these amounts as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, NASD will recognize actuarial gains and losses that arise in subsequent periods, that it does not recognize as net periodic benefit cost in the same periods, as a component of other comprehensive income. The Company will subsequently recognize those amounts as a component of net periodic benefit cost on the same basis as it recognizes the amounts in accumulated other comprehensive income at adoption of SFAS No. 158.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for the Company on January 1, 2008. The Company is currently evaluating the potential impact of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value and expands the use of fair value measurement. SFAS No. 159 is effective for the Company on January 1, 2008. The Company is currently evaluating the potential impact of adopting SFAS No. 159.

Management Report on Internal Control Over Financial Reporting

NASD 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 (GAAP) and include amounts based on management's estimates and judgments. NASD 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 GAAP.

NASD 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. NASD'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 NASD's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of NASD are being made only in accordance with authorizations of NASD's management and governors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of NASD'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 Chief Executive Officer and Chief Financial Officer, NASD's management assessed the effectiveness of NASD's internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 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 NASD maintained effective internal control over financial reporting as of December 31, 2006.

NASD's financial statements included in this annual report have been audited by Ernst & Young LLP, an independent registered accounting firm. Ernst & Young LLP has also issued an attestation report on management's assessment of NASD's internal control over financial reporting as of December 31, 2006.

Mary L. Schapiro

Mary L. Schapiro
Chairman and CEO

Todd T. Diganci
Executive Vice President and CFO

Certification for 2006 Annual Financial Report

We, Mary L. Schapiro and Todd T. Diganci, certify that:

1. We have reviewed this annual financial report of the National Association of Securities Dealers, Inc. (NASD);

2. The purpose of this report is principally to set forth management's report on financial operations with respect to NASD during the year ended December 31, 2006, together with the consolidated financial statements of NASD as of and for the years ended December 31, 2006 and 2005. 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 to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

4. Based on our knowledge, the financial statements and other financial information set forth under the caption "Management Report on Financial Operations" fairly present, in all material respects, the financial condition, results of operations, and cash flows of NASD as of, and for, the periods presented in this report;

5. NASD has established disclosure controls and procedures to ensure that material information relating to NASD, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

6. NASD has 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. NASD has carried out its evaluation of the effectiveness of the design and operation of NASD's disclosure controls and procedures as of December 31, 2006. Based upon that evaluation, we have concluded that the disclosure controls and procedures are effective;

8. We have disclosed, based on NASD's most recent evaluation of internal control over financial reporting, to NASD's auditors and the Audit Committee of NASD's Board of 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 NASD's ability to record, process, summarize, and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in NASD's internal control over financial reporting.

Date: April 18, 2007

Mary L. Schapiro
Chairman and CEO

Todd T. Diganci
Executive Vice President and CFO

Audit Committee Report

In accordance with its written Charter adopted by the Board of Governors, the Audit Committee of the Board of Governors assists the Board in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing, and financial reporting practices of NASD. Each member of the Committee is an independent director as defined by SEC Rule 10A-3 under The Securities Exchange Act of 1934, Listing Standards Relating to Audit Committees. In addition, the Audit Committee and Board of Governors have determined that James E. Burton and Charles A. Bowsher are audit committee financial experts, as defined by the SEC. The Charter gives the Audit Committee responsibility for monitoring the independence of the independent auditors and recommending the appointment of the independent auditors for approval by the Board of Governors, and makes clear that the independent auditors are accountable to the Audit Committee and the Board of Governors, as representatives of the members and the public. In addition, the Charter and the By-laws of NASD make the Director of Internal Audit directly responsible to the Audit Committee. In all respects, the Charter complies with standards applicable to publicly owned companies. (The Charter for the NASD Audit Committee is available at the following URL: *www.nasd.com/auditcommittee/charter2007*.)

During 2006, the Committee met seven times, with the Committee members having a 91 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 discussed with management, the internal auditors, and the independent auditors the quality and adequacy of NASD's internal controls and the internal audit organization, responsibilities, budget, and staffing.

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

Independent Registered Public Accountant (IRPA) Fees

	NASD (1)	
	2006	2005
Audit services (2)	$1,189,220	$1,348,881
Audit-related services (3)	742,875	192,250
Tax services (4)	44,000	23,470
Total	$1,976,095	$1,564,601

(1) NASD based its fees reported for 2006 and 2005 on fees approved by NASD's Audit Committee as of March 31, 2007 and March 31, 2006, respectively. The 2006 audit services, audit-related services and tax services include estimates to complete the current work in process. NASD has updated 2005 fees from the prior year report to reflect final amounts paid for the 2005 approved services. Since NASD ceased consolidating NASDAQ on December 20, 2006, it has presented NASDAQ as a discontinued operation for the 2006 and 2005 periods. As such, NASD has excluded fees associated with NASDAQ's IRPA from the scope of this Audit Committee Report. NASDAQ, as a separate entity, has its own Audit Committee that separately reviews, approves, and monitors NASDAQ's IRPA fees.

(2) For 2006 and 2005, audit services represent the year-end financial statement audit and the attestation on internal controls under Section 404 of the Sarbanes-Oxley Act of 2002.
(3) Audit-related services in 2006 and 2005 reflect fees associated with special purpose audits and agreed-upon procedures, such as IARD, CRD and the employee benefit plans. In 2006 and 2005, audit-related services also include consultations associated with the planned separation from NASDAQ.
(4) Tax services represent fees related to tax compliance, advice, and planning.

The Audit Committee discussed and reviewed with the independent auditors all communications required by Statement on Auditing Standard No. 61, *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, 2006, management's assessment of the effectiveness of NASD's internal control over financial reporting, and E&Y's report on the financial statements and on NASD's internal controls over financial reporting. Based on those discussions, the Audit Committee recommended to the Board of Governors that NASD's audited financial statements and related reports on internal control be included in the Annual Report for the year ended December 31, 2006.

Members of the Audit Committee:
James E. Burton, Chair
John W. Bachmann
Charles A. Bowsher
Admiral Tyler F. Dedman
Joel Seligman

April 18, 2007

Investment Committee Report

Period Ending December 31, 2006

NASD's investment portfolio is a permanent fund (the Fund) principally created from the proceeds of the sale of NASD's interests in The Nasdaq Stock Market, Inc. The purpose of the Fund is to support NASD's operations for the benefit of investors and member firms and to provide NASD with financial stability to allow it to implement long-range plans in support of its mission. The investment policy of the Fund is to preserve principal, in real terms, while seeking to maximize returns within acceptable levels of risk in a manner consistent with endowment best practices for producing long-term returns. Spending from the Fund will be determined annually by the NASD Board of Governors as part of the operating budget. In addition to the annual distribution to support operations, other strategic and non-recurring distributions may arise subject to prior approval by the Board.

NASD's managed investments realized strong absolute returns in calendar year 2006, generating net investment returns of 12.9 percent (compared to a custom benchmark return of 13.7 percent) and bringing NASD's total managed investments to more than $1.8 billion. Relative performance reflects the fact that the current investment policy was revised in 2005 and will take time to be fully implemented.

	1 Year	2 Years	Since Inception (10/04)
Managed Investments*	12.9%	10.2%	12.7%
Custom Benchmark	13.7%	10.3%	12.9%

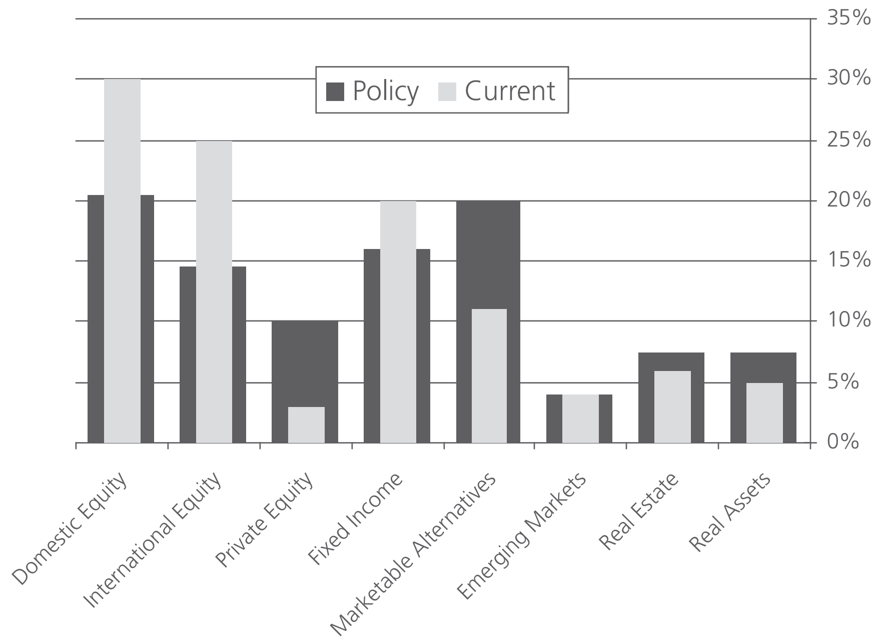
* Excludes cash and cash equivalents, auction rate securities, and private investments.

The NASD Board of Governors is responsible for NASD's investments. In accordance with its written Charter adopted by the Board of Governors, the NASD Investment Committee, comprised of Board members and investment professionals, serves as an advisory committee and provides overall guidance and advice in determining the appropriate policy, guidelines, and allocation for NASD's managed investments. NASD engages investment consultants to support the Investment Committee in the areas of policy and guidelines, and to monitor the performance of the portfolio and investment managers, including selection and evaluation of asset managers. The Investment Committee met six times during 2006.

NASD bases its investment policy on best practices as applied to its investment objectives. The NASD Board of Governors reviews the policy annually and last revised the policy on July 21, 2005. Due to the perpetual nature of the endowment, NASD generally seeks to make long-term investments. NASD also intends 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 current portfolio asset allocation is still in its early stages of allocation, given the recent funding origins.

Asset Allocation



NASD's investment policy guidelines prohibit the purchase of any debt or equity interest in an entity that derives more than 25 percent of its gross revenue from stock exchanges and the combined broker-dealer and/or investment advisory businesses of all its subsidiaries and affiliates. The guidelines also prohibit the purchase of any security during its initial public offering or distribution. Furthermore, the guidelines contain a proxy-voting policy and specify permissible holdings, market capitalization constraints and credit quality standards, as appropriate, for each asset class in the portfolio, all of which are monitored by the Investment Committee. Annually, the Investment Committee reviews the investment policy guidelines to ensure the relevance of its content to current capital market conditions.

During 2006, the NASD Board of Governors approved the creation of the NASD Investments Office. NASD hired its first Chief Investment Officer in October 2006 and expects the Investments Office to execute and support the strategic policies of the investment portfolio, as approved at the Board level.

Members of the Investment Committee:

Sir Brian Corby, Chair
John J. Brennan
James E. Burton
William H. Heyman
Scott C. Malpass
Richard C. Romano

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

BOARD OF GOVERNORS

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

We have audited management's assessment, included in the accompanying *Management Report on Internal Control Over Financial Reporting*, that the National Association of Securities Dealers, Inc. (NASD) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). NASD'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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, 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 directors 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, management's assessment that NASD maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, NASD maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, 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 NASD as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in equity, and cash flows for the years then ended of NASD and our report dated April 18, 2007 expressed an unqualified opinion thereon.

Ernst & Young LLP

McLean, Virginia
April 18, 2007

Report of Independent Registered Public Accounting Firm

BOARD OF GOVERNORS

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

We have audited the accompanying consolidated balance sheets of the National Association of Securities Dealers, Inc. (NASD) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We 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 NASD at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, in 2006 the Company adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of NASD's internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 18, 2007 expressed an unqualified opinion thereon.

Ernst + Young LLP

McLean, Virginia
April 18, 2007

NASD Consolidated Balance Sheets

(DOLLARS IN THOUSANDS)

	December 31, 2006	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 82,941	$ 129,443
Investments		
Trading, at fair value	1,286,785	–
Available-for-sale, at fair value	654,128	1,370,400
Foundation unrestricted available-for-sale, at fair value	22,488	24,059
Foundation restricted available-for-sale, at fair value	3,492	5,911
Receivables, net	118,146	132,391
Due from custodial agent	130,372	2,800
Other current assets	21,077	13,119
Current assets – discontinued operations	–	597,825
Total current assets	2,319,429	2,275,948
Property and equipment		
Land, buildings, and improvements	99,531	93,298
Data processing equipment and software	173,377	168,246
Furniture, equipment and leasehold improvements	104,531	118,728
	377,439	380,272
Less accumulated depreciation and amortization	(226,249)	(233,480)
Total property and equipment, net	151,190	146,792
Revolving credit facility receivable	20,040	18,030
Other investments	345,496	381,629
Other assets	66,953	38,317
Long term assets – discontinued operations	–	1,449,822
Total assets	$ 2,903,108	$ 4,310,538

See accompanying notes.

NASD Consolidated Balance Sheets

(DOLLARS IN THOUSANDS)

	December 31, 2006	December 31, 2005
Liabilities and equity		
Current liabilities		
Accounts payable and accrued expenses	$ 40,979	$ 31,281
Accrued personnel and benefit costs	106,600	121,066
Deferred revenue	69,414	61,051
Deferred contribution income	2,744	–
Deposits and renewals	54,652	55,485
Due to custodial agent	38,965	41,001
Other current liabilities	13,969	14,225
SEC fee payable	157,190	157,176
Current liabilities – discontinued operations	–	487,826
Total current liabilities	484,513	969,111
Accrued pension and other post-retirement benefit costs	126,913	30,750
Deferred revenue	15,925	16,775
Deferred contribution income	52,004	53,115
Other liabilities	38,720	39,637
Non-current liabilities – discontinued operations	–	1,459,919
Total liabilities	718,075	2,569,307
Minority interest in discontinued operations	–	129,967
Commitments and contingencies		
Equity	2,178,415	1,526,318
Unrealized gain on available-for-sale investments	87,975	93,112
Foreign currency translation	–	295
Minimum pension liability	–	(8,461)
Net unrecognized employee benefit plan amounts	(81,357)	–
Total equity	2,185,033	1,611,264
Total liabilities and equity	$ 2,903,108	$ 4,310,538

See accompanying notes.

NASD Consolidated Statements of Income

(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2006	2005
Revenues		
Operating revenues		
Regulatory fees, net of member rebates of $50,000 in both 2006 and 2005	$ 222,020	$ 185,448
User fees	158,677	145,266
Dispute resolution fees	55,660	72,942
Transparency services fees	43,552	22,807
Contract services fees	27,228	22,488
Other	4,443	7,205
Total operating revenues	511,580	456,156
Fines	75,088	148,496
Activity assessment	184,965	147,809
Total revenues	771,633	752,461
Activity assessment cost of revenues	(184,805)	(149,364)
Net revenues	586,828	603,097
Expenses		
Compensation and benefits	395,079	351,564
Professional and contract services	148,396	134,368
Computer operations and data communications	26,156	24,296
Depreciation and amortization	36,092	37,555
Occupancy	30,263	28,307
General and administrative	62,669	60,469
Total expenses	698,655	636,559
Interest and dividend income	77,331	52,206
Operating income	(34,496)	18,744
Other income, net		
Net realized investment gains	57,810	13,880
Net mark-to-market gain on trading securities	73,697	–
Equity earnings from other investments	40,645	17,770
Income from continuing operations	137,656	50,394
Income from discontinued operations (net of tax of $2,605 in 2006 and $13,168 in 2005)	419,779	251,987
Net income	$ 557,435	$ 302,381

See accompanying notes.

NASD Consolidated Statements of Changes in Equity

(DOLLARS IN THOUSANDS)

	Equity	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2005	$ 1,199,924	$ 61,101	$ 1,261,025
Net income	302,381	–	302,381
Unrealized gain on available-for-sale investments, net of tax of ($253), net of minority interests of ($39)	–	24,862	24,862
Foreign currency translation, net of minority interests of $537	–	(693)	(693)
Minimum pension liability, net of tax of $303, net of minority interests of ($1,065)	–	(324)	(324)
Comprehensive income			326,226
Increase in equity attributable to the minority interest in preferred stock dividends, accretion of preferred stock, and distributions to NASD for the NIA	5,673	–	5,673
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of $57,282	17,481	–	17,481
Increase in equity attributable to issuance of warrants by NASDAQ, net of minority interest of $1,870	423	–	423
Increase in equity attributable to amortization of restricted stock awards by NASDAQ, net of minority interest of $922	436	–	436
Balance, December 31, 2005	1,526,318	84,946	1,611,264
Net income	557,435	–	557,435
Unrealized loss on available-for-sale investments	–	(5,137)	(5,137)
Foreign currency translation	–	(295)	(295)
Minimum pension liability	–	4,415	4,415
Comprehensive income			556,418
Adjustment to initially record net unrecognized employee benefit plan amounts	–	(77,311)	(77,311)
Decrease in equity attributable to the minority partners share of Preferred Stock Dividends	577	–	577
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of ($940,583)	94,085	–	94,085
Balance, December 31, 2006	$ 2,178,415	$ 6,618	$ 2,185,033

See accompanying notes.

NASD Consolidated Statements of Cash Flows

(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2006	2005
Reconciliation of net income to cash provided by operating activities		
Net income	$ 557,435	$ 302,381
Net income from discontinued operations	419,779	251,987
Income from continuing operations	$ 137,656	$ 50,394
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation and amortization	36,092	37,555
Net realized gains on investments	(86,153)	(37,654)
Net mark-to-market gain on trading securities	(73,697)	–
Investment impairment charges	31,171	23,774
Equity earnings from other investments	(40,645)	(17,770)
Return on capital from other investments	2,574	–
Gain on sale of DTCC	(2,828)	–
Asset impairment charges	–	1,718
Discount on revolving credit facility receivable from Amex	–	8,589
Bad debt expense	12,322	3,828
Contributions and net investment income temporarily restricted	(772)	(6,900)
Other net non-cash income items	(3,423)	(2,914)
Net change in operating assets and liabilities, net of acquisitions and dispositions		
Receivables, net	1,923	(91,447)
Net sales of trading securities	200,789	–
Amounts due from related parties	–	1,037
Other current assets	(14,783)	(1,055)
Other assets	(76,369)	(8,727)
Accounts payable and accrued expenses	8,676	6,435
Accrued personnel and benefit costs	(14,466)	24,892
Deferred revenue	7,513	(17,398)
Deferred contribution income	1,633	53,115
Deposits and renewals	(833)	(5,117)
SEC fee payable	14	88,901
Other current liabilities	515	(2,496)
Accrued pension and other post-retirement costs	23,267	(1,373)
Other liabilities	(831)	11,446
Net cash provided by continuing operations	149,345	118,833
Cash provided by discontinued operations	80,613	41,286
Net cash provided by operating activities	$ 229,958	$ 160,119

See accompanying notes.

NASD Consolidated Statements of Cash Flows

(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2006	2005
Cash flow from investing activities		
Proceeds from redemptions of available-for-sale investments	$ 1,275,568	$ 2,908,496
Purchases of available-for-sale investments	(1,920,041)	(3,184,765)
Issuance of revolving credit facility to Amex	–	(25,000)
Repayment by Amex of note receivable	–	25,000
Purchases of other investments	(76,041)	(238,376)
Return of capital from other investments	21,067	19,707
Proceeds from the sale of DTCC common stock	3,006	–
Purchases of property and equipment	(41,704)	(22,598)
Proceeds from sales of property and equipment	8,335	–
Cash used in investing activities – continuing operations	(729,810)	(517,536)
Cash used in investing activities – discontinued operations	(931,466)	(567,886)
Net cash used in investing activities	(1,661,276)	(1,085,422)
Cash flow from financing activities		
Change in restricted cash	49,778	–
Contributions and net investment income temporarily restricted	772	6,900
Principal payments on capital leases	(859)	(659)
Cash provided by financing activities – continuing operations	49,691	6,241
Cash provided by financing activities – discontinued operations	1,335,125	982,857
Net cash provided by financing activities	1,384,816	989,098
(Decrease) increase in cash and cash equivalents	(46,502)	63,795
Cash and cash equivalents at beginning of year	129,443	65,648
Cash and cash equivalents at end of year	$ 82,941	$ 129,443

See accompanying notes.

NASD 2006 Notes to Consolidated Financial Statements

1. ORGANIZATION AND NATURE OF OPERATIONS

The National Association of Securities Dealers, Inc. (NASD), a Delaware corporation, wholly owns the following significant subsidiaries: NASD Regulation, Inc. (NASDR), NASD Dispute Resolution, Inc. (NASD DR) and NASD Investor Education Foundation (the Foundation); collectively referred to as the Company.

NASD is the world's leading private-sector provider of financial regulatory services. Through its subsidiary NASDR, NASD regulates the activities of the U.S. securities industry and regulates The NASDAQ Stock Market, Inc. (NASDAQ), the American Stock Exchange LLC (Amex), and the over-the-counter (OTC) securities markets. NASDR carries out NASD's regulatory functions, including onsite examinations of securities firms, continuous automated surveillance of markets operated by NASDAQ and Amex, and disciplinary actions against firms and registered representatives. NASD DR provides arbitration and mediation services to assist in the resolution of monetary and business disputes between and among investors, securities firms and registered representatives. The Foundation is a tax exempt membership corporation incorporated in the State of Delaware with NASD as the sole member. The Foundation provides investors with high quality, easily accessible information and tools to better understand the markets and the basic principles of saving and investing. The Foundation funds innovative research and educational projects aimed at segments of the investing public who could benefit from additional resources.

Prior to December 20, 2006, NASD maintained voting control over NASDAQ through its ownership of the only share of Series D Preferred Stock. On December 20, 2006, NASDAQ redeemed the only share of Series D Preferred Stock that had been issued to NASD. Because of the redemption, NASD no longer maintains voting control over NASDAQ and has ceased consolidating NASDAQ effective December 20, 2006. *See* Note 3, "Discontinued Operations" for additional information.

On November 28, 2006, NASD and NYSE Group, Inc. (NYSE) announced the signing of a letter of intent to consolidate their member regulation, associated enforcement, and dispute resolution operations into a new self-regulatory organization (SRO) that will be the private-sector regulator for all securities brokers and dealers doing business with the public in the U.S. As of December 31, 2006, the transaction is subject to completion of definitive agreements, NASD member vote and regulatory approvals. *See* Note 12, "Subsequent Events."

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of NASD, its wholly-owned subsidiaries and discontinued operations. NASD has eliminated all significant intercompany balances and transactions in consolidation.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

SEGMENTS

The Company operates in two primary business segments, NASD and the Foundation, as defined by Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information." The Foundation does not meet the quantitative thresholds as described in SFAS No. 131 for separate disclosure as a reportable segment. NASD's chief operating decision maker, as defined by SFAS No. 131, is its Chief Executive Officer.

NASD 2006 **Notes to Consolidated Financial Statements**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CASH AND CASH EQUIVALENTS

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

INVESTMENTS

Debt and Marketable Equity Securities

NASD accounts for its investments in debt and marketable equity securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which requires that, at the time of purchase, individual securities be classified as trading, available-for-sale, or held-to-maturity based on the Company's intent and ability to hold these securities. Such designations are re-evaluated annually. NASD has designated its 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 realized gain (loss) in the consolidated statements of income. NASD records available-for-sale securities at fair value, and recognizes changes in fair value as an unrealized gain (loss) as a component of equity in the consolidated balance sheets.

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

The Company regularly monitors and evaluates the realizable value of its securities portfolio. When assessing for other-than-temporary declines in value, the Company considers such factors as intent and ability to hold, the extent of the decline in value, the duration for which the market value was less than cost, the performance of the investee's stock price in relation to the stock price of its competitors within the industry and the market in general, information that has been released specific to the investee, and the outlook for the overall industry in which the investee operates. The Company also reviews the financial statements of the investee to determine if the investee is experiencing financial difficulties. 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 security is reduced to its fair value and the impairment is charged to earnings.

Other Investments

NASD is a limited partner in several private investment funds. NASD accounts for investments in private investment limited partnerships under the cost or equity method in accordance with Emerging Issues Task Force (EITF) No. D-46, "Accounting for Limited Partnership Investments," which states the Securities and Exchange Commission (SEC) staff's current position that such investments be accounted for pursuant to AICPA Statement of Position (SOP) No. 78-9, "Accounting for Investments in Real Estate Ventures." NASD also has investments in hedge funds and hedge funds of funds. NASD made a policy election effective January 1, 2006 to account for these investments in hedge funds and hedge funds of funds under the equity method consistent with its treatment of private investment funds and common industry practice. These investments had previously been accounted for as available-for-sale securities. NASD applied this change retroactively to 2005 in accordance with Accounting Principles Board (APB) No. 18, "The Equity Method of Accounting for Investments in Common Stock." As a result of this change, NASD reclassified $5.9 million from accumulated other comprehensive income to equity as of January 1, 2005 and recognized approximately $18.0 million in equity earnings during the year ended December 31, 2005, of which $9.0 million was previously recorded in other comprehensive income. Additionally, NASD has retained the specialized accounting for its other investments pursuant to EITF Issue No. 85-12, "Retention of Specialized Accounting for Investments in Consolidation."

NASD 2006 **Notes to Consolidated Financial Statements**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECEIVABLES, NET

The Company's receivables are concentrated with NASD members, associated persons, NASDAQ, Amex, and other exchanges. The financial statements show receivables net of reserves for uncollectible accounts of $15.4 million and $5.3 million as of December 31, 2006, and 2005, respectively. NASD calculates reserves based on the age, source of the underlying receivable and past collections. NASD maintains the reserve for bad debts at a level that management believes to be sufficient to absorb estimated losses inherent in the accounts receivable portfolio, but not yet specifically identified. The reserve balance as of December 31, 2006 included specific adjustments related to Fines activity as well as estimates related to the Activity Assessment self-reporting review. *See* Note 2 "*Activity Assessment and Cost of Revenues*" for further discussion. The reserve is increased by the provision for bad debts, which is charged against operating results and decreased by the amount of charge-offs, net of recoveries. NASD based the amount charged against operating results on several factors, including a continuous assessment of the collectibility of each account. In circumstances where a specific customer's inability to meet its financial obligations is known (i.e., bankruptcy filings), the Company records a specific provision for bad debts to reduce the receivable to the amount the Company reasonably believes will be collected.

Included in receivables, net as of December 31, 2006, are $15.6 million representing amounts due from NASDAQ for market regulatory services. In 2005, the Company eliminated all receivables from NASDAQ in consolidation. Also included in receivables, net as of December 31, 2006 and 2005 were $8.0 million and $7.7 million, respectively, representing amounts due from Amex for market regulatory services.

PROPERTY AND EQUIPMENT

NASD records property and equipment at cost less accumulated depreciation. It initially records equipment acquired under capital leases at the lower of fair value or the present value of future lease payments. It expenses repairs and maintenance costs as incurred. The Company calculates depreciation and amortization 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. It amortizes leasehold improvements using the straight-line method over the lesser of the useful life of the improvement or the term of the applicable lease. Depreciation and amortization expense for property and equipment, including amortization of capitalized software costs, totaled $30.6 million, and $31.8 million for the years ended December 31, 2006 and 2005, respectively.

In November 2005, NASD executed an agreement to sell one of its buildings (Diamondback) located in Rockville, Maryland to a third party for $8.7 million. As of December 31, 2005, NASD recorded this building in property and equipment, net of accumulated depreciation, as an asset held for sale, with a carrying value of $6.7 million, representing the lesser of its book value and fair value less cost to sell. NASD sold the Diamondback building in April 2006.

In December 2006, NASD exercised the option in its lease to purchase the grounds where one of its buildings (Decoverly) is located in Rockville, Maryland. The cost of exercising the option was $6.1 million, which NASD recorded in land, buildings, and improvements, as appropriate, in the consolidated balance sheet as of December 31, 2006.

SOFTWARE COSTS

NASD capitalizes internal computer software development costs incurred during the development stage in accordance with SOP No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." NASD capitalizes significant purchased application software and operational software programs that are an integral part of computer hardware and amortizes them using the straight-line method over their estimated useful life, generally three years. NASD charges all other purchased software to expense as incurred. Computer software costs incurred prior to or subsequent to the application development stage are charged to expense as incurred.

NASD 2006 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The financial statements reflect unamortized, capitalized software development costs of $29.3 million and $27.8 million as of December 31, 2006 and 2005, respectively, within data processing equipment and software in the consolidated balance sheets. Amortization of costs capitalized under SOP No. 98-1 totaled $12.7 million and $12.9 million for the years ended December 31, 2006 and 2005, respectively, and is included in depreciation and amortization in the consolidated statements of income. Net additions to capitalized software were $14.2 million and $9.3 million in 2006 and 2005, respectively.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company reviews its long-lived assets for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In the event facts and circumstances indicate that long-lived assets or other assets may be impaired, NASD would perform an evaluation of recoverability, which would compare the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount to determine if a write-down is required. If the evaluation indicated impairment, the Company would prepare a discounted cash flow analysis to determine the amount of the impairment. NASD recognized impairment on long-lived assets of $1.7 million in 2005. In 2006, there were no indicators of long-lived asset impairment and no amounts were recorded.

REVOLVING CREDIT FACILITY RECEIVABLE

In February 2005, Amex borrowed $25.0 million under a revolving credit facility, and NASD recorded a discount of $8.6 million, representing the difference between the stated rate of interest of 5.0 percent and the estimated market rate of 11.2 percent. This discount was recorded in general and administrative expenses in the consolidated statements of income for 2005. NASD recognizes interest using the effective interest method. For the years ended December 31, 2006 and December 31, 2005, $2.0 million and $1.6 million, which represent interest on the note and accretion of the discount, are included in interest and dividend income in the consolidated statements of income. The maturity date for the revolving credit facility is October 31, 2011. At maturity, NASD will receive a total of $33.4 million including accrued interest.

OTHER ASSETS

The consolidated balance sheet at December 31, 2006 includes other assets of $45.8 million from the Global Research Analyst Settlement (the Settlement). This amount is included in other assets because its use is restricted to the Foundation. The Foundation invests the Settlement funds in a U.S. Treasury money market fund in accordance with the terms of the 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. *See* Note 2, "Deferred Contribution Income" for more information.

DEFERRED REVENUE

Deferred revenue represents cash received and billed receivables for which NASD has not yet provided the related services. Included in deferred revenue is the unearned portion of registration fees, arbitration fees, and member application fees. The Company recognizes revenue from the upfront initial components of these fees on a straight-line basis over estimated customer relationship periods, determined based on historical experience, ranging from 15 months to 120 months. The estimated service period for registration fees is 42 months, with the annual portion recognized over 12 months. The estimated service period for arbitration fees is 15 months. The estimated service period for member application fees is 120 months.

DEFERRED CONTRIBUTION INCOME

On September 2, 2005, the Federal District Court for the Southern District of New York issued an order (the Order) approving the SEC's new investor education plan, whereby all funds collected in connection with the Settlement, less expenses previously

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

approved by the Court, will be remitted to the Foundation. Pursuant to the final judgments against each of the defendants under the Settlement, a total of $55.0 million was to be collected in equal annual installments of $11.0 million beginning in October 2003.

Upon issuance of the Order in September 2005, the Foundation recorded a contribution receivable and contribution revenue of $52.6 million, representing the net present value of the Settlement funds due to the Foundation. This amount was to accrete to $55.0 million, less expenses, using the interest method. For the year ended December 31, 2005, the Foundation recorded additional income on the Settlement funds of $1.0 million, which represents interest from the SEC and accretion of the discount on the receivable. As of December 31, 2005, the receivable was $53.6 million, of which the Foundation recorded $43.9 million as a current receivable and recorded $9.7 million in other assets.

During 2006, the Foundation received $33.6 million of the Settlement funds from the SEC, which was net of expenses and included interest income. In October 2006, the Foundation received $11.0 million from the defendants as scheduled. For the year ended December 31, 2006, the Foundation recorded additional income on the Settlement funds of $1.6 million, which represents interest from the SEC and accretion of the discount on the receivable. As of December 31, 2006, $10.6 million remains as a current receivable on the Foundation balance sheet, representing the net present value of the final annual installment due in October 2007.

As mentioned in Note 1, the Foundation is a consolidated subsidiary of NASD. At the consolidated level, NASD has recorded the amounts the Foundation received in relation to the Order as deferred contribution income in the consolidated balance sheets, and recognizes revenue as the Foundation makes grant payments and incurs expenses pursuant to the guidelines in the Order. For the year ended December 31, 2006, the Foundation incurred grant payments and expenses against the Settlement funds of $0.4 million. There were no expenses incurred against the Settlement funds in 2005.

DEPOSIT AND RENEWAL LIABILITIES

NASD-registered firms make deposits into NASD's Central Registration Depository (CRD) system to pay for services, including registration fees charged by states and other SROs. Total CRD-related deposits were $50.7 million and $55.0 million as of December 31, 2006, and December 31, 2005, respectively. Also included in deposits and renewals in the consolidated balance sheets as of December 31, 2006, and 2005 were $4.0 million and $0.5 million, respectively, related to funds temporarily held in escrow, to be distributed in connection with an NASD enforcement case.

OTHER LIABILITIES

NASD's other liabilities include amounts associated with the Investment Advisers Registration Depository (IARD) Program.

NASDR 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 Association. The IARD system collects and maintains the registration and disclosure information for investment advisers and their associated persons. As administrator of the IARD program, NASDR collects all fees and incurs expenses, and tracks and reports them to the SEC on a quarterly basis. NASD records fees that it has collected but not earned yet as deferred revenue in the consolidated balance sheets.

In accordance with the Memorandum of Understanding (MOU) with the SEC, signed on July 24, 2001, and as amended, the SEC will determine the distribution of the cumulative cash basis surplus attributable to filings by SEC-registered investment advisers upon termination of the MOU for the benefit of IARD filers. NASD recorded a reserve, which represents the cumulative cash basis surplus, in deferred revenue and other liabilities in the consolidated balance sheets as detailed below. NASDR has applied the same principles of the MOU with the SEC to the cumulative surplus attributable to filings by state-registered investment advisers.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

As of December 31, 2006 and 2005, NASD recorded the cumulative cash basis surplus for the IARD program in its consolidated financial statements as follows:

	AS OF DECEMBER 31,	
	2006	2005
	(in thousands)	
Current deferred revenue	$ 7,119	$ 1,610
Non-current deferred revenue	2,265	2,605
Other liabilities	21,407	22,915
Total	$ 30,791	$ 27,130

REVENUE RECOGNITION AND COST OF REVENUE

Regulatory Fees

NASD uses regulatory fees to fund member regulatory activities, including the supervision and regulation of members through examinations, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. Regulatory fees are recorded net of any member rebates. Regulatory fees include a trading activity fee, gross income assessment, personnel assessment, and branch office assessment. The trading activity fee is assessed on the sell side of all member transactions in all covered securities regardless of where the trade is executed and is assessed directly to the firm responsible for clearing the transaction on behalf of the member firm. Member firms self-report the trading activity fee to NASD, which recognizes the income as member transactions occur. Due to the trading activity fee being a self-reported revenue stream for NASD, subsequent adjustments by firms of their trading activity fee obligation may occur. NASD recognizes these adjustments as revenue adjustments in the period they become known to NASD. Gross income assessments, personnel assessments, and branch office assessments represent annual fees charged to member firms and representatives, which NASD recognizes ratably over the annual period to which they relate.

User Fees

User fees are charged for initial and annual registrations, qualification exams, NASD-sponsored meetings and conferences, processing of membership applications, and reviews of advertisements and corporate filings. Registration fees include both an initial and annual fee charged to all NASD-registered representatives and investment advisors. NASD recognizes the initial fee over the estimated customer relationship period and the annual fee over the related annual period. Qualification fees consist of examination and continuing education fees. NASD recognizes qualification fees as examinations or continuing education programs are administered. NASD-sponsored meetings and conference fees include fees paid by financial services industry participants for attendance at NASD's education programs. NASD recognizes these fees when the program or conference takes place. Advertising fees represent fees charged for the review of NASD member firms' communications to ensure that they are fair, balanced, and not misleading. NASD recognizes advertising fees as revenue as the review is completed. Corporate financing fees consist of amounts charged by NASD for reviewing proposed public offerings. NASD recognizes corporate financing fees as the review is completed.

Dispute Resolution Fees

NASD DR earns fees during the arbitration and mediation processes and recognizes fees paid on open cases as revenue over the average life of a case. Upon the closing of a case, NASD DR prepares a final billing and recognizes any unpaid fees as revenue at that time. Dispute resolution fees also include mediation fees, SRO annual fees, neutral training fees, and other fees that NASD DR recognizes as the cash is received. SRO annual fees relate to the maintenance of dispute resolution services including arbitration and mediation for SROs. Arbitrator training fees relate to NASD DR's comprehensive arbitrator and mediator application and training program.

NASD 2006 **Notes to Consolidated Financial Statements**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Transparency Services Fees

Transparency services fees are charged through the Trade Reporting and Compliance Engine (TRACE), OTC Bulletin Board (OTCBB) and other OTC Equities, including the pink sheets, (together "OTC Equities"), and the Alternative Display Facility (ADF). TRACE fees include market data fees as well as fees charged on secondary market transactions in eligible fixed income securities reported to NASD. ADF fees include market data fees as well as fees for posting quotes and for reporting and comparing trades. The OTCBB and OTC Equities is a regulated quotation service in which fees are charged for the display of real-time quotes, last-sale prices and volume information in OTC equity securities. NASD recognizes transparency services fee revenues as the transactions occur.

Contract Services Fees

Contract services fees represent amounts charged by NASDR for regulatory services provided under contractual arrangements. NASD recognizes contract service fees as revenue as it provides the regulatory service.

Activity Assessment Revenues and Cost of Revenues

NASD, 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 cover costs incurred by the government in the supervision and regulation of securities markets and securities professionals and are based on a percentage of the total dollar value of securities sold through the OTC securities markets. NASD remits these fees to the U.S. Treasury semiannually in March and September.

NASD, in turn, collects activity assessment fees from securities firms based on the total dollar value of securities sold through the OTC securities markets. NASD recognizes assessments billed to securities firms when the transactions are reported. NASD reports the activity assessment on a gross basis within revenues in accordance with EITF No. 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." Amounts due to the SEC are reported as a cost of revenue. NASD reports amounts pending remittance to the SEC in SEC fee payable in the accompanying consolidated balance sheets.

Prior to automation in December 2006, the activity assessments for certain transactions in the OTC securities markets were self-reported to NASD. Given the nature of these transactions, subsequent adjustments by firms of their self-reported transactions may occur. NASD recognizes the resulting activity assessments in the period reported to NASD.

In connection with a review that NASD is performing to ensure that member firms were properly self-reporting transactions in accordance with Schedule A of NASD's By-Laws for the periods of 1997 through 2004, it has been determined that certain transactions were not properly self-reported to NASD. The activity assessment fees related to these transactions have been reflected in the accompanying balance sheet in receivables, net and SEC fee payable as of December 31, 2006. The Company reflected the related amounts in the income statement as activity assessment revenues and cost of revenues for the year ended December 31, 2006.

Fines

Fines represent sanctions for rule violations, which NASD recognizes upon issuance of a written consent or litigation decision. NASD established separate guidelines for the use of fines, which provide that:

(1) All fine monies are collected and segregated from NASD revenues into a separate account;

(2) Fine monies collected or anticipated are not included in NASD operating revenues and play no role in developing its operating budget;

(3) Fine monies are not used to fund employee compensation;

(4) The use of fine monies is limited to expenditures on regulatory capital purchases and strategic initiatives; and

(5) NASD reports to its Board of Governors the projects and purposes for which it has used fine monies.

NASD 2006 **Notes to Consolidated Financial Statements**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PENSION BENEFITS

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

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," an amendment of SFAS No. 87, 88, 106 and 132(R). SFAS No. 158 requires that plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, "postretirement benefit plans"): (1) recognize the funded status of their postretirement benefit plans in the consolidated balance sheets, (2) measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end, and (3) provide additional disclosures. NASD has included the effect of adopting SFAS No. 158 on the Company's financial condition at December 31, 2006 in the accompanying consolidated financial statements. SFAS No. 158 did not have an effect on the Company's consolidated financial condition at December 31, 2005. The provisions of SFAS No. 158 regarding the change in the measurement date of postretirement benefit plans are not applicable as the Company already uses a measurement date of December 31 for its postretirement benefit plans. *See* Note 9, "Employee Benefits" for further discussion of the effect of adopting SFAS No. 158 on the Company's consolidated financial statements.

INCOME TAXES

NASD, NASDR, and NASD 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). The remaining consolidated subsidiaries of NASD are taxable entities. NASD determines 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). NASD measures these assets and liabilities at the enacted rates that will be in effect when it will realize these differences. If necessary, the Company establishes a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized.

ISSUANCE OF SUBSIDIARY STOCK

The Company recognized gains and losses on issuances of NASDAQ stock by NASDAQ in equity until it ceased consolidating NASDAQ on December 20, 2006.

MINORITY INTEREST IN DISCONTINUED OPERATIONS

Minority interest in discontinued operations in the consolidated balance sheets represents the minority owners' share of equity of NASDAQ as of December 31, 2005. On December 20, 2006, NASD ceased consolidating NASDAQ. Minority interest expense, which represents the minority owners' share of the income of NASDAQ during the period owned by NASD, has been reflected as a reduction of income from discontinued operations in the consolidated income statements.

NASD 2006 **Notes to Consolidated Financial Statements**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CONCENTRATION OF RISK

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

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

NASD is dependent on a supplier that provides its information technology services. To the extent this supplier is not able to perform, it could have an adverse effect on the Company's business.

The Company transacts business with multiple customers, with no individual customer exceeding 10 percent of total revenues.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for the Company on January 1, 2008. NASD is currently evaluating the potential impact of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value and expands the use of fair value measurement. SFAS No. 159 is effective for NASD on January 1, 2008. The Company is currently evaluating the potential impact of adopting SFAS No. 159.

RECLASSIFICATIONS

NASD has reclassified certain amounts for the prior year to conform to the 2006 presentation. The primary reclassification relates to the treatment of NASDAQ as a discontinued operation.

NASD 2006 Notes to Consolidated Financial Statements

3. DISCONTINUED OPERATIONS

In 2006, NASDAQ redeemed from NASD all outstanding shares of the Series C Cumulative Preferred Stock and Series D Preferred Stock. NASD also sold all remaining shares of NASDAQ's common stock.

In accordance with SFAS No. 144, the Company reflects NASDAQ as a discontinued operation for all years presented. As of December 31, 2005, it has segregated the assets and liabilities of NASDAQ on the consolidated balance sheets. The revenues, costs and expenses, and cash flows of NASDAQ for the years ended December 31, 2006 and 2005 are presented separately as "income from discontinued operations, net of tax" and the cash flows associated with NASDAQ are presented as "cash provided by (used in) discontinued operations." Previously, NASD reported NASDAQ as a separate segment under the provisions of SFAS No. 131.

NASD income from discontinued operations relates to its disposition of NASDAQ, as summarized below.

	YEARS ENDED DECEMBER 31,	
	2006	2005
	(in millions)	
NASDAQ, net of tax and minority interest		
Net income	$ 127.9	$ 61.7
Minority interest in NASDAQ	(124.0)	(43.5)
Subtotal	3.9	18.2
Consolidating adjustments		
Intercompany eliminations	$ 16.8	$ 29.7
Gains on sales of NASDAQ stock	215.9	383.9
Warrants mark-to-market and expiration	183.2	(180.1)
Other	–	0.3
Subtotal	415.9	233.8
Income from discontinued operations	$ 419.8	$ 252.0

NASD 2006 Notes to Consolidated Financial Statements

3. DISCONTINUED OPERATIONS (CONTINUED)

The following table summarizes the total proceeds and net realized gains recognized by NASD on all transactions related to the divestiture of NASDAQ's Series C Cumulative Preferred Stock and of NASDAQ's common stock.

	Common Stock	Preferred Stock	Net Proceeds	Gain
		(in millions)		
2006				
Secondary offerings – February/March	4.5	–	$ 169.1	$ 156.6
Repayment of Series C Preferred Stock – February	–	1.0	104.7	–
Rule 144 sale – July	0.3	–	7.2	4.4
Warrant exercises	10.5	–	166.7	54.9
Total	15.3	1.0	$ 447.7	$ 215.9
2005				
Secondary offering – February	16.6	–	$ 140.4	$ 133.0
Rule 144 sales – November	4.5	–	161.3	154.4
Pay down of Series C Cumulative Preferred Stock	0	0.4	40.0	–
Warrant exercises	6.8	–	102.5	96.5
Total	27.9	0.4	$ 444.2	$ 383.9
2004 and Prior				
Phase I – stock and warrants	0.3	–	$ 72.2	$ 2.3
Phase II – stock and warrants	4.2	–	113.4	31.4
Hellman & Friedman	18.5	–	240.0	134.4
NASDAQ share buyback	33.8	–	305.2	277.5
Exercise of warrants	–	–	0.6	0.6
Total	56.8	–	$ 731.4	$ 446.2
Total	100.0	1.4	$1,623.3	$1,046.0

NASDAQ redeemed the one outstanding share of Series D Preferred Stock for one dollar on December 20, 2006.

NASD 2006 Notes to Consolidated Financial Statements

3. DISCONTINUED OPERATIONS (CONTINUED)

The following table presents NASDAQ's combined carrying amounts of the major classes of assets and liabilities:

	DECEMBER 31, 2006	DECEMBER 31, 2005
	(in millions)	
Current assets:		
Cash and cash equivalents	$–	$ 166.6
Available-for-sale investments	–	179.4
Receivables, net	–	207.1
Other current assets	–	44.7
Total current assets of discontinued operations	$–	$ 597.8
Net fixed assets	–	$ 122.6
Goodwill	–	961.9
Deferred taxes	–	133.3
Intangible assets	–	215.5
Other non-current assets	–	16.5
Total non-current assets of discontinued operations	$–	$1,449.8
Current liabilities:		
Accounts payable and accrued expenses	–	$ 118.9
Accrued personnel costs	–	67.4
Deferred revenue	–	53.6
Warrants to purchase NASDAQ common stock from NASD	–	183.9
Other current liabilities	–	64.0
Total current liabilities of discontinued operations	$–	$ 487.8
Long-term debt	–	$1,184.9
Non-current deferred taxes	–	95.2
Non-current deferred revenue	–	92.0
Other non-current liabilities	–	87.8
Total non-current liabilities of discontinued operations	$–	$1,459.9

The following table presents condensed results of operations for NASDAQ for the years ended December 31, 2006 and December 31, 2005.

	2006	2005
	(in millions)	
Net revenues	$668.0	$516.7
Income from discontinued operations	$ 20.7	$ 47.9

NASD and NASDAQ have several agreements that remain in effect after completion of the divestiture. NASD evaluated these relationships in accordance with EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations," and concluded that they do not represent significant continuing involvement. Below is a summary of the services that continue between NASD and NASDAQ, the related fees which NASD eliminated in consolidation. Going forward, NASD will no longer eliminate these amounts.

NASD 2006 Notes to Consolidated Financial Statements

3. DISCONTINUED OPERATIONS (CONTINUED)

Operational and Regulatory Services

NASD provides regulatory services including surveillance, examination, investigation, and enforcement for NASDAQ. NASD charges the costs for these services to NASDAQ either through directly attributable NASDAQ effort or through an allocation of volume. Regulatory charges from NASD to NASDAQ were $30.2 million and $40.9 million for the years ended December 31, 2006 and 2005, respectively.

As the SRO for the NASDAQ Trade Reporting Facility (TRF), NASD provides operational services, including governance, rule making, and market operations and regulatory services, including surveillance, examination, investigation, and prosecution. NASD charges the costs for these services to the NASDAQ TRF either through directly attributable NASDAQ TRF effort or through an allocation of volume. Operational and regulatory charges from NASD to the NASDAQ TRF were $3.1 million for the year ended December 31, 2006.

TRACE

NASDAQ and NASD have a contractual agreement to provide support services for the TRACE system. TRACE charges were $2.9 million and $3.9 million for the years ended December 31, 2006 and 2005, respectively.

OTCBB and OTC Equities

On September 2, 2005, NASD executed the OTCBB and OTC Equities Revocation of Delegation and Asset Transfer and Services Agreement with NASDAQ related to the OTCBB and OTC Equities businesses. Under the agreement, effective October 1, 2005, NASDAQ transferred responsibility for the OTCBB and OTC Equities businesses back to NASD. The purpose of this transfer was to address concerns the SEC expressed regarding NASDAQ continuing to operate the OTCBB and OTC Equities businesses after Exchange Registration. As consideration for this agreement, NASD has agreed to outsource the operation of the OTCBB and OTC Equities businesses to NASDAQ for an initial two-year period, subject to one-year renewals upon mutual consent. NASDAQ will bill to NASD, on a time and materials basis, any NASD-directed enhancements to the OTCBB and OTC Equities system, as described in the agreement. Intercompany charges from NASDAQ to NASD for OTCBB and OTC Equities businesses were $14.6 million and $3.8 million for the years ended December 31, 2006 and 2005, respectively.

NASD and NASDAQ structured this transfer of the businesses to be seamless to the customers of the OTCBB and OTC Equities businesses. NASD recorded the transfer at book value on October 1, 2005, as NASD and NASDAQ were entities under common control.

AMEX

As of December 31, 2006 and 2005, NASD had accrued liabilities of $5.6 million representing transaction and employee costs incurred as part of the sale agreement. These amounts are included in other current liabilities in the consolidated balance sheets.

4. DEFERRED REVENUE

NASD accounts for revenue on its registration, member application and arbitration fees in accordance with EITF No. 00-21, "Revenue Arrangements with Multiple Deliverables." The first year's registration and member application fees consist of two elements, an upfront initial fee and an annual fee. NASD segregates the initial and annual components of this fee using the residual value approach within EITF No. 00-21, and defers and amortizes the initial fee element over an estimated customer relationship period of 10 years for firms and three-and-a-half years for individual representatives. Fees received on open arbitration cases also include multiple elements. NASD defers and amortizes these fees over the average life of an arbitration case, or 15 months. Registration and member application fees are included within user fees, and arbitration fees are included within dispute resolution fees in the consolidated statements of income.

The following is a summary of amounts that NASD included in current and non-current deferred revenue as of December 31, 2006, and the years over which NASD will recognize those amounts:

	Registration	Arbitration	Annual and Other	Total
		(in thousands)		
Year ending December 31,				
2007	$10,656	$16,668	$42,090	$69,414
2008	7,454	382	–	7,836
2009	4,270	–	–	4,270
2010	1,476	–	–	1,476
2011 and thereafter	2,343	–	–	2,343
	$26,199	$17,050	$42,090	$85,339

The following is a summary of activity in NASD's current and non-current deferred revenue for the years ended December 31, 2006 and 2005 for all revenue arrangements. The additions reflect the fees charged during the period while the amortization reflects the revenues recognized during the period based on the accounting methodology described above:

	Registration	Arbitration	Annual and Other	Total
		(in thousands)		
Balance as of January 1, 2006	$ 26,932	$ 22,026	$ 28,868	$ 77,826
Additions	11,770	30,290	215,274	257,334
Amortization	(12,503)	(35,266)	(202,052)	(249,821)
Balance as of December 31, 2006	$ 26,199	$ 17,050	$ 42,090	$ 85,339

	Registration	Arbitration	Annual and Other	Total
		(in thousands)		
Balance as of January 1, 2005	$ 27,265	$ 30,139	$ 37,822	$ 95,226
Additions	12,320	38,601	138,632	189,553
Amortization	(12,653)	(46,714)	(147,586)	(206,953)
Balance as of December 31, 2005	$ 26,932	$ 22,026	$ 28,868	$ 77,826

NASD 2006 Notes to Consolidated Financial Statements

5. INVESTMENTS

NASD

NASD manages a diverse investment portfolio consisting of auction rate securities, U.S. Treasury securities, obligations of government-sponsored enterprises, U.S. corporate debt securities, obligations of states and political subdivisions, debt securities issued by foreign governments, asset-backed securities, equity securities, mutual funds, commingled funds, hedge funds, hedge funds of funds, and exchange traded funds. NASD classifies its marketable investments as trading or available-for-sale based on their nature and NASD's intent and ability to hold these securities.

In recent years, NASD shifted to a more diversified investment strategy to provide expected returns that meet NASD's spending requirements, while trying to mitigate and manage investment risks. NASD executes its investment strategy through separately-managed accounts (SMAs) and direct investments. NASD has SMAs with several investment managers that have the authority to buy and sell investments within NASD-determined pre-established parameters. NASD controls the buying and selling decisions of its direct investments.

Trading Investments

In July 2006, NASD's Board of Governors approved the creation of an investment office responsible for overseeing NASD's investment portfolio in the best interests of the organization and its members. The investment office is also responsible for managing and implementing NASD's investment policies and guidelines. Concurrent with the creation of the investment office, NASD, in accordance with SFAS No. 115, re-evaluated the designation of its investments and re-designated certain debt and marketable equity securities from available-for-sale to trading. These securities include investments in auction rate securities and investments managed through SMAs. NASD predicated the decision to re-designate these securities from available-for-sale to trading on the shift in NASD's strategy to a more diversified investment portfolio, combined with the decision by NASD management, with the Board of Governors approval, to create an investment office to assist with managing the investment portfolio. Re-designating these securities to trading was also consistent with recent accounting guidance, including FASB Staff Position (FSP) No. 115-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," as it relates to the accounting for outsourced portfolio management services.

NASD re-designated investments in SMAs with a market value of $601.9 million to trading and recognized a net realized gain of $47.3 million, representing the net unrealized gain on securities in SMAs as of July 31, 2006. NASD recognized an additional $26.4 million through the remainder of the year to bring the total mark-to-market gain on trading securities to $73.7 million for the year ended December 31, 2006. There was no impact of re-designating auction rate securities to trading, as cost is equal to fair market value for these investments. The cost and fair market value of auction rate securities re-designated in July was $862.2 million. As of December 31, 2006 the fair value of NASD's investments in SMAs was $639.9 million. Also included in trading securities as of December 31, 2006 are auction rate securities with a cost and fair market value of $646.9 million. From July 31, 2006, the date of re-designation to trading, through December 31, 2006, NASD recognized gross realized gains and losses on sales of investments in SMAs of $22.8 million and $7.4 million, respectively.

NASD 2006 **Notes to Consolidated Financial Statements**

5. INVESTMENTS (CONTINUED)

Available-for-Sale Investments

As of December 31, 2006, NASD's available-for-sale investments principally consisted of the following:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
Mutual/commingled/exchange traded funds	$ 561.6	$ 88.3	$ 0.7	$ 649.2
U.S. Treasury securities	4.9	–	–	4.9
Total available-for-sale securities	$ 566.5	$ 88.3	$ 0.7	$ 654.1

As of December 31, 2005, NASD's available-for-sale investments principally consisted of the following:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
U.S. Treasury securities	$ 45.4	$ 0.3	$ 0.7	$ 45.0
Debt securities issued by government-sponsored enterprises	69.9	0.2	0.8	69.3
Obligations of states and political subdivisions	2.0	0.2	–	2.2
Debt securities issued by foreign governments	4.4	0.3	0.2	4.5
Asset-backed securities	4.1	0.2	0.1	4.2
U.S. corporate debt securities	59.3	0.4	1.0	58.7
Other debt securities	22.5	0.1	0.5	22.1
Auction rate securities	291.0	–	–	291.0
Total debt securities	498.6	1.7	3.3	497.0
Mutual funds	503.1	54.7	1.4	556.4
Equity securities	274.9	46.2	4.1	317.0
Total available-for-sale securities	$ 1,276.6	$ 102.6	$ 8.8	$ 1,370.4

For the year ended December 31, 2006, NASD recognized gross realized gains and losses on sales of its investments in its SMAs through July 31, 2006—the date of re-designation to trading—of $44.0 million and $7.0 million, respectively, and net investment gains from its investments in mutual and commingled funds of $33.8 million. For the year ended December 31, 2005, NASD recognized gross realized gains and losses on sales of investments of $36.6 million and $10.1 million, respectively, and net investment gains from its investments in mutual and commingled funds of $11.1 million. These gains are included in net realized investment gains in the consolidated income statements.

The above-mentioned net realized gains and losses include reclassifications from unrealized gains and losses on investments in SMAs, prior to their redesignation to trading in July 2006, of $9.9 million and $21.0 million for the years ended December 31, 2006 and 2005, respectively. These reclassifications represent the recognition of amounts recorded as unrealized gain (loss) in accumulated comprehensive income as of the end of the previous year that NASD had recognized when it sold the security.

As of December 31, 2006, the Foundation had investments in domestic mutual funds with a cost of $25.6 million and a fair market value of $26.0 million. As of December 31, 2005, the cost and fair market value of these investments was $30.0 million. Of the Foundation's investments, $3.5 million and $5.9 million were restricted as of December 31, 2006 and 2005, respectively, since the use of these funds is limited to financial education programs for military personnel and their families. NASD intends to use the remaining funds of $22.5 million and $24.1 million as of December 31, 2006 and 2005, respectively, to continue to fund future Foundation research and educational projects.

NASD 2006 Notes to Consolidated Financial Statements

5. INVESTMENTS (CONTINUED)

Other-Than-Temporary Declines in Fair Market Value

For the year ended December 31, 2006, NASD recorded impairment charges of $25.4 million related to 400 publicly traded equity and fixed income securities that were included in available-for-sale securities prior to their re-designation to trading in July 2006. In addition, NASD recorded $5.1 million in impairment related to three mutual/commingled funds and the Foundation recorded impairment charges of $0.7 million related to its mutual funds in 2006. For the year ended December 31, 2005, NASD recorded impairment charges of $10.6 million related to 38 publicly traded equity securities, and $12.7 million related to two investments in mutual/commingled funds. The Foundation recorded $0.5 million of impairment related to its mutual funds for the year ended December 31, 2005. Impairment charges relate to declines in the fair value of available-for-sale investments that NASD judged as other-than-temporary. NASD reflected these charges in net realized investment gains in the consolidated statements of income.

Temporary Declines in Fair Market Value

As of December 31, 2005, NASD had 280 securities in an unrealized loss position. The following table shows the fair value of NASD's available-for-sale investments with an unrealized loss position deemed temporary as of December 31, 2005:

	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Market Value	Unrealized Loss	Fair Market Value	Unrealized Loss	Fair Market Value	Unrealized Loss
	(in millions)					
U.S. Treasury securities	$ 36.1	$ 0.7	$ –	$ –	$ 36.1	$ 0.7
Debt securities issued by government-sponsored enterprises	43.6	0.6	2.2	0.2	45.8	0.8
Debt securities issued by foreign governments	2.5	0.2	–	–	2.5	0.2
Asset-backed securities	3.4	0.1	–	–	3.4	0.1
U.S. corporate debt securities	29.9	0.8	6.6	0.2	36.5	1.0
Other debt securities	13.0	0.2	2.2	0.3	15.2	0.5
Total debt securities	128.5	2.6	11.0	0.7	139.5	3.3
Mutual funds	19.5	0.3	26.1	1.1	45.6	1.4
Equity securities	55.4	4.1	–	–	55.4	4.1
Total	$ 203.4	$ 7.0	$ 37.1	$ 1.8	$ 240.5	$ 8.8

As of December 31, 2006, NASD had one mutual fund in an unrealized loss position of $0.7 million for one month.

Other Investments

As of December 31, 2006, the Company had an investment of $15.2 million in one limited partnership, which is accounted for under the equity method, and $21.7 million of investments in 11 limited partnerships that are accounted for under the cost method. These investments are included in other investments in the consolidated balance sheets. The Company has total outstanding commitments of $157.4 million to 16 partnerships as of December 31, 2006 including four for which the initial funding will take place in 2007. NASD also has investments in hedge funds and hedge funds of funds that it accounts for under the equity method and includes in other investments in the consolidated balance sheets. As of December 31, 2006, the Company had hedge fund investments of $308.3 million. Also, included within other investments are $0.3 million of other cost-based investments. As of December 31, 2005, NASD had investments in six limited partnerships totaling $6.6 million and investments in hedge funds and hedge funds of funds totaling $374.5 million. Also included within other investments as of December 31, 2005, are $0.5 million of other cost-based investments.

NASD 2006 Notes to Consolidated Financial Statements

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company considers cash and cash equivalents, investments (other than equity method investments), receivables, due from custodial agent, the revolving credit facility receivable, accrued expenses, accrued personnel costs, and due to custodial agent to be its financial instruments. The carrying amounts reported in the balance sheets for these financial instruments equal or closely approximate fair value.

NASD determined the initial fair value of the revolving credit facility receivable based on a third-party valuation.

7. NASD CREDIT FACILITY

NASD maintains an unsecured line of credit agreement and has the option to borrow up to $50.0 million at LIBOR plus 0.3 percent (approximately 5.6 percent as of December 31, 2006). As of December 31, 2006, and December 31, 2005, no amounts were outstanding under this line of credit. This line of credit agreement expires on November 30, 2007.

8. INCOME TAXES

NASD, NASDR, and NASD DR are tax-exempt organizations under IRC Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). The remaining consolidated subsidiaries of NASD are taxable entities.

As of December 31, 2006 and 2005, New NASD Holding, Inc., a wholly-owned subsidiary of NASD, had net operating loss carryforwards of $105.6 million related to the operations of Amex prior to its disposition by NASD, which begin to expire in 2020. As of December 31, 2006 and 2005, NASD had unrelated business loss carryforwards of $30.3 million and $28.0 million, respectively, primarily related to NASD's TRACE, ADF, OTCBB and OTC Equities operations. The unrelated business losses expire in 2006 through 2026.

Under SFAS No. 109, "Accounting for Income Taxes," 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. NASD does not believe it is more likely than not that it will realize the net operating loss and unrelated business loss carryforwards and therefore, has recorded a full valuation allowance as of December 31, 2006 and 2005.

9. EMPLOYEE BENEFITS

As of December 31, 2006, and 2005, the Company provided two non-contributory defined benefit pension plans and one non-contributory post-retirement benefit plan for the benefit of eligible employees of its subsidiaries. The non-contributory defined benefit plans consist of a funded ERP plan and an unfunded SERP plan. The benefits are based primarily on years of service and the employees' average salary during the highest 60 consecutive months of employment. The post-retirement benefit plan represents a life insurance benefit available to eligible retired employees. NASD has frozen both the SERP and the post-retirement benefit plan with respect to new participants.

NASD 2006 **Notes to Consolidated Financial Statements**

9. EMPLOYEE BENEFITS (CONTINUED)

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

	Target Allocation	2006	2005
Equity securities	45.0-75.0%	64.7%	65.5%
Debt securities and cash equivalents	10.0-40.0%	20.1%	19.5%
Other investment strategies	10.0-20.0%	15.2%	15.0%
Total		100.0%	100.0%

The expected long-term rate of return for the plan's total assets is based on the expected return of each of the above categories, weighted based on the current target allocation for each class. Based on historical experience, the committee expects that the plan's asset managers overall will provide a modest premium to their respective market benchmark indexes.

On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS No. 158 requires the Company to recognize the funded status (*i.e.*, the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans and its post-retirement benefit plan in the December 31, 2006 consolidated balance sheet, with a corresponding adjustment to accumulated other comprehensive income. The adjustment to accumulated other comprehensive income at adoption represents the net unrecognized actuarial losses, unrecognized prior service costs, and unrecognized transition asset, all of which were previously netted against the plan's funded status in the Company's consolidated balance sheets pursuant to the provisions of SFAS No. 87, "Employers' Accounting for Pensions." NASD will subsequently recognize these amounts as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, NASD will recognize actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods as a component of other comprehensive income. The Company will subsequently recognize those amounts as a component of net periodic benefit cost on the same basis as the amounts recognized in accumulated other comprehensive income at adoption of SFAS No. 158.

NASD 2006 Notes to Consolidated Financial Statements

9. EMPLOYEE BENEFITS (CONTINUED)

The table below presents the incremental effects of adopting the provisions of SFAS No. 158 on the Company's consolidated balance sheet at December 31, 2006. The adoption of SFAS No. 158 had no effect on the Company's consolidated statement of income for the year ended December 31, 2006, or for any prior period presented, and it will not affect the Company's operating results in future periods. Prior to adopting SFAS No. 158 at December 31, 2006, the Company recognized an additional minimum liability pursuant to the provisions of SFAS No. 87. The effect of recognizing the additional minimum liability is included in the table below in the column labeled "Prior to Adopting SFAS No. 158."

	DECEMBER 31, 2006		
	Prior to Adopting SFAS No. 158	Effect of Adopting SFAS No. 158	As Reported
		(in thousands)	
Accrued personnel and benefit costs	$ 117,256	$ (10,656)	$ 106,600
Total current liabilities	495,169	(10,656)	484,513
Accrued pension and other post-retirement benefit costs	38,946	87,967	126,913
Total liabilities	640,764	77,311	718,075
Minimum pension liability	(4,046)	4,046	–
Net unrecognized employee benefit plan amounts	–	(81,357)	(81,357)
Total equity	2,262,344	(77,311)	2,185,033

Included in accumulated other comprehensive income at December 31, 2006, are the following employee benefit amounts that have not yet been recognized in net periodic benefit cost in the consolidated statements of income: unrecognized transition asset of $(0.1) million, unrecognized prior service costs of $2.4 million and unrecognized actuarial losses of $79.0 million. The transition asset, prior service cost, and actuarial loss included in accumulated other comprehensive income and expected to be recognized in net periodic pension cost during the year ending December 31, 2007, are $(0.1) million, $0.3 million, and $4.2 million, respectively.

NASD 2006 Notes to Consolidated Financial Statements

9. EMPLOYEE BENEFITS (CONTINUED)

The reconciliation of the beginning and ending balances of the projected benefit obligation and the fair value of plan assets for the years ended December 31, 2006, and 2005, and the accumulated benefit obligation at December 31, 2006, and 2005, are as follows:

	2006			2005		
	ERP	SERP	Total	ERP	SERP	Total
			(in thousands)			
Change in benefit obligation						
Benefit obligation at beginning of year	$ 213,434	$ 31,434	$ 244,868	$ 178,524	$ 19,900	$ 198,424
Service cost	19,811	4,366	24,177	16,308	4,503	20,811
Interest cost	11,820	1,544	13,364	10,127	1,412	11,539
Amendments	2,116	(337)	1,779	–	–	–
Actuarial losses (gains)	10,579	(81)	10,498	128	6,175	6,303
Benefits paid	(16,633)	(9,430)	(26,063)	(7,203)	(1,788)	(8,991)
(Gain) loss due to change in discount rate	(12,422)	(1,077)	(13,499)	11,094	1,232	12,326
Change in retirement age assumption	–	–	–	4,456	–	4,456
Benefit obligation at end of year	$ 228,705	$ 26,419	$ 255,124	$ 213,434	$ 31,434	$ 244,868
Change in plan assets						
Fair value of plan assets at beginning of year	$ 91,750	$ –	$ 91,750	$ 79,547	$ –	$ 79,547
NASDAQ spin-off adjustment	(359)	–	(359)	–	–	–
Actual return on plan assets	12,621	–	12,621	6,943	–	6,943
Company contributions	36,553	9,430	45,983	12,463	1,788	14,251
Benefits paid	(16,633)	(9,430)	(26,063)	(7,203)	(1,788)	(8,991)
Fair value of plan assets at end of year	$ 123,932	$ –	$ 123,932	$ 91,750	$ –	$ 91,750
Funded status of the plan (underfunded)	(104,773)	(26,419)	(131,192)	(121,684)	(31,434)	(153,118)
Unrecognized net actuarial loss	–	–	–	75,795	18,260	94,055
Unrecognized prior service cost	–	–	–	883	97	980
Unrecognized transition asset	–	–	–	(288)	–	(288)
Amount recognized to reflect minimum pension liability	–	–	–	–	(8,131)	(8,131)
Net amount accrued	$(104,773)	$(26,419)	$ (131,192)	$ (45,294)	$(21,208)	$ (66,502)
Accumulated benefit obligation	$ 134,305	$ 19,135	$ 153,440	$ 123,594	$ 21,208	$ 144,802
Weighted-average assumptions, as of December 31,						
Discount rate	5.75%	5.75%		5.5%	5.5%	
Expected return on plan assets	8.5	–		8.5	–	
Rate of compensation increase	5.5	4.0		5.5	4.0	

NASD 2006 Notes to Consolidated Financial Statements

9. EMPLOYEE BENEFITS (CONTINUED)

Pursuant to the provisions of SFAS No. 158, NASD recognized the full underfunded status of the pension plans and the post-retirement benefit plan of $131.2 million and $0.3 million, respectively, at December 31, 2006, in the consolidated balance sheets as a component of accrued benefits costs. The Company does not expect any plan assets to be returned to it during the year ending December 31, 2007.

The components of the accrued benefit cost for NASD's defined benefit pension plans and post-retirement benefit plan as of December 31, 2006, and 2005, and the location of these amounts in the consolidated balance sheets, are as follows:

	DECEMBER 31,	
	2006	2005
	(in thousands)	
Current (included in accrued personnel and benefit costs):		
ERP	$ —	$ (31,844)
SERP	(4,623)	(4,209)
Total current	(4,623)	(36,053)
Non-current (included in accrued pension and other post retirement benefit costs):		
ERP	(104,773)	(13,450)
SERP	(21,796)	(16,999)
Total non-current pension	(126,569)	(30,449)
Post-retirement benefit plan	(344)	(301)
Total non-current	(126,913)	(30,750)
Accrued benefit costs	$ (131,536)	$ (66,803)

As of December 31, 2005, pursuant to the provisions of SFAS No. 87, related to the SERP, NASD recorded intangible assets of $0.1 million as well as minimum pension liabilities of $8.0 million in the consolidated balance sheets.

The components of net periodic benefit cost for NASD's defined benefit pension plans for the years ended December 31, 2006 and 2005 were as follows:

	YEARS ENDED DECEMBER 31,	
	2006	2005
	(in thousands)	
Components of net periodic benefit cost:		
Service cost	$ 24,177	$ 20,811
Interest cost	13,364	11,539
Expected return on plan assets	(9,887)	(6,730)
Amortization of unrecognized transition asset	(157)	(157)
Recognized net actuarial losses	5,125	5,271
Prior service cost recognized	333	442
Settlement loss recognized	4,528	—
Benefit cost (included in compensation expense)	$ 37,483	$ 31,176

NASD 2006 **Notes to Consolidated Financial Statements**

9. EMPLOYEE BENEFITS (CONTINUED)

NASD measures the plan at the beginning of each year. In 2007, NASD expects to contribute $10.4 million to the ERP plan and $9.6 million to the SERP plan. The ERP contribution represents the unfunded accumulated benefit obligation as of December 31, 2006. In addition, NASD expects to make the following benefit payments to participants over the next 10 years:

	ERP	SERP	Total
		(in thousands)	
Year ending December 31,			
2007	$ 10,656	$ 4,623	$ 15,279
2008	9,713	1,573	11,286
2009	12,107	1,671	13,778
2010	12,500	4,321	16,821
2011	14,009	6,802	20,811
2012 through 2016	106,042	27,329	133,371
Total	$ 165,027	$ 46,319	$ 211,346

NASD also maintains voluntary savings plans for eligible employees of its subsidiaries. Employees are immediately eligible to contribute to the plan and are eligible for an employer contribution match at an amount equal to 100 percent of the first 4 percent of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from NASD. Savings plan expense for 2006 and 2005 was $11.8 million and $10.7 million, respectively, and is included within compensation expense in the consolidated statements of income. The expense included a discretionary match totaling $3.6 million for 2006 and $3.2 million for 2005.

NASD established a deferred compensation plan for certain eligible employees under the provision of Section 457(b) of the IRC. Eligible employees may contribute to the plan and, at its discretion, NASD may make additional contributions to the plan. NASD placed the assets of this plan within an irrevocable rabbi trust. NASD consolidates this trust in accordance with EITF No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested." As of December 31, 2006, $2.3 million of investments and $2.3 million of amounts due to plan participants are included in the available-for-sale investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing participant contributions to this plan. As of December 31, 2005, $1.3 million of investments and $1.3 million of payables to plan participants are included in the available-for-sale investments and accrued personnel costs, respectively, in the consolidated balance sheet. As of December 31, 2006 and 2005, NASD made no additional contributions to this plan.

In December 2005, NASD contributed to an irrevocable rabbi trust an amount equal to its SERP obligation. NASD consolidates this trust in accordance with EITF No. 97-14. As of December 31, 2006 and 2005, $16.8 million and $24.5 million of investments are included in cash and cash equivalents in the consolidated balance sheets, representing the amounts contributed by NASD, plus earned interest, less distributions to retirees. The SERP expected contribution of $9.6 million for 2007 represents the amount necessary to fund the full projected benefit obligation to the rabbi trust as of December 31, 2006.

On January 1, 2006, NASD established a new defined contribution SERP plan for the Company's senior officers. NASD makes annual contributions based on salary and a portion of incentive compensation. Contributions and earnings vest at the end of each third-year and become fully vested at the age of 62. As of December 31, 2006, $0.4 million of investments and $0.4 million of amounts due to plan participants are included in the available-for-sale investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing NASD's contributions to this plan.

NASD 2006 Notes to Consolidated Financial Statements

10. LEASES

NASD leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was $19.6 million and $21.8 million for the years ended December 31, 2006, and 2005, respectively, and is included in occupancy expense in the consolidated statements of income.

Future minimum lease payments under non-cancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 2006:

	(in thousands)
Year ending December 31,	
2007	$ 17,252
2008	17,399
2009	17,632
2010	17,627
2011	17,659
Remaining years	105,980
Total minimum lease payments	$193,549

11. COMMITMENTS AND CONTINGENCIES

EDS

On April 1, 2003, NASD and EDS entered into a service agreement (2003 EDS Agreement) that superseded an existing agreement with NASD. The 2003 EDS Agreement expires on December 31, 2012. Under the 2003 EDS Agreement, NASD was obligated to pay EDS a minimum of $24.0 million for the first year, (prorated for a nine-month period during 2003 commencing on the effective date), which is reduced ratably to $16.0 million in the final year for both applications development and maintenance services. NASD is also required to use EDS for all its production services needs. As consideration for the 2003 EDS Agreement, NASD agreed to forgive a $35.3 million deposit with EDS related to the previous EDS agreement. NASD is amortizing this deposit on a straight-line basis over the remaining term of the 2003 EDS Agreement. As of December 31, 2006 and 2005, NASD recorded other assets of $21.8 million and $25.4 million, respectively, representing the unamortized balance of the deposit with EDS. NASD recorded amortization expense (included in depreciation and amortization in the consolidated statements of income) of $3.6 million during both years ended December 31, 2006 and 2005.

New York City

In 2001, NASD entered into a series of incentive agreements with the City of New York resulting in potential incentives aggregating $53.6 million on a net present value basis to NASD, NASDAQ and Amex. The terms of this agreement required NASD, NASDAQ and Amex together to maintain a set number of full-time employees within New York City annually until December 31, 2020. If NASD does not meet the required headcount, it will be required to pay back either all or a portion of the benefits recognized. In 2004, NASD amended this agreement to separate the benefits among NASD, NASDAQ and Amex individually. As of December 31, 2006, NASD met the headcount requirements as stipulated in the agreement.

Series 7 Exam

On January 6, 2006, NASD announced that 1,882 individuals who took the Series 7 broker qualification exam between October 1, 2004, and December 20, 2005, incorrectly received a failing grade due to a software error. This error caused some test takers to

NASD 2006 Notes to Consolidated Financial Statements

11. COMMITMENTS AND CONTINGENCIES (CONTINUED)

score just below the minimum passing grade. As of April 19, 2006, there were 10 class action cases and one individual case pending in federal courts in the District of Columbia, New York, Ohio and Arkansas. In May 2006, NASD requested the Judicial Panel on Multi-District Litigation (MDL Panel) to consolidate these cases in the Southern District of New York. By October 2006, the number of cases had increased to 14, but the U.S. District Court for the District of Columbia then consolidated all cases under the MDL Panel.

A consolidated amended complaint seeking damages from NASD and one of its contractors for breach of contract was filed in October 2006. NASD filed a motion to dismiss in December 2006. At this time, NASD is not able to reasonably estimate a potential loss on these lawsuits or any additional unasserted claims. As a result, NASD has not recorded any estimate for loss as of December 31, 2006, in accordance with SFAS No. 5, "Accounting for 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 the Company. Management believes, based on the opinion of counsel, it has adequately provided for any liabilities or settlements arising from these proceedings and does not believe the results of such proceedings would have a material adverse affect on the financial position and results of operations of the Company. Management is not aware of any unasserted claims or assessments that would have a material adverse effect on the financial position and the results of operations of the Company.

12. SUBSEQUENT EVENTS

Effective January 1, 2007, NASD implemented a Retiree Medical Account Plan (the Plan) to help NASD employees cover the high cost of health care expenses during retirement. Under the Plan, Retiree Medical Accounts are created for eligible employees and retirees and fixed annual credits are applied to those accounts for each year of NASD service beginning at age 40. Active employees may also accrue credit for a portion of their unused vacation and personal time. The credits can be accessed only in retirement and may be used only toward paying a portion of monthly premiums under NASD-sponsored retiree health plans. NASD estimates that this program will result in annual expense of approximately $5.0 million with an initial accumulated post-retirement benefit obligation on January 1, 2007 of approximately $27.0 million.

On January 21, 2007, NASD announced that NASD members had voted to approve By-Law changes necessary for the consolidation of the NASD and NYSE member regulatory functions into a single SRO. The By-Law changes, which facilitate governance changes at the new SRO, are subject to SEC approval. NASD anticipates that the transaction will close during the second quarter of 2007.

NASD Boards and Committees

NASD Board of Governors as of April 15, 2007

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