

2007 Year in Review and Annual Financial Report

Shaping the future of regulation.

The securities business has experienced remarkable growth during the last seven decades, 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 to combine NASD with the member regulation operations of the New York Stock Exchange (NYSE) in order to create FINRA, the Financial Industry Regulatory Authority, a next-generation regulatory body suited to the complexity and competitiveness of today's capital markets.

Created in July 2007, FINRA is the leading non-governmental regulator for all securities firms doing business with the U.S. public—more than 5,000 firms employing nearly 673,000 registered representatives (as of December 31, 2007). Our chief role is to protect investors by maintaining the fairness of the U.S. capital markets. We carry it out by writing and enforcing rules, examining firms for compliance with the rules, informing and educating investors, helping firms pre-empt risk and stay in compliance, and providing trade reporting and other industry utilities.

FINRA's educational foundation is the largest of its kind in the United States dedicated to investor education. To date, the FINRA Investor Education Foundation has approved approximately \$14.7 million in grants and an additional \$16.2 million in direct investor education programming.

FINRA has 3,000 employees and operates from Washington, DC, and New York, NY, with 15 district offices around the country.

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Shaping the Future of Regulation

By any measure, 2007 was an historic year for securities industry self-regulation.

The creation of the Financial Industry Regulatory Authority in July ended years of duplicative regulation and marked the beginning of a new era for our industry. Following a successful vote by the securities industry, FINRA was formed through the consolidation of NASD and the member regulation operations of the NYSE as the largest self-regulatory organization (SRO) responsible for the oversight of all public securities firms doing business in the United States.

2007 was also a challenging year for our nation's capital markets.

As America's credit crisis emerged, a fundamental truth about today's multi-layered financial services industry was confirmed: The structural risks inherent in our modern financial system no longer impact one institution or sector at a time, but now reverberate throughout the entire marketplace in an instant, often leaving investors exposed and confused.

Today, an important dialogue is taking place about the future of both the capital markets and regulation. Transforming the way we regulate tomorrow's marketplace will be the key to delivering greater efficiency, clarity and protections to all market participants.

Mary L. Schapiro
Chief Executive Officer



The self-regulatory model as embodied in FINRA is better positioned to serve firms and investors than at any time in its history. FINRA is working to create a modern regulatory approach flexible enough to evolve with the world's global economy, while protecting and assisting individual investors in navigating a complex financial marketplace. Our ability to carry out that mission relies, to a large degree, on the vigilant stewardship of FINRA's financial resources.

Today, FINRA's financial position, simply stated, is strong—and allows us to have the resources necessary to fulfill our regulatory mission. This financial success is a testament not only to our continued disciplined approach to spending, but also to diversified and prudent management of our investment assets—assets that are overseen by professionals with extensive experience who comprise FINRA's Investment Committee. FINRA has established a foundation from which to build an innovative and cost-effective regulatory framework that ensures market integrity and investor protection in the days ahead.

**Integration:
Greater Efficiency,
More Streamlined
Regulation**

The path to greater efficiency and more streamlined regulation began in 2007 with the integration of two world-class operations, NASD and the member regulation operations of the NYSE.

The integration process started before the merger was finalized in July and it continues today. Every department has been extensively involved in making the consolidation as seamless as possible, while maintaining the highest regulatory standards.

The transformation of FINRA's Enforcement department is complete, and legacy NASD and NYSE examination programs are now fully integrated and up and running.

Cycle examinations will be conducted by one team of examiners, which will conduct a single opening meeting and exit meeting with firm management. We'll also continue our efforts to make exams more risk-based in order to best deploy our resources.

On the technology front, FINRA expects to have its full suite of applications integrated within 24 months of the consolidation.

Keeping Markets Fair

5,005

securities firms regulated

FINRA is the largest non-governmental regulator for all securities firms that do business with the public in the United States. Created in 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the NYSE, FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services.

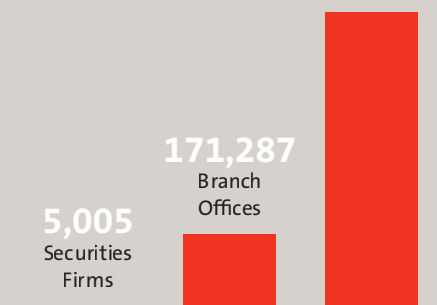
In our role to protect investors and keep the markets fair, we touch virtually every aspect of the securities business—including the oversight of 5,005 securities firms, 171,287 branch offices and 672,688 registered securities representatives (as of December 31, 2007).

**FINRA
Jurisdiction
in 2007**

672,688
Registered
Representatives

5,005
Securities
Firms

171,287
Branch
Offices



**The End of
Duplicative Regulation:
Building a
New Rulebook**

At the heart of making securities regulation more streamlined is the new, single rulebook.

Merging the two rulebooks is a complex task. Not only are we choosing the very best of the legacy NASD and NYSE rules, but we are also determining if there is a better way to address regulatory concerns than simply picking between two existing rules. Times are changing and old rules may no longer apply to today's issues.

Above all, FINRA will write new rules to make them as clear as possible. Increased clarity will foster compliance and enhance the soundness of the markets.

**Confident Investors
= Strong Markets**

FINRA's dedication to investor education remains steadfast.

In November, FINRA for the first time unveiled a broad-based advertising campaign to help raise awareness of FINRA educational resources available to all investors.

Using TV, print, radio and online ads, our goal is to encourage investors to take advantage of the abundant financial tools available at www.finra.org, from our updated version of BrokerCheck to the new Market Data section of our Web site.

This campaign comes at a critical time. In the United States, 78 million baby boomers are on the brink of retirement and are dependent on the future health of the markets—and the strength of the U.S. regulatory system—to finance and protect their retirement.

FINRA research shows that baby boomers feel anxious about their lack of investing knowledge and want to better understand their investment options. One of the primary goals of the campaign is to ease that anxiety and raise FINRA's profile among baby boomers as a trustworthy source of comprehensive and unbiased information on saving and investing.

The FINRA Investor Education Foundation is also focused on educating this critical population and last year awarded more than \$6 million in grants. Through FINRA's Office of Investor Education, we issued more than 25 new investor publications and received record Internet traffic to www.finra.org's Investor Information section.

770 million

quotes, orders and trades monitored each day

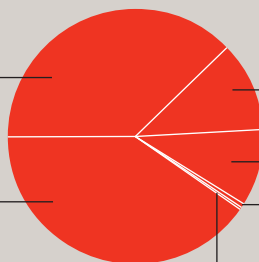
**FINRA
Regulatory Actions
in 2007**

1,107

Formal Actions Resolved

1,177

New Disciplinary Actions



338

Individuals Barred

288

Individuals Suspended

16

Firms Expelled

5

Firms Suspended

To fulfill its mission, FINRA enforces both its own rules as well as federal securities laws. Depending on the type of violation and the degree of investor harm involved, the actions we take can range from monetary fines to expulsion from the securities industry.

FINRA also performs electronic surveillance of trading on The NASDAQ Stock Market, the American Stock Exchange, the Alternative Display Facility, OTC Equities, the corporate bond market and the International Securities Exchange. All told, in 2007 FINRA monitored an average of 770 million quotes, orders and trades each day.

To help cement FINRA's leadership role in financial literacy, we are focused on building effective partnerships with others involved in promoting investor education.

While we aim to educate all investors, there are two groups that receive special attention through our www.SaveAndInvest.org Web site—members of the military and senior citizens.

Our ongoing partnership with the Department of Defense as an active member of its Financial Readiness Campaign helps us play a critical role in educating America's military men and women about saving and investing.

We've also recently launched a major campaign for older investors through our SaveAndInvest program. Partnering with AARP and state regulators, in May 2008 FINRA conducted the first of a series of high-profile forums aimed at teaching seniors to protect themselves from fraud. The inaugural event was at The Villages senior community in Florida, home to more than 70,000 individuals at or near retirement.

The Path Ahead

In 2008, as FINRA continues to improve and shape the future of securities regulation, it must be done within the framework of financial regulation as a whole and from the perspective of the individual investor.

In this world of increasingly complex financial products, there are so many different regulatory oversight systems for an endless number of new financial products that no investor can possibly know what protections they are receiving.

It shouldn't be that complicated.

Tomorrow's regulatory system must guarantee investors equal protections regardless of what product they choose. The antiquated notion that financial products, and their respective regulatory jurisdictions, are distinct and separate simply no longer has relevance in today's complex marketplace.

Protecting Investors

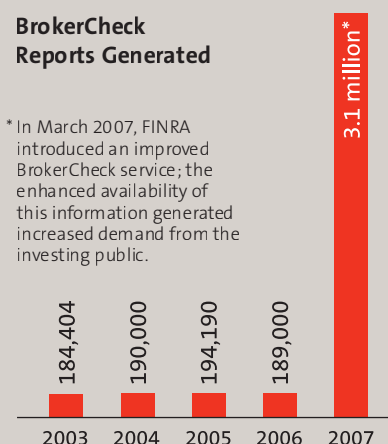
10,000

Americans will turn 60 every day over the next 20 years

We believe that the most potent form of investor protection is investor education. We're particularly focused on helping older investors and members of the military improve their financial literacy. For baby boomers, we introduced an advertising campaign designed to raise their awareness of FINRA and direct them to the investment tools and resources available at www.finra.org. With more than 10,000 Americans turning 60 every day over the next 20 years, we believe it's critical to reach out to them now, as they approach retirement. We also developed and launched www.SaveAndInvest.org/55plus, which is filled with information designed to help seniors avoid fraud and better prepare for retirement. Both the ad campaign and the new Web site direct seniors to our free BrokerCheck service, which enables users to check the professional background of current and former FINRA-registered securities firms and brokers.

BrokerCheck Reports Generated

* In March 2007, FINRA introduced an improved BrokerCheck service; the enhanced availability of this information generated increased demand from the investing public.

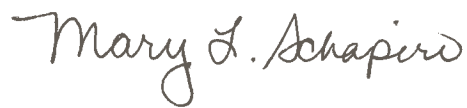


As investors navigate the marketplace of the future, there are four primary protections that must come with every financial product, from securities to insurance to mortgages.

For both the peace of mind of investors and the soundness of the retail markets, investors should be able to enter into any transaction knowing that every person selling a financial product is tested, qualified and licensed; that the product's advertising is not misleading; that every product sold is suitable for them; and that there is full, comprehensive disclosure for all products being sold.

As simple as this approach sounds, regrettably, not all financial products come with all of these basic safeguards. That needs to change.

While transforming financial regulation will take hard work and commitment, FINRA is committed to playing a central role. There will be challenges, but if 2007 and the creation of FINRA taught us one thing, it's that real change is possible.

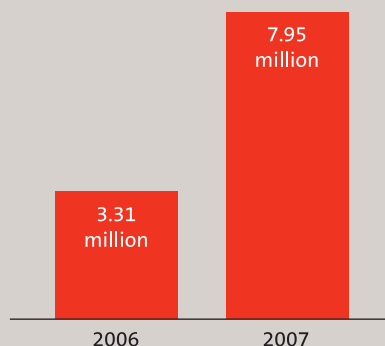


Mary L. Schapiro
Chief Executive Officer

7.95 million

page views of www.finra.org's Investor Information section in 2007

**Page Views: www.finra.org
Investor Information Section**



We also continued to reach U.S. servicemembers through our Military Financial Education Program. Under this initiative, we hosted 22 investor education forums, reaching nearly 3,600 participants in 16 military duty stations worldwide.

The Investor Information section of www.finra.org—which attracted 7.95 million page views in 2007—offers a wealth of unbiased facts and tools to educate investors and help them make informed investment decisions. Here, investors can find various FINRA Investor Alerts focusing on investment scams and problems; the “Smart Investing” series of mini-sites that address major investment topics, such as saving for college and preparing for retirement; and the interactive Expense Analyzers that allow investors to compare competing investment alternatives.

Financial Summary

FINRA Total Revenues by Year

(In millions)

	Years Ended December 31,	
	2007	2006
Regulatory fees	\$ 345.0	\$ 222.0
User fees	170.1	158.7
Dispute resolution fees	42.5	55.7
Transparency service fees	55.8	43.6
Contract service fees	62.7	27.2
Other fees	4.5	4.4
Total operating revenues	680.6	511.6
Fines	47.6	75.0
Activity assessment	281.6	185.0
Total revenues	1,009.8	771.6
Cost of revenues	(285.1)	(184.8)
Net revenues	\$ 724.7	\$ 586.8

2007 data reflects 12 months of NASD operations plus NYSE member regulation operations from July 30 through December 31, 2007.

2006 data reflects 12 months of NASD operations only.

Net Revenues

(In millions)

Total Expenses

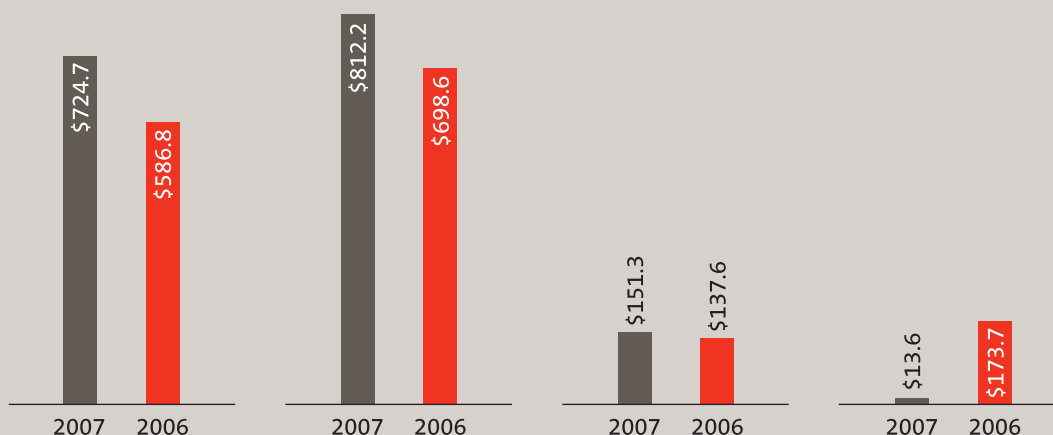
(In millions)

Comparable Income ¹

(In millions)

EBITDA ²

(In millions)



¹ (Loss)/income from continuing operations before one-time special payment to member firms of \$178.3 million in 2007.

² Calculated as (loss)/income from continuing operations, plus depreciation and amortization expense.

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Management Report on Financial Operations

OVERVIEW

The Financial Industry Regulatory Authority, Inc. (FINRA) is the largest non-governmental regulator of securities firms doing business in the United States. FINRA oversees more than 5,000 brokerage firms, almost 172,000 branch offices and nearly 673,000 registered securities representatives (as of December 31, 2007). Created on July 30, 2007, through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange (NYSE), FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance- and technology-based services. FINRA examines firms for compliance with both FINRA rules and federal securities laws.

This Management Report should be read in connection with the consolidated financial statements and accompanying notes, included elsewhere in this Annual Financial Report. The 2007 consolidated financial statements reflect the activities of FINRA and its consolidated subsidiaries, primarily FINRA Regulation, Inc. (FINRA REG), FINRA Dispute Resolution, Inc. (FINRA DR) and the FINRA Investor Education Foundation (the Foundation) as of and for the years ended December 31, 2007, and 2006, and FINRA'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 FINRA or the "Company."

2007 YEAR IN REVIEW

On January 21, 2007, NASD member firms overwhelmingly approved by-law changes necessary for the consolidation of NASD and the member regulation operations of NYSE. The consolidation was approved by the Securities and Exchange Commission (SEC) on July 26, 2007. Subsequently, with the consolidation on July 30, 2007, of NASD and the member regulation, enforcement and arbitration functions of NYSE, FINRA became the largest self-regulatory organization (SRO) responsible for the oversight of securities brokers and dealers doing business in the U.S. FINRA brings together all of NASD's 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 LLC (Amex) and the International Securities Exchange. Throughout this Management Report, FINRA or the Company will be used in reference to operations both prior and subsequent to the July 30, 2007, consolidation of personnel and functions from NASD and NYSE.

Prior to December 20, 2006, FINRA maintained voting control over NASDAQ through its ownership of the only share of Series D Preferred Stock. On December 20, 2006, NASDAQ redeemed the share of Series D Preferred Stock that had been issued to FINRA. Because of the redemption, FINRA no longer maintains voting control over NASDAQ and has ceased consolidating NASDAQ operations effective December 20, 2006.

Income from continuing operations, excluding the 2007 special payment to member firms, for the years ended December 31, 2007, and 2006, was \$151.3 million and \$137.6 million, respectively. The Company's consolidated net (loss) income for the years ended December 31, 2007, and 2006, was \$(27.0) million and \$557.4 million, respectively. Included in the consolidated net loss for December 31, 2007, was a \$178.3 million special payment made to member firms on August 1, 2007. Included in net income for the year ended December 31, 2006, was income from the discontinued operations of NASDAQ of \$419.8 million.

Management Report on Financial Operations (continued)

RESULTS OF OPERATIONS

REVENUES

The following table sets forth consolidated revenues by category for the years ended December 31, 2007, and 2006.

	Years Ended December 31,		Change	
	2007	2006	\$	%
	<i>(in millions)</i>			
Revenues				
Regulatory fees	\$ 345.0	\$ 222.0	\$ 123.0	55.4%
User fees	170.1	158.7	11.4	7.2%
Dispute resolution fees	42.5	55.7	(13.2)	-23.7%
Transparency services fees	55.8	43.6	12.2	28.0%
Contract services fees	62.7	27.2	35.5	130.5%
Other	4.5	4.4	0.1	2.3%
Total operating revenues	680.6	511.6	169.0	33.0%
Fines	47.6	75.0	(27.4)	-36.5%
Activity assessment	281.6	185.0	96.6	52.2%
Total revenues	1,009.8	771.6	238.2	30.9%
Activity assessment cost of revenues	(285.1)	(184.8)	(100.3)	54.3%
Net revenues	\$ 724.7	\$ 586.8	\$ 137.9	23.5%

FINRA's operating revenues were \$680.6 million in 2007, compared with \$511.6 million in 2006 — an increase of \$169.0 million, or 33.0 percent, led mainly by higher regulatory, user, transparency services and contract services revenues offset by lower dispute resolution fees.

Regulatory fees fund FINRA's regulatory activities, including the supervision and regulation of members through examination, policy making, rulemaking 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), personnel (principals and registered representatives) and branch offices. Regulatory fees were \$345.0 million in 2007, compared with \$222.0 million in 2006 — an increase of \$123.0 million, or 55.4 percent, due to a \$70.5 million increase in Gross Income Assessments, of which \$48.9 million was related to legacy NYSE operations. The Trading Activity Fee increased by \$8.8 million due to an increase in trading activity volumes from 2006 to 2007. Additionally, FINRA issued rebates to its membership of \$6.1 million and \$50.0 million in 2007 and 2006, respectively. FINRA recorded these rebates as a reduction of regulatory fees.

User fees include initial and annual registration fees, qualifications exams, fees associated with FINRA-sponsored educational programs and conferences, processing of membership applications and charges related to the review of advertisements and corporate financing filings. User fees totaled \$170.1 million in 2007, compared with \$158.7 million in 2006 — an increase of \$11.4 million, or 7.2 percent, due to the inclusion of NYSE's Central Registration Depository (CRD) system registration and annual fees post consolidation, as well as increased volumes in corporate financing filings.

Dispute resolution fees represent fees earned during the arbitration and mediation processes. Dispute resolution fees totaled \$42.5 million in 2007 compared with \$55.7 million in 2006 — a decrease of \$13.2 million, or 23.7 percent. Driving this decrease was a 29.8 percent decline in the number of new cases filed from 4,614 in 2006 to 3,238 in 2007.

Transparency services fees represent amounts charged for services offered through FINRA's Trade Reporting and Compliance Engine (TRACE), FINRA's Alternative Display Facility (ADF), the Over-the-Counter Bulletin Board (OTCBB) and the OTC Reporting Facility (ORF). Transparency services fees were \$55.8 million in 2007 compared with \$43.6 million in 2006 — an increase of \$12.2 million, or 28.0 percent, primarily due to additional ADF volume and market data revenue.

Management Report on Financial Operations (continued)

Contract services fees represent amounts charged for regulatory services provided primarily to NASDAQ, Amex, the Trade Reporting Facilities (TRFs), the State Regulatory Registry, LLC and other exchanges for services including surveillance, monitoring, development, legal and enforcement activities. Contract services fees were \$62.7 million in 2007, compared with \$27.2 million in 2006 — an increase of \$35.5 million, or 130.5 percent, due mainly to the final divestiture of NASDAQ in December 2006. Prior to divestiture, the NASDAQ revenues were eliminated from FINRA's consolidated financial results. In 2007, regulatory services fees charged to NASDAQ totaling \$28.7 million were included in contract service fees in FINRA's consolidated financial results.

Other revenues remained consistent with the prior year totaling \$4.5 million in 2007, compared with \$4.4 million in 2006.

Fines represent amounts billed as sanctions for rule violations. FINRA does not view fines as part of its operating revenues. Fine revenues totaled \$47.6 million in 2007 and \$75.0 million in 2006 — a decrease of \$27.4 million, or 36.5 percent. Cash collections from fines were \$47.8 million in 2007, compared with \$84.9 million in 2006. The process that FINRA 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. FINRA's fine guidelines provide that:

- 1) All fine monies are collected and segregated from FINRA revenues into a separate account;
- 2) Fine monies collected or anticipated are not included in FINRA 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 capital expenditures and specified regulatory projects; and
- 5) FINRA reports to its Board of Governors the projects and purposes for which it plans to and has used fine monies.

Activity assessment revenues represent amounts billed to FINRA members to cover FINRA's obligation to the SEC under Section 31 of the Securities Exchange Act of 1934. Activity assessment cost of revenues represents the amounts owed and remitted to the SEC under this obligation. Activity assessment revenues were \$281.6 million in 2007, compared to \$185.0 million in 2006 — an increase of \$96.6 million, or 52.2 percent. Activity assessment cost of revenues was \$285.1 million in 2007, compared to \$184.8 million in 2006 — an increase of \$100.3 million, or 54.3 percent. An increase in the dollar volume of contracts traded, partially offset by a rate reduction in the first quarter of 2007 drove the increase in both activity assessment revenues and activity assessment cost of revenues.

EXPENSES

The following table sets forth consolidated operating expenses by category for the years ended December 31, 2007, and 2006.

	Years Ended December 31,		Change	
	2007	2006	\$	%
	<i>(in millions)</i>			
Operating expenses				
Compensation and benefits	\$446.1	\$395.1	\$ 51.0	12.9%
Professional and contract services	199.2	148.4	50.8	34.2%
Computer operations and data communications	30.8	26.1	4.7	18.0%
Depreciation and amortization	40.6	36.1	4.5	12.5%
Occupancy	40.2	30.2	10.0	33.1%
General and administrative	55.3	62.7	(7.4)	-11.8%
Total operating expenses	\$812.2	\$698.6	\$113.6	16.3%

FINRA's total expenses were \$812.2 million in 2007, compared to \$698.6 million in 2006 — an increase of \$113.6 million, or 16.3 percent, of which \$56.7 million is related to the newly acquired NYSE operations.

Management Report on Financial Operations (continued)

Compensation and benefits increased to \$446.1 million in 2007 from \$395.1 million in 2006 — an increase of \$51.0 million, or 12.9 percent, primarily attributable to the addition of the approximately 440 NYSE employees transferred to FINRA as a result of the consolidation of NASD and the member regulation operations of NYSE. Higher compensation expense, incentive compensation, annual merit and promotion increases, and the new retiree medical plan also contributed to this increase. These increases were offset by decreased employee benefit costs, attributable to decreased claims for health care services as well a shift in employee and employer premium contributions.

Professional and contract services increased to \$199.2 million in 2007, from \$148.4 million in 2006 — an increase of \$50.8 million or 34.2 percent, due primarily to increases in application development and application maintenance technology-related initiatives. An increase of \$16.1 million in application development charges over last year was driven by initiative efforts such as the integration of NASD and the member regulation operations of NYSE, the Next Generation Exam Program, the Firm Gateway, the Member Data Repository, PROCTOR, the National Mortgage Licensing System, Forms Filing and the PeopleSoft upgrade. Application maintenance expense increased \$22.9 million over last year. Application maintenance increases are the result of projects moving from development to in-service status, such as the Firm Gateway, Member Data Repository and various Market Regulation applications. Additionally, maintenance increased due to support of the NYSE member regulation legacy applications and additional costs to support the ADF as a result of increased volume. Also included in professional and contract services for 2007 was \$16.9 million related to the operation of TRACE and the OTC Equities businesses by NASDAQ on behalf of FINRA. In 2006, these amounts were eliminated in consolidation. Beginning in 2007, FINRA no longer eliminates NASDAQ contract service fees and shared facilities expenses, as FINRA ceased consolidation of NASDAQ operations effective December 20, 2006.

All other operating expenses (computer operations and data communications, depreciation and amortization, occupancy and general and administrative) increased to \$166.9 million in 2007 from \$155.1 million in 2006 — an increase of \$11.8 million, or 7.6 percent. This increase was primarily driven by \$10.4 million of occupancy, security and facilities administration charges related to the consolidation of NASD and the member regulation operations of NYSE.

INTEREST AND DIVIDEND INCOME

Interest and dividend income primarily reflects income earned on FINRA's operating cash accounts and investments. Interest and dividend income remained consistent with the prior year totaling \$77.2 million in 2007, compared with \$77.3 million in 2006.

OTHER INCOME (EXPENSE)

The following table sets forth consolidated other income by category for the years ended December 31, 2007, and 2006.

	Years Ended December 31,		Change	
	2007	2006	\$	%
	<i>(in millions)</i>			
Other income (expense)				
Special payment to members in connection with the consolidation of NASD and the member regulation operations of NYSE	\$(178.3)	\$ —	\$(178.3)	-100.0%
Net investment gains	113.8	131.5	(17.7)	-13.5%
Equity earnings from other investments	42.1	40.6	1.5	3.7%
Other	5.7	—	5.7	100.0%
Total other (expense) income	\$ (16.7)	\$172.1	\$(188.8)	-109.7%

On August 1, 2007, after the consolidation of NASD and the member regulation operations of NYSE, FINRA paid each of its member firms \$35,000 (\$178.3 million in total) to reflect the anticipated benefits and cost-savings of the consolidation.

Management Report on Financial Operations (continued)

Included in net investment gains in the consolidated statements of operations are net realized gains and losses on sales of available-for-sale and trading securities and mark-to-market holding gains and losses on FINRA's trading portfolio. Equity earnings from other investments represent the Company's share in the earnings from its ownership interests in hedge funds, funds of hedge funds and one limited partnership accounted for under the equity method. FINRA's weighted ownership interest of all equity method investees was 1.3 percent at December 31, 2007.

PROVISION FOR INCOME TAXES

FINRA, FINRA REG and FINRA DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). The accompanying consolidated financial statements present taxes associated with NASDAQ's discontinued operations within "income from discontinued operations" in the consolidated statements of operations for 2006.

DISCONTINUED OPERATIONS

On December 20, 2006, NASDAQ redeemed the one outstanding share of Series D Preferred stock from FINRA, eliminating FINRA's voting control over NASDAQ, and FINRA ceased consolidation of NASDAQ operations. Discontinued operations in FINRA'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 FINRA and NASDAQ through the disposal date. Also included in income from discontinued operations are net gains on the sales of NASDAQ stock by FINRA 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 FINRA operations going forward. Finally, the amounts FINRA processed under Section 31 of the Securities Exchange Act of 1934 and recorded in activity assessments and activity assessment cost of revenues have been adjusted to eliminate transactions that were generated through NASDAQ markets in 2006; such amounts are no longer included in FINRA's operations in 2007.

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

	2006
	<i>(in millions)</i>
NASDAQ, net of tax and minority interest:	
Net income	\$ 127.9
Minority interest in NASDAQ	(124.0)
Subtotal	3.9
Consolidating adjustments:	
Intercompany eliminations	\$ 16.8
Gains on sales of NASDAQ stock	215.9
Warrants mark-to-market and expiration	183.2
Subtotal	415.9
Income from discontinued operations	\$ 419.8

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is the ongoing ability to fund asset growth and business operations, and meet contractual obligations through unrestricted access to funding at reasonable market rates. Liquidity management involves forecasting funding requirements and maintaining sufficient capacity to meet business needs and accommodate fluctuations in asset and liability levels due to changes in business operations or unanticipated events. FINRA primarily relies on operating cash flows, which include returns on its investment portfolio, to fund current and future operations.

Management Report on Financial Operations (continued)

FINRA's investment portfolio is governed by a policy based on best practices of endowment funds as applied to its investment objectives. The FINRA Investment Committee (Investment Committee), whose members have extensive background and experience in the investment community, provides overall guidance and advice in determining the appropriate policy and allocation for these investments. FINRA's endowment fund (the Fund) may invest in illiquid assets, assets that cannot be liquidated for cash in 52 weeks or less, so long as the aggregate market value of all such illiquid assets does not exceed 45 percent of the aggregate market value of the Fund.

In July 2006, FINRA established an internal investments office to support the Investment Committee. See separate Investment Committee Report contained elsewhere in the 2007 Annual Financial Report for further discussion of liquidity and capital resources.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT RISK

Market risk represents the risk of changes in 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, 2007, investments in the Company's consolidated financial statements consist of: (i) global government (state and local) securities; (ii) corporate and asset-backed securities; (iii) equity securities; (iv) exchange-traded funds; (v) mutual and commingled funds; (vi) other investments (hedge funds, funds of hedge funds and private investments), and (vii) other financial instruments or structures.

The Company's primary market risk relates to its investment portfolio. The Company's investments are impacted by fluctuations in the securities markets.

FINRA's investment portfolio contains fixed income securities that have a duration, or weighted-average maturity of cash flows, of approximately 2.3 years, outside of derivative investments, as of December 31, 2007. 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 two years is expected to change inversely by 2 percent). FINRA 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, which was approximately 6.1 percent as of December 31, 2007.

FINRA has foreign currency exposure in its trading and other investments. FINRA captures changes in the market value of its trading and equity method investments from foreign currency fluctuations in the consolidated statements of operations. Changes in the market value of available-for-sale investments are recorded through unrealized gain (loss) in other comprehensive income.

FINRA management believes that other-than-temporary fluctuations in market indices could have a significant impact on its available-for-sale investment portfolio, earnings and cash flows. FINRA reviews its available-for-sale investment portfolio for other-than-temporary declines on a quarterly basis. Based on these reviews, FINRA recorded impairment charges for other-than-temporary declines of \$31.2 million in 2006 primarily related to its available-for-sale investments in separately managed accounts (SMAs). In July 2006, FINRA re-designated its investments in SMAs from available-for-sale to trading. With the re-designation of FINRA's investments in SMAs from available-for-sale to trading, FINRA captures fluctuations in the market value of those investments in the consolidated statements of operations as part of net investment gains. Impairment charges in 2007 were not material. FINRA relies on year-end fair value estimates for the impairment assessment on its private investments. In relying on this information, FINRA reviews current financial statements and subsequently verifies valuations from annual audited statements obtained from each fund. FINRA also reviews valuation procedures used by the funds.

FINRA is exposed to credit risk from third parties, including NASDAQ, Amex and FINRA members. These parties may default on obligations to FINRA due to bankruptcy, lack of liquidity, operational failure or other reasons. In addition, FINRA has a revolving credit facility receivable from Amex for \$25.0 million as of December 31, 2007. This revolving credit facility accrues interest at a fixed rate of 5.0 percent, and both interest and principal are due in October 2011. In 2005, FINRA performed a valuation of this revolving credit facility 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

Management Report on Financial Operations (continued)

December 31, 2007, and 2006, FINRA recognized interest on the note and accretion of discount of \$2.3 million and \$2.0 million, respectively. These amounts are included in interest and dividend income in the consolidated statements of operations. As of December 31, 2007, and 2006, the estimated fair value of the receivable was \$22.3 million and \$20.0 million, respectively.

CASH FLOWS

FINRA prepares its statement of cash flows using the indirect method. Under this method, net (loss) income is reconciled to cash flows from continuing operations by adjusting for those items that do not result in actual cash receipts or payments during the period. These reconciling items include depreciation, returns on the investment portfolios, and changes in the consolidated balance sheet for working capital from the beginning to the end of the period. See the table below for a summary of cash flows from continuing operations (excluding the 2007 special member payment) and discontinued operations:

	Years Ended December 31,					
	2007			2006		
	<i>(in millions)</i>					
	Continuing	Special Member Payment	Total	Continuing	Discontinued Operations	Total
Operating	\$ 818.7	\$(178.3)	\$ 640.4	\$ 149.3	\$ 80.6	\$ 229.9
Investing	(321.6)	—	(321.6)	(729.7)	(931.5)	(1,661.2)
Financing	10.8	—	10.8	49.7	1,335.1	1,384.8
Total	\$ 507.9	\$(178.3)	\$ 329.6	\$(530.7)	\$ 484.2	\$ (46.5)

FINRA generated cash inflows from operating activities of \$640.4 million in 2007, compared with \$149.3 million in the prior year, driven primarily by the sale of securities in its trading portfolio during the first quarter of 2007. Net cash used in investing activities from continuing operations was \$321.6 million in 2007 and \$729.7 million in 2006. In both years, cash used in investing activities consisted primarily of net purchases of available-for-sale securities and other investments (hedge funds, funds of hedge funds and private investments), as well as payments related to the consolidation of NASD and the member regulation operations of NYSE in 2007. Net cash provided by financing activities was \$10.8 million and \$49.7 million in 2007 and 2006, respectively, representing contributions to the Foundation from external parties.

Overall cash and cash equivalents, trading investments and available-for-sale investments totaled \$1,901.4 million as of December 31, 2007, and \$2,049.8 million as of December 31, 2006. This overall decrease of \$148.4 million or 7.2 percent was driven primarily by the \$178.3 million special payment to members made in connection with the consolidation of NASD and the member regulation operations of NYSE, as well as net purchases of other investments of \$33.6 million.

FINRA's working capital was \$1,560.5 million as of December 31, 2007, and \$1,834.8 million as of December 31, 2006. FINRA has been able to generate sufficient funds from operations to meet working capital requirements. FINRA has a line of credit of up to \$50.0 million that has a variable interest rate; no amounts were outstanding under this credit agreement as of December 31, 2007, and 2006. FINRA believes that the liquidity provided by existing cash and cash equivalents, investments and cash generated from operations will provide sufficient capital to meet current and future operating requirements.

Management Report on Financial Operations (continued)

CONTRACTUAL OBLIGATIONS AND CONTINGENT COMMITMENTS

FINRA 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
	<i>(in millions)</i>				
Commitments to investments in limited partnerships	\$166.5	\$ 49.6	\$ 87.7	\$ 27.4	\$ 1.8
Minimum rental commitments under non-cancelable operating leases and subleases	265.9	29.0	59.2	53.3	124.4
Commitments related to facility operations and security in New York, NY	93.8	19.0	40.5	34.3	—
Information and technology services agreement	90.0	20.0	37.0	33.0	—
Total	\$616.2	\$117.6	\$224.4	\$148.0	\$126.2

Investments in limited partnerships represent the expected funding of FINRA's total commitment to 24 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. Commitments related to operations in New York include facilities and security costs for personnel employed by FINRA working in buildings leased by NYSE as a result of the consolidation of NASD and the member regulation operations of NYSE. Information and technology services agreement commitments relate to FINRA's minimum annual spending requirements under an agreement with Electronic Data Systems Corporation (EDS). EDS provides application development and maintenance services to FINRA 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 U.S. generally accepted accounting principles (GAAP) 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

Debt and Marketable Equity Securities

FINRA 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. FINRA 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 component of net investment gains (losses) in the consolidated statements of operations.

Management Report on Financial Operations (continued)

FINRA records available-for-sale securities at fair value, and records changes in fair value as an unrealized gain (loss) within equity in the consolidated balance sheets.

Fair value is determined based on quoted market prices. Realized gains and losses on sales of securities are included in earnings using the average cost method. Investments receivable or payable (including short sales) relate to security trades executed prior to the balance sheet date, but not yet settled, as FINRA follows trade date accounting.

Other Investments

FINRA has investments in hedge funds and funds of hedge funds. FINRA accounts for these investments under the equity method. FINRA is also a limited partner in a number of private investment funds. FINRA accounts for its interest in private investment limited partnerships under the cost or equity method in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 78-9, "Accounting for Investments in Real Estate Ventures," and as clarified by Emerging Issues Task Force (EITF) No. D-46, "Accounting for Limited Partnership Investments." FINRA has retained the specialized accounting for its other investments accounted for under the equity method pursuant to EITF Issue No. 85-12, "Retention of Specialized Accounting for Investments in Consolidation." FINRA relies on fair value estimates from fund managers to determine year-end fair values for investments in private investments, hedge funds and funds of hedge funds, and verifies those values through the subsequent review of audited financial information, additional due diligence procedures, and follow-up discussions with the fund managers.

Valuation Factors

The Company regularly monitors and evaluates the realizability of its available-for-sale and cost method investments. When assessing realizability, including 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 of unrealized losses;
- 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 its cost and equity method investments for potential indicators of impairment. If events and circumstances indicate that a decline in the value of these assets has occurred, and FINRA 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.

REVENUE RECOGNITION AND COST OF REVENUE

Regulatory Fees

Regulatory fees represent fees to fund FINRA's regulatory activities, including the supervision and regulation of members through examination, policy making, rulemaking 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 calculated on the sell side of all member transactions in all covered securities regardless of where the trade is executed and is assessed directly on the firm responsible for clearing the transaction. The Trading Activity Fee is self-reported to FINRA by the firms and the revenue is recognized in the month the transactions occur. Due to the Trading Activity Fee being a self-reported revenue stream for FINRA, subsequent adjustments by firms may occur and are recognized as an adjustment to revenue in the period the adjustment becomes known to FINRA. The Gross Income Assessment and Personnel

Management Report on Financial Operations (continued)

Assessment represent annual fees charged to member firms. The Branch Office Assessment has an initial fee component in addition to annual fees. The initial fee is recognized over the estimated customer relationship period and the annual fee over the related annual period.

User Fees

User fees consist of fees charged for initial and annual registrations, qualification exams, FINRA-sponsored educational programs and conferences, reviews of advertisements and corporate filings (corporate financing fees). Registration fees primarily include both initial and annual fees charged on all FINRA-registered representatives and investment advisors. 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. FINRA-sponsored meetings and conference fees include fees paid by financial services industry participants for participating in FINRA's educational programs. FINRA recognizes these fees when the program or conference takes place. Advertising fees represent fees charged for the review of FINRA 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 FINRA for reviewing proposed public offerings; thus, FINRA 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 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 FINRA 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, whichever occurs first.

Transparency Services Fees

Transparency services fees for quoting and trade reporting are charged through TRACE and the ADF. In addition, fees are charged for services relating to quoting of certain OTC Equities on the OTCBB and trade reporting of OTC Equities through the ORF. TRACE fees include market data fees as well as fees charged on secondary market transactions in eligible fixed income securities reported to FINRA. ADF fees include market data fees as well as fees for posting quotes and for reporting and comparing trades. OTCBB is a regulated quotation service in which fees are charged for a variety of services related to the display of real-time quotes in OTC Equity securities that are eligible for quotation on the OTCBB. In addition, fees are earned for the sale of market data from the OTCBB and the ORF. FINRA recognizes transparency services fees as the transactions occur and when the market data is sold.

Contract Services Fees

Contract services fees represent amounts charged by FINRA and FINRA REG for regulatory and registration services provided under contractual arrangements. FINRA recognizes this revenue as the services are provided.

Fines

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

Activity Assessment

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

Management Report on Financial Operations (continued)

FINRA recovers the cost of the SEC's fees and assessments through an activity assessment billed to clearing and self-clearing firms based on the aggregate dollar amount of sales of covered securities transacted by or through any member otherwise than on a national securities exchange. The assessments billed to securities firms are recognized when the transactions are reported. FINRA, 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." FINRA reports the amounts due to the SEC as an activity assessment cost of revenue.

FINRA relies on third party providers and securities firms to report activity in a complete, accurate and timely manner for purposes of determining the activity assessment revenues and cost of revenues. In addition, prior to automation in December 2006, the activity assessments for certain discrete OTC transactions were self-reported to FINRA. Given these factors, subsequent adjustments may occur. FINRA recognizes any resulting activity assessment adjustments in the period they become known to FINRA.

PENSION AND OTHER POSTRETIREMENT BENEFITS

As of December 31, 2007, and 2006, the Company provided two non-contributory defined benefit pension plans for the benefit of eligible employees. The non-contributory defined benefit plans consist of a qualified Employee Retirement Plan and a non-qualified Supplemental Executive Retirement Plan (collectively referred to as "pension benefits"). On January 1, 2007, FINRA implemented an employer-funded defined contribution Retiree Medical Plan to assist FINRA employees and retirees with the cost of health care expenses during retirement ("other benefits"). 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, as well as assumptions regarding future salary increases, mortality, turnover, retirement ages and the medical trend rate. The Company considers market conditions, including changes in investment returns and interest rates, in making these assumptions. The discount rate used in the calculations is developed considering changes in Moody's Aa bond rating and a hypothetical bond portfolio, or specific bond matching approach. The Company determines the long-term rate of return based on an analysis of historical and projected returns as prepared by the Company's actuary and external investment consultant. 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 and other 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. A 25-basis-point increase (decrease) in the discount rate assumption as of December 31, 2007, would cause the projected benefit obligation for pension benefits to decrease (increase) by approximately \$12.0 million. A 25-basis-point increase (decrease) in the discount rate assumption as of December 31, 2006, would have caused the 2007 pension benefits expense to decrease (increase) by approximately \$2.4 million. A 25-basis-point increase (decrease) in the discount rate assumption would not have a material impact on the projected benefit obligation or expenses related to other benefits.

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 required the Company to recognize on a plan-by-plan basis the funded status (*i.e.*, the difference between the fair value of plan assets and the projected benefit obligations) of its postretirement benefit plans 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." FINRA will subsequently recognize these amounts as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, FINRA 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

Management Report on Financial Operations (continued)

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 recognized 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 FINRA on January 1, 2008. The Company is currently assessing the potential impact that the implementation of SFAS No. 157 will have on its financial statements, if any.

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 FINRA on January 1, 2008. The Company does not plan to utilize the fair value option on any financial assets or liabilities not already recorded at fair value effective January 1, 2008. As such, the adoption of SFAS No. 159 will not have a material impact on the Company's consolidated results of operation and financial position.

Management Report on Internal Control Over Financial Reporting

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

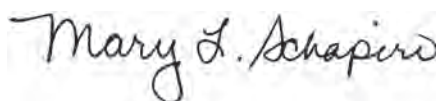
FINRA maintains a system of internal control that is designed to provide reasonable assurance as to the fair and reliable preparation and presentation of the consolidated financial statements, as well as to safeguard assets from unauthorized use or disposition that could have a material effect on the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

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

Under the supervision of the Chief Executive Officer and Chief Financial Officer, FINRA's management assessed the effectiveness of FINRA's internal control over financial reporting as of December 31, 2007. 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 FINRA maintained effective internal control over financial reporting as of December 31, 2007.

FINRA's financial statements included in this annual report have been audited by Ernst & Young LLP, an independent registered accounting firm. Ernst and Young LLP has also issued an attestation report on FINRA's internal control over financial reporting as of December 31, 2007.

May 22, 2008



Mary L. Schapiro
Chief Executive Officer



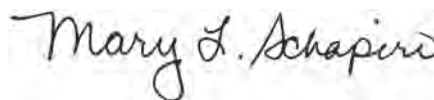
Todd T. Diganci
Executive Vice President and CFO

Certification of 2007 Annual Financial Report

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

1. We have reviewed this annual financial report of the Financial Industry Regulatory Authority, Inc. (FINRA);
2. The purpose of this report is principally to set forth management's report on financial operations with respect to FINRA during the year ended December 31, 2007, together with the consolidated financial statements of FINRA as of and for the years ended December 31, 2007, and 2006. 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 information set forth under the caption "Management Report on Financial Operations" fairly present in all material respects the financial condition, results of operations and cash flows of FINRA as of, and for, the periods presented in this report;
5. FINRA has established disclosure controls and procedures to ensure that material information relating to FINRA, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
6. FINRA has established internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
7. FINRA has carried out its evaluation of the effectiveness of the design and operation of FINRA's disclosure controls and procedures as of December 31, 2007. Based upon that evaluation, we have concluded that the disclosure controls and procedures are effective;
8. We have disclosed, based on FINRA's most recent evaluation of internal control over financial reporting, to FINRA's auditors and the Audit Committee of FINRA's Board of Governors:
 - a) Any significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect FINRA's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in FINRA's internal control over financial reporting.

May 22, 2008



Mary L. Schapiro
Chief Executive Officer



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 FINRA. 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 auditor and recommending the appointment of the independent auditor for approval by the Board of Governors, and makes clear that the independent auditor is 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 FINRA make the Chief Audit Executive directly responsible to the Audit Committee. In all respects, the Charter complies with standards applicable to publicly-owned companies. (The Charter for the FINRA Audit Committee is available at the following URL: www.finra.org/AboutFINRA/AuditCommitteeCharter/index.htm.)

During 2007, the Committee met five times, with the Committee members having a 96 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 auditor. The Audit Committee also had discussions with management, the internal auditors and the independent auditor related to the quality and adequacy of FINRA's internal controls and the internal audit organization, responsibilities, budget and staffing.

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

INDEPENDENT REGISTERED PUBLIC ACCOUNTANT (IRPA) FEES

	FINRA (1)	
	2007	2006
Audit services (2)	\$1,095,150	\$1,186,710
Audit-related services (3)	602,800	662,659
Tax services (4)	25,000	—
Total	\$1,722,950	\$1,849,369

(1) FINRA based its fees reported for 2007 and 2006 on fees approved by FINRA's Audit Committee as of March 31, 2008, and March 31, 2007, respectively. The 2007 audit services, audit-related services and tax services include estimates to complete the current work in process. FINRA has updated 2006 fees from the prior year report to reflect final amounts paid for the 2006 approved services. Since FINRA ceased consolidating NASDAQ operations on December 20, 2006, it 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 2007 and 2006, audit services represent the year-end financial statement audit and the attestation on internal control under Section 404 of the Sarbanes-Oxley Act of 2002.

(3) Audit-related services in 2007 and 2006 reflect fees associated with the special-purpose audit of the Investment Advisers Registration Depository, agreed-upon procedures over the Central Registration Depository, and the audit of the FINRA Investor Education Foundation and the Company's employee benefit plans. In 2007, audit-related services also include consultations associated with the consolidation of NASD and the member regulation operations of NYSE and agreed-upon procedures over the Continuing Education Program. In 2006, 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.

Audit Committee Report (continued)

The Audit Committee discussed and reviewed with the independent auditor 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, 2007; management's assessment of the effectiveness of FINRA's internal control over financial reporting; and E&Y's report on the financial statements and on FINRA's internal control over financial reporting. Based on those discussions, the Audit Committee recommended to the Board of Governors that FINRA's audited financial statements and related reports on internal control be included in the Annual Report for the year ended December 31, 2007.

Members of the Audit Committee:

James E. Burton, Chair
Charles A. Bowsher
John F. X. Dolan
W. Dennis Ferguson
Kurt P. Stocker

May 22, 2008

Investment Committee Report

Year Ended December 31, 2007

The FINRA endowment (the Fund) is a permanent fund principally created from the proceeds of the sale of FINRA's interest in NASDAQ. The purpose of the Fund is to support FINRA's operations for the benefit of investors and member firms and to provide FINRA 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 is determined annually by the FINRA 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.

The Fund generated net investment returns of 8.6 percent (compared to a custom benchmark return of 10.1 percent). At the end of the year, the Fund totaled more than \$1.9 billion. Relative performance reflects revisions to the current investment policy in 2007 which will take time to fully implement. The custom benchmark is reflective of a future targeted allocation and may not be fully representative in the early years of the endowment.

	1 Year	2 Years	3 Years
Managed Investments*	8.6%	10.8%	9.3%
Custom Benchmark	10.1%	11.9%	10.4%

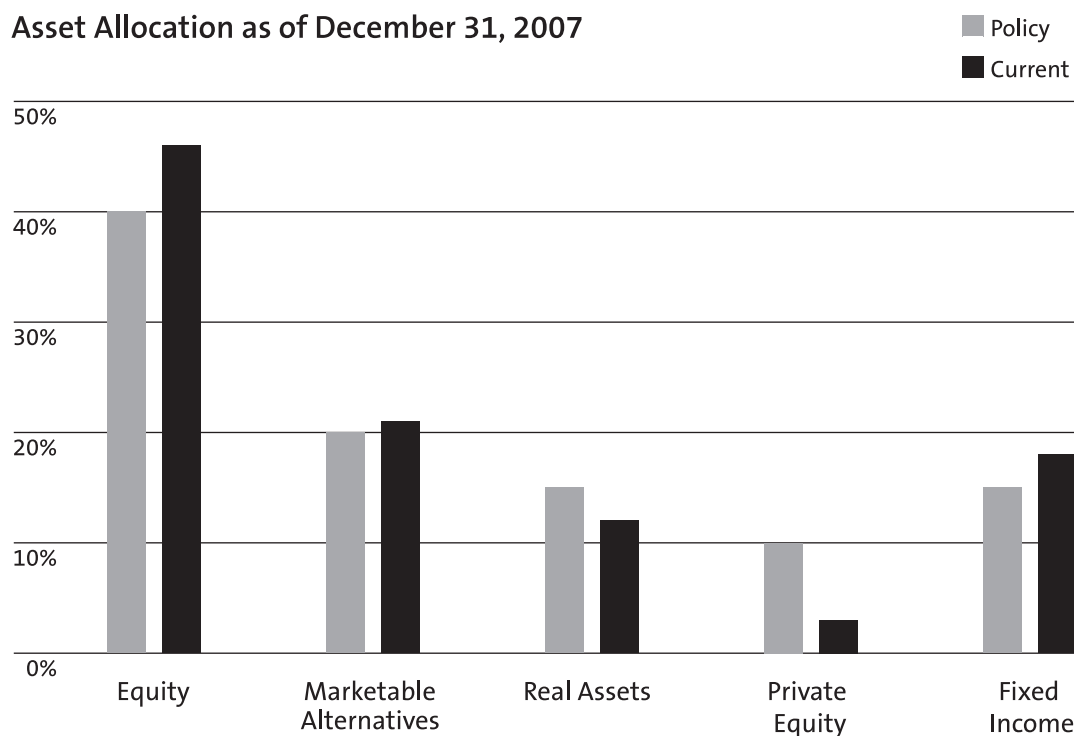
* Excludes operating funds

The FINRA Board of Governors is responsible for the Fund. In accordance with its written Charter adopted by the Board of Governors, the FINRA 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, strategy and allocation for the Fund. The FINRA Investments Office is responsible for managing the Fund within the framework of the Investment Policy Statement. FINRA engages investment consultants to support the Investments Office as needed in the areas of policy and guidelines. The Investment Committee met four times during 2007, with the committee members having a 93 percent attendance rate.

FINRA bases its Investment Policy Statement on best practices of endowment funds as applied to its investment objectives. The FINRA Investment Committee reviews the policy annually and recommends changes as deemed necessary, subject to approval by the FINRA Board of Governors. The Board last revised the policy on April 19, 2007. Due to the perpetual nature of the Fund, FINRA generally seeks to make long-term investments. FINRA 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.

Investment Committee Report (continued)



FINRA's Investment Policy Statement prohibits the purchase of any debt or equity interest in broker-dealer, exchange, contract market, regulatory client, alternative trading system or electronic communications network, as well as 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, unless this is an opportunity made available to a similarly situated asset manager or institutional investor. FINRA's Investments Office monitors the Fund to ensure that there are no prohibited investments. Furthermore, the Investment Policy Statement contains a proxy-voting policy and provisions related to conflicts of interest and professional conduct and ethics. The Investment Committee reviews the Investment Policy Statement annually to ensure the relevance of its content to current capital market conditions.

Members of the Investment Committee:

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

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

Board of Governors

Financial Industry Regulatory Authority, Inc.

We have audited the Financial Industry Regulatory Authority, Inc.'s (FINRA — see Note 1 to the Consolidated Financial Statements) internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). FINRA's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

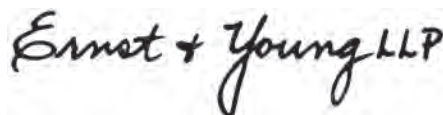
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material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

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

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

In our opinion, FINRA maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of FINRA as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in equity, and cash flows for the years then ended and our report dated May 22, 2008 expressed an unqualified opinion thereon.

The logo for Ernst & Young LLP, featuring the company name in a stylized, handwritten-style script.

McLean, Virginia
May 22, 2008

Report of Independent Registered Public Accounting Firm

Board of Governors

Financial Industry Regulatory Authority, Inc.

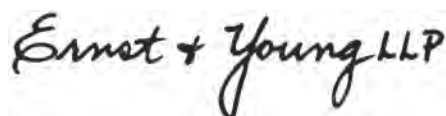
We have audited the accompanying consolidated balance sheets of the Financial Industry Regulatory Authority, Inc. (FINRA — see Note 1) as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in equity, and cash flows for the years then ended. These financial statements 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 FINRA at December 31, 2007 and 2006, 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), FINRA's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 22, 2008 expressed an unqualified opinion thereon.

The image shows the signature of Ernst & Young LLP in a cursive, handwritten style. The signature is written in black ink and is centered on the page.

McLean, Virginia
May 22, 2008

FINRA Consolidated Balance Sheets

(In millions)

	December 31,	
	2007	2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 412.5	\$ 82.9
Investments:		
Trading, at fair value	555.6	1,286.8
Available-for-sale, at fair value	911.0	654.1
Foundation available-for-sale, at fair value	22.3	26.0
Receivables, net	143.9	118.1
Investments receivable	80.6	155.1
Other current assets	24.1	21.1
Total current assets	2,150.0	2,344.1
Property and equipment:		
Land, buildings and improvements	101.0	99.5
Data processing equipment and software	192.2	173.4
Furniture, equipment and leasehold improvements	96.3	104.5
	389.5	377.4
Less accumulated depreciation and amortization	(233.2)	(226.2)
Total property and equipment, net	156.3	151.2
Goodwill and other intangible assets, net	43.4	0.5
Revolving credit facility receivable	22.3	20.0
Other investments	515.7	345.5
Other assets	71.3	66.5
Total assets	\$2,959.0	\$2,927.8

See accompanying notes.

FINRA Consolidated Balance Sheets (continued)

(In millions)

	December 31,	
	2007	2006
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 44.7	\$ 41.0
Accrued personnel and benefit costs	138.7	106.6
Deferred revenue	63.3	69.4
Deferred contribution income	5.2	2.7
Deposits and renewals	62.4	54.7
Investments payable	150.9	63.7
Other current liabilities	15.6	14.0
SEC fee payable	108.7	157.2
Total current liabilities	589.5	509.3
Accrued pension and other postretirement benefit costs	153.6	126.9
Deferred revenue	17.5	15.9
Deferred contribution income	51.3	52.0
Other liabilities	40.7	38.7
Total liabilities	852.6	742.8
Equity	2,151.4	2,178.4
Unrealized gain on available-for-sale investments	41.3	88.0
Net unrecognized employee benefit plan amounts	(86.3)	(81.4)
Total equity	2,106.4	2,185.0
Total liabilities and equity	\$2,959.0	\$2,927.8

See accompanying notes.

FINRA Consolidated Statements of Operations

(In millions)

	Years Ended December 31,	
	2007	2006
Revenues		
Operating revenues		
Regulatory fees, net of member rebates of \$6.1 in 2007 and \$50.0 in 2006	\$ 345.0	\$ 222.0
User fees	170.1	158.7
Dispute resolution fees	42.5	55.7
Transparency services fees	55.8	43.6
Contract services fees	62.7	27.2
Other	4.5	4.4
Total operating revenues	680.6	511.6
Fines	47.6	75.0
Activity assessment	281.6	185.0
Total revenues	1,009.8	771.6
Activity assessment cost of revenues	(285.1)	(184.8)
Net revenues	724.7	586.8
Expenses		
Compensation and benefits	446.1	395.1
Professional and contract services	199.2	148.4
Computer operations and data communications	30.8	26.1
Depreciation and amortization	40.6	36.1
Occupancy	40.2	30.2
General and administrative	55.3	62.7
Total expenses	812.2	698.6
Interest and dividend income	77.2	77.3
Operating loss	(10.3)	(34.5)
Other income (expense)		
Special payment to members in connection with the consolidation of NASD and the member regulation operations of NYSE	(178.3)	—
Net investment gains	113.8	131.5
Equity earnings from other investments	42.1	40.6
Other	5.7	—
(Loss) income from continuing operations	(27.0)	137.6
Income from discontinued operations (net of tax of \$2.6)	—	419.8
Net (loss) income	\$ (27.0)	\$ 557.4

See accompanying notes.

FINRA Consolidated Statements of Changes in Equity

(In millions)

	Equity	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2006	\$1,526.3	\$ 84.9	\$1,611.2
Net income	557.4	—	557.4
Unrealized loss on available-for-sale investments	—	(5.1)	(5.1)
Foreign currency translation	—	(0.3)	(0.3)
Minimum pension liability	—	4.4	4.4
Comprehensive income			556.4
Adjustment to initially record net unrecognized employee benefit plan amounts	—	(77.3)	(77.3)
Increase in equity attributable to the minority partners share of Preferred Stock Dividends	0.6	—	0.6
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of (\$940.6)	94.1	—	94.1
Balance, December 31, 2006	2,178.4	6.6	2,185.0
Net loss	(27.0)	—	(27.0)
Unrealized loss on available-for-sale investments	—	(46.7)	(46.7)
Employee benefit plan adjustments		(4.9)	(4.9)
Comprehensive loss			(78.6)
Balance, December 31, 2007	\$2,151.4	\$(45.0)	\$2,106.4

See accompanying notes.

FINRA Consolidated Statements of Cash Flows

(In millions)

	Years Ended December 31,	
	2007	2006
Reconciliation of net income to cash provided by operating activities		
Net (loss) income	\$ (27.0)	\$ 557.4
Net income from discontinued operations	—	419.8
(Loss) income from continuing operations	\$ (27.0)	\$ 137.6
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	40.6	36.1
Net investment gains	(113.8)	(131.5)
Undistributed earnings from other investments	(39.6)	(38.0)
Bad debt (recovery) expense	(5.6)	12.3
Other net non-cash income items	(1.5)	(4.2)
Net change in operating assets and liabilities, net of acquisitions and dispositions:		
Receivables, net	(20.1)	1.9
Net sales of trading securities	816.0	200.8
Other current assets	(5.3)	(14.8)
Other assets	(17.6)	(76.4)
Accounts payable and accrued expenses	3.5	8.7
Accrued personnel and benefit costs	30.9	(14.5)
Deferred revenue	(4.5)	7.5
Deferred contribution income	1.7	1.6
Deposits and renewals	7.7	(0.8)
SEC fee payable	(48.5)	—
Other current liabilities	1.2	0.5
Accrued pension and other postretirement costs	21.2	23.3
Other liabilities	1.1	(0.8)
Net cash provided by continuing operations	640.4	149.3
Cash provided by discontinued operations	—	80.6
Net cash provided by operating activities	\$ 640.4	\$ 229.9

See accompanying notes.

FINRA Consolidated Statements of Cash Flows (continued)

(In millions)

	Years Ended December 31,	
	2007	2006
Cash flow from investing activities		
Proceeds from redemptions of available-for-sale investments	\$ 321.3	\$ 1,275.6
Purchases of available-for-sale investments	(528.3)	(1,920.0)
Purchases of other investments	(248.9)	(76.0)
Return of capital from other investments	215.3	21.1
Proceeds from the sale of DTCC common stock	—	3.0
Purchase of NYSE member regulation operations	(48.4)	—
Purchases of property and equipment	(32.6)	(41.7)
Proceeds from sales of property and equipment	—	8.3
Cash used in investing activities — continuing operations	(321.6)	(729.7)
Cash used in investing activities — discontinued operations	—	(931.5)
Net cash used in investing activities	(321.6)	(1,661.2)
Cash flow from financing activities		
Change in restricted cash	11.1	49.8
Contributions and net investment income temporarily restricted	—	0.8
Other	(0.3)	(0.9)
Cash provided by financing activities — continuing operations	10.8	49.7
Cash provided by financing activities — discontinued operations	—	1,335.1
Net cash provided by financing activities	10.8	1,384.8
Increase (decrease) in cash and cash equivalents	329.6	(46.5)
Cash and cash equivalents at beginning of year	82.9	129.4
Cash and cash equivalents at end of year	\$ 412.5	\$ 82.9

See accompanying notes.

FINRA 2007 Notes to Consolidated Financial Statements

1. ORGANIZATION AND NATURE OF OPERATIONS

The Financial Industry Regulatory Authority, Inc. (FINRA), a Delaware corporation, wholly owns the following significant subsidiaries: FINRA Regulation, Inc. (FINRA REG), FINRA Dispute Resolution, Inc. (FINRA DR) and FINRA Investor Education Foundation (the Foundation); collectively referred to as FINRA or the “Company.”

FINRA is the largest non-governmental regulator of securities firms doing business in the U.S. Through its subsidiary FINRA REG, FINRA regulates the activities of the U.S. securities industry and regulates The Nasdaq Stock Market, Inc. (NASDAQ), the American Stock Exchange LLC (Amex), the International Securities Exchange and regulates and operates the over-the-counter (OTC) securities markets. FINRA REG carries out FINRA’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. FINRA 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 FINRA 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.

On July 30, 2007, NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange (NYSE) consolidated to form FINRA, the primary non-governmental regulator of securities brokers and dealers doing business with the public in the U.S. Throughout these Notes to Consolidated Financial Statements, FINRA or the Company will be used in reference to operations both prior and subsequent to the July 30, 2007, consolidation of personnel and functions from NASD and NYSE. See Note 3, “Consolidation of NASD and the Member Regulation Operations of NYSE” for additional information.

Prior to December 20, 2006, FINRA maintained voting control over NASDAQ through its ownership of the only share of Series D Preferred Stock. On December 20, 2006, NASDAQ redeemed the share of Series D Preferred Stock that had been issued to FINRA. As a result, FINRA no longer maintains voting control over NASDAQ and ceased consolidating NASDAQ operations effective December 20, 2006. See Note 4, “Discontinued Operations” for additional information.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of FINRA, its wholly-owned subsidiaries and discontinued operations. FINRA 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 units, FINRA 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 Statement 131 for separate disclosure as a reportable segment. FINRA’s chief operating decision maker, as defined by SFAS No. 131, is its Chief Executive Officer.

FINRA 2007 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

FINRA 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. FINRA 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 component of net investment gains in the consolidated statements of operations. FINRA carries available-for-sale securities at fair value and recognizes changes in fair value as an unrealized gain (loss) as a separate component of equity in the consolidated balance sheets.

Fair value is determined based on quoted market prices. Realized gains and losses on sales of securities are included in earnings using the average cost method. Investment receivables or payables (including short sales) relate to security trades executed prior to the balance sheet date, but not yet settled, as FINRA follows trade date accounting.

Other Investments

FINRA has investments in hedge funds and funds of hedge funds. FINRA accounts for these under the equity method. FINRA is also a limited partner in a number of private investment funds. FINRA accounts for investments in private investment limited partnerships under the cost or equity method in accordance with AICPA Statement of Position (SOP) No. 78-9, "Accounting for Investments in Real Estate Ventures," and as clarified by Emerging Issues Task Force (EITF) No. D-46, "Accounting for Limited Partnership Investments." Additionally, FINRA has retained the specialized accounting for its investments accounted for under the equity method pursuant to EITF Issue No. 85-12, "Retention of Specialized Accounting for Investments in Consolidation."

Valuation Factors

The Company regularly monitors and evaluates the realizability of its available-for-sale and cost method investments. When assessing realizability, including 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 of unrealized losses, 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 its cost and equity method investments for potential indicators of impairment. If events and circumstances indicate that a decline in the value of these assets has occurred and is deemed other-than-temporary, the carrying value of the investment is reduced to its fair value and the impairment is charged to earnings.

RECEIVABLES, NET

The Company's receivables are primarily concentrated with FINRA members, associated persons, NYSE, NASDAQ, Amex and other exchanges. The financial statements show receivables net of reserves for uncollectible accounts of \$6.5 million and \$15.4 million as of December 31, 2007, and 2006, respectively. FINRA calculates reserves based on the age, source of the underlying receivable, and past collections. FINRA 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. The reserve balance as of December 31, 2007, included specific adjustments related to fines activity. 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 Revenues and Cost of Revenues" for further discussion. The reserve is increased by the provision for bad debts, which is charged against

FINRA 2007 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

operating results and decreased by the amount of charge-offs, net of recoveries. FINRA based the amount charged against operating results on several factors, including a continuous assessment of the collectability 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.

PROPERTY AND EQUIPMENT

FINRA records property and equipment at cost less accumulated depreciation. 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 \$33.6 million and \$30.6 million for the years ended December 31, 2007, and 2006, respectively.

In December 2006, FINRA exercised the option in its lease to purchase the grounds of its Decoverly building, located in Rockville, Maryland. The cost of exercising the option was \$6.1 million, which FINRA recorded in land, buildings and improvements, as appropriate, in the accompanying consolidated balance sheets.

SOFTWARE COSTS

FINRA 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." FINRA 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. FINRA 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.

The financial statements reflect unamortized, capitalized software development costs of \$34.7 million and \$29.3 million as of December 31, 2007, and 2006, respectively, within data processing equipment and software in the consolidated balance sheets. Amortization of costs capitalized under SOP No. 98-1 totaled \$15.0 million and \$12.7 million for the years ended December 31, 2007, and 2006, respectively, and is included in depreciation and amortization in the consolidated statements of operations. Net additions to capitalized software were \$20.4 million and \$14.2 million in 2007 and 2006, respectively.

GOODWILL AND INTANGIBLE ASSETS

FINRA's \$14.8 million goodwill balance represents the excess of consideration paid for the acquired member regulation operations of NYSE over the fair value of the net assets acquired. FINRA's acquired intangible assets as a result of the consolidation of NASD and the member regulation operations of NYSE were recognized at fair value as of the date acquired apart from goodwill. The accounting for goodwill and intangible assets is governed by the provisions of SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires the evaluation of goodwill and intangibles with indefinite lives for impairment at least annually or more frequently if events and circumstances indicate that the asset might be impaired. Intangible assets with finite lives are amortized over their useful lives and tested for impairment when events or circumstances warrant. Intangible assets related to the NASD/NYSE consolidation totaled \$28.0 million, net of accumulated amortization of \$2.5 million as of December 31, 2007. FINRA also has intangible assets related to software licenses that are not related to the NYSE transaction in the amount of \$0.6 million, net of accumulated amortization of \$0.3 million, and \$0.5 million, net of accumulated amortization of \$3.5 million as of December 31, 2007, and 2006, respectively. See Note 3, "Consolidation of NASD and the Member Regulation Operations of NYSE" for additional information.

FINRA 2007 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, FINRA performs an evaluation of recoverability, which compares 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 indicates impairment, the Company prepares a discounted cash flow analysis to determine the amount of the impairment. In 2007 and 2006, there were no indicators of long-lived asset impairment, and no write-downs were recorded.

REVOLVING CREDIT FACILITY RECEIVABLE

In February 2005, Amex borrowed \$25.0 million from FINRA under a revolving credit facility. FINRA recorded an initial discount of \$8.6 million related to this receivable, representing the difference between the stated rate of interest of 5.0 percent and the estimated market rate of 11.2 percent. FINRA recognizes interest using the effective interest method, taking into account credit risk. For the years ended December 31, 2007, and December 31, 2006, FINRA recognized interest on the note and accretion of the discount of \$2.3 million and \$2.0 million, respectively, within interest and dividend income in the consolidated statements of operations. The maturity date for the revolving credit facility is October 31, 2011. At maturity, FINRA will receive a total of \$33.4 million including accrued interest.

OTHER ASSETS

Included in other current assets are funds held in escrow, to be distributed in connection with a FINRA enforcement case, in the amount of \$4.2 million and \$4.0 million as of December 31, 2007, and 2006, respectively. See Note 2, "Deposit and Other Renewal Liabilities," for the corresponding liability related to these funds.

Included in other current assets and other long-term assets in the consolidated balance sheets are funds from the Global Research Analyst Settlement (the Settlement), including the interest earned on these funds. The Settlement funds are included in other assets because their 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. The current and long-term portions of the Settlement funds as of December 31, 2007, were \$5.2 million and \$51.6 million, respectively. The current and long-term portions of the Settlement funds as of December 31, 2006, were \$2.7 million and \$43.1 million, respectively. See Note 2, "Deferred Contribution Income" for more information related to the Settlement.

DEFERRED REVENUE

Deferred revenue represents cash received and billed receivables for which FINRA 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 14 months to 11 years. The estimated service period for registration fees is four years and three-and-a-half years as of December 31, 2007, and 2006, respectively, with the annual portion recognized over 12 months. The estimated service period for arbitration fees is 14 months and 15 months as of December 31, 2007, and 2006, respectively. The estimated service period for member application fees is 11 years and 10 years as of December 31, 2007, and 2006, respectively. The changes in estimated service periods represent a change in accounting estimate in accordance with SFAS No. 154, "Accounting Changes and Error Corrections," that did not have a material effect on FINRA's consolidated statements of operations.

FINRA 2007 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 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 accreted to \$55.0 million, less expenses, using the interest method.

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 was reported as a current receivable on the Foundation balance sheet, representing the net present value of the final annual installment due in October 2007.

During 2007, the Foundation received the final installment of \$11.0 million. The Foundation recorded additional income on the Settlement funds of \$0.4 million, which represented interest from the SEC and accretion of the interest on the receivable.

As mentioned in Note 1, the Foundation is a consolidated subsidiary of FINRA. At the consolidated level, FINRA has recorded the amounts the Foundation received in relation to the Order, including interest earned on these funds, as deferred contribution income in the consolidated balance sheets, and recognizes the related revenue as the Foundation makes grant payments and incurs expenses pursuant to the guidelines in the Order. To the extent any of the \$55.0 million is not used, FINRA may be required to return it to the SEC. For the years ended December 31, 2007, and 2006, the Foundation recognized revenue and incurred grant payments and expenses against the Settlement funds of \$2.0 million and \$0.4 million, respectively.

DEPOSIT AND RENEWAL LIABILITIES

FINRA-registered firms make deposits into FINRA's Central Registration Depository (CRD) system to pay for services, including registration fees charged by states and other SROs. Total CRD-related deposits were \$58.2 million and \$50.7 million as of December 31, 2007, and December 31, 2006, respectively. Also included in deposits and renewals in the consolidated balance sheets as of December 31, 2007, and 2006 were \$4.2 million and \$4.0 million, respectively, to be distributed in connection with a FINRA enforcement case. See Note 2, "Other Assets," concerning the funds held in escrow related to this distribution.

OTHER LIABILITIES

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

FINRA REG 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, FINRA REG collects all fees and incurs expenses, and tracks and reports them to the SEC on a quarterly basis. FINRA records fees that it has collected but not earned yet as deferred revenue in the consolidated balance sheets.

In accordance with the IARD Memorandum of Understanding (MOU) with the SEC, signed on July 24, 2001, 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. FINRA recorded a reserve, which represents the cumulative cash basis

FINRA 2007 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

surplus, in deferred revenue and other liabilities in the consolidated balance sheets as detailed below. FINRA REG has applied the same principles of the MOU with the SEC to the cumulative surplus attributable to filings by state-registered investment advisers.

As of December 31, 2007, and 2006, FINRA recorded the cumulative cash basis surplus for the IARD program in its consolidated financial statements as follows:

	As of December 31,	
	2007	2006
	<i>(in millions)</i>	
Current deferred revenue	\$ 7.8	\$ 7.1
Non-current deferred revenue	1.9	2.3
Other liabilities	25.4	21.4
Total	\$35.1	\$30.8

REVENUE RECOGNITION AND COST OF REVENUE

Regulatory Fees

FINRA uses regulatory fees to fund regulatory activities, including the supervision and regulation of members through examination, policy making, rulemaking 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 calculated on the sell side of all member transactions in all covered securities regardless of where the trade is executed and is assessed directly on the firm responsible for clearing the transaction. Member firms self-report the Trading Activity Fee to FINRA, which recognizes the income in the month the transactions occur. Due to the Trading Activity Fee being a self-reported revenue stream for FINRA, subsequent adjustments by clearing firms may occur. FINRA recognizes these adjustments as revenue adjustments in the period they become known to FINRA. The Gross Income Assessment and Personnel Assessments represent annual fees charged to member firms and representatives. The Branch Office Assessment has an initial fee component in addition to annual fees. The initial fee component is recognized over the estimated economic relationship period, while annual fees are recognized ratably over the annual period to which they relate.

User Fees

User fees are charged for initial and annual registrations, qualification exams, FINRA-sponsored educational programs and conferences, reviews of advertisements and corporate filings (corporate financing fees). Registration fees include both an initial and annual fee charged to all FINRA-registered representatives and investment advisers. FINRA 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. FINRA recognizes qualification fees as examinations or continuing education programs are administered. FINRA-sponsored meetings and conference fees include fees paid by financial services industry participants for participating in FINRA's educational programs. FINRA recognizes these fees when the program or conference takes place. Advertising fees represent fees charged for the review of FINRA member firms' communications to ensure that they are fair, balanced and not misleading. FINRA recognizes advertising fees as revenue as the review is completed. Corporate financing fees consist of amounts charged by FINRA for reviewing proposed public offerings. FINRA recognizes corporate financing fees when the review is completed.

Dispute Resolution Fees

FINRA 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, FINRA DR prepares a final bill 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 FINRA DR

FINRA 2007 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 FINRA DR's comprehensive arbitrator and mediator application and training program.

Transparency Services Fees

Transparency services fees for quoting and trade reporting are charged through the Trade Reporting and Compliance Engine (TRACE) and the Alternative Display Facility (ADF). In addition, fees are charged for services relating to quoting of certain OTC Equities on the OTC Bulletin Board (OTCBB) and trade reporting of OTC Equities through the OTC Reporting Facility (ORF). TRACE fees include market data fees as well as fees charged on secondary market transactions in eligible fixed income securities reported to FINRA. ADF fees include market data fees as well as fees for posting quotes and for reporting and comparing trades. OTCBB is a regulated quotation service in which fees are charged for a variety of services related to the display of real-time quotes in OTC Equity securities that are eligible for quotation on the OTCBB. In addition, fees are earned for the sale of market data from the OTCBB and the ORF. FINRA recognizes transparency services fees as the transactions occur and when the market data is sold.

Contract Services Fees

Contract services fees represent amounts charged by FINRA and FINRA REG for regulatory and registration services provided under contractual arrangements. FINRA recognizes contract service fees as the services are provided.

Interest and Dividend Income

FINRA recognizes interest and dividend income from cash, trading investments and available-for-sale investments as it is earned.

Fines

Fines represent sanctions for rule violations, which FINRA recognizes upon issuance of a written consent or litigation decision. FINRA does not view fines as part of its operating revenues. FINRA established separate guidelines for the use of fines, which provide that:

- 1) All fine monies are collected and segregated from FINRA revenues into a separate account;
- 2) Fine monies collected or anticipated are not included in FINRA 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 capital expenditures and specified regulatory projects; and
- 5) FINRA reports to its Board of Governors the projects and purposes for which it plans to and has used fine monies.

Activity Assessment Revenues and Cost of Revenues

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

FINRA recovers the cost of the SEC's fees and assessments through an activity assessment billed to clearing and self-clearing firms based on the aggregate dollar amount of sales of covered securities transacted by or through any member otherwise than on a national securities exchange. The assessments billed to securities firms are recognized when the transactions are reported.

FINRA 2007 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FINRA 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. FINRA reports amounts pending remittance to the SEC in SEC fee payable in the accompanying consolidated balance sheets.

FINRA relies on third-party providers and securities firms to report activity in a complete, accurate and timely manner for purposes of determining the activity assessment revenues and cost of revenues. In addition, prior to automation in December 2006, the activity assessments for certain discrete OTC transactions were self-reported to FINRA. Given these factors, subsequent adjustments may occur. FINRA recognizes any resulting activity assessments adjustments in the period they become known to FINRA.

In connection with a review that FINRA performed to ensure that member firms were properly self-reporting transactions in accordance with Schedule A of FINRA's By-Laws for the periods of 1997 through 2004, it was determined that certain transactions were not properly self-reported to FINRA. 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, 2007, and 2006. During 2007, FINRA notified the SEC of its final findings related to the improperly reported transactions and settled this matter during the first quarter of 2008. The Company reflected the related amounts in the income statement as activity assessment revenues and cost of revenues for the years ended December 31, 2007, and 2006.

PENSION AND OTHER POSTRETIREMENT 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 qualified Employee Retirement Plan (ERP) and a non-qualified Supplemental Executive Retirement Plan (SERP). On January 1, 2007, FINRA implemented an employer-funded defined contribution Retiree Medical Account Plan (the Plan) to assist FINRA employees and retirees with the 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 FINRA service beginning at age 40. FINRA uses several statistical and other factors, which attempt to anticipate future events, in calculating the expense and liability related to these plans. Key factors include assumptions about the expected rates of return on plan assets and the discount rate as determined by the Company, within certain guidelines, as well as assumptions regarding future salary increases, mortality, turnover, retirement ages and the medical trend rate. The Company considers market conditions, including changes in investment returns and interest rates, in making these assumptions. The discount rate used in the calculations is developed considering changes in Moody's Aa bond ratings and a hypothetical bond portfolio, or specific bond matching approach. 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 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. FINRA included the effect of adopting SFAS No. 158 on the Company's financial condition at December 31, 2006, in the accompanying consolidated financial statements. 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.

FINRA 2007 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INCOME TAXES

FINRA, FINRA REG and FINRA DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). The remaining consolidated subsidiaries of FINRA are taxable entities. FINRA 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). FINRA 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

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

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.

FINRA 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. FINRA uses multiple outside investment managers to manage its investment portfolio and a custody agent, a publicly traded company located in New York, to hold the Company's trading securities.

FINRA is dependent on a supplier that provides many of its infrastructure-related 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 FINRA on January 1, 2008. The Company is currently assessing the potential impact that the implementation of SFAS No. 157 will have on its financial statements, if any.

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 FINRA on January 1, 2008. The Company does not plan to utilize the fair value option on any financial assets or liabilities not already recorded at fair value effective January 1, 2008. As such, the adoption of SFAS No. 159 will not have a material impact on the Company's consolidated results of operation and financial position.

RECLASSIFICATIONS

FINRA has reclassified certain amounts for the prior year to conform to the 2007 presentation.

FINRA 2007 Notes to Consolidated Financial Statements

3. CONSOLIDATION OF NASD AND THE MEMBER REGULATION OPERATIONS OF NYSE

On July 30, 2007, NASD and NYSE consummated their plan to consolidate their member regulation operations into FINRA, the largest non-governmental regulator for all securities firms doing business with the public in the U.S. In accordance with the related Asset Purchase Agreement (APA), NYSE transferred to NASD approximately 440 employees and related expenses and revenues from NYSE's: (i) member firm regulation (including testing, continuing education and registration); (ii) risk assessment; (iii) arbitration; and (iv) enforcement (except for the portion relating to cases with respect to market surveillance and NYSE trading rules) operations. The results of the consolidation of NASD and the member regulation operations of NYSE are included in FINRA's statements of operations starting with the July 30, 2007, consolidation date.

NASD and NYSE also entered into the following agreements as a result of the planned consolidation: (i) a Security and Facilities Services Agreement (SFSA), whereby FINRA agreed to sublet certain NYSE-leased premises, and NYSE agreed to provide FINRA with certain security and facilities services, such as leased premises inspection; (ii) a Transition Services Agreement, whereby NYSE agreed to provide FINRA with certain information technology services; and (iii) two Regulatory Services Agreements, whereby FINRA agreed to provide both NYSE and NYSE Arca, an indirectly wholly-owned subsidiary of NYSE, with certain regulatory services.

The transaction was accounted for as a business combination using the purchase method of accounting, in accordance with the provisions of SFAS No. 141, "Business Combinations," with FINRA as the acquirer. Accordingly, FINRA compared the total cost of the consolidation to the estimated fair values (on July 30, 2007, the date of consolidation) of the tangible and intangible assets acquired and liabilities assumed. The excess of FINRA's purchase price paid over the fair value of the assets it acquired and the liabilities it assumed is recorded as goodwill.

FINRA paid \$48.4 million in cash related to the consolidation, including \$5.8 million of direct transaction costs incurred by the Company. FINRA acquired assets totaling \$6.2 million, consisting of capitalized software, furniture and fixtures and IT equipment. Additionally, FINRA has identified separate intangible assets arising from the transaction totaling \$30.5 million, consisting of its access to NYSE Group Membership Lists (\$10.3 million), transferred copyrights (\$6.5 million) and an executory contract related intangible asset (\$13.7 million). The executory contract related intangible asset in the amount of \$13.7 million relates to the SFSA and represents the difference between the net present value of the payment stream at cost versus fair value. This asset will be amortized over the five-year life of the contract. FINRA also assumed certain liabilities in connection with the transaction totaling \$3.1 million.

The following table summarizes the calculation of the resulting goodwill balance (dollars in millions):

Total cash consideration paid	\$ 48.4
Less: Fair value of acquired assets	(6.2)
Fair value of intangible assets	(30.5)
Add: Assumed liabilities	3.1
Goodwill	<u>\$ 14.8</u>

A detail of the separately identified intangibles that were acquired by FINRA is as follows (dollars in millions):

Description	Useful Life	Gross Carrying Amount July 30, 2007	Accumulated Amortization through December 31, 2007	Net Carrying Amount as of December 31, 2007
Membership lists	11 years	\$10.3	\$0.4	\$ 9.9
Copyrights	3 years	6.5	0.9	5.6
Executory contract related	5 years	13.7	1.2	12.5
Total		<u>\$30.5</u>	<u>\$2.5</u>	<u>\$28.0</u>

FINRA 2007 Notes to Consolidated Financial Statements

3. CONSOLIDATION OF NASD AND THE MEMBER REGULATION OPERATIONS OF NYSE (CONTINUED)

As of December 31, 2007, estimated amortization expense for each of the next five years is as follows: 2008, \$5.9 million; 2009, \$5.9 million; 2010, \$4.9 million; 2011, \$3.7 million; and 2012, \$2.5 million.

After assuming the member regulation operations of NYSE, on August 1, 2007, FINRA made a \$178.3 million special payment to member firms.

4. DISCONTINUED OPERATIONS

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

In accordance with SFAS No. 144, FINRA reflected NASDAQ as a discontinued operation for the year ended December 31, 2006. Accordingly, the revenues, costs and expenses of NASDAQ for the year ended December 31, 2006, 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, FINRA reported NASDAQ as a separate segment under the provisions of SFAS No. 131.

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

	Year Ended December 31, 2006
	<i>(in millions)</i>
NASDAQ, net of tax and minority interest:	
Net income	\$ 127.9
Minority interest in NASDAQ	(124.0)
Subtotal	3.9
Consolidating adjustments:	
Intercompany eliminations	\$ 16.8
Gains on sales of NASDAQ stock	215.9
Warrants mark-to-market and expiration	183.2
Subtotal	415.9
Income from discontinued operations	\$ 419.8

FINRA 2007 Notes to Consolidated Financial Statements

4. DISCONTINUED OPERATIONS (CONTINUED)

The following table summarizes the total proceeds and net realized gains recognized by FINRA 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
	<i>(in millions)</i>			
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
Exercise of warrants	10.5	—	166.7	54.9
Total	15.3	1.0	\$ 447.7	\$ 215.9
2005 and Prior				
Rule 144 sales — November 2005	4.5	—	\$ 161.3	\$ 154.4
Secondary offering — February 2005	16.6	—	140.4	133.0
Pay down of Series C Cumulative Preferred Stock	—	0.4	40.0	—
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	6.8	—	103.1	97.1
Total	84.7	0.4	\$1,175.6	\$ 830.1
Grand 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.

The following table presents the condensed results of operations for NASDAQ for the year ended December 31, 2006 (in millions):

Net revenues	\$668.0
Income from discontinued operations	\$ 20.7

FINRA and NASDAQ have several agreements that remain in effect after completion of the divestiture. FINRA evaluated these relationships in accordance with EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of SFAS 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 FINRA and NASDAQ and the related fees.

FINRA provides regulatory services including surveillance, examination, investigation and enforcement for NASDAQ. Regulatory charges from FINRA to NASDAQ were \$21.8 million and \$30.2 million for the years ended December 31, 2007, and 2006, respectively, and are presented within contract service fees in the consolidated statements of operations. As the SRO for the NASDAQ TRF, FINRA provides operational services, including governance, rule making and market operations and regulatory services, including surveillance, examination, investigation and prosecution. Operational and regulatory charges from FINRA to the NASDAQ TRF were \$6.9 million and \$3.1 million for the years ended December 31, 2007, and 2006, respectively, and are presented within contract service fees in the consolidated statements of operations.

NASDAQ and FINRA have a contractual agreement to provide support services for the TRACE system. TRACE charges from NASDAQ to FINRA were \$2.6 million and \$2.9 million for the years ended December 31, 2007, and 2006, respectively, and are presented within professional and contract services in the consolidated statements of operations.

FINRA 2007 Notes to Consolidated Financial Statements

4. DISCONTINUED OPERATIONS (CONTINUED)

NASDAQ and FINRA have a contractual agreement to provide support services for the OTCBB and OTC Equities businesses. OTCBB and OTC Equities charges from NASDAQ to FINRA were \$14.3 million and \$14.6 million for the years ended December 31, 2007, and 2006, respectively, and are presented within professional and contract services in the consolidated statements of operations.

5. DEFERRED REVENUE

FINRA 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. FINRA 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 for firms over an estimated customer relationship period of 11 years and 10 years, as of December 31, 2007, and 2006, respectively. The initial fee element for individual representatives is amortized over an estimated customer relationship period of four years and three-and-a-half years, as of December 31, 2007, and 2006, respectively. Fees received on open arbitration cases also include multiple elements. FINRA defers and amortizes these fees over the average life of an arbitration case, or 14 months and 15 months as of December 31, 2007, and 2006, respectively. The changes in the estimated customer relationship periods above represent a change in accounting estimate, in accordance with SFAS No. 154, that did not have a material effect on FINRA's consolidated statements of operations. Registration and member application fees are included within user fees, and arbitration fees are included within dispute resolution fees in the consolidated statements of operations.

The following is a summary of amounts that FINRA included in current and non-current deferred revenue as of December 31, 2007, and the years over which FINRA will recognize those amounts:

	Registration	Arbitration	Annual	Total
	<i>(in millions)</i>			
Year ending December 31,				
2008	\$10.0	\$10.0	\$43.3	\$63.3
2009	7.7	0.1	—	7.8
2010	5.0	—	—	5.0
2011	2.3	—	—	2.3
2012 and thereafter	2.4	—	—	2.4
	\$27.4	\$10.1	\$43.3	\$80.8

FINRA 2007 Notes to Consolidated Financial Statements

5. DEFERRED REVENUE (CONTINUED)

The following is a summary of activity in FINRA's current and non-current deferred revenue for the years ended December 31, 2007, and 2006, 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
	<i>(in millions)</i>			
Balance as of January 1, 2007	\$ 26.2	\$ 17.0	\$ 42.1	\$ 85.3
Additions	11.3	19.1	237.0	267.4
Amortization	(10.1)	(26.0)	(235.8)	(271.9)
Balance as of December 31, 2007	\$ 27.4	\$ 10.1	\$ 43.3	\$ 80.8

	Registration	Arbitration	Annual and Other	Total
	<i>(in millions)</i>			
Balance as of January 1, 2006	\$ 26.9	\$ 22.0	\$ 28.9	\$ 77.8
Additions	11.8	30.3	215.3	257.4
Amortization	(12.5)	(35.3)	(202.1)	(249.9)
Balance as of December 31, 2006	\$ 26.2	\$ 17.0	\$ 42.1	\$ 85.3

6. INVESTMENTS

FINRA manages a diverse investment portfolio consisting of: (i) global government (state and local) securities; (ii) corporate and asset-backed securities; (iii) equity securities; (iv) exchange-traded funds; (v) mutual and commingled funds; (vi) hedge funds; (vii) private investments; and (viii) other financial instruments or structures. FINRA classifies its marketable investments as trading or available-for-sale based on their nature and FINRA's intent and ability to hold these securities.

In recent years, FINRA adopted a more diversified investment strategy 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. FINRA executes its investment strategy through separately-managed accounts (SMAs) and direct investments. FINRA has SMAs with several investment managers that have the authority to buy and sell investments within FINRA-determined, pre-established parameters. FINRA controls the buying and selling decisions of its direct investments.

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

	December 31,	
	2007	2006
	<i>(in millions)</i>	
Trading investments	\$555.6	\$1,286.8
Available-for-sale investments	933.3	680.1
Other investments:		
Equity method investments	445.0	323.5
Cost method investments	70.7	22.0
Total other investments	515.7	345.5

Trading Investments

As of December 31, 2007, FINRA's trading investments consisted of SMAs with a fair value of \$555.6 million. The total mark-to-market holding loss on trading securities held at December 31, 2007, was \$(20.1) million.

FINRA 2007 Notes to Consolidated Financial Statements

6. INVESTMENTS (CONTINUED)

In July 2006, FINRA's Board of Governors approved the creation of an investments office responsible for overseeing FINRA's investment portfolio in the best interests of the organization and its members. The investments office is also responsible for managing and implementing FINRA's investment policies and guidelines. Concurrent with the creation of the investments office, FINRA, 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. FINRA predicated the decision to re-designate these securities from available-for-sale to trading on the shift in FINRA's strategy to a more diversified 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.

FINRA 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. FINRA 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 was 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 FINRA'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, FINRA recognized gross realized gains and losses on sales of investments in SMAs of \$22.8 million and \$7.4 million, respectively.

Available-for-Sale Investments

As of December 31, 2007, FINRA's available-for-sale investments principally consisted of the following:

	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
		<i>(in millions)</i>		
Mutual/commingled/exchange-traded funds	\$870.5	\$56.8	\$16.3	\$911.0

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

	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
		<i>(in millions)</i>		
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

For the year ended December 31, 2007, FINRA recognized net investment gains from its investments in mutual and commingled funds of \$94.7 million. The above-mentioned net investment gains include reclassifications from unrealized gains and losses on investments in mutual and commingled funds of \$47.3 million. 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 FINRA had recognized when it sold the security.

For the year ended December 31, 2006, FINRA 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. 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 for the year ended December 31, 2006.

FINRA 2007 Notes to Consolidated Financial Statements

6. INVESTMENTS (CONTINUED)

As of December 31, 2007, the Foundation had investments in domestic mutual funds with a cost of \$21.5 million and a fair market value of \$22.3 million. As of December 31, 2006, the cost and fair market value of these investments was \$25.6 million and \$26.0 million, respectively. Of the Foundation's investments, \$0.8 million and \$3.5 million were restricted as of December 31, 2007, and 2006, respectively. These investments are restricted since their use is limited to financial education programs for military personnel and their families. FINRA intends to use the remaining funds of \$21.5 million and \$22.5 million as of December 31, 2007, and 2006, respectively, to continue to fund future Foundation research and educational projects.

Other-Than-Temporary Declines in Fair Market Value

For the year ended December 31, 2007, FINRA did not record any impairment charges related to its trading and available-for-sale investment portfolios. In addition, the Foundation recorded less than \$0.1 million in impairment related to one mutual fund in 2007. For the year ended December 31, 2006, FINRA 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 2006, FINRA also recorded \$5.1 million in impairment charges related to three mutual/commingled funds. In addition, the Foundation recorded impairment charges of \$0.7 million related to its mutual funds. Impairment charges relate to declines in the fair value of available-for-sale investments that FINRA judged as other-than-temporary. FINRA reflected these charges in net investment gains in the consolidated statements of operations.

Temporary Declines in Fair Market Value

As of December 31, 2007, FINRA had five mutual/commingled/exchange-traded funds with a fair market value of \$323.1 million and aggregate unrealized losses of \$16.3 million in an unrealized loss position for two months or less. The company has the ability and intent to hold these investments until recovery. As of December 31, 2006, FINRA had one mutual fund with a fair market value of \$30.6 million in an unrealized loss position of \$0.7 million for one month.

Other Investments

As of December 31, 2007, the Company had an investment of \$13.8 million in one limited partnership accounted for under the equity method, and \$70.4 million of investments in 20 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 \$166.5 million to 24 partnerships as of December 31, 2007, including three for which the initial funding will take place in 2008. FINRA also has investments in hedge funds and funds of hedge funds that it accounts for under the equity method and includes in other investments in the consolidated balance sheets. As of December 31, 2007, the Company had hedge fund investments of \$431.2 million. Also included within other investments are \$0.3 million of other cost-based investments. FINRA's weighted ownership interest of all equity method investees was 1.3 percent at December 31, 2007.

For the year ended December 31, 2007, FINRA recognized equity in earnings of hedge funds of \$44.0 million and equity losses of \$4.4 million. For the year ended December 31, 2007, FINRA recognized equity in earnings of a limited partnership of \$2.5 million. FINRA recorded impairment charges of \$2.0 million related to its investment in one limited partnership for the year ended December 31, 2007.

As of December 31, 2006, the Company had an investment of \$15.2 million in one limited partnership 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 had total outstanding commitments of \$157.4 million to 16 partnerships as of December 31, 2006, including four for which the initial funding took place in 2007. FINRA also has investments in hedge funds and funds of hedge funds that it accounts for under the equity method

FINRA 2007 Notes to Consolidated Financial Statements

6. INVESTMENTS (CONTINUED)

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.

For the year ended December 31, 2006, FINRA recognized equity in earnings of hedge funds of \$38.1 million and equity in earnings of a limited partnership of \$2.5 million.

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

8. FINRA CREDIT FACILITY

FINRA maintains an unsecured line of credit agreement and has the option to borrow up to \$50.0 million at LIBOR plus 0.3 percent (4.9 percent at December 31, 2007). This line of credit agreement expires on May 31, 2008. As of December 31, 2007, and December 31, 2006, no amounts were outstanding under this line of credit.

9. INCOME TAXES

FINRA, FINRA REG and FINRA DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). The remaining consolidated subsidiaries of FINRA are taxable entities.

As of December 31, 2007, and 2006, New NASD Holding, Inc., a wholly-owned subsidiary of FINRA, had net operating loss carry forwards of \$105.6 million, respectively, related to the operations of Amex prior to its disposition by FINRA, which begin to expire in 2020. Under SFAS No. 109, "Accounting for Income Taxes" and FASB Interpretation No. 48, "Accounting for Uncertainty in 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. FINRA does not believe it is more likely than not that it will realize the net operating loss and unrelated business loss carry forwards and therefore, has recorded a full valuation allowance as of December 31, 2007, and 2006. The amount of both the deferred tax asset and valuation allowance as of December 31, 2007, and 2006, was \$47.5 million.

As of December 31, 2007, and 2006, FINRA had unrelated business loss carry forwards of \$23.9 million and \$30.0 million, respectively, primarily related to FINRA's ADF, OTCBB and OTC Equities operations. The unrelated business loss carryforwards expire through 2027. There are no other significant deferred tax assets or liabilities related to unrelated business income activity.

10. EMPLOYEE BENEFITS

Defined Benefit Pension Plans

As of December 31, 2007, and 2006, the Company provided two non-contributory defined benefit pension plans for the benefit of its eligible employees, consisting of a qualified ERP plan and a non-qualified SERP plan. The benefits are based primarily on years of service and the employees' average compensation, as defined, during the highest 60 consecutive months of employment. FINRA has frozen the SERP plan with respect to new participants.

FINRA 2007 Notes to Consolidated Financial Statements

10. EMPLOYEE BENEFITS (CONTINUED)

FINRA established an irrevocable rabbi trust amount equal to its SERP obligation and consolidates this trust in accordance with EITF No. 97-14. As of December 31, 2007, and 2006, \$16.1 million and \$16.8 million of investments are included in cash and cash equivalents in the consolidated balance sheets, representing the amounts contributed by FINRA, plus earned interest, less distributions to retirees.

The investment policy and strategy of the plan assets, as established by the FINRA Pension Plan Committee (the 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. FINRA 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	2007	2006
Equity securities	55.0%	59.4%	64.7%
Debt securities and cash equivalents	20.0%	24.5%	20.1%
Other investment strategies	25.0%	16.1%	15.2%
Total	100.0%	100.0%	100.0%

The target allocations were amended in 2007 and transition to the new targets is in process.

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

Postretirement and Retiree Medical Benefit Plans

As of December 31, 2007, and 2006, the Company provided a non-contributory postretirement life insurance benefit plan for the benefit of eligible employees. The postretirement benefit plan provides a specified life insurance benefit to eligible retired employees. FINRA has frozen the postretirement benefit plan with respect to new participants.

On January 1, 2007, FINRA implemented an employer-funded defined contribution Retiree Medical Account Plan (the Plan) to assist FINRA employees and retirees with the 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 FINRA service beginning at age 40. Active employees may also accrue credits for a portion of their unused vacation and personal leave. The credits can be accessed only in retirement and may be used only toward paying a portion of monthly premiums under FINRA-sponsored retiree health plans.

Adoption of SFAS No. 158

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 required the Company to recognize the funded status (*i.e.*, the difference between the fair value of plan assets and the projected benefit obligation) of its pension plans and its postretirement 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." FINRA will subsequently recognize these amounts as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, FINRA will recognize actuarial

FINRA 2007 Notes to Consolidated Financial Statements

10. EMPLOYEE BENEFITS (CONTINUED)

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.

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 operations for the year ended December 31, 2006, 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
	<i>(in millions)</i>		
Accrued personnel and benefit costs	\$ 117.3	\$(10.7)	\$ 106.6
Total current liabilities	520.0	(10.7)	509.3
Accrued pension and other postretirement benefit costs	38.9	88.0	126.9
Total liabilities	665.5	77.3	742.8
Minimum pension liability	(4.0)	4.0	—
Net unrecognized employee benefit plan amounts	—	(81.4)	(81.4)
Total equity	2,262.3	(77.3)	2,185.0

FINRA 2007 Notes to Consolidated Financial Statements

10. EMPLOYEE BENEFITS (CONTINUED)

Plan Disclosures

The following tables disclose “pension benefits,” which include the defined benefit pension plans described above, and “other benefits,” which include the postretirement and retiree medical plans described above. The reconciliation of the projected benefit obligation, the change in the fair value of plan assets for the years ended December 31, 2007, and 2006, and the accumulated benefit obligation at December 31, 2007, and 2006, are as follows:

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
	<i>(in millions)</i>			
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 255.1	\$ 244.9	\$ 0.3	\$ 0.4
Service cost	23.8	24.2	1.6	—
Interest cost	14.2	13.3	1.2	—
Plan initiation	—	—	20.0	—
Amendments	—	1.8	0.5	—
Actuarial (gains) losses	(13.3)	(3.0)	(0.6)	(0.1)
Benefits paid	(9.0)	(26.1)	(0.5)	—
Benefit obligation at end of year	\$ 270.8	\$ 255.1	\$ 22.5	\$ 0.3
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 123.9	\$ 91.8	\$ —	\$ —
NASDAQ spin-off adjustment	—	(0.4)	—	—
Actual return on plan assets	6.4	12.6	—	—
Company contributions	12.5	46.0	0.5	—
Benefits paid	(9.0)	(26.1)	(0.5)	—
Fair value of plan assets at end of year	\$ 133.8	\$ 123.9	\$ —	\$ —
Underfunded status of the plan	\$(137.0)	\$(131.2)	\$(22.5)	\$(0.3)
Accumulated benefit obligation (ABO)	\$ 165.4	\$ 153.4		

FINRA 2007 Notes to Consolidated Financial Statements

10. EMPLOYEE BENEFITS (CONTINUED)

The liability recorded in the accrued personnel and benefits and accrued pension and other postretirement benefit cost sections of the consolidated balance sheets is as follows:

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
	<i>(in millions)</i>			
Current	\$ 5.0	\$ 4.6	\$ 0.9	\$ —
Noncurrent	132.0	126.6	21.6	0.3
Net amount at December 31	\$137.0	\$131.2	\$22.5	\$0.3

The Company does not expect any plan assets to be returned to it during the year ending December 31, 2008.

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

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
	<i>(in millions)</i>			
Unrecognized net transition (obligation) asset	\$ —	\$ 0.1	\$ (0.1)	\$(0.1)
Unrecognized prior service cost	(2.2)	(2.4)	(18.6)	—
Unrecognized net actuarial (loss) gain	(65.6)	(79.1)	0.2	0.1
Net amount at December 31	\$(67.8)	\$(81.4)	\$(18.5)	\$ —

The following amounts were included in other comprehensive income (loss) during the year ended December 31, 2007, in accordance with FAS 158:

	Incurred but Not Recognized	Reclassification Adjustment for
		Prior Period Amounts Recognized
	<i>(in millions)</i>	
Net transition asset		
Pension benefits	\$ —	\$(0.1)
	—	(0.1)
Prior service cost		
Pension benefits	(0.1)	0.3
Other benefits	(18.6)	—
	(18.7)	0.3
Actuarial (loss) gain		
Pension benefits	9.7	3.8
Other benefits	0.1	—
	9.8	3.8
	\$ (8.9)	\$ 4.0

FINRA 2007 Notes to Consolidated Financial Statements

10. EMPLOYEE BENEFITS (CONTINUED)

Estimated amounts to be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost during 2008 based on December 31, 2007, plan measurements are as follows:

	Pension Benefits	Other Benefits
	<i>(in millions)</i>	
Unrecognized prior service costs	\$0.2	\$1.4
Unrecognized actuarial losses	3.4	—

The weighted-average assumptions for all plans are as follows:

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
Discount rate	6.00%	5.75%	6.00%	5.75%
Expected return on plan assets	8.50%	8.50%	—	—
Rate of compensation increase	5.34%	5.34%	—	—

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

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
	<i>(in millions)</i>			
Service cost	\$ 23.8	\$24.2	\$1.6	\$—
Interest cost	14.2	13.4	1.2	—
Expected return on plan assets	(10.4)	(9.9)	—	—
Amortization of unrecognized transition asset	(0.1)	(0.1)	—	—
Recognized net actuarial losses	3.8	5.1	—	—
Prior service cost recognized	0.3	0.3	1.4	—
Curtailment/settlement loss recognized	0.2	4.5	—	—
	\$ 31.8	\$37.5	\$4.2	\$—

The assumed health care cost trend rate to be used for the next year to measure the expected cost of other benefits is 10.0 percent, with a gradual decline to 5.0 percent by the year 2015. This estimated trend rate is subject to change. The assumed health care cost trend rate can have a significant effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would not have a material impact on the benefit obligation or service and interest components of net periodic benefit cost.

FINRA measures its plans as of the end of each fiscal year. The ERP's funding policy targets a funded ratio of 100 percent of the ABO, with a corridor between 95 percent and 110 percent of the ABO. In 2008, FINRA expects to contribute \$8.6 million to the ERP plan and \$13.0 million to the SERP plan. In addition, FINRA expects to make the following benefit payments to participants over the next 10 years:

	Pension Benefits	Other Benefits
	<i>(in millions)</i>	
Year ending December 31,		
2008	\$ 15.9	\$ 0.9
2009	15.1	1.1
2010	14.5	1.4
2011	18.9	1.6
2012	26.6	1.9
2013 through 2017	146.2	12.6
Total	\$237.2	\$19.5

FINRA 2007 Notes to Consolidated Financial Statements

10. EMPLOYEE BENEFITS (CONTINUED)

All Other Benefit Plans

FINRA also maintains a voluntary contributory savings plan for eligible employees. Employees are immediately eligible to make elective contributions to the plan up to specified plan limits. Employees are also eligible to receive a corresponding dollar-for-dollar matching contribution from FINRA on any elective contribution made by the participant to the savings plan, up to a maximum of 4 percent of compensation. Eligible plan participants may also receive an additional discretionary matching contribution from FINRA. Savings plan expense for 2007 and 2006 was \$14.0 million and \$11.8 million, respectively, and is included within compensation expense in the consolidated statements of operations. The expense included a discretionary match totaling \$4.2 million for 2007 and \$3.6 million for 2006. On January 1, 2008, the plan was amended to increase the maximum limit on amounts eligible for the dollar-for-dollar matching contribution from 4 percent to 6 percent of compensation. The plan also added the retiree medical match equal to 25 cents on the dollar for elective contributions in excess of 6 percent of compensation, up to an annual limit of \$1,000.

FINRA established a deferred compensation plan for certain eligible employees under the provisions of Section 457(b) of the IRC. Eligible employees may contribute to the plan and, at its discretion, FINRA may make additional contributions to the plan. FINRA placed the assets of this plan within an irrevocable rabbi trust. FINRA 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, 2007, \$3.4 million of investments and \$3.4 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 participant contributions to this plan and accrued earnings. 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 and accrued earnings. As of December 31, 2007, and 2006, FINRA made no additional contributions to this plan.

On January 1, 2006, FINRA established a new defined contribution SERP plan for the Company's senior officers. FINRA makes annual contributions based on salary and a portion of incentive compensation. Contributions and earnings vest upon the earlier of: (i) the end of each third-year of participation following such contribution; (ii) attainment of age 62; (iii) death; or (iv) a disabled participant's termination of employment. As of December 31, 2007, \$0.9 million of investments and \$0.9 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 FINRA's contributions to this plan plus accrued earnings. 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 FINRA's contribution to this plan plus accrued earnings.

11. LEASES

FINRA leases and sublets certain office space and equipment in connection with its operations. The majority of these leases and subleases 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 and subleases was \$22.1 million and \$19.6 million for the years ended December 31, 2007, and 2006, respectively, and is included in occupancy expense in the consolidated statements of operations.

FINRA 2007 Notes to Consolidated Financial Statements

11. LEASES (CONTINUED)

Future minimum lease payments under non-cancelable operating leases and subleases with initial or remaining terms of one year or more consisted of the following at December 31, 2007 (amounts are in millions):

Year ending December 31,	
2008	\$ 29.0
2009	29.5
2010	29.7
2011	29.8
2012	23.5
Remaining years	124.4
Total minimum lease payments	\$265.9

12. COMMITMENTS AND CONTINGENCIES

Electronic Data Systems Corporation (EDS)

On April 1, 2003, FINRA and EDS entered into a service agreement (2003 EDS Agreement) that superseded an existing agreement with FINRA. The 2003 EDS Agreement expires on December 31, 2012. Under the 2003 EDS Agreement, FINRA 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. FINRA is also required to use EDS for all its production services needs. As consideration for the 2003 EDS Agreement, FINRA agreed to forgive a \$35.3 million deposit with EDS related to the previous EDS agreement. FINRA is amortizing this deposit on a straight-line basis over the remaining term of the 2003 EDS Agreement. As of December 31, 2007, and 2006, FINRA reported in other assets \$18.2 million and \$21.8 million, respectively, representing the unamortized balance of the deposit with EDS. FINRA recorded amortization expense (included in depreciation and amortization in the consolidated statements of operations) of \$3.6 million during both years ended December 31, 2007, and 2006.

Series 7 Exam

On January 6, 2006, FINRA 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 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, FINRA 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 FINRA and one of its contractors for breach of contract was filed in October 2006. FINRA filed a motion to dismiss in December 2006, and oral argument was heard in April 2007. In September 2007, FINRA's motion to dismiss was granted. In October 2007, the plaintiffs filed a notice of appeal. At this time, FINRA is not able to reasonably estimate a potential loss on these lawsuits or any additional unasserted claims. As a result, FINRA has not recorded any estimate for loss as of December 31, 2007, 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

FINRA **2007** Notes to Consolidated Financial Statements

12. COMMITMENTS AND CONTINGENCIES (CONTINUED)

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. Litigation settlements are included in professional and contract services in the consolidated statements of operations.

FINRA Board of Governors as of April 18, 2008

Richard G. Ketchum

Chairman
NYSE Regulation, Inc.
New York, NY

Charles A. Bowsher (Public)

Former Comptroller General
of the United States
Bethesda, MD

John J. Brennan (Industry)

The Vanguard Group, Inc.
Malvern, PA

Ellyn L. Brown (Public)

Brown & Associates
Lutherville, MD

Richard F. Brueckner (Industry)

Pershing LLC
Jersey City, NJ

James E. Burton (Public)

World Gold Council
London, England

Sir Brian Corby (Public)

Prudential Corporation plc (Retired)
Albury Ware, England

John F. X. Dolan (Industry)

Kellogg Specialist Group, LLC
Stowe, VT

W. Dennis Ferguson (Industry)

Sterne, Agee & Leach, Inc.
Boca Raton, FL

Richard L. Goble (Industry)

North American Clearing, Inc.
Longwood, FL

Harvey J. Goldschmid (Public)

Columbia University Law School
New York, NY

William H. Heyman (Public)

The Travelers Companies, Inc.
St. Paul, MN

Dr. Shirley Ann Jackson (Public)

Rensselaer Polytechnic Institute
Troy, NY

Robert J. McCann (Industry)

Merrill Lynch Global Wealth
Management
New York, NY

Richard S. Pechter (Public)

DLJ Financial Services Group &
DLJ Direct (Retired)
New York, NY

Thomas A. Russo (Industry)

Lehman Brothers Inc.
New York, NY

Mark A. Sargent (Public)

Villanova University School of Law
Villanova, PA

Mary L. Schapiro

FINRA
Washington, DC

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Enforcement

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Vice President and
Regional Director, West Region,
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Telecommunications

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Director of Operations,
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Business Area Audit,
Internal Audit

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Enforcement

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Investment Companies Regulation

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Vice President and
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Dispute Resolution

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Vice President and Director,
Washington Enforcement

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Vice President and
Chief Counsel,
Market Regulation

Geraldine M. Walsh
Vice President,
Office of Investor Education

George Walz
Vice President,
Examination Programs

FINRA Corporate Offices

1735 K Street, NW
Washington, DC 20006
Tel: (202) 728-8000

1801 K Street, NW
Washington, DC 20006
Tel: (202) 728-8000

9509 Key West Avenue
Rockville, MD 20850
Tel: (240) 386-4000

9513 Key West Avenue
Rockville, MD 20850
Tel: (240) 386-4000

One Liberty Plaza
165 Broadway
New York, NY 10006
Tel: (212) 858-4000

14 Wall Street
New York, NY 10005
Tel: (646) 315-7474

20 Broad Street
New York, NY 10005
Tel: (646) 315-8787

FINRA District Offices

Atlanta
3490 Piedmont Road, NE
Suite 500
Atlanta, GA 30305
Tel: (404) 239-6100
Fax: (404) 237-9290

Boca Raton

Crystal Corporate Center
2500 North Military Trail
Suite 302
Boca Raton, FL 33431
Tel: (561) 443-8000
Fax: (561) 443-7995

Boston

99 High Street
Suite 900
Boston, MA 02110
Tel: (617) 532-3400
Fax: (617) 451-3524

Chicago

55 West Monroe Street
Suite 2700
Chicago, IL 60603
Tel: (312) 899-4400
Fax: (312) 606-0742

Dallas

12801 North Central Expressway
Suite 1050
Dallas, TX 75243
Tel: (972) 701-8554
Fax: (972) 716-7646

Denver

4600 South Syracuse Street
Suite 1400
Denver, CO 80237
Tel: (303) 446-3100
Fax: (303) 620-9450

Kansas City

120 West 12th Street
Suite 800
Kansas City, MO 64105
Tel: (816) 421-5700
Fax: (816) 421-5029

Long Island

Two Jericho Plaza
2nd Floor, Wing A
Jericho, NY 11753
Tel: (516) 949-4200
Fax: (516) 949-4201

Los Angeles

300 South Grand Avenue
Suite 1600
Los Angeles, CA 90071
Tel: (213) 229-2300
Fax: (213) 617-3299

New Jersey

581 Main Street
Suite 710
Woodbridge, NJ 07095
Tel: (732) 596-2000
Fax: (732) 596-2001

New Orleans

1100 Poydras Street
Energy Centre
Suite 850
New Orleans, LA 70163
Tel: (504) 522-6527
Fax: (504) 522-4077

New York

One Liberty Plaza
165 Broadway
52nd Floor
New York, NY 10006
Tel: (212) 858-4000
Fax: (212) 858-4189

Philadelphia

1835 Market Street
Suite 1900
Philadelphia, PA 19103
Tel: (215) 665-1180
Fax: (215) 496-0434

San Francisco

One Montgomery Street
Suite 2100
San Francisco, CA 94104
Tel: (415) 217-1100
Fax: (415) 956-1931

Seattle

601 Union Street
Suite 1616
Seattle, WA 98101
Tel: (206) 624-0790
Fax: (206) 623-2518

FINRA Dispute Resolution Regional Offices

Midwest Region

55 West Monroe Street
Suite 2600
Chicago, IL 60603
Tel: (312) 899-4440

Northeast Region

One Liberty Plaza
165 Broadway
27th Floor
New York, NY 10006
Tel: (212) 858-4200

Southeast Region

Boca Center Tower 1
5200 Town Center Circle
Suite 200
Boca Raton, FL 33486
Tel: (561) 416-0277

West Region

300 South Grand Avenue
Suite 900
Los Angeles, CA 90071
Tel: (213) 613-2680

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