2005 Annual Financial Report

Contents

Management Report on Financial Operations

OVERVIEW

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

The following discussion and analysis of financial condition and results of operations should be read in connection with the consolidated financial statements and notes thereto included elsewhere in this Annual Financial Report. The 2005 consolidated financial statements reflect the activity of NASD and its consolidated subsidiaries, The Nasdaq Stock Market, Inc. (NASDAQ); NASD Regulation, Inc. (NASDR); NASD Dispute Resolution, Inc. (NASD DR); NASD Investor Education Foundation (the Foundation); and New NASD Holding, Inc. (NASD Holding), which held NASD's Class B interest in The American Stock Exchange LLC (Amex) until December 31, 2004. (References to NASD and its consolidated subsidiaries throughout are collectively referred to as "the Company.")

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

While this report reflects the consolidated operations of the Company, the primary focus is on the NASD segment, including NASDR and NASD DR. This focus is consistent with the steps NASD has taken to divest itself of ownership and operation of securities markets and is intended to highlight discussion of areas that will remain with NASD upon completion of the NASDAQ separation, which is expected in 2006.

For the years ended December 31, 2005 and 2004, the Company's consolidated net income was $293.4 million and $66.5 million, respectively. Included in net income in 2004 is the cumulative effect of a change in accounting principle of ($58.3) million, and for the years ended December 31, 2005 and 2004, (loss) income from discontinued operations of ($0.3) million and $19.7 million, respectively. Income from continuing operations for the years ended December 31, 2005 and 2004 was $293.7 million and $105.1 million, respectively. NASD management, along with the Board of Governors, made a commitment to adopt the provisions of Section 404 of the Sarbanes-Oxley Act of 2002 relating to internal control over financial reporting. With the issuance of this Annual Financial Report, NASD is one of the first tax-exempt organizations to adopt these provisions.

2005 YEAR-IN-REVIEW

In 2005, in addition to performing our core regulatory responsibilities, NASD came closer to completing its separation from NASDAQ. Through a series of transactions, we reduced our ownership stake in NASDAQ common stock to 18.4 percent (generating proceeds of $444.2 million). Through additional transactions in 2006, NASD has reduced its ownership in NASDAQ common stock to 11.4 percent. The U.S. Securities and Exchange Commission (SEC) approved NASDAQ's application to become an exchange on January 13, 2006, subject to certain conditions. We anticipate that NASDAQ will start operating as an exchange later this year, and NASD will complete its transition to becoming primarily a private-sector regulator.

Following are 2005 highlights for NASD in fulfilling its mission of investor protection and market integrity:

- NASD intensified its regulatory focus on sales of mutual funds, variable annuities and 529 College Savings Plans by bringing significant enforcement actions, advocating enhanced point-of-sale transparency and creating tools for investors and brokers aimed at better understanding and accessing information on these products.

- In February 2005, NASD's TRACE (Trade Reporting and Compliance Engine) began disseminating publicly, in real-time, price data for 99 percent of corporate bond trades and on January 9, 2006, NASD implemented full, real-time public dissemination of all TRACE price data. At the same time, NASD significantly expanded the distribution and accessibility of corporate bond information to both individual investors and professional subscribers.

- As part of its ongoing efforts to demystify the corporate, municipal and government bond markets for retail investors, NASD introduced a comprehensive, online learning center called Smart Bond Investing. NASD also introduced two major tools for mutual fund investing, including a new and improved Mutual Fund Expense Analyzer that delivers fee and expense information to investors for virtually all of the more than 18,000 mutual funds and 160 Exchange Traded Funds (ETFs). NASD's new Mutual Fund Breakpoint Search Tool offers investors and brokers an easy way to research eligibility for breakpoint discounts.

- NASD continued to bolster its investor education initiatives by issuing a variety of Investor Alerts on topics ranging from identifying bogus stock tips on cell phones to protecting online brokerage accounts from identity theft.

- The Foundation issued 15 grants totaling $3.4 million, and actively managed the 11 grants awarded in 2004, the Foundation's inaugural year. In addition, the Foundation initiated the Military Education Program with $6.8 million received from the First Command enforcement settlement. In September 2005, the U.S. District Court of the Southern District of New York issued an order allowing the SEC to turn over to the Foundation $55.0 million from its effort to set up an investor education foundation.

- NASD DR saw 6,074 new arbitration claims and 1,253 mediation claims filed, and closed 9,043 arbitration cases and 1,675 mediation cases in 2005. In addition, NASD realized its plan to establish dispute resolution hearing locations in all 50 states—the only SRO forum to do so; at year-end, there were 68 locations in the United States, Puerto Rico, and London.

- NASD worked with the SEC to make the mutual fund point-of-sale disclosure regime less complex and clearer to investors. NASD also advocated its proposed "Profile Plus" disclosure document, drafted in support of the recommendation of the Mutual Fund Task Force that NASD organized.

- In 2005, NASD's Examiner University commenced its first year of operation and graduated its first class, with 123 examiners completing Phase I, 81 completing Phase II, 50 completing Phase III, and 36 completing Phase IV. Examiner University provides a one-year course of classroom and on-the-job training for all incoming NASD examiners, with the goal of making sure that all examiners know as much about a firm and its products at the beginning of an examination as their predecessors knew at the end of one. The result is more efficient, cost-effective and consistent administration of our exam programs. In addition, NASD began an in-depth review of NASD's entire examination program, with the goal of creating a new operating model that is enabled by technology to better identify potential risks by analyzing data and thereby tailoring each exam based upon a member firms risk characteristics.

- With SEC approval, NASD executed a smooth transfer of the Over-the-Counter Bulletin Board (OTCBB) and other OTC Equities, including the pink sheets, (together "OTC Equities") from NASDAQ, effective October 1, 2005. This satisfied another condition of NASDAQ Exchange Registration, further expanded NASD's role in operating industry information services, and put more focus on the regulatory needs of OTC Equities.

- NASD continued to expand its compliance and regulatory related educational offerings in the U.S. and entered into a partnership with the University of Reading in England to establish a European hub for global capital markets regulation and compliance educational programs.

RESULTS OF OPERATIONS

REVENUES

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

	YEARS ENDED DECEMBER 31,							
	2005				2004			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated	NASD	NASDAQ	Consolidating Adjustments	Consolidated
				(in millions)				
Market services	$ –	$ 653.7	$ (7.7)	$ 646.0	$ –	$ 334.5	$ (2.0)	$ 332.5
Issuer services	–	226.0	(1.5)	224.5	–	205.8	(4.3)	201.5
Regulatory fees	185.5	–	–	185.5	222.8	–	–	222.8
User fees	145.3	–	–	145.3	137.3	–	–	137.3
Transparency services	22.8	–	–	22.8	14.7	–	–	14.7
Contract services	63.4	–	(40.9)	22.5	58.1	–	(53.4)	4.7
Dispute resolution fees	72.9	–	–	72.9	80.2	–	–	80.2
Other fees	7.2	0.2	(0.1)	7.3	14.3	0.1	(12.1)	2.3
Total operating revenue	497.1	879.9	(50.2)	1,326.8	527.4	540.4	(71.8)	996.0
Activity assessment	411.9	–	(12.8)	399.1	230.9	–	–	230.9
Fines	148.5	–	–	148.5	114.4	–	–	114.4
Total revenues	1,057.5	879.9	(63.0)	1,874.4	872.7	540.4	(71.8)	1,341.3
Cost of revenue	(413.5)	(353.9)	12.8	(754.6)	(230.9)	(55.8)	–	(286.7)
Net revenue	$ 644.0	$ 526.0	$ (50.2)	$ 1,119.8	$ 641.8	$ 484.6	$ (71.8)	$ 1,054.6

NASD

NASD net revenues were $644.0 million in 2005, compared with $641.8 million in 2004, an increase of $2.2 million or 0.3 percent.

Operating Revenues

Regulatory fees are used to fund NASD's member regulatory activities, including the regulation of members through examinations, financial monitoring, policymaking, rulemaking and enforcement activities. Regulatory fees include the transaction-based trading activity fee, as well as assessments based on member firm gross income and number of personnel. Regulatory fees were $185.5 million in 2005 compared with $222.8 million in 2004, a decrease of $37.3 million, or 16.7 percent, mainly due to a 25.0 percent rate reduction on the trading activity fee. In November 2004, the trading activity fee was reduced as part of a three-year phase-in of regulatory fee pricing changes, which were instituted to better align NASD's regulatory fees with its functions, efforts, and costs. Trading activity fees decreased from $110.0 million in 2004 to $78.5 million in 2005. Furthermore, due to NASD's overall solid financial performance, NASD issued rebates to its membership of $50.0 million in 2005, up from $30.0 million in the prior year. These rebates are recorded as a reduction of regulatory fees.

User fees include fees charged for initial and annual registrations, qualifications exams, fees associated with NASD-sponsored meetings and conferences, processing of membership applications and charges related to the review of advertisements and corporate filings. User fees were $145.3 million in 2005, compared with $137.3 million in 2004, an increase of $8.0 million, or 5.8

percent. User fees increased due mainly to a change in the rate structure for corporate financing fees, which increased by $4.1 million to $20.0 million in 2005. In 2004, NASD separated first-year registration fees into the initial and annual components and began deferring and amortizing the initial fee component over an estimated customer relationship period. See the "Cumulative Effect of a Change in Accounting Principle" section for further discussion.

Transparency services represent fees charged for services offered through TRACE, NASD's Alternative Display Facility (ADF) and, beginning October 1, 2005, fees associated with the OTC Equities. Transparency services revenues were $22.8 million in 2005 compared with $14.7 million in 2004, an increase of $8.1 million, or 55.1 percent. Included in transparency services in 2005 were revenues of $5.4 million from the OTC Equities. On September 2, 2005, NASD executed the OTCBB and OTC Equities Revocation of Delegation and Asset Transfer and Services Agreement (OTC Equities Agreement) with NASDAQ related to the OTC Equities. The OTC Equities includes OTCBB and is an electronic screen-based quotation service for securities that, among other things, are not listed on The NASDAQ Stock Market or any U.S. national securities exchange. Under the OTC Equities Agreement, effective October 1, 2005, NASD assumed responsibility for the OTC Equities from NASDAQ. NASD has included revenues generated from the OTC Equities within transparency services effective with the transfer on October 1, 2005.

Contract services represent amounts charged for regulatory services provided primarily to NASDAQ and Amex, as well as other exchanges such as the International Stock Exchange and the Chicago Climate Exchange, associated with surveillance, monitoring, legal and enforcement activities. Contract services fees were $63.4 million in 2005 compared with $58.1 million in 2004, an increase of $5.3 million or 9.1 percent. In June 2004 NASD and Amex executed a regulatory services agreement for NASD to provide such services to Amex. In 2005, NASD recognized $20.1 million in revenues from the regulation of Amex, compared with $6.6 million in 2004, as the Amex regulatory agreement became effective in June 2004. Offsetting this increase from Amex was a decline of $3.8 million in NASD's regulation charge to NASDAQ.

Dispute resolution fees totaled $72.9 million in 2005 compared with $80.2 million in 2004, a decrease of $7.3 million, or 9.1 percent. This decrease was driven by a 26.0 percent decline in the number of cases filed combined with a slight decline in the number of closed cases. Dispute resolution closed 9,043 cases in 2005, compared with 9,209 cases in 2004. Dispute resolution fees also include mediation fees, SRO annual fees, neutral training fees and other fees totaling $2.1 million for each year ended December 31, 2005 and 2004, respectively. SRO annual fees relate to the maintenance of dispute resolution services including arbitration and mediation, for SROs. Neutral training fees relate to NASD Dispute Resolution's comprehensive arbitrator and mediator application and training program. In 2004, in connection with the implementation of Emerging Issues Task Force (EITF) No. 00-21, "Revenue Arrangements with Multiple Deliverables," NASD changed its accounting for dispute resolution fees collected on open cases. See the "Cumulative Effect of a Change in Accounting Principle" section for further discussion.

Other fees decreased $7.1 million from 2004 to $7.2 million in 2005. Included in other fees were amounts recognized for administrative services provided to Amex of $4.4 million and $5.4 million for the years ended December 31, 2005 and 2004, respectively. In 2004, NASD and NASDAQ fulfilled their obligations to Amex with respect to the separation of NASDAQ and Amex shared technology applications. As part of this obligation, NASD and NASDAQ agreed to reimburse Amex for up to $29.0 million of costs it incurred to reintegrate its technology applications. In 2004, NASD received $4.6 million from NASDAQ (included in other fees for NASD) and contributed the $4.6 million, along with NASD's matching portion, to Amex in the form of a capital contribution. As of December 31, 2004, this program was fully funded.

Total Revenue and Net Revenue

Activity assessment fee and cost of revenues represent amounts incurred by NASD and owed to the SEC pursuant to Section 31 of the Securities Exchange Act of 1934. Activity assessment fees were $411.9 million in 2005 compared with $230.9 million in 2004, an increase of $181.0 million, or 78.4 percent. This increase was due to the increase in the SEC Section 31 fee rate that NASD collects through the activity assessment. The SEC Section 31 rate changed three times in 2005, resulting in an average rate increase for the year of 69 percent. The remaining increase is due to the increase in dollar volume trades during 2005 as compared to the prior year. Cost of revenues was $413.5 million in 2005 and $230.9 million in 2004, an increase of $182.6 million, or 79.1 percent. Cost of revenues increased consistently with revenues, as expected.

Fines represent amounts billed as sanctions for rule violations. NASD does not view fines as part of its operating revenues. Fines totaled $148.5 million in 2005 and $114.4 million in 2004, an increase of $34.1 million, or 29.8 percent. NASD's cash collections from fines were $134.3 million, of which $6.8 million was received by the Foundation, in 2005, compared with $103.9 million in 2004. The process that NASD has in place regarding the use of fines is designed to guard against potential conflicts in the organization's collection and use of fine monies. NASD's fine guidelines provide that: (1) all fine monies are collected and segregated from NASD revenues into a separate account, (2) fine monies collected or anticipated are not included in NASD operating revenues and play no role in developing its operating budget, (3) fine monies are not used to fund employee compensation, (4) the use of fine monies is limited to capital expenditures (approved by executive management, the Finance Committee of NASD's Board of Governors or NASD's Board of Governors) and regulatory projects specified by those groups as having a clear and direct link to protecting investors and ensuring market integrity, and (5) NASD reports annually to its Board of Governors the projects and purposes for which fine monies have been used.

NASDAQ

NASDAQ total revenues increased $339.5 million, or 62.8 percent, due to increases in market services of $319.3 million and issuer services of $20.2 million. Market services increased primarily due to increases in execution and trade reporting revenues from the acquisitions of Toll Associates, LLC (Toll) and Instinet Group Incorporated (Instinet). Toll is a holding company that owns a 99.8 percent interest in Brut, LLC (Brut). Instinet owns 100.0 percent of INET Holding Company, Inc., which owns 100.0 percent of INET ATS, Inc. (INET). Also contributing were increases in NASDAQ's execution market share for both NASDAQ-listed securities and securities listed on other exchanges, and an increase in the percentage of share volume reported to NASDAQ's systems, despite a decrease in average daily share volume. Furthermore, NASDAQ Market Center revenues increased from reductions in the liquidity rebate payments for the non-Brut portion and non-INET portion of the NASDAQ Market Center in 2005, which are accounted for as a contra-revenue. NASDAQ's issuer services revenues increased primarily due to increased annual fees from the NASDAQ National and NASDAQ Capital Markets.

CONSOLIDATING ADJUSTMENTS

Consolidating adjustments for 2005 represent the elimination of intercompany revenues between NASD and NASDAQ for regulation charges, the maintenance of TRACE and the OTC Equities platforms, the activity assessment and cost of revenues associated with INET and Brut, and premiums paid by NASD to the NASDAQ Insurance Agency. In 2004, the consolidating adjustments represented the elimination of the regulation charge for NASDAQ and Amex, administrative services provided to Amex and revenues earned by NASDAQ from the maintenance of TRACE. Given the sale of Amex on December 31, 2004, revenues generated from Amex are third-party revenues in 2005 and, thus, not eliminated in consolidation.

EXPENSES

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

	YEARS ENDED DECEMBER 31,							
	2005				2004			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in millions)							
Compensation and benefits	$ 352.5	$ 152.1	$ (0.9)	$ 503.7	$ 306.8	$ 148.2	$ (0.2)	$ 454.8
Professional and contract services	147.5	28.8	(4.2)	172.1	118.5	23.7	(3.0)	139.2
Computer operations and data communications	24.3	62.4	–	86.7	24.8	98.9	(0.3)	123.4
Depreciation and amortization	37.6	67.0	–	104.6	39.5	76.3	0.1	115.9
Occupancy	28.3	28.4	(0.1)	56.6	30.4	28.7	–	59.1
General and administrative	60.7	31.3	(0.3)	91.7	49.1	55.0	0.3	104.4
Intercompany	1.6	41.7	(43.3)	–	0.3	45.6	(45.9)	–
Total expenses	$ 652.5	$ 411.7	$ (48.8)	$ 1,015.4	$ 569.4	$ 476.4	$ (49.0)	$ 996.8

NASD

NASD total expenses were $652.5 million in 2005 compared with $569.4 million in 2004, an increase of $83.1 million, or 14.6 percent.

Compensation and benefits increased $45.7 million, or 14.9 percent, from $306.8 million to $352.5 million primarily due to normal pay increases and additional headcount for market regulation and enforcement. In June 2004, NASD added approximately 117 employees related to the Amex regulatory service agreement. NASD had 2,432 employees as of December 31, 2005, and 2,333 employees as of December 31, 2004. Also contributing to the expense increase were costs associated with NASD's defined benefit pension plans due to continued reductions in the interest rate environment.

Professional and contract services increased $29.0 million to $147.5 million, or 24.5 percent, from $118.5 million in 2004. The significant increases in professional and contract services included additional investment manager fees related to NASD's continued diversification of its investment portfolio and costs associated with the Next Generation Program and Sarbanes-Oxley Section 404 compliance.

Computer operations and data communications expense, depreciation and amortization expense, and occupancy expense all remained consistent with prior year.

General and administrative expenses include NASD's expenditures on matters such as travel, supplies and marketing. General and administrative expenses increased by $11.6 million, or 23.6 percent, to $60.7 million in 2005. In February 2005, Amex withdrew $25.0 million on its revolving credit facility with NASD, which has a stated interest rate of 5.0 percent per annum. NASD recognized a loss of $8.6 million on this revolving credit facility representing an adjustment to record this receivable at net realizable value using a market rate of 11.2 percent. Also contributing to the increase in general and administrative expenses were increases in travel expenses, mainly due to NASD's Examiner University program.

NASDAQ

NASDAQ total expenses were $411.7 million for 2005, compared with $476.4 million in 2004, a decrease of $64.7 million, or 13.6 percent. These decreases were primarily due to a reduction in general and administrative expense, computer operations and data communications expense, and depreciation and amortization expense.

General and administrative expense decreased $23.7 million, or 43.1 percent, in 2005 compared with 2004. The decrease in 2005 was primarily due to decisions affecting NASDAQ's real estate subsequent to the acquisition of INET in 2005. These decisions resulted in NASDAQ management deciding to occupy space in its New York office that it had previously intended to vacate. As a result, NASDAQ recorded $12.1 million of income as an offset to general and administrative expenses representing the reversal of the sub-lease reserve for this space. Furthermore, in the fourth quarter of 2004, NASDAQ recorded a loss of $7.4 million for the write-down of the Key West Building to fair market value. Computer operations and data communications expense decreased $36.5 million, or 36.9 percent, in 2005 compared with 2004, due to lower costs from the favorable renegotiation of certain maintenance contracts and hardware leases. Also contributing to the decreases were lower costs associated with NASDAQ's renegotiated contract with MCI, effective in the second quarter of 2004. Depreciation and amortization expense decreased $9.3 million, or 12.2 percent, in 2005 compared with 2004 due to declines in depreciation and amortization expense on equipment associated with NASDAQ's quoting platform and its trading and quoting network, as NASDAQ migrates to lower-cost operating environments as part of its cost-reduction plan.

CONSOLIDATING ADJUSTMENTS

Consolidating adjustments for 2005 represent the elimination of intercompany expenses between NASD and NASDAQ for regulation charges, the maintenance of TRACE and the OTC Equities platforms, and insurance premiums paid by NASD to the NASDAQ Insurance Agency. In 2004, the consolidating adjustments represented the elimination of the regulation charge for NASDAQ and expenses for the maintenance of TRACE.

OTHER INCOME (EXPENSE)

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

	YEARS ENDED DECEMBER 31,							
	2005				2004			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in millions)							
Interest and dividend income	$ 66.6	$ 12.7	$ (6.6)	$ 72.7	$ 42.7	$ 5.9	$ (13.2)	$ 35.4
Interest expense	–	(20.4)	–	(20.4)	(0.3)	(11.5)	–	(11.8)
Net realized investment gains	20.5	–	–	20.5	25.7	–	–	25.7
Gain on NASDAQ common stock sold by NASD	384.4	(0.6)	–	383.8	–	–	–	–
(Loss) gain on NASDAQ warrants	(180.1)	–	0.8	(179.3)	3.9	–	–	3.9
Equity loss from affiliate	(0.2)	–	–	(0.2)	–	–	–	–
Minority interest expense	–	0.2	(43.5)	(43.3)	–	–	(5.1)	(5.1)
Total other income (expense)	$ 291.2	$ (8.1)	$ (49.3)	$ 233.8	$ 72.0	$ (5.6)	$ (18.3)	$ 48.1

NASD

NASD net other income was $291.2 million in 2005, compared with $72.0 million in 2004, an increase of $219.2 million. This increase is due to three transactions consisting of two sales of NASDAQ common stock by NASD and the exercise of warrants under Tranches III and IV. NASD sold 21.1 million shares of NASDAQ common stock in two separate transactions generating aggregate net proceeds of $301.7 million and a gain of $288.0 million. In addition, 6.8 million shares of common stock were issued in connection with the exercise of warrants, generating net proceeds of $102.5 million and a gain of $96.4 million.

Also contributing to the increase in net other income was an increase in interest and dividend income of $23.9 million, which is related to increases in the available-for-sale investments held by NASD from the proceeds generated from the sales of NASDAQ common stock. Offsetting this gain was a loss on NASDAQ warrants of $180.1 million, representing the adjustment to the fair value of the outstanding warrants.

NASDAQ

NASDAQ incurred net other expenses of $8.1 million in 2005 compared with $5.6 million in 2004, with the increase attributable to additional interest expense from the $205.0 million convertible notes issued in April 2005 and the $750.0 million senior-term debt issued in December 2005, in connection with the financing of the INET acquisition.

CONSOLIDATING ADJUSTMENTS

Consolidating adjustments represent the intercompany elimination of dividends recognized by NASD on NASDAQ preferred stock, as well as NASD's sharing of NASDAQ's net income with minority interest partners. Minority interest expense was $43.5 million in 2005 compared with $5.1 million in 2004. The increase in minority interest expense is due to an increase in NASDAQ's net income to $61.7 million in 2005 from $11.4 million in 2004, combined with a decrease in NASD's ownership of NASDAQ common stock from 54.7 percent as of December 31, 2004, to 18.4 percent as of December 31, 2005.

PROVISION FOR INCOME TAXES

As NASD is a tax-exempt organization under the provisions of the Internal Revenue Code Section 501(c)(6), tax expenses reflected in the Company's consolidated financial statements represent the tax expense of NASDAQ. NASDAQ's income tax provision was $44.6 million and $0.7 million for the years ended December 31, 2005 and 2004, respectively. The overall effective tax rate for NASDAQ in 2005 and 2004 was 41.9 percent and 29.3 percent, respectively. The change in NASDAQ's tax provision in 2005 was primarily due to a loss on the restructuring of the $240.0 million convertible notes, a portion of which is not deductible for U.S. income tax purposes. In addition, the effective tax rate was reduced in 2004 by the realization of research and development tax credits, as well as a reduction of a valuation allowance related to a foreign net operating loss carryforward.

DISCONTINUED OPERATIONS

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

	YEARS ENDED DECEMBER 31, 2005	2004
	(in millions)	
Discontinued Operations:		
NASD Holding	$ (0.3)	$ 10.1
NASDAQ	–	9.6
Total	$ (0.3)	$ 19.7

NASD

NASD Holding's net (loss) income from discontinued operations relates to the disposition of Amex, which closed on December 31, 2004. The net income of $10.1 million in 2004 represented the net income generated by Amex for the year, net of intercompany eliminations and taxes, offset by an additional estimated loss on disposal of $6.8 million. In 2005, NASD Holding incurred approximately $0.3 million of additional expenses related to the disposition of Amex, mainly for transaction costs. See Note 15, "Discontinued Operations," to the consolidated financial statements for further discussion.

NASDAQ

NASDAQ's net loss from discontinued operations in 2004 represented amounts associated with the disposal of NASDAQ Europe. As a result of its strategic review, NASDAQ supported the closing of the market operated by NASDAQ Europe. These operations were wound down pursuant to a transition plan approved by the Belgian Banking and Finance Commission. As NASDAQ Europe was winding down its market operations, NASDAQ reached an agreement to transfer all of NASDAQ's shares in NASDAQ Europe to one of the original investors in NASDAQ Europe. The transfer of shares was completed in December 2003. In 2004, NASDAQ released a reserve previously held to satisfy any potential claims against NASDAQ associated with the wind-down of NASDAQ Europe. See Note 15, "Discontinued Operations," to the consolidated financial statements for further discussion.

CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE

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

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

LIQUIDITY AND CAPITAL RESOURCES

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

NASD

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

NASD's investment policy is reviewed annually by its Board of Governors and was re-approved on July 21, 2005. The goal of NASD's investment policy is to generate long-term returns to be used to support NASD operations for the benefit of investors and members, to preserve the real purchasing power of those funds for future contingencies and to maintain financial balance sheet strength. Portfolio returns may be used to achieve these goals and for other strategic or operational purposes. NASD seeks to maintain a broadly diversified investment portfolio. To this end, the portfolio includes absolute return-oriented investments, the goals of which are to post a positive return in both strong and weak market environments, and particularly to protect capital in down market environments. NASD's targeted investment portfolio allocations are 35.0 to 50.0 percent equities, 10.0 to 20.0 percent fixed income, and 35.0 to 50.0 percent alternative investments.

NASD's investment policy guidelines prohibit the purchase of any debt or equity interest in an entity that derives more than 25.0 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. The guidelines further contain a proxy voting policy and specify permissible holdings, market capitalization constraints, and credit quality standards, as appropriate, for each asset class in the portfolio, all of which are monitored by the Investment Committee. The investment policy guidelines are reviewed annually by the Investment Committee to ensure the relevance of its content to current capital market conditions.

NASDAQ

NASDAQ's treasury department manages NASDAQ's capital structure, funding, liquidity, collateral, and relationships with bankers, investment advisors and creditors. The NASDAQ Board of Directors approved an investment policy for NASDAQ and its subsidiaries for internally and externally managed portfolios. The goal of the policy is to maintain adequate liquidity at all times and to fund current budgeted operating and capital requirements and to maximize returns. All securities must meet credit rating standards as established by the policy and must be denominated in subsidiary specific currencies. The investment portfolio duration must not exceed 18 months. Since October 2003, the policy prohibits the purchasing of any investment in equity securities. The policy also prohibits any investment in debt interest in an entity that derives more than 25.0 percent of its gross revenue from the combined broker-dealer and/or investment advisory businesses of all of its subsidiaries and affiliates. NASDAQ's Board of Directors reviews its investment policy annually and re-approved it on January 17, 2006. NASDAQ also periodically reviews its investments and investment managers.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Market risk represents the risks of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates and equity prices. As of December 31, 2005, investments in the Company's consolidated financial statements consisted of equities, U.S. Treasury securities, obligations of U.S. government-sponsored enterprises and other financial instruments.

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

NASD

NASD's investment portfolio contained fixed income securities that have a duration, or weighted-average maturity of cash flows, of approximately 3.3 years as of December 31, 2005. Duration is a measure of the sensitivity of a fixed income portfolio to a change in interest rates: for NASD, every 100-basis-point change in interest rates, a portfolio with a duration of 3.3 years is expected to change inversely by 3.3 percent. NASD believes that any decline in the value of its fixed income securities due to a 100-basis-point increase in interest rates should be largely offset by the portfolio's yield of approximately 5.1 percent.

NASD reviews its investment portfolio for other-than-temporary declines on a quarterly basis. Based on these reviews, NASD recorded impairment charges for other-than-temporary declines of $23.8 million and $3.1 million in 2005 and 2004, respectively. NASD management believes that other-than-temporary fluctuations in market indices could have a significant impact on its investment portfolio, earnings and cash flows. As of December 31, 2005, NASD had no significant foreign currency exposure or related hedges. NASD investment policy does allow for investments in derivative instruments, including options, interest rate swaps and futures contracts. As of December 31, 2005 and 2004, NASD's investments in such instruments were not material to the consolidated financial statements.

NASD is exposed to credit risk from third parties, including its members, NASDAQ and Amex. These parties may default on obligations to NASD due to bankruptcy, lack of liquidity, operational failure, or other reasons. In addition, NASD has a revolving credit facility receivable from Amex for $25.0 million as of December 31, 2005. This revolving credit facility accrues interest at a fixed rate of 5.0 percent, and both interest and principal are due in October 2011. NASD performed a valuation of this revolving credit facility on the date of issuance, and estimated its fair market value to be $16.4 million, representing the net realizable value using a market rate of interest of 11.2 percent. For the year ended December 31, 2005, NASD recognized interest income of $1.6 million and as of December 31, 2005, the fair value was $18.0 million.

NASD has a line of credit of up to $50.0 million that has a variable interest rate; however, as of December 31, 2005 and 2004, no amounts were outstanding under this credit agreement.

NASDAQ

At December 31, 2005, NASDAQ's investments consisted of fixed income instruments with an average duration of 0.3 years. At December 31, 2005, NASDAQ's $205.0 million convertible notes and $240.0 million convertible notes specified a fixed interest rate until October 22, 2012, and for NASDAQ's $750.0 million senior-term debt a floating interest rate until maturity in 2011. These investment securities and outstanding debt obligations are subject to interest rate risk and fair values may fluctuate with changes in interest rates. NASDAQ management does not believe that a 100-basis-point fluctuation in market interest rates will have a material effect on the carrying value of its investment portfolio or outstanding debt obligations as of December 31, 2005. However, the fair value of NASDAQ's debt obligations exceeds its carrying value. NASDAQ does not currently hedge any variable interest rates on either the investment portfolio or debt obligations.

As of December 31, 2005, NASDAQ had no significant foreign currency exposure or related hedges. NASDAQ periodically evaluates its hedging policies and may choose to enter into future transactions. NASDAQ is exposed to credit risk from third parties, including customers, counterparties and clearing agents. These parties may default on their obligations to NASDAQ due to bankruptcy, lack of liquidity, operational failure or other reasons. In particular, NASDAQ's subsidiaries, Brut and INET, may be exposed to credit risk, due to the default of trading counterparties in connection with the external routing and agency brokerage services Brut and INET provide its customers. While NASDAQ is not exposed to counterparty risk for trades executed on The NASDAQ Market Center, NASDAQ is exposed to counterparty risk in connection with trades executed on or through the Brut ECN and INET ECN systems, or Brut and INET System Trades, given that Brut and INET act as central counterparties on an agency basis for these trades.

CASH FLOWS

Both NASD and NASDAQ primarily rely on cash flows from operations to provide working capital for current and future operations. The Company's net cash provided by operating activities was $268.6 million and $156.2 million for 2005 and 2004, respectively. Net cash used in investing activities was $1,085.4 million and $364.9 million, respectively; net cash provided by (used in) financing activities was $989.0 million and ($0.2) million for 2005 and 2004, respectively. See the table below for total cash flows by segment between years:

	YEARS ENDED DECEMBER 31, 2005			2004		
	NASD	NASDAQ	Total	NASD	NASDAQ	Total
			(in millions)			
Operating:						
Continuing	$ 148.0	$ 120.9	$ 268.9	$ 46.5	$ 107.5	$ 154.0
Discontinued operations	(0.3)	–	(0.3)	(7.4)	9.6	2.2
Total operating	147.7	120.9	268.6	39.1	117.1	156.2
Investing	(132.0)	(953.4)	(1,085.4)	(163.6)	(201.3)	(364.9)
Financing	49.5	939.5	989.0	6.3	(6.5)	(0.2)
Total	$ 65.2	$ 107.0	$ 172.2	$ (118.2)	$ (90.7)	$ (208.9)

NASD

Cash and cash equivalents and available-for-sale investments totaled $1,904.3 million as of December 31, 2005, compared with $1,282.3 million as of December 31, 2004, an increase of $622.0 million, or 48.5 percent. This increase was primarily due to the receipt of $301.7 million associated with the sales of NASDAQ common stock, $102.5 million from the exercise of warrants, $40.0 million from NASDAQ for the partial payment on the Series C Cumulative Preferred Stock and $147.7 million in operating cash flows.

NASD generated cash inflows from operating activities of $147.7 million, compared with $39.1 million in the prior year. The increase was due to changes in working capital, namely an increase in the SEC payable associated with rate changes during the year, combined with net income (before depreciation and amortization) generated during the period. NASD incurred investing cash outflows of $132.0 million in 2005 and $163.6 million in 2004. NASD invested the majority of the proceeds generated from the sale of NASDAQ common stock and exercise of warrants into its available-for-sale investments. In addition, NASD incurred capital expenditures of $41.0 million, which included $18.0 million paid to NASDAQ for an office building (Key West) adjacent to its Rockville, Maryland facility. Cash inflows from financing activities were $49.5 million in 2005 and $6.3 million in 2004. Cash inflows from financing activities in 2005 include the partial repayment of Series C Cumulative Preferred Stock from NASDAQ.

NASD's working capital was $1,416.1 million as of December 31, 2005, and $1,009.5 million as of December 31, 2004. NASD has been able to generate sufficient funds from operations to meet working capital requirements. NASD has a $50.0 million line of credit available through November 2006, if it temporarily needs liquidity to meet its current obligations. NASD 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.

NASDAQ

Cash and cash equivalents and available-for-sale investments totaled $344.6 million as of December 31, 2005, compared with $233.1 million as of December 31, 2004, an increase of $111.5 million, or 47.8 percent. This increase was primarily due to the receipt of funds from employee stock options exercised, the sale of the Key West building to NASD and positive cash flows generated from operations. Partially offsetting these increases were the payment for the partial redemption of NASDAQ's Series C Cumulative Preferred Stock and payments made for the acquisitions of INET and Carpenter Moore.

Cash flows from operating activities totaled $120.9 million and $117.1 million in 2005 and 2004, respectively. The increase in operating cash flows was primarily due to an increase in net income. Cash used in investing activities was $953.4 million and $201.3 million in 2005 and 2004, respectively. The increase in cash used in investing activities was due to the acquisitions of INET and Carpenter Moore, completed during 2005. NASDAQ paid $934.5 million and direct acquisition costs of $34.3 million for INET and paid $27.5 million for Carpenter Moore. In 2004, NASDAQ acquired Brut for $190.0 million, plus post-closing adjustments. During 2005, NASDAQ purchased $591.6 million of available-for-sale investments and $32.0 million of held-to-maturity investments. Capital expenditures and proceeds from sales of property and equipment were $25.4 million and $18.0 million, respectively, in 2005. Investing activities also included proceeds of $585.4 million and $62.7 million from the redemption and maturities of available-for-sale investments and held-to-maturity investments, respectively, in 2005.

Cash provided by (used in) financing activities was $939.5 million and ($6.5) million in 2005 and 2004, respectively. The increase in 2005 was due to the issuances of the $750.0 million senior-term debt in December 2005 and the $205.0 million convertible notes in April 2005, partially offset by the partial redemption of NASDAQ's Series C Cumulative Preferred Stock and the redemption of the $25.0 million senior notes. In 2005, NASDAQ also received proceeds from the issuances of common stock, primarily from employee stock option exercises.

Working capital (calculated as current assets, reduced for held-to-maturity investments classified as current assets, less current liabilities) was $271.6 million as of December 31, 2005, compared with $169.3 million as of December 31, 2004. NASDAQ has been able to generate sufficient funds from operations to meet working capital requirements. NASDAQ has a $75.0 million five-year revolving line of credit obtained in connection with the financing of the INET acquisition. NASDAQ 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. In conjunction with the issuance of the $750.0 million senior-term debt, NASDAQ prepaid in full the $25.0 million senior notes and recorded a loss on the early extinguishment of the $25.0 million senior notes of approximately $1.1 million, which is recorded in general and administrative expense in the consolidated statements of income.

On February 15, 2006, NASDAQ issued 7.0 million shares in a public offering of its common stock, received net proceeds of $268.9 million and used $104.7 million of these proceeds to redeem the Series C Cumulative Preferred Stock from NASD. NASDAQ plans to use the remaining proceeds for general corporate purposes, including potential acquisitions.

CONTRACTUAL OBLIGATIONS AND CONTINGENT COMMITMENTS

NASD

NASD has contractual obligations to make future payments under investments in limited partnerships, minimum rental commitments under non-cancelable operating leases and other obligations. A summary of those contractual obligations is provided below:

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(in millions)		
Commitments to investments in limited partnerships	$ 69.7	$ 22.9	$ 31.5	$ 13.6	$ 1.7
Minimum rental commitments under non-cancelable operating leases, net	202.8	19.1	34.6	33.1	116.0
Minimum rental commitments under capitalized leases	0.9	0.8	0.1	–	–
Information and technology services agreement	132.0	21.0	41.0	37.0	33.0
Total	$ 405.4	$ 63.8	$ 107.2	$ 83.7	$ 150.7

Investments in limited partnerships represent the expected funding of NASD's total commitment to seven 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.

NASDAQ

NASDAQ has contractual obligations to make future payments under debt obligations, minimum rental commitments under non-cancelable operating leases, and other obligations, and has contingent commitments under a variety of arrangements. The following table shows these contractual obligations at December 31, 2005:

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(in millions)		
Long-term debt by contractual maturity	$ 1,195.0	$ 7.5	$ 15.0	$ 15.0	$ 1,157.5
Minimum rental commitments under non-cancelable operating leases, net	237.6	33.2	44.5	37.4	122.5
Other long-term obligations	26.8	14.8	9.3	2.7	–
Total	$ 1,459.4	$ 55.5	$ 68.8	$ 55.1	$ 1,280.0

NASDAQ RESTRUCTURING

On January 13, 2006, the SEC approved NASDAQ's application for registration as a national securities exchange (Exchange Registration). NASDAQ will begin operating as an exchange once it meets conditions imposed by the SEC. Upon effectiveness of Exchange Registration, NASDAQ will redeem the Series D Preferred Stock and NASD will no longer have voting control over NASDAQ. As a result, NASD will cease consolidating NASDAQ and will have reduced its ownership of NASDAQ to any remaining shares underlying the unexercised warrants for Tranche IV.

Previous NASD transactions in NASDAQ stock included sales of NASDAQ common stock and warrants in 2000 and 2001. As part of these transactions, NASD issued 10,806,494 warrants to purchase up to 43,225,976 shares of NASDAQ common stock from NASD in four tranches. In March 2002, NASD sold 33.8 million shares of NASDAQ common stock to NASDAQ and received total consideration of $305.2 million in cash, 1,338,402 shares of Series A Cumulative Preferred Stock and one share of Series B Preferred Stock.

In November 2004, NASD and NASDAQ entered into an exchange agreement pursuant to which NASD exchanged 1,338,402 shares of Series A Cumulative Preferred Stock for 1,338,402 shares of newly issued Series C Cumulative Preferred Stock. The Series C Cumulative Preferred Stock accrues quarterly dividends at an annual rate of 3.0 percent for all periods until July 1, 2006, and at 10.6 percent thereafter. In December 2005, NASD exchanged its one share of Series B Preferred Stock for one newly issued share of Series D Preferred Stock, which had terms substantially similar to the terms of the Series B Preferred Stock.

Series C Cumulative Preferred Stock

On April 21, 2005, NASD and NASDAQ entered into a Stock Repurchase and Waiver Agreement whereby NASD consented to the financing used in connection with the acquisition of Instinet. In exchange for the waiver, NASDAQ repurchased 384,932 shares of its Series C Cumulative Preferred Stock from NASD for approximately $40.0 million.

On February 15, 2006, NASDAQ redeemed all remaining outstanding shares of its Series C Cumulative Preferred Stock from NASD, as NASDAQ was required to redeem it after the closing of the public offering of common stock, which took place on the same date. The total redemption price was $104.7 million.

Sales of NASDAQ Common Stock

On February 15, 2005, NASDAQ completed an underwritten secondary offering of 16,586,980 shares of common stock owned by NASD and an additional 3,246,536 shares of common stock owned by certain other selling stockholders, who had purchased the shares in NASDAQ's private placements in 2000 and 2001. NASDAQ, its officers or other employees did not sell any shares in the secondary offering. NASD received net proceeds of $140.4 million and recognized a gain on the sale of subsidiary stock of $133.6 million. As part of this offering, NASDAQ incurred legal fees of $0.6 million, resulting in a consolidated gain of $133.0 million.

On November 16, 2005, NASD completed a block sale of 4.5 million shares of NASDAQ common stock. NASDAQ, its officers or other employees did not sell any shares in the secondary offering. NASD received net proceeds of $161.3 million from this sale and recognized a gain on sale of subsidiary stock of $154.4 million.

On February 15, 2006, NASD sold 3,505,886 shares of NASDAQ common stock in NASDAQ's public offering. NASD received net proceeds of $129.1 million and recognized a gain on sale of subsidiary stock of $121.8 million.

On March 2, 2006, the underwriters for NASDAQ's public offering exercised their option and purchased an additional 1,042,142 shares of common stock from NASD. NASD received net proceeds of $40.0 million on this sale and recognized a gain on sale of subsidiary stock of $34.8 million.

Warrants to Purchase NASDAQ Common Stock from NASD

Tranche I expired on June 27, 2003, and prior to the expiration, NASD issued 35,830 shares of NASDAQ common stock for the exercise of warrants, generating proceeds of $0.5 million and a gain of $0.4 million. Upon expiration of Tranche I, 10,770,664 shares of common stock underlying unexercised warrants reverted back to NASD. Tranche II expired on June 25, 2004, and 6,750 shares of NASDAQ common stock were issued following the exercise of warrants generating proceeds and a gain of $0.1 million. Following expiration of Tranche II, 10,799,744 shares of common stock underlying the unexercised warrants reverted back to NASD. Tranche III expired on June 27, 2005, and NASD issued 6,741,894 shares of NASDAQ common stock for exercises of warrants, generating proceeds of $101.1 million and a gain of $95.2 million. Upon expiration of Tranche III, 4,064,600 shares of common stock underlying unexercised warrants reverted back to NASD. Tranche IV expires on June 27, 2006. As of December 31, 2005, NASD issued 87,675 shares of NASDAQ common stock for exercises of warrants under Tranche IV, generating proceeds to NASD of $1.4 million and a gain of $1.2 million.

The table below summarizes the effect of all transactions executed by NASD in relation to the NASDAQ restructuring through March 31, 2006.

EFFECT OF NASDAQ RESTRUCTURING ACTIVITIES (DOLLARS IN MILLIONS)

			NASDAQ SHARES OWNED BY NASD			
	NASD Ownership %	Fully Diluted %	NASDAQ Shares Not Underlying Warrants	NASDAQ Shares Underlying Warrants	Total NASDAQ Shares Owned by NASD	Cash Proceeds to NASD
As of 12/31/99 after Stock Split	**100.0%**	**100.0%**	**100,000,000**	**–**	**100,000,000**	**$ –**
Phase I – Shares			(323,796)	–	(323,796)	3.5
Phase I – Warrants			(25,661,396)	25,661,396	–	68.7
Balance / Cumulative Impact, 12/31/00	**80.6%**	**59.9%**	**74,014,808**	**25,661,396**	**99,676,204**	**72.2**
Phase II – Shares			(4,219,795)	–	(4,219,795)	53.5
Phase II – Warrants			(17,564,580)	17,564,580	–	59.9
Hellman & Friedman			(18,461,538)	–	(18,461,538)	240.0
Balance / Cumulative Impact, 12/31/01	**68.9%**	**30.2%**	**33,768,895**	**43,225,976**	**76,994,871**	**425.6**
NASDAQ Share Buyback – March 2002*			(33,768,895)	–	(33,768,895)	305.2
Warrant Exercises – Tranche I			–	(20,830)	(20,830)	0.3
Balance / Cumulative Impact, 12/31/02	**55.2%**	**0.0%**	**–**	**43,205,146**	**43,205,146**	**731.1**
Warrant Exercises – Tranche I			–	(15,000)	(15,000)	0.2
Warrant Expiration – Tranche I			10,770,664	(10,770,664)	–	–
Balance / Cumulative Impact, 12/31/03	**55.0%**	**13.7%**	**10,770,664**	**32,419,482**	**43,190,146**	**731.3**
Warrant Exercises – Tranche II			–	(6,750)	(6,750)	0.1
Warrant Expiration – Tranche II			10,799,744	(10,799,744)	–	–
Balance / Cumulative Impact, 12/31/04	**54.7%**	**27.3%**	**21,570,408**	**21,612,988**	**43,183,396**	**731.4**
Secondary Offering – February 2005			(16,586,980)	–	(16,586,980)	140.4
Preferred Stock Paydown			–	–	–	40.0
Warrant Exercises – Tranche III			–	(6,741,894)	(6,741,894)	101.1
Warrant Expiration – Tranche III			4,064,600	(4,064,600)	–	–
Block Trade – November 2005			(4,500,000)	–	(4,500,000)	161.3
Warrant Exercises – Tranche IV			–	(87,675)	(87,675)	1.4
Balance / Cumulative Impact, 12/31/05	**18.4%**	**–**	**4,548,028**	**10,718,819**	**15,266,847**	**1,175.6**
Preferred Stock Payoff			–	–	–	104.7
Public Offering – February 2006			(3,505,886)	–	(3,505,886)	129.1
Public Offering – March 2006			(1,042,142)	–	(1,042,142)	40.0
Warrant Exercises – Tranche IV			–	(202,277)	(202,277)	3.2
Balance / Cumulative Impact, 3/31/06	**11.4%**	**–**	**–**	**10,516,542**	**10,516,542**	**1,452.6**
Warrant Exercises – Tranche IV**				(10,516,542)	(10,516,542)	168.3
Balance / Cumulative Impact, Proforma	**–**	**–**	**–**	**–**	**–**	**$ 1,620.9**

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

** Assumes full exercise of the remaining outstanding warrants under Tranche IV prior to expiration in June 2006.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

INVESTMENTS

Under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," management determines the appropriate classification of investments at the time of purchase. Investments for which the Company does not have the intent or ability to hold to maturity are classified as available-for-sale and are carried at fair value, with any unrealized gains and losses, net of tax, reported as a separate component of members' equity. Investments for which the Company has the intent and ability to hold to maturity are classified as held-to-maturity and are carried at amortized cost. The amortized cost of debt securities classified as held-to-maturity is adjusted for amortization of premiums and accretion of discounts. Fair value is determined based on quoted market prices when available, or if quoted market prices are not available, on discounted expected cash flows using market rates commensurate with the credit quality and maturity of the investment. Realized gains and losses on sales of securities are included in earnings using the average cost method. Amounts due to or from the custodial agent relate to security trades executed prior to the balance sheet date, but not yet settled.

The Company regularly monitors and evaluates the realizable value of its securities portfolio. When assessing for other-than-temporary declines in value, the Company considers such factors as the extent of the decline in value, the duration for which the market value had been less than cost, the performance of the investee's stock price in relation to the stock price of its competitors within the industry and the market in general, any news that has been released specific to the investee and the outlook for the overall industry in which the investee operates. The Company also reviews the financial statements of the investee to determine if the investee is experiencing financial difficulties. If events and circumstances indicate that a decline in the value of these assets has occurred and is deemed other-than-temporary, the carrying value of the security is reduced to its fair value and the impairment is charged to earnings.

SOFTWARE COSTS

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

GOODWILL AND INTANGIBLE ASSETS, NET

NASDAQ's business acquisitions typically result in the recording of goodwill and other intangible assets, and the recorded values of those assets may become impaired in the future. As of December 31, 2005, goodwill totaled $961.9 million and intangible assets, net of accumulated amortization, totaled $217.2 million. The determination of the value of such intangible assets requires management to make estimates and assumptions that affect the consolidated financial statements. The Company assesses potential impairments to intangible assets when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recovered. Judgments regarding the existence of impairment indicators and future cash flows related to intangible assets are based on operational performance of NASDAQ's acquired businesses, market conditions and other factors. Although there are inherent uncertainties in this assessment process, the estimates and assumptions we use are consistent with NASDAQ's internal planning. If these estimates or their related assumptions change in the future, NASDAQ may be required to record an impairment charge on all or a portion of goodwill and intangible assets. Impairment exists if the carrying value of the indefinite-lived intangible asset exceeds its fair value. For intangible assets subject to amortization, impairment is recognized if the carrying amount is not recoverable and the carrying amount exceeds the fair value of the intangible asset.

IMPAIRMENT OF LONG-LIVED ASSETS

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

REVENUE RECOGNITION AND COST OF REVENUE

Market Services

Market services revenues are derived from NASDAQ Market Center and NASDAQ Market Services Subscriptions revenues. NASDAQ Market Center revenues are variable, based on service volumes, and recognized as transactions occur. NASDAQ Market Services Subscriptions revenues are based on the number of presentation devices in service and quotes delivered through those devices. NASDAQ Market Services Subscriptions revenues are recognized in the month that information is provided. These revenues are recorded net of amounts due under revenue-sharing arrangements with market participants. Pursuant to EITF No. 99-19, "Reporting Revenue Gross as Principal vs. Net as an Agent," NASDAQ records execution revenues from transactions executed through Brut and INET on a gross basis in revenues and records expenses such as liquidity rebate payments as cost of revenues as both Brut and INET act as principal. Before the second quarter of 2005, NASDAQ reported other execution revenues net of liquidity rebates since NASDAQ does not act as principal.

Issuer Services

Issuer services revenues include annual fees, initial listing fees (IL) and listing of additional shares (LAS) fees. Annual fees are recognized ratably over the following 12-month period. IL and LAS fees are recognized on a straight-line basis over estimated service periods of six and four years, respectively, based on historical listing experience. Issuer services also include commission income from NASDAQ Insurance Agency. Commission income is recognized when coverage becomes effective, the premium due under the policy is known or can be reasonably estimated, and substantially all required services related to placing the insurance have been provided. The effect on income of subsequent premium adjustments, including policy cancellations, is recorded when the adjustment is known. Fee income for services other than placement of insurance coverage is recognized as those services are provided. Broker commission adjustments and commissions on premiums billed directly by underwriters are recognized when such amounts can be reasonably estimated.

NASDAQ receives license fees for its trademark licenses related to the QQQQ and other financial products linked to NASDAQ indexes issued in the U.S. and abroad. NASDAQ primarily has two types of license agreements: transaction-based licenses and asset-based licenses. Transaction-based licenses are generally renewable long-term agreements. Customers are charged based on transaction volume, a minimum contract amount, or both. If a customer is charged based on transaction volume, NASDAQ recognizes revenue when the transactions occur. If a customer is charged based on a minimum contract amount, NASDAQ recognizes revenue on a pro-rata basis over the licensing term. Asset-based licenses are also generally long-term agreements. Customers are charged based on a percentage of assets under management for licensed products, per the agreement, on a monthly or quarterly basis. These revenues are recorded on a monthly or quarterly basis over the term of the license agreement.

Regulatory Fees

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

User Fees

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

Dispute Resolution Fees

Dispute resolution fees consist of fees earned during the arbitration and mediation processes. Fees on open cases are recognized as revenue over the average life of a case. Upon the closing of a case, a final billing is prepared and any unpaid fees are recognized as revenue at that time. Dispute resolution fees also include mediation fees, SRO annual fees, neutral training fees and other fees totaling $2.1 million for both years ended December 31, 2005 and 2004. SRO annual fees relate to the maintenance of dispute resolution services including arbitration and mediation, for SROs. Neutral training fees relate to NASD Dispute Resolution's comprehensive arbitrator and mediator application and training program. These fees are recognized either when the cash is received or when the service is provided.

Transparency Services

Transparency services represent fees charged through TRACE, OTC Equities and ADF. TRACE represents fees charged on secondary market transactions in eligible fixed income securities reported to NASD, TRACE system-related fees and TRACE market data fees. ADF is a facility for posting quotes and for reporting and comparing trades. The OTC Equities is a regulated quotation service that displays real-time quotes, last-sale prices and volume information in OTC equity securities. Transparency services are recognized as the transactions occur.

Contract Services

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

Activity Assessment

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

NASD recovers the cost of the SEC's fees and assessments through an activity assessment billed to securities firms based on the total dollar value of securities sold in The NASDAQ Stock Market and the ADF. The assessments billed to securities firms are recognized when the transactions occur. The activity assessments for transactions on the OTC Equities are self-reported to NASD and recognized as the transactions are reported. Because this is a self-reported revenue stream for NASD, subsequent adjustments by firms of their activity assessment may occur and are recognized as adjustments to revenue in the period the adjustment becomes known to NASD. As a result of the new SEC rule, beginning in 2004, NASD reported the activity assessment on a gross basis within revenues in accordance with EITF No. 99-19. Amounts due to the SEC are reported as a cost of revenue. This change had no impact on consolidated net income.

Fines

Fines represent sanctions for rule violations and commencing in 2004, are recognized upon assessment.

PENSION BENEFITS

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

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

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

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which revises SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) also amended SFAS No. 95, "Statement of Cash Flows." SFAS No. 123(R) requires that new, modified and unvested share-based payment transactions with employees, such as stock options and restricted stock, be recognized in the financial statements based on their fair value and recognized as compensation expense over the vesting period. NASDAQ adopted SFAS No. 123(R) effective January 1, 2006, using the modified prospective transition method, and will recognize share-based compensation cost on a straight-line basis over the requisite service periods of awards. Under the modified prospective method, non-cash compensation expense will be recognized for the portion of outstanding stock option awards granted prior to the adoption of SFAS No. 123(R) for which service has not been rendered, and for any future stock option grants. The pro forma information presented in Note 12, "NASDAQ Stock Compensation, Stock Awards, and Capital Stock," presents the estimated compensation charges under SFAS No. 123(R). NASDAQ's assessment of the estimated compensation charges is affected by its stock price, as well as assumptions regarding a number of complex and subjective variables and related tax impact. These variables include, but are not limited to, NASDAQ's stock price volatility and employee stock option exercise behaviors.

In 2004, the Emerging Issues Task Force issued EITF No. 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," to provide detailed guidance on assessing impairment losses on debt and equity investments. In September 2004, the FASB voted unanimously to delay the effective date of EITF No. 03-1. On November 3, 2005, the FASB issued FASB Staff Position FAS (FSP) No. 115-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," revising the guidance in EITF No. 03-1. FSP No. 115-1 is effective on January 1, 2006. The Company is currently evaluating the impact of FSP No. 115-1 on its consolidated financial statements. The disclosures required by EITF No. 03-1 are included in Note 7, "Investments," to the consolidated financial statements.

Management Report on Internal Control Over Financial Reporting

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

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

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

Management's assessment of and conclusions on the effectiveness of internal control over financial reporting did not include the internal control of Instinet Group Incorporated, subsequently renamed Norway Acquisition Corp., and its subsidiaries, including INET ECN (the "INET Entities"), which are included in the 2005 consolidated financial statements and in 2005 reflect total assets constituting 26.0 percent (which includes 22.5 percent related to goodwill and intangible assets) and net revenues constituting less than 0.6 percent of the related consolidated totals. We did not assess the effectiveness of internal controls over financial reporting at the INET Entities because NASDAQ did not complete its acquisition of these entities until December 2005.

Under the supervision of the Chief Executive Officer and Chief Financial Officer, NASD's management assessed the effectiveness of NASD's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. This evaluation included reviews of the documentation of controls, evaluations of the design effectiveness of controls, tests of the operating effectiveness of controls, and a conclusion on management's evaluation. Based on this assessment, we assert that NASD maintained effective internal control over financial reporting as of December 31, 2005.

NASD's financial statements included in this annual report have been audited by Ernst & Young LLP, an independent registered accounting firm. Ernst & Young LLP has also issued an attestation report on management's assessment of the Company's internal control over financial reporting and on the effectiveness of internal control over financial reporting as of December 31, 2005.

Robert R. Glauber

Robert R. Glauber
Chairman and CEO

Todd T. Diganci
Executive Vice President and CFO

Certification for 2005 Annual Financial Report

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

1. We have reviewed this annual financial report of the National Association of Securities Dealers, Inc. (NASD);
2. The purpose of this report is principally to set forth management's report on financial operations with respect to NASD during the year ended December 31, 2005, together with the consolidated financial statements of NASD as of and for the year ended December 31, 2005 and 2004. This report is not intended to comply with the substantive or form requirements for periodic reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations promulgated thereunder (the "Exchange Act Rules and Regulations") required of issuers of securities subject to the periodic reporting requirements under Sections 12, 13 and 15 of the Exchange Act of 1934 and the related Exchange Act Rules and Regulations;
3. Based on our knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
4. Based on our knowledge, the financial statements and other financial information set forth under the caption "Management Report on Financial Operations," fairly present in all material respects the financial condition, results of operations and cash flows of NASD as of, and for, the periods presented in this report;
5. NASD has established disclosure controls and procedures to ensure that material information relating to NASD, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
6. NASD has established internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
7. NASD has carried out its evaluation of the effectiveness of the design and operation of NASD's disclosure controls and procedures as of December 31, 2005. Based upon that evaluation, we have concluded that the disclosure controls and procedures are effective;
8. We have disclosed, based on NASD's most recent evaluation of internal control over financial reporting, to NASD's auditors and the Audit Committee of NASD's Board of Directors:
   a) Any significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect NASD's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in NASD's internal control over financial reporting.

Date: May 11, 2006

Robert R. Glauber

Robert R. Glauber
Chairman and CEO

Todd T. Diganci
Executive Vice President and CFO

Audit Committee Report

In accordance with its written Charter adopted by the Board of Governors, the Audit Committee of the Board of Governors assists the Board in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing and financial reporting practices of NASD. Each member of the Committee is an independent director as defined by SEC Rule 10A-3 under The Securities Exchange Act of 1934, Listing Standards Relating to Audit Committees. In addition, the Audit Committee and Board of Governors have determined that James E. Burton and Charles A. Bowsher are audit committee financial experts, as defined by the SEC. The Charter gives the Audit Committee responsibility for monitoring the independence of the independent auditors and recommending the appointment of the independent auditors for approval by the Board of Governors, and makes clear that the independent auditors are accountable to the Audit Committee and the Board of Governors, as representatives of the members and the public. In addition, the Charter and the By-laws of NASD make the Director of Internal Audit directly responsible to the Audit Committee. In all respects, the Charter complies with standards applicable to publicly owned companies. (The Charter for the NASD Audit Committee is available at the following URL: *www.nasd.com/auditcommittee_2006*.)

During 2005, the Committee met six times, with the Committee members having a 94 percent attendance rate.

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

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

INDEPENDENT REGISTERED PUBLIC ACCOUNTANT (IRPA) FEES

	NASD (4)		NASDAQ (5)		Amex		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
Audit services (1)	$ 1,359,130	$ 646,620	$ 2,935,590	$ 2,307,100	$ –	$ 258,000	$ 4,294,720	$ 3,211,720
Audit-related services (2)	254,152	278,139	622,714	278,314	–	8,456	876,866	564,909
Tax services (3)	37,318	–	36,450	100,000	–	–	73,768	100,000
Total	$ 1,650,600	$ 924,759	$ 3,594,754	$ 2,685,414	$ –	$ 266,456	$ 5,245,354	$ 3,876,629

(1) For 2005, audit services for NASD represent the year-end financial statement audit and the attestation on internal controls under Section 404 of the Sarbanes-Oxley Act of 2002. For 2004, audit services for NASD represent only the year-end financial statement audit. 2005 and 2004 audit services for NASDAQ represent the year-end financial statement audits, attestation procedures in connection with the internal control reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002, reviews of NASDAQ's Form 10-K, and accounting consultations on matters addressed during the audit or interim reviews. For 2004, audit services for Amex include the year-end financial statement audit. In 2005, Amex was no longer part of NASD's consolidated financial statements.

(2) Audit-related services in 2005 and 2004 for NASD reflect fees associated with special purpose audits and agreed-upon procedures, such as IARD, CRD and the employee benefit plans. In 2004, audit-related services for NASD also include consultations associated with the planned disposition of Amex, and consultations related to Section 404 of the Sarbanes-Oxley Act of 2002. NASDAQ audit-related fees represent acquisition due diligence services, the employee benefit plan audit in 2005, and assurance and consultations on NASDAQ's Section 404 internal control program design and employee benefit plan audit in 2004.

(3) Tax services for NASD represent fees related to tax compliance, advice and planning. Tax services for NASDAQ represent preparation of tax returns for expatriate employees.

(4) 2005 and 2004 fees reported for NASD are based on fees approved by NASD's Audit Committee as of March 31, 2006 and March 31, 2005, respectively. The 2005 audit services, audit-related services and tax services include estimates to complete the current work in process. NASD's 2004 fees have been updated from the prior year report to reflect final amounts paid for the 2004 approved services. NASD's IPRA fees for 2004 are less than previously reported due to actual payments made being less than anticipated for services. NASDAQ's fees are presented on a cash basis in accordance with the SEC proxy guidelines.

(5) The NASDAQ Audit Committee separately reviews and approves NASDAQ IRPA services and fees. The NASD Audit Committee has oversight of NASDAQ's Audit Committee, but does not review actions taken with respect to the approval of IRPA fees. NASDAQ fees exclude services provided to non-profit entities of The Nasdaq Stock Market, Inc., services provided in relation to NASDAQ's role as the Securities Information Processor under the Unlisted Trading Privileges Plan and the audit of the NASDAQ-100 Trust, Series 1, and the trust for the NASDAQ-100 Index Tracking Stock, also known as the "QQQ."

NASDAQ also incurred fees to PricewaterhouseCoopers LLP (PwC) for fiscal year ended 2005, totaling $265,187. On December 8, 2005, NASDAQ completed its acquisition of the INET ECN subsidiary. These fees represent audit fees for the INET ECN for the year ended December 31, 2005. The results of the INET ECN have been included in the consolidated NASDAQ results for the period December 8, 2005 through December 31, 2005. PwC was the IRPA for Instinet, including the INET ECN subsidiary prior to the acquisition; and, given their historical knowledge, the NASDAQ Audit Committee chose to continue the relationship through the remainder of 2005.

NASDAQ also incurred fees payable to Deloitte & Touché LLP (Deloitte & Touché) for fiscal year ended 2004, totaling $226,750. On September 7, 2004, NASDAQ completed its acquisition of Toll Associates LLC and affiliated entities, which includes Brut, LLC, from SunGard Data Systems Inc. These fees represent audit fees on the consolidated financial statements of Toll Associates as of December 31, 2004 and for the period September 7, 2004 through December 31, 2004. Deloitte & Touché was the IRPA for Toll Associates prior to the acquisition; and, given their historical knowledge, the NASDAQ Audit Committee chose to continue the relationship through the remainder of 2004.

The Audit Committee discussed and reviewed with the independent auditors all communications required by Statement on Auditing Standard No. 61, *Communications With Audit Committees*. Further, the Committee has reviewed and discussed with management and with E&Y, with and without management present, the audited financial statements as of December 31, 2005, management's assessment of the effectiveness of NASD's internal control over financial reporting, and E&Y's report on the financial statements and on NASD's internal controls over financial reporting. Based on those discussions, the Audit Committee recommended to the Board of Governors that NASD's audited financial statements and related reports on internal control be included in the Annual Report for the year ended December 31, 2005.

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

May 10, 2006

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

BOARD OF GOVERNORS

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

We have audited management's assessment, included in the accompanying *Management Report on Internal Control over Financial Reporting*, that the National Association of Securities Dealers, Inc. (NASD) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). NASD's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

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

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

As indicated in the accompanying *Management Report on Internal Control Over Financial Reporting*, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Instinet Group Incorporated, subsequently renamed Norway Acquisition Corp., and its subsidiaries, including INET ECN (the "INET Entities"), which are included in the 2005 consolidated financial statements of NASD and constituted 26.0 percent (which includes 22.5 percent related to goodwill and intangible assets) of the consolidated net assets and less than 0.6 percent of the consolidated net revenues as of December 31, 2005. Management did not assess the effectiveness of internal control over financial reporting at this entity because the Company did not complete its acquisition of these entities until December 2005. Our audit of internal control over financial reporting of NASD also did not include an evaluation of the internal control over financial reporting of Norway and its subsidiaries, including INET ECN.

In our opinion, management's assessment that NASD maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, NASD maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of NASD as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in members' equity, and cash flows for the years then ended of NASD and our report dated May 10, 2006 expressed an unqualified opinion thereon.

Ernst + Young LLP

McLean, Virginia
May 10, 2006

Report of Independent Registered Public Accounting Firm

BOARD OF GOVERNORS

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

We have audited the accompanying consolidated balance sheets of the National Association of Securities Dealers, Inc. (NASD) as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in members' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NASD at December 31, 2005 and 2004, 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.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of NASD's internal control over financial reporting as of December 31, 2005, 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 10, 2006 expressed an unqualified opinion thereon.

Ernst + Young LLP

McLean, Virginia
May 10, 2006

NASD 2005 Consolidated Balance Sheets

(DOLLARS IN THOUSANDS)

	December 31, 2005	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 296,057	$ 123,834
Investments:		
Available-for-sale, at fair value	1,924,296	1,381,682
Foundation unrestricted available-for-sale, at fair value	24,059	10,177
Foundation temporarily restricted available-for-sale, at fair value	5,911	–
Held-to-maturity, at amortized cost	–	28,600
Receivables, net	342,309	151,830
Receivables from related parties	18	4,946
Deferred tax assets	9,953	24,209
Other current assets	47,873	21,056
Total current assets	2,650,476	1,746,334
Held-to-maturity investments, at amortized cost	–	2,008
Property and equipment:		
Land, buildings and improvements	154,218	172,350
Data processing equipment and software	348,236	369,239
Furniture, equipment and leasehold improvements	234,279	264,442
	736,733	806,031
Less accumulated depreciation and amortization	(467,365)	(492,186)
Total property and equipment, net	269,368	313,845
Non-current deferred tax assets	133,336	48,765
Revolving credit facility receivable from Amex	18,030	—
Note receivable from Amex	—	25,000
Goodwill	961,893	141,381
Intangible assets, net	217,178	44,260
Other assets	60,257	33,125
Total assets	$ 4,310,538	$ 2,354,718

See accompanying notes.

NASD 2005 Consolidated Balance Sheets

(DOLLARS IN THOUSANDS)

	December 31, 2005	December 31, 2004
Liabilities and members' equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 150,166	$ 65,026
SEC fee payable	157,176	68,275
Accrued personnel and benefit costs	188,481	145,557
Deferred revenue	114,644	137,523
Deposits and renewals	57,740	63,032
Current portion of debt obligations	7,500	–
Due to custodial agent	41,001	17,696
Due to related parties	–	450
Warrants to purchase NASDAQ common stock from NASD	183,180	–
Other current liabilities	69,223	56,681
Total current liabilities	969,111	554,240
Accrued pension and other post retirement benefit costs	49,056	57,794
Long-term debt	1,184,928	265,000
Non-current deferred tax liabilities	95,151	29,514
Deferred revenue	108,794	107,061
Deferred contribution income	53,115	–
Warrants to purchase NASDAQ common stock from NASD	–	3,836
Other liabilities	109,152	64,310
Total liabilities	2,569,307	1,081,755
Minority interest	129,967	11,938
Commitments and contingencies		
Members' equity	1,511,453	1,194,043
Unrealized gain on available-for-sale investments	107,977	74,131
Foreign currency translation	295	988
Minimum pension liability	(8,461)	(8,137)
Total members' equity	1,611,264	1,261,025
Total liabilities and members' equity	$ 4,310,538	$ 2,354,718

See accompanying notes.

NASD 2005 Consolidated Statements of Income

(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2005	2004
Revenues		
Operating revenues		
Market services	$ 645,953	$ 332,540
Issuer services	224,525	201,458
Regulatory fees, net of member rebates of $50,000 in 2005 and $30,000 in 2004	185,448	222,844
User fees	145,266	137,277
Dispute resolution fees	72,942	80,181
Transparency services	22,806	14,736
Contract services	22,488	4,693
Other	7,340	2,321
Total operating revenues	1,326,768	996,050
Activity assessment	399,100	230,853
Fines	148,496	114,414
Total revenues	1,874,364	1,341,317
Cost of revenues		
SEC activity remittance	(413,483)	(230,853)
Liquidity rebates	(255,501)	(38,114)
Brokerage, clearance and exchange fees	(85,580)	(17,731)
Total cost of revenues	(754,564)	(286,698)
Net revenues	1,119,800	1,054,619
Expenses		
Compensation and benefits	503,677	454,827
Professional and contract services	172,051	139,182
Computer operations and data communications	86,684	123,443
Depreciation and amortization	104,541	115,867
Occupancy	56,648	59,081
General and administrative	91,769	104,354
Total expenses	1,015,370	996,754
Net revenues less expenses	104,430	57,865
Other income (expense)		
Interest and dividend income	72,717	35,348
Interest expense	(20,359)	(11,773)
Net realized investment gains	20,503	25,684
Gain on sale of NASDAQ common stock	383,838	–
(Loss) gain on NASDAQ warrants	(179,344)	3,909
Loss from equity affiliate	(234)	–
Minority interest in earnings of subsidiaries	(43,264)	(5,149)
Income before income taxes, discontinued operations and cumulative effect of change in accounting principle	338,287	105,884
Provision for income taxes	(44,572)	(749)
Income from continuing operations	293,715	105,135
(Loss) income from discontinued operations (net of tax of $0 in 2005 and $5,596 in 2004)	(318)	19,698
Cumulative effect of change in accounting principle	–	(58,342)
Net income	$ 293,397	$ 66,491
Pro forma net income assuming the accounting change is applied retroactively		$ 124,833

See accompanying notes.

NASD 2005 Consolidated Statements of Changes in Members' Equity

(DOLLARS IN THOUSANDS)

	Members' Equity	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2004	$ 1,120,191	$ 36,723	$ 1,156,914
Net income	66,491		66,491
Unrealized gain on available-for-sale investments, net of tax of $599, net of minority interests of ($409)	–	34,689	34,689
Foreign currency translation, net of minority interests of $99	–	113	113
Minimum pension liability, net of tax of $293, net of minority interests of ($201)	–	(4,543)	(4,543)
Comprehensive income	–	–	96,750
Increase in equity attributable to the minority interest in the loss on exchange and accretion of NASDAQ preferred stock	2,191	–	2,191
Increase in equity attributable to the minority interest in preferred stock dividends and distributions to NASD for the NASDAQ insurance agency	3,894	–	3,894
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of $1,121	1,154	–	1,154
Increase in equity attributable to amortization of restricted stock awards by NASDAQ, net of minority interest of $100	122	–	122
Balance, December 31, 2004	1,194,043	66,982	1,261,025
Net income	293,397	–	293,397
Unrealized gain on available-for-sale investments, net of tax of ($253), net of minority interests of ($39)	–	33,846	33,846
Foreign currency translation, net of minority interests of $537	–	(693)	(693)
Minimum pension liability, net of tax of $303, net of minority interests of ($1,065)	–	(324)	(324)
Comprehensive income	–	–	326,226
Increase in equity attributable to the minority interest in preferred stock dividends, accretion of preferred stock, and distributions to NASD for the NIA	5,673	–	5,673
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of $57,282	17,481	–	17,481
Increase in equity attributable to issuance of warrants by NASDAQ, net of minority interest of $1,870	423	–	423
Increase in equity attributable to amortization of restricted stock awards by NASDAQ, net of minority interest of $922	436	–	436
Balance, December 31, 2005	$ 1,511,453	$ 99,811	$ 1,611,264

See accompanying notes.

NASD 2005 Consolidated Statements of Cash Flows

(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31,	
	2005	2004
Reconciliation of net income to cash provided by operating activities		
Net income	$ 293,397	$ 66,491
Net (loss) income from discontinued operations	(318)	19,698
Income from continuing operations	$ 293,715	$ 46,793
Adjustments to reconcile net income to cash provided by operating activities:		
Cumulative effect of change in accounting principle	–	58,342
Depreciation and amortization	104,541	115,867
Gain on sales of NASDAQ common stock by NASD	(383,838)	–
Loss (gain) on NASDAQ warrants	179,344	(3,909)
Amortization of restricted stock and other stock-based compensation	1,358	541
Net realized gains on investments	(44,277)	(28,773)
Investment impairment charges	23,774	3,089
Loss on assets held-for-sale	–	7,369
Loss on disposal of fixed assets	–	3,664
Asset impairment charges	1,718	1,506
Discount on revolving credit facility receivable from Amex	8,589	–
Charge on restructuring the $240.0 million convertible notes	7,393	–
Deferred taxes	3,469	26,142
Bad debt expense	6,826	7,502
Loss from equity affiliate	234	–
Minority interest in earnings of subsidiaries	43,264	5,149
Contributions and net investment income temporarily restricted	(6,900)	–
Other net non-cash income items	1,807	6,003
Net change in operating assets and liabilities, net of acquisitions and dispositions:		
Receivables, net	(108,076)	35,162
Amounts due from related parties	1,613	(2,885)
Other current assets	(10,802)	1,854
Other assets	(27,452)	1,306
Accounts payable and accrued expenses	35,634	(14,970)
Accrued personnel and benefit costs	34,159	8,504
Deferred revenue	31,939	4,993
Deposits and renewals	(5,292)	(4,188)
SEC fee payable	88,901	(83,923)
Other current liabilities	(11,001)	(61,387)
Accrued pension and other post-retirement costs	(8,738)	11,026
Other liabilities	6,963	9,209
Net cash provided by continuing operations	268,865	153,986
Cash (used in) provided by discontinued operations	(318)	2,178
Net cash provided by operating activities	$ 268,547	$ 156,164

See accompanying notes.

NASD 2005 Consolidated Statements of Cash Flows

(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31, 2005	2004
Cash flow from investing activities		
Proceeds from redemptions of available-for-sale investments	$ 3,512,717	$ 4,266,970
Purchases of available-for-sale investments	(4,007,031)	(4,396,417)
Proceeds from maturities and redemptions of held-to-maturity investments	62,702	26,828
Purchases of held-to-maturity investments	(32,009)	(29,058)
Issuance of revolving credit facility to Amex	(25,000)	–
Repayment by Amex of note receivable	25,000	–
Net proceeds from the sale of NASDAQ common stock by NASD	403,537	–
Acquisitions of businesses, net of cash and cash equivalents acquired	(970,467)	(190,000)
Investments in and advances to affiliates	(7,528)	–
Return on capital from investments in affiliates	1,015	–
Purchases of property and equipment	(48,400)	(54,555)
Proceeds from sales of property and equipment	42	11,299
Net cash used in investing activities	(1,085,422)	(364,933)
Cash flow from financing activities		
Proceeds from issuances of debt obligations	955,000	–
Redemption of senior notes	(25,000)	–
Net proceeds from the issuance of NASDAQ common stock by NASDAQ	52,930	2,273
Temporarily restricted contributions to the Foundation	6,900	–
Payments for treasury stock purchases by NASDAQ	(73)	(85)
Principal payments on capital leases	(659)	(2,369)
Net cash provided by (used in) financing activities	989,098	(181)
Increase (decrease) in cash and cash equivalents	172,223	(208,950)
Cash and cash equivalents at beginning of year	123,834	332,784
Cash and cash equivalents at end of year	$ 296,057	$ 123,834
SUPPLEMENTAL DISCLOSURES:		
Cash payments for interest	$ 15,727	$ 11,772
Cash payments (refunds) of taxes, net	$ 37,061	$ (49,986)

See accompanying notes.

NASD 2005 Notes to Consolidated Financial Statements

1. ORGANIZATION AND NATURE OF OPERATIONS

NASD

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

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

On January 13, 2006, the SEC approved NASDAQ's application to operate as a national securities exchange (Exchange Registration). NASDAQ will begin operating as an exchange once it meets conditions imposed by the SEC. Upon effectiveness of Exchange Registration, NASDAQ will redeem the Series D Preferred Stock and NASD will no longer have voting control over NASDAQ and will cease consolidating NASDAQ and will have reduced its ownership of NASDAQ to the number of shares underlying the unexercised warrants for Tranche IV. See Note 3, "NASDAQ Restructuring" for additional information.

NASD INVESTOR EDUCATION FOUNDATION

On February 13, 2004, NASD established the Foundation, a non-profit membership organization incorporated in Delaware. The Foundation provides investors with high quality, easily accessible information and tools to better understand investing and the markets. The Foundation awards grants to fund educational programs and research aimed at segments of the investing public who could benefit from additional resources. NASD is the sole member of the Foundation.

NASD HOLDING

NASD Holding owned the Class B interest in The American Stock Exchange, LLC (Amex) until December 31, 2004, when it sold the Class B interest in Amex to Amex Membership Corporation. See Note 15, "Discontinued Operations," for additional information.

NASDAQ

NASDAQ is a leading provider of securities listing, trading and information products and services. NASDAQ operates The NASDAQ Stock Market, the largest electronic equity securities market in the U.S., both in terms of number of listed companies and traded share volume.

On December 8, 2005, NASDAQ completed the acquisition of Instinet Group Incorporated (Instinet), subsequently renamed Norway Acquisition Corp. (Norway), and the immediate sale of Instinet's Institutional Brokerage division to an affiliate of Silver Lake Partners, an unaffiliated private equity firm. As a result of these transactions NASDAQ owns Norway. Norway owns 100.0 percent of INET Holding Company, Inc. (IHC). IHC owns 100.0 percent of INET ATS, Inc. (INET), an electronic communication network and Island Execution Services, LLC, which are broker-dealers registered pursuant to the Securities Exchange Act of 1934.

NASD 2005 Notes to Consolidated Financial Statements

1. ORGANIZATION AND NATURE OF OPERATIONS (CONTINUED)

On October 1, 2005, NASDAQ completed the acquisition of Carpenter Moore Insurance Services, Inc. (Carpenter Moore), a privately held, San Francisco-based insurance brokerage firm specializing in management liability. Carpenter Moore is a wholly owned subsidiary of NASDAQ Insurance Agency.

On June 7, 2005, NASDAQ and Reuters announced the formation of the Independent Research Network (IRN), a new joint venture created to help public companies obtain independent analyst coverage. The IRN began operations in the third quarter of 2005.

On January 1, 2005, NASDAQ purchased the remaining 50.0 percent interest in the NASDAQ Insurance Agency from AIG NJV, Inc. for nominal consideration.

On September 7, 2004, NASDAQ completed its acquisition of Toll Associates LLC (Toll) and affiliated entities from SunGard Data Systems Inc. Toll is a holding company that owns a 99.8 percent interest in Brut, LLC, the owner and operator of the Brut ECN, a broker-dealer registered under the Securities Exchange Act of 1934. Toll also holds a 100.0 percent interest in Brut Inc., which owns the remaining 0.2 percent interest in Brut and serves as its manager under an operating agreement. As of December 31, 2005, Brut also owned Brut Europe Limited as a wholly owned subsidiary. NASDAQ determined to dissolve Brut Europe Limited and it was placed into members' voluntary liquidation on July 27, 2005. NASDAQ expects Brut Europe Limited to be completely dissolved by the end of the first quarter of 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

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

USE OF ESTIMATES

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

SEGMENTS

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

CASH AND CASH EQUIVALENTS

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

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INVESTMENTS

Under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," management determines the appropriate classification of investments at the time of purchase. Investments for which the Company does not have the intent or ability to hold to maturity are classified as available-for-sale and are carried at fair value, with any unrealized gains and losses, net of tax, reported as a separate component of members' equity. Investments for which the Company has the intent and ability to hold to maturity are classified as held-to-maturity and are carried at amortized cost. The amortized cost of debt securities classified as held-to-maturity is adjusted for amortization of premiums and accretion of discounts. Fair value is determined based on quoted market prices when available, or if quoted market prices are not available, on discounted expected cash flows using market rates commensurate with the credit quality and maturity of the investment. Realized gains and losses on sales of securities are included in earnings using the average cost method. Amounts due to or from the custodial agent relate to security trades executed prior to the balance sheet date but not yet settled.

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

The Company regularly monitors and evaluates the realizable value of its securities portfolio. When assessing for other-than-temporary declines in value, the Company considers such factors as the extent of the decline in value, the duration for which the market value had been less than cost, the performance of the investee's stock price in relation to the stock price of its competitors within the industry and the market in general, any news that has been released specific to the investee and the outlook for the overall industry in which the investee operates. The Company also reviews the financial statements of the investee to determine if the investee is experiencing financial difficulties. If events and circumstances indicate that a decline in the value of these assets has occurred and is deemed other-than-temporary, the carrying value of the security is reduced to its fair value and the impairment is charged to earnings.

DERIVATIVE INSTRUMENTS

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

NASD invests in derivative instruments in accordance with its investment policy. The goal of NASD's investment policy is to generate long-term returns to support NASD operations for the benefit of investors and members, to preserve the real purchasing power of those funds for future contingencies, and to maintain financial balance sheet strength. To this end, the portfolio includes absolute return-oriented investments, the goals of which are to post a positive return in both strong and weak market environments, and particularly to protect capital in down market environments. As of December 31, 2005 and 2004, the Company

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

had investments in written options, futures contracts, forward contracts and swaps; the fair value of these derivative instruments was insignificant.

RECEIVABLES, NET

The Company's receivables are primarily concentrated with NASD members, market data vendors and NASDAQ-listed companies. Receivables are shown net of reserves for uncollectible accounts. Reserves are calculated based on the age and source of the underlying receivable and are tied to past collections experience. The reserve for bad debts is maintained at a level that management believes to be sufficient to absorb estimated losses in the accounts receivable portfolio. The reserve is increased by the provision for bad debts, which is charged against operating results and decreased by the amount of charge-offs, net of recoveries. The amount charged against operating results is based on several factors, including a continuous assessment of the collectibility of each account. In circumstances where a specific customer's inability to meet its financial obligations is known (i.e., bankruptcy filings), the Company records a specific provision for bad debts against amounts due to reduce the receivable to the amount the Company reasonably believes will be collected. For all other customers, provisions for bad debts are made based on the length of time the receivable is past due and historical experience. For receivables past due 31-60 days, 61-90 days, and over 90 days, the outstanding account balances are reserved for between 0.0 and 10.0 percent, 10.0 to 50.0 percent, and 50.0 to 100.0 percent of the outstanding account balances, respectively. If circumstances change (e.g., higher than expected defaults or an unexpected material adverse change in a major customer's ability to pay), the Company estimates of recoverability could be reduced by a material amount. Total reserves netted against receivables in the consolidated balance sheets were $12.5 million and $8.3 million at December 31, 2005 and 2004, respectively.

RELATED PARTY TRANSACTIONS

Related party receivables and payables are the result of various transactions between the Company and its affiliates. Related party receivables and payables, as of December 31, 2004, also include transactions with Amex. As of December 31, 2005, amounts due from Amex were included within accounts receivable, net, in the consolidated balance sheet, as Amex is no longer a related party.

DEPOSIT ASSETS

Other current assets include $4.2 million and $2.0 million of deposits as of December 31, 2005 and 2004, respectively. These deposits, which are held at clearing organizations and clearing brokers, are for Brut and INET and serve primarily for clearance and settlement services.

PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost less accumulated depreciation. Equipment acquired under capital leases is initially recorded at the lower of fair value or the present value of future lease payments. Repairs and maintenance costs are expensed as incurred. Depreciation and amortization are calculated using the straight-line method over estimated useful lives ranging from 10 years to 40 years for buildings and improvements, two years to seven years for data processing equipment and software, and five years to 10 years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the lesser of the useful life of the improvement or the term of the applicable lease. Depreciation and amortization expense for property and equipment, including amortization of capitalized software costs, totaled $91.2 million and $106.5 million for the years ended December 31, 2005 and 2004, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and equipment includes capital leases of $2.5 million and $2.4 million and accumulated amortization of $1.5 million and $0.7 million for the years ended December 31, 2005 and 2004, respectively. Amortization of assets under capital lease was $0.8 million and $3.6 million for the years ended December 31, 2005 and 2004, respectively, and is included within depreciation and amortization expense in the consolidated statements of income.

As of December 31, 2005, property and equipment, net, included an asset "held-for-sale" with a carrying value of $6.7 million, related to an owned building (Diamondback) in Rockville, Maryland. In November 2005, NASD executed an agreement to sell this building to a third party, which is expected to close in the summer of 2006.

As of December 31, 2004, property and equipment, net, included an asset "held-for-sale" with a carrying value of $17.6 million, related to an owned building (Key West) in Rockville, Maryland. The carrying value for this building was determined based on the fair value of $18.0 million less estimated costs to sell of $0.4 million. In June 2005, NASDAQ completed the sale of the building to NASD for $18.0 million, and the building was re-categorized as "held and used" in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

SOFTWARE COSTS

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

Unamortized, capitalized software development costs of $60.2 million and $85.2 million as of December 31, 2005 and 2004, respectively, are classified within data processing equipment and software in the consolidated balance sheets. Amortization of costs capitalized under SOP No. 98-1 totaled $43.1 million and $31.4 million for 2005 and 2004, respectively, and is included in depreciation and amortization in the consolidated statements of income. Additions to capitalized software were $18.1 million and $16.4 million in 2005 and 2004, respectively.

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

GOODWILL AND INTANGIBLE ASSETS, NET

The Company accounts for its goodwill and intangible assets in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of a business acquired. Goodwill is tested for impairment at the reporting unit level annually, or in interim periods if certain events occur indicating that the carrying value may be impaired. If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill is less than the carrying

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

value. The fair value of goodwill is determined based on discounted cash flows. The Company completed the required annual impairment test, which resulted in no impairment of goodwill in 2005.

Intangible assets, net, which include technology and customer relationships, are amortized on a straight-line basis over their estimated average useful lives, ranging from one year to 20 years. Upon the adoption of SFAS No. 142, intangible assets deemed to have indefinite useful lives are not amortized and are subject to annual impairment tests. Impairment exists if the carrying value of the indefinite-lived intangible asset exceeds its fair value. For finite-lived intangible assets subject to amortization, impairment is considered upon certain "triggering events" and is recognized if the carrying amount is not recoverable and the carrying amount exceeds the fair value of the intangible asset.

NASD had license agreements of $6.7 million and $7.5 million with accumulated amortization of $5.1 million and $4.3 million as of December 31, 2005 and 2004, respectively. Licenses are amortized over a five-year estimated useful life. Amortization expense for the next three years commencing in 2006 is expected to be $1.1 million, $0.5 million, and $0.04 million, respectively. NASD had a Supplemental Executive Retirement Plan (SERP) pension asset of $0.1 million and $0.3 million as of December 31, 2005 and 2004, respectively. Pension intangible assets were recorded as required by SFAS No. 87. Amounts are not amortized but are adjusted as part of the annual minimum pension liability assessment.

NASDAQ had net intangible assets of $215.5 million and $40.8 million as of December 31, 2005 and 2004, respectively. See Note 4, "NASDAQ Business Combinations," for additional information.

IMPAIRMENT OF LONG-LIVED ASSETS

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

NASDAQ recorded write-downs for property and equipment of $7.4 million related to long-lived assets held-for-sale in the fourth quarter of 2004, related to an owned building. This charge is included in general and administrative expense in the consolidated statements of income.

INVESTMENTS IN AND ADVANCES TO AFFILIATES

NASD is a limited partner in several private equity funds. Investments in these funds are accounted for using either the cost or equity method. This accounting treatment is in accordance with Emerging Issues Task Force (EITF) No. D-46, "Accounting for Limited Partnership Investments," which states that the SEC staff's current position is that investments in limited partnerships should be accounted for pursuant to SOP No. 78-9, "Accounting for Investments in Real Estate Ventures." As of December 31, 2005, the Company had an investment of $4.2 million in a limited partnership, which is accounted for under the equity method, and $2.4 million of investments in six limited partnerships that are accounted for under the cost method. These investments are included in other assets in the consolidated balance sheets. The company has total outstanding commitments of $69.7 million to these partnerships.

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NOTE RECEIVABLE AND REVOLVING CREDIT FACILITY RECEIVABLE FROM AMEX

On December 31, 2004, NASD and Amex entered into an Amended and Restated Loan Agreement (New Note), which amended Amex's previous borrowings from NASD from $50.0 million to a $25.0 million note. The New Note had a scheduled maturity of October 31, 2011 and bore interest at a rate of 10.0 percent per annum (non-compounding) until December 31, 2005, and 5.0 percent per annum thereafter. In August 2005, Amex repaid this note in full, plus accrued interest of $1.6 million. This income is included within interest and dividend income in the consolidated statements of income.

On December 31, 2004, NASD and Amex entered into a revolving credit facility, pursuant to which Amex has the ability to borrow from NASD additional amounts, up to a maximum, at any one time, of $25.0 million at an interest rate of 5.0 percent. The maturity date for the revolving credit facility is October 31, 2011. In February 2005, Amex borrowed $25.0 million under the revolving credit facility, and NASD recorded a discount of $8.6 million, representing the difference between the stated rate of interest and the estimated market rate of 11.2 percent. This discount was recorded in general and administrative expenses in the consolidated statements of income. Interest is recognized using the effective interest method. For the year ended December 31, 2005, interest income was $1.6 million and is included within interest and dividend income in the consolidated statements of income.

DEFERRED REVENUE

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

DEFERRED CONTRIBUTION INCOME

On September 2, 2005, the Federal District Court for the Southern District of New York issued an order approving the SEC's new investor education plan, whereby all funds collected in connection with the Global Research Analyst Settlement (the Settlement) will be remitted to the Foundation. Pursuant to the final judgments against each of the defendants under the Settlement, the SEC was to collect a total of $55.0 million in equal annual installments of $11.0 million beginning in October 2003.

Upon the issuance of the order, the Foundation recorded a contribution receivable and contribution revenues of approximately $52.3 million, representing the net present value of all payments to be received. For the year ended December 31, 2005, the Foundation recognized contribution revenue of $0.8 million, representing accretion income on the receivable. As of December 31, 2005, the total contribution receivable is $53.1 million, of which $43.7 million is recorded as a current asset in accounts receivable, net in the consolidated balance sheets. The remaining $9.4 million relates to the final annual installment due in October 2007, and is recorded as a non-current asset in other assets in the consolidated balance sheets.

As mentioned in Note 1, the Foundation is a consolidated subsidiary of NASD. On a consolidated basis, the $53.1 million has been recorded as deferred contribution income in the accompanying financial statements and will be recognized as revenue as the Foundation administers grant payments pursuant to the guidelines of its grant program. As of December 31, 2005, no amounts were received by the Foundation related to the Settlement and no grant payments were incurred by the Foundation related to this contribution.

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Under the Settlement, the Foundation must invest funds received 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. Amounts received in relation to this order will be reported by the Foundation as unrestricted. In the event of a proposed dissolution of the Foundation, the SEC shall file an application with the Court setting forth a plan for the disposition of any remaining funds in the Foundation.

DEPOSIT AND RENEWAL LIABILITIES

NASD-registered firms make deposits into NASD's Central Registration Depository (CRD) system to pay for services including registration fees charged by states and other SROs. Total CRD-related deposits were $55.0 million and $48.9 million as of December 31, 2005 and 2004, respectively.

In July 2004, NASD agreed to administer the monies of a restitution fund collected for defrauded victims of A.S. Goldmen pursuant to an Order of Restitution issued by the Supreme Court of the State of New York. Total deposits related to this restitution fund were $11.7 million as of December 31, 2004. As of December 31, 2005, $0.5 million remained to be distributed to the appropriate parties. The corresponding funds are included in cash and cash equivalents as of December 31, 2005 and 2004.

OTHER LIABILITIES

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

Investment Advisers Registration Depository Program

NASDR administers the IARD program. IARD is an electronic filing system for investment advisers regulated by the SEC under the Investment Advisers Act of 1940, and by the states, represented by the North American Securities Administrators Association. The IARD system collects and maintains the registration and disclosure information for investment advisers and their associated persons. As administrator of the IARD program, NASDR collects all fees and incurs expenses, which are tracked and reported to the SEC on a quarterly basis. In accordance with the Memorandum of Understanding (MOU) with the SEC, signed on July 24, 2001, the distribution of the cumulative cash basis surplus attributable to filings by SEC-registered investment advisers upon termination of the MOU, will be determined by the SEC for the benefit of IARD filers. NASDR 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, 2005 and 2004, the cumulative cash basis surplus for the IARD program was $27.1 million and $24.6 million, respectively, which was recorded in NASD's consolidated financial statements as follows:

	DECEMBER 31,	
	2005	2004
	(in thousands)	
Current deferred revenue	$ 1,610	$ 11,121
Non-current deferred revenue	2,605	2,478
Other liabilities	22,915	11,003
Total	$ 27,130	$ 24,602

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Continuing Education Program

NASDR, in conjunction with NYSE and the Securities Industry/Regulatory Council on Continuing Education (the Council), administers a two-part mandatory CE program. The CE program requires all registered persons to take a computer-based program on the second anniversary of their initial securities registration and every three years thereafter, and for broker-dealers to provide on-going training, tailored specifically to the products and services they provide. Compliance with CE program requirements is evaluated as part of the on-site examinations that are conducted by the SROs. As administrator of the CE program, NASDR collects all fees and incurs expenses, which are tracked and reported to the Council on a quarterly basis. In accordance with the CE program agreement with the NYSE and the Council, signed on June 9, 1995, the pro-rata cumulative excess of income over expenses attributable to the CE program is due back to each party upon termination of the agreement. As of December 31, 2005 and 2004, NASDR has established a reserve for the NYSE's portion of the cumulative surplus for the CE program of $2.7 million and $3.5 million, respectively, representing the cumulative income over expenses for the program attributable to NYSE. This reserve is included within other liabilities in the consolidated balance sheets.

WARRANTS TO PURCHASE NASDAQ COMMON STOCK FROM NASD

In 2000 and 2001, NASD issued 10.8 million warrants for the purchase of 43.2 million shares of NASDAQ common stock. NASD accounts for these warrants in accordance with EITF No. 00-6, "Accounting for Freestanding Derivative Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary." These warrants are carried at fair value with changes in the fair value recorded in income, which resulted in a (loss) gain of ($179.3) million and $3.9 million for the years ended December 31, 2005 and 2004, respectively. As of December 31, 2005, the fair value of the warrants is reported within current liabilities, as the exercise period for the outstanding warrants expires in June 2006. NASD obtained a third-party valuation to determine the fair value of these warrants as of December 31, 2005. As of December 31, 2004, NASD determined the fair value using a Black-Scholes valuation model using the following assumptions: a weighted-average expected life of 1.4 years, a weighted-average expected volatility of 30.0 percent and a weighted-average risk free interest rate of 3.06 percent.

REVENUE RECOGNITION AND COST OF REVENUE

Market Services

Market services revenues are derived from NASDAQ Market Center and NASDAQ Market Services Subscriptions revenues. NASDAQ Market Center revenues are variable, based on service volumes, and recognized as transactions occur. NASDAQ Market Services Subscriptions revenues are based on the number of presentation devices in service and quotes delivered through those devices. NASDAQ Market Services Subscriptions revenues are recognized in the month that information is provided. These revenues are recorded net of amounts due under revenue-sharing arrangements with market participants. Pursuant to EITF No. 99-19, "Reporting Revenue Gross as Principal vs. Net as an Agent," NASDAQ records execution revenues from transactions executed through Brut and INET on a gross basis in revenues and records expenses such as liquidity rebate payments as cost of revenues as both Brut and INET act as principal. Before the second quarter of 2005, NASDAQ reported other execution revenues net of liquidity rebates since NASDAQ does not act as principal.

Issuer Services

Issuer services revenues include annual fees, IL fees and LAS fees. Annual fees are recognized ratably over the following 12-month period. IL and LAS fees are recognized on a straight-line basis over estimated service periods of six and four years, respectively,

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

based on historical listing experience. Issuer services also include commission income from NASDAQ Insurance Agency. Commission income is recognized when coverage becomes effective, the premium due under the policy is known or can be reasonably estimated, and substantially all required services related to placing the insurance have been provided. The effect on income of subsequent premium adjustments, including policy cancellations, is recorded when the adjustment is known. Fee income for services other than placement of insurance coverage is recognized as those services are provided. Broker commission adjustments and commissions on premiums billed directly by underwriters are recognized when such amounts can be reasonably estimated.

NASDAQ receives license fees for its trademark licenses related to the NASDAQ-100 Index Tracking Stock (QQQQ) and other financial products linked to NASDAQ indexes issued in the U.S. and abroad. NASDAQ primarily has two types of license agreements: transaction-based licenses and asset-based licenses. Transaction-based licenses are generally renewable long-term agreements. Customers are charged based on transaction volume, a minimum contract amount, or both. If a customer is charged based on transaction volume, NASDAQ recognizes revenue when the transactions occur. If a customer is charged based on a minimum contract amount, NASDAQ recognizes revenue on a pro-rata basis over the licensing term. Asset-based licenses are also generally long-term agreements. Customers are charged based on a percentage of assets under management for licensed products, per the agreement, on a monthly or quarterly basis. These revenues are recorded on a monthly or quarterly basis over the term of the license agreement.

Regulatory Fees

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

User Fees

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Dispute Resolution Fees

Dispute resolution fees consist of fees earned during the arbitration and mediation processes. Fees on open cases are recognized as revenue over the average life of a case. Upon the closing of a case, a final billing is prepared and any unpaid fees are recognized as revenue at that time. Dispute resolution fees also include mediation fees, SRO annual fees, neutral training fees and other fees totaling $2.1 million for both years ended December 31, 2005 and 2004. SRO annual fees relate to the maintenance of dispute resolution services including arbitration and mediation, for SROs. Neutral training fees relate to NASD Dispute Resolution's comprehensive arbitrator and mediator application and training program. These fees are recognized either when the cash is received or when the service is provided.

Transparency Services

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

Contract Services

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

Activity Assessment

NASD, as an SRO, pays certain fees and assessments to the SEC pursuant to Section 31 of the Securities Exchange Act of 1934. These fees are designed to cover costs incurred by the government in the supervision and regulation of securities markets and securities professionals and are based on a percentage of the total dollar value of securities sold in The NASDAQ Stock Market, the ADF and the OTC Equities. NASD remits these fees to the U.S. Treasury semiannually in March and September.

NASD recovers the cost of the SEC's fees and assessments through an activity assessment billed to securities firms based on the total dollar value of securities sold in The NASDAQ Stock Market and the ADF. The assessments billed to securities firms are recognized when the transactions are reported. The activity assessments for transactions on the OTC Equities are self-reported to NASD and recognized as the transactions occur. Due to this being a self-reported revenue stream for NASD, subsequent adjustments by firms of its activity assessment may occur and are recognized as an adjustment to revenue in the period the adjustment becomes known to NASD. NASD reports the activity assessment on a gross basis within revenues in accordance with EITF No. 99-19. Amounts due to the SEC are reported as a cost of revenue.

Fines

Fines represent sanctions for rule violations and commencing in 2004, are recognized upon assessment. Regarding the use of fines, NASD has a process in place designed to guard against potential conflicts in the organization's collection and use of fines. NASD's fines guidelines provide that: (1) all fine monies are collected and segregated from NASD revenues into a separate account, (2) fine

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

monies collected or anticipated are not included in NASD operating revenues and play no role in developing its operating budget, (3) fine monies are not used to fund employee compensation, (4) the use of fine monies is limited to capital expenditures (approved by executive management, the Finance Committee of NASD's Board of Governors or NASD's Board of Governors) and regulatory projects specified by those groups as having a clear and direct link to protecting investors and ensuring market integrity, and (5) NASD reports annually to its Board of Governors the projects and purposes for which fine monies have been used.

ADVERTISING COSTS

The Company expenses advertising costs, which include media advertising and production costs. Advertising costs are recorded in the period incurred. Advertising costs totaled $10.5 million and $14.6 million for 2005 and 2004, respectively, and are included in general and administrative expense in the consolidated statements of income.

PENSION BENEFITS

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

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

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

STOCK COMPENSATION

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

As required under SFAS No. 123, "Accounting for Stock-Based Compensation," and SFAS No. 148 "Accounting for Stock-Based Compensation—Transition and Disclosure," pro forma information regarding net income has been determined as if NASDAQ had accounted for all stock option grants based on a fair value method. The fair value of each stock option grant was estimated at the date of grant using the Black-Scholes valuation model assuming a weighted-average expected life of five years, weighted-average

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

expected volatility of 30.0 percent and a weighted-average risk-free interest rate of 4.05 percent and 3.43 percent for 2005 and 2004, respectively. The weighted-average fair value of options granted in 2005 and 2004 was $7.05 and $2.49, respectively. Pro forma net income includes the amortization of the fair value of stock options over the vesting period and the difference between the fair value and the purchase price of common shares purchased by employees under the employee stock purchase plan. The pro forma net income also includes a reduction in option expense due to the true-up of actual forfeitures. The pro forma information for the years ended December 31, 2005 and 2004 is as follows:

	2005	2004
	(in thousands)	
Income from continuing operations	$293,715	$105,135
Compensation expense (net of minority interest of $2,639 in 2005 and $1,784 in 2004)	(1,107)	(2,152)
Pro forma income from continuing operations	$292,608	$102,983

In December 2004, the FASB issued SFAS No. 123(R), which revises SFAS No. 123, supersedes APB No. 25 and amends SFAS No. 95. See "Recent Accounting Pronouncements" below.

INCOME TAXES

NASD, NASDR and NASD DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). All other consolidated subsidiaries of NASD are taxable entities. Deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences are realized. If necessary, a valuation allowance is established to reduce deferred tax assets to the amount that is more likely than not to be realized.

ISSUANCE OF SUBSIDIARY STOCK

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

FOREIGN CURRENCY TRANSLATION

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

MINORITY INTERESTS

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

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CONCENTRATION OF RISK

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

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

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

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

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which revises SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) also amended SFAS No. 95, "Statement of Cash Flows." SFAS No. 123(R) requires that new, modified and unvested share-based payment transactions with employees, such as stock options and restricted stock, be recognized in the financial statements based on their fair value and recognized as compensation expense over the vesting period. NASDAQ adopted SFAS No. 123(R) effective January 1, 2006, using the modified prospective transition method, and will recognize share-based compensation cost on a straight-line basis over the requisite service periods of awards. Under the modified prospective method, non-cash compensation expense will be recognized for the portion of outstanding stock option awards granted prior to the adoption of SFAS No. 123(R) for which service has not been rendered, and for any future stock option grants. The pro forma information presented in Note 12, "NASDAQ Stock Compensation, Stock Awards, and Capital Stock," presents the estimated compensation charges under SFAS No. 123(R). NASDAQ's assessment of the estimated compensation charges is affected by its stock price, as well as assumptions regarding a number of complex and subjective variables and related tax impact. These variables include, but are not limited to, NASDAQ's stock price volatility and employee stock option exercise behaviors.

In 2004, the Emerging Issues Task Force issued EITF No. 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," to provide detailed guidance on assessing impairment losses on debt and equity investments. In September 2004, the FASB voted unanimously to delay the effective date of EITF No. 03-1. On November 3, 2005, the FASB issued FASB Staff Position FAS (FSP) No. 115-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," revising the guidance in EITF No. 03-1. FSP No. 115-1 is effective on January 1, 2006. The Company is currently evaluating the impact of FSP No. 115-1 on its consolidated financial statements. The disclosures required by EITF No. 03-1 are included in Note 7, "Investments," to the consolidated financial statements.

NASD 2005 Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECLASSIFICATIONS

Certain amounts for the prior year have been reclassified to conform to the 2005 presentation. For the years ended December, 31, 2005 and 2004, NASD classified the IARD program and CE program liabilities in other liabilities in the consolidated balance sheets. These amounts were previously reported in other current liabilities in the consolidated balance sheets.

3. NASDAQ RESTRUCTURING

On January 13, 2006, the SEC approved NASDAQ's application for registration as a national securities exchange (Exchange Registration). NASDAQ will begin operating as an exchange once it meets conditions imposed by the SEC. Upon effectiveness of Exchange Registration, NASDAQ will redeem the Series D Preferred Stock and NASD will no longer exert voting control over NASDAQ. Upon redemption of the Series D Preferred Stock, NASD will cease consolidating NASDAQ and will have reduced its ownership of NASDAQ to any remaining shares underlying the unexercised warrants for Tranche IV.

Previous NASD transactions in NASDAQ common stock included Phase I and Phase II sales of NASDAQ common stock and warrants in 2000 and 2001. As part of these transactions, NASD issued 10,806,494 warrants to purchase up to 43,225,976 shares of NASDAQ common stock from NASD in four annual tranches, with the first tranche beginning in 2002.

Preferred Stock

In March 2002, NASD sold 33.8 million shares of NASDAQ common stock to NASDAQ and received total consideration of $305.2 million in cash, 1,338,402 shares of Series A Cumulative Preferred Stock, and one share of Series B Preferred Stock. In December 2005, NASD exchanged its one share of Series B Preferred Stock for one newly issued share of Series D Preferred Stock, which has terms substantially similar to the terms of the Series B Preferred Stock. The Series D Preferred Stock does not pay dividends and provides NASD with voting control of NASDAQ.

Cumulative Preferred Stock

The Series A Cumulative Preferred Stock carried a 7.6 percent dividend rate for the year beginning in March 2003, and carried a 10.6 percent dividend rate in all subsequent years. On September 30, 2004, NASD waived a portion of the dividend for the third quarter of 2004 of $2.5 million and accepted an aggregate amount of $1.0 million (calculated based on an annual rate of 3.0 percent) as payment in full of the dividend for this period. In November 2004, NASD and NASDAQ entered into an exchange agreement pursuant to which NASD exchanged 1,338,402 shares of Series A Cumulative Preferred Stock for 1,338,402 shares of newly issued Series C Cumulative Preferred Stock. The Series C Cumulative Preferred Stock accrues quarterly dividends at an annual rate of 3.0 percent for all periods until July 1, 2006, and at 10.6 percent thereafter.

For the years ended December 31, 2005 and 2004, NASDAQ paid dividends of $3.2 million and $8.4 million, respectively. In 2004, NASDAQ recognized a loss of $3.9 million on the exchange of the Series A Cumulative Preferred Stock with the Series C Cumulative Preferred Stock. This loss was due to the difference between the combined fair market value of the Series C Cumulative Preferred Stock and additional dividend ($137.7 million) versus the redemption value ($133.8 million) of the Series A Cumulative Preferred Stock. For the years ended December 31, 2005 and 2004, NASDAQ recognized expenses of $3.4 million and $0.9 million, respectively, for the accretion of the Series C Cumulative Preferred Stock to its redemption value. As a result of these

3. NASDAQ RESTRUCTURING (CONTINUED)

transactions, NASD realized an increase in its consolidated members' equity of $4.4 million and $2.2 million, representing the minority owners' portion of these transactions.

On April 21, 2005, NASD and NASDAQ entered into a Stock Repurchase and Waiver Agreement whereby NASD consented to the financing used in connection with the acquisition of Instinet. In exchange for the waiver, NASDAQ repurchased 384,932 shares of its Series C Cumulative Preferred Stock from NASD for approximately $40.0 million.

On February 15, 2006, NASDAQ redeemed all remaining outstanding shares of its Series C Cumulative Preferred Stock from NASD, as NASDAQ was required to redeem it after the closing, which took place on the same date of the public offering of its common stock. The total redemption price was $104.7 million.

Sales of NASDAQ Common Stock

On February 15, 2005, NASDAQ completed an underwritten secondary offering of 16,586,980 shares of common stock owned by NASD, and an additional 3,246,536 shares of common stock owned by certain selling stockholders that purchased the shares in NASDAQ's private placements in 2000 and 2001. NASDAQ, its officers, or other employees did not sell any shares in the secondary offering. NASD received net proceeds of $140.4 million and recognized a gain on the sale of subsidiary stock of $133.0 million.

On November 16, 2005, NASD completed a block trade of 4,500,000 shares of NASDAQ common stock. NASDAQ, its officers, or other employees did not sell any shares in the secondary offering. NASD received net proceeds of $161.3 million from this sale and recognized a gain on sale of subsidiary stock of $154.4 million.

On February 15, 2006, NASD sold 3,505,886 shares of NASDAQ common stock in NASDAQ's public offering. NASD received net proceeds of $129.1 million and recognized a gain on sale of subsidiary stock of $121.8 million. On March 2, 2006, the underwriters for NASDAQ's public offering exercised its option and purchased an additional 1,042,142 shares of common stock from NASD. NASD received net proceeds of $40.0 million on this sale and recognized a gain on sale of subsidiary stock of $34.8 million.

Warrants to Purchase NASDAQ Common Stock from NASD

Tranche I expired on June 27, 2003 and prior to the expiration, NASD issued 35,830 shares of NASDAQ common stock for the exercise of warrants, generating proceeds of $0.5 million and a gain of $0.4 million. Upon expiration of Tranche I, 10,770,664 shares of common stock underlying unexercised warrants reverted back to NASD. Tranche II expired on June 25, 2004, and 6,750 shares of NASDAQ common stock were issued following the exercise of warrants, generating proceeds and a gain of $0.1 million. Following expiration of Tranche II, 10,799,744 shares of common stock underlying the unexercised warrants reverted back to NASD. Tranche III expired on June 27, 2005, and NASD issued 6,741,894 million shares of NASDAQ common stock for exercises of warrants, generating proceeds of $101.1 million and a gain of $95.2 million. Upon expiration of Tranche III, 4,064,600 shares of common stock underlying unexercised warrants reverted back to NASD. Tranche IV expires on June 27, 2006. As of December 31, 2005, NASD issued 87,675 shares of NASDAQ common stock for exercises of warrants under Tranche IV, generating proceeds to NASD of $1.4 million and a gain of $1.2 million.

As of December 31, 2005, NASD owned 18.4 percent of NASDAQ common stock, 100 percent of NASDAQ Series C Cumulative Preferred Stock, and 100 percent of NASDAQ Series D Preferred Stock.

4. NASDAQ BUSINESS COMBINATIONS

PURCHASE ACQUISITIONS AND COMBINATIONS

NASDAQ completed the following acquisitions and asset purchases in 2005 and 2004:

- Acquisition of Instinet Group, December 8, 2005 – Through this acquisition, NASDAQ acquired the INET ECN. NASDAQ expects to migrate its existing NASDAQ and Brut trading platforms to the INET platform by the fourth quarter of 2006.
- Acquisition of Carpenter Moore, October 1, 2005 – NASDAQ acquired Carpenter Moore to increase NASDAQ's depth of brokerage expertise in directors and officers, errors and omissions and other management liability insurance products, and to expand the regional coverage by NASDAQ's insurance business through Carpenter Moore's unique co-brokerage distribution model. NASDAQ's acquisition encompasses four of Carpenter Moore's geographic locations, including California, Texas, Minnesota and Massachusetts.
- Purchase of remaining 50.0 percent interest in the NASDAQ Insurance Agency, January 1, 2005 – NASDAQ purchased the remaining 50.0 percent interest in the NASDAQ Insurance Agency from AIG. The purchase did not have any impact on the operations of the agency. As of January 1, 2005, NASDAQ consolidated NASDAQ Insurance Agency's financial position and results of operations in its consolidated financial statements. Before January 1, 2005, NASDAQ accounted for its investment in NASDAQ Insurance Agency under the equity method of accounting.
- Acquisition of Brut, September 7, 2004 – NASDAQ acquired Brut to enhance its execution quality, provide additional quote information and create a deeper pool of liquidity in NASDAQ-listed securities and securities listed on other exchanges.

The following table presents a summary of the acquisitions and asset purchases in 2005 and 2004:

	Purchase Consideration	Total Net (Liabilities) Assets Acquired (1)	Purchased Intangible Assets	Goodwill
		(in thousands)		
2005				
INET	$ 968,900	$ (3,100)	$ 172,870	$ 799,130
Carpenter Moore	27,500 (2)	240	8,600	18,660
NASDAQ Ins. Agency	–	(1,577)	1,000	577
Total for 2005	996,400	(4,437)	182,470	818,367
2004				
Brut	190,000	6,270	42,000	141,730
Total	$ 1,186,400	$ 1,833	$ 224,470	$ 960,097

(1) NASDAQ acquired net assets of INET totaling $64.7 million and recorded non-current deferred tax liabilities of $67.8 million related to INET's intangible assets resulting in total net liabilities acquired of $3.1 million. NASDAQ acquired net assets of Carpenter Moore totaling $2.5 million and recorded non-current deferred tax liabilities of $2.3 million related to Carpenter Moore's intangible assets resulting in total net assets of $0.2 million.

(2) Includes $11.8 million held in escrow for post-closing settlement adjustments. This balance will be paid over the next three years in accordance with the purchase agreement.

4. NASDAQ BUSINESS COMBINATIONS (CONTINUED)

As of September 7, 2005, NASDAQ finalized the allocation of the purchase price for the acquisition of Brut, except for related tax adjustments. The purchase price allocation for NASDAQ's other acquisitions and asset purchases will be finalized within one year from the purchase date. NASDAQ expects future adjustments related to taxes and settlement of post-closing adjustments.

The consolidated financial statements include the operating results of each business from the date of acquisition. Unaudited pro forma combined historical results for the years ended December 31, 2005 and 2004 are included in the table below. For the years ended December 31, 2005 and 2004, the unaudited pro forma combined historical results combine the historical consolidated statements of income of NASD with Brut and INET, giving effect to the acquisitions as if they had occurred on January 1, 2004, respectively. The acquisitions of Carpenter Moore and NASDAQ Insurance Agency are not included in these pro forma results as these acquisitions were not considered significant.

	YEARS ENDED DECEMBER, 31, 2005	2004
	(in thousands)	
Revenues	$ 2,269,800	$ 1,891,171
Net revenue	1,235,682	1,194,351
Net income from continuing operations (net of minority interest expense of $20,470 in 2005 and $5,197 in 2004)	$ 302,298	$ 111,405

The pro forma results include amortization of the intangible assets presented above and the elimination of intercompany transactions had NASD, Brut and INET acted as a combined company. The pro forma results are not necessarily indicative of what actually would have occurred if the acquisitions had been completed as of the beginning of 2004, nor are they necessarily indicative of future consolidated results.

4. NASDAQ BUSINESS COMBINATIONS (CONTINUED)

Purchased Intangible Assets

The following table presents the details of the purchased intangible assets acquired during 2005 and 2004:

	TECHNOLOGY		CUSTOMER RELATIONSHIP		OTHER		TOTAL
	Estimated Useful Life	Amount	Estimated Useful Life	Amount	Estimated Useful Life	Amount	Amount
	(in thousands, except estimated useful lives, which are in years)						
2005							
INET	5	$ 9,400	13	$ 163,100	1	$ 370	$ 172,870
Carpenter Moore	10	1,000	20	6,000	4.5	1,600	8,600
NASDAQ Ins. Agency	–	–	7	1,000	–	–	1,000
Total for 2005		10,400		170,100		1,970	182,470
2004							
Brut	10[1]	15,700	10	26,300	–	–	42,000
Total		$ 26,100		$ 196,400		$ 1,970	$ 224,470

(1) The Brut technology software license was originally amortized over an estimated useful life of 10 years on a straight-line basis. As a result of NASDAQ's acquisition of INET and NASDAQ's plans to replace Brut's technology with INET technology, a recoverability test was performed pursuant to SFAS No. 144, as the acquisition and planned technology retirement was deemed an impairment "triggering event." As a result of the recoverability test, NASDAQ determined that the Brut technology software license was not impaired. However, as a result of the plans, NASDAQ changed the estimated useful life of the technology software license to nine months, consistent with the planned implementation of INET technology.

Amortization expense for purchased intangible assets was $7.5 million and $1.7 million for the years ended December 31, 2005 and 2004, respectively. The estimated future amortization expense of purchased intangible assets as of December 31, 2005 is as follows:

	(in thousands)
2006	$ 30,214
2007	18,064
2008	17,864
2009	17,833
2010	17,565
Thereafter	113,938
Total	$ 215,478

4. NASDAQ BUSINESS COMBINATIONS (CONTINUED)

Goodwill

The increase in goodwill in 2005 primarily relates to the acquisitions discussed above and settlement of post-closing adjustments related to the acquisition of Brut. NASDAQ expects to deduct approximately $9.5 million of goodwill for income tax purposes for the year ended December 31, 2005.

ACQUISITION OF JOINT VENTURE

On June 7, 2005, NASDAQ and Reuters announced the formation of the Independent Research Network (IRN), a new joint venture created to help public companies obtain independent analyst coverage. The IRN's business plan is to aggregate multiple, independent research providers to procure and distribute equity research on behalf of under-covered companies to increase the market's understanding of a company's fundamental prospects. The service will be targeted to all companies listed in the U.S., as well as private companies looking for research coverage.

To fund the operations of the IRN, NASDAQ and Reuters contributed $1.8 million and $1.2 million, respectively, in July 2005. The IRN began operations in the third quarter of 2005 and NASDAQ consolidated IRN's financial position and results of operations. As of December 31, 2005, NASDAQ recorded minority interest of approximately $1.0 million in the consolidated balance sheets for Reuters' share of IRN's equity.

5. NASDAQ 2005 AND 2004 COST REDUCTIONS AND STRATEGIC REVIEW

2005 AND 2004 COST REDUCTIONS

During 2005 and 2004, in connection with actions NASDAQ took to improve operational efficiency, NASDAQ incurred expenses of approximately $20.0 million and $62.6 million, respectively. The following table summarizes the cost reduction charges included in the consolidated statements of income:

	YEARS ENDED DECEMBER 31,	
	2005	2004
	(in millions)	
Real estate consolidation, net	$ (5.4)	$ 29.0
Reductions in force	4.6	9.4
Technology migration	20.8	24.2
Total cost reduction charges	$ 20.0	$ 62.6

Real Estate Consolidation

During 2004, NASDAQ's management re-evaluated all of NASDAQ's owned and leased real estate and determined that NASDAQ would consolidate staff into fewer locations and save significant costs. As part of this re-evaluation, management decided not to occupy expansion space that it had leased at NASDAQ's headquarters in New York. As a result, for the year ended December 31, 2004, NASDAQ recorded charges of $29.0 million. However, as a result of the acquisition of INET, management has now

5. NASDAQ 2005 AND 2004 COST REDUCTIONS AND STRATEGIC REVIEW (CONTINUED)

determined that NASDAQ will occupy the expansion space for INET operations. As a result of this decision, NASDAQ recorded a release of part of the sublease loss reserve recorded in 2004, resulting in a net benefit of $5.4 million for the year ended December 31, 2005. More detail on the lease at headquarters, as well as NASDAQ's other leased, subleased, and owned properties are provided below.

New York

As of December 31, 2003, NASDAQ had a sublease loss reserve of $20.5 million related to its leased property at 1500 Broadway. In 2004, NASDAQ signed subleases for all of its space at 1500 Broadway. As of December 31, 2005 and 2004, NASDAQ updated the sublease loss estimate based on current assumptions and known sublease incomes and recorded an additional loss of $1.7 million and $1.2 million, respectively, to general and administrative expense in the consolidated statements of income. In 2005, the additional loss recorded was primarily due to an increase in real estate taxes as a result of a reassessment of the building. The additional loss recorded in 2004 was primarily due to a change in the assumption of sublease term commencement dates.

During 2004, NASDAQ recorded a sublease loss reserve of $12.8 million, included in general and administrative expense in the consolidated statements of income, on a lease for expansion space at its headquarters in New York, which was to commence on October 1, 2004. NASDAQ began marketing the expansion space for sublease during the third quarter of 2004. NASDAQ is obligated under the terms of the expansion space lease to pay $33.9 million over the remaining life of the lease. As a result of the INET acquisition and NASDAQ's intention to occupy the expansion space, NASDAQ released the sublease loss reserve recorded for the expansion space. This loss reserve totaled $12.1 million, net of fourth quarter of 2005 rental payments, which is also recorded in general and administrative expense in the consolidated statements of income.

In the fourth quarter of 2004, NASDAQ's management decided to consolidate additional space at its headquarters in New York and recorded an additional estimated sublease loss reserve of $4.8 million for such space. This charge is included in general and administrative expense in the consolidated statements of income. NASDAQ is obligated under the terms of this lease to pay $12.6 million over the remaining useful life of the lease. In 2005, NASDAQ signed a sublease for this space with NASD.

New Jersey

As a part of NASDAQ's strategic review, NASDAQ vacated the space NASDAQ Tools occupied at 15 Exchange Place, Jersey City, New Jersey. As of December 31, 2003, NASDAQ was obligated under the terms of this lease to pay $2.8 million over the remaining life of the lease and recorded a sublease loss reserve of $1.2 million. As of December 31, 2005 and 2004, NASDAQ updated the sublease loss reserve based on current assumptions and recorded an additional loss of $0.6 million and $0.2 million, respectively, to general and administrative expense in the consolidated statements of income.

Maryland

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

5. NASDAQ 2005 AND 2004 COST REDUCTIONS AND STRATEGIC REVIEW (CONTINUED)

NASDAQ began actively marketing the 9513 Key West building for sale in the fourth quarter of 2004 and in June 2005 completed the sale of the building to NASD for $18.0 million. During the fourth quarter of 2004, NASDAQ recognized a $7.4 million loss, which is included in general and administrative expense in the consolidated statement of income, for the write-down of the building's carrying amount to fair market value less cost to sell. Fair value was determined using a quoted market price from an independent third party. The building was classified as held-for-sale and was included in land, buildings and improvements in the consolidated balance sheets with a carrying value of $17.6 million as of December 31, 2004. This facility was NASDAQ's disaster recovery site. In September 2005, NASDAQ relocated its disaster recovery site to a third party outsource facility. As a result of vacating the Key West building, NASDAQ recorded $2.1 million of accelerated depreciation for certain assets for the year ended December 31, 2005.

Connecticut

In 2004, NASDAQ also evaluated its real estate needs in Trumbull, Connecticut. NASDAQ currently owns and occupies a building located at 80 Merritt Boulevard and leases and occupies another building located at 35 Nutmeg Drive. NASDAQ's management determined that, based on staff reductions, all employees in Trumbull would consolidate into NASDAQ's building at 80 Merritt Boulevard. Although NASDAQ's lease at 35 Nutmeg Drive terminates in July 2008, NASDAQ planned on moving all employees from 35 Nutmeg Drive to 80 Merritt Boulevard before the end of the lease. To accommodate all employees in the Merritt building, two data center spaces were converted into office space. The data centers ceased being used by the end of the first quarter of 2005, and accordingly, NASDAQ began accelerating the data centers' fixed assets and leasehold improvements over the new estimated useful life. NASDAQ recorded $4.5 million of accelerated depreciation for the data center assets for the year ended December 31, 2004, and recorded an additional $2.3 million in the first quarter of 2005. As a result of the acquisition of INET, NASDAQ's management continues to evaluate its real estate needs in Connecticut. This evaluation may result in additional consolidations and charges in 2006.

Sublease Loss Reserves

As of December 31, 2005 and 2004, the estimated sublease loss reserve for all subleased properties was approximately $23.2 million and $36.7 million, respectively, and is included in accounts payable and accrued expenses and other liabilities in the consolidated balance sheets. The reserve is adjusted throughout the year to reflect interest accretion, rental payments made during the year, depreciation on leasehold improvements, if applicable, and sublease receipts. The estimated losses were calculated using a 7.5 percent net discount rate and estimated sublease terms ranging from five years to 20 years at estimated market rates.

Reductions in Force

During the years ended December 31, 2005 and 2004, NASDAQ eliminated 69 and 172 positions, respectively, associated with staff reduction plans and recorded charges of $4.6 million and $9.4 million, respectively, for severance and outplacement costs. These costs are included in compensation and benefits expense in the consolidated statements of income. NASDAQ paid approximately $5.8 million and $4.9 million during the years ended December 31, 2005 and 2004, respectively, for these severance and outplacement costs from the staff reduction plans. NASDAQ expects to pay the remainder of the severance and outplacement costs by the end of the third quarter of 2007. Total headcount increased from 786 employees at December 31, 2004 to 865 employees at December 31, 2005, as a result of employees acquired in the INET, Carpenter Moore, and NASDAQ Insurance Agency transactions, partially offset by staff reductions.

5. NASDAQ 2005 AND 2004 COST REDUCTIONS AND STRATEGIC REVIEW (CONTINUED)

Technology Migration

As a result of a continued review of its technology infrastructure in 2005 and 2004, NASDAQ shortened the estimated useful life of certain assets and changed the lease terms on certain operating leases associated with its quoting platform and its trading and quoting network as it migrates to lower cost operating environments. Shortening the estimated useful life of the assets resulted in incremental depreciation and amortization expense. The incremental depreciation and amortization expense associated with these assets was $4.2 million for the year ended December 31, 2005, and $18.7 million for the year ended December 31, 2004. These amounts included both incremental depreciation and amortization expense on these assets and operating leases.

In November 2004, NASDAQ purchased a technology platform held-for-sale and owned by Easdaq, for €1.9 million ($2.4 million). Additionally, in order to make use of the purchased technology platform, NASDAQ purchased a license for the use of certain software for $0.5 million. NASDAQ had a multi-year initiative to migrate The NASDAQ Market Center applications to lower cost operating environments and processes. The purchased platform was intended to provide a baseline of functionality for The NASDAQ Market Center. As a result of the migration initiative, NASDAQ shortened the estimated useful life of its then-current application platform and, in addition to the incremental depreciation and amortization expense of $4.2 million and $18.7 million discussed above, NASDAQ recorded incremental amortization expense of $10.8 million and $2.9 million for the years ended December 31, 2005 and 2004, respectively.

As a result of the acquisition of INET, NASDAQ will now migrate The NASDAQ Market Center to INET's lower cost trading system by the fourth quarter of 2006. NASDAQ believes that INET's technology platform will enable it to compete more effectively and deliver increased capabilities demanded by its customers. Therefore, beginning December 8, 2005, NASDAQ recorded additional amortization expense of $5.8 million due to a change in estimated useful life of some of The NASDAQ Market Center assets including the purchased technology platform from Easdaq and NASDAQ's current application platform. The additional amortization expense also includes a change in estimated useful life of the Brut technology license intangible asset as NASDAQ will no longer use this technology license once the migration to INET's trading platform is completed.

In October 2004, NASDAQ entered into an agreement for technology equipment and also renegotiated related operating leases with a major vendor. NASDAQ sold equipment with a net book value of $13.6 million and entered into a three-year lease agreement, which included new upgraded equipment. NASDAQ received $11.0 million in cash from the vendor and recognized a $2.6 million loss on this transaction. This loss is included in general and administrative expense in the consolidated statements of income. NASDAQ paid $8.2 million and $1.6 million in 2005 and 2004, respectively, and will pay $0.4 million in both 2006 and 2007 under the terms of the lease agreement. NASDAQ also upgraded related leased equipment and entered into a new three-year operating lease and extended the terms of license and maintenance agreements. Under the terms of the operating lease and license and maintenance agreements, NASDAQ paid $15.3 million and $11.2 million in 2005 and 2004, respectively, and will pay $9.0 million and $3.0 million in 2006 and 2007, respectively.

STRATEGIC REVIEW

During the second quarter of 2003, NASDAQ announced the results of a strategic review of its operations designed to position NASDAQ for improved profitability and growth. This strategic review included the elimination of non-core product lines and initiatives and resulted in a reduction in NASDAQ's workforce. The liability for strategic review costs is recorded in other accrued liabilities and accrued personnel costs in the current liabilities section and in other liabilities in the non-current liabilities section of

5. NASDAQ 2005 AND 2004 COST REDUCTIONS AND STRATEGIC REVIEW (CONTINUED)

the consolidated balance sheets. NASDAQ funded the majority of these reserves, except for a $4.6 million contract payment that it paid in January 2006, and other contractual sublease obligations that will continue through 2010.

	Severance for U.S. Employees	Products & Other	Total
		(in millions)	
Accrued liabilities associated with the strategic review, as of December 31, 2004	$ 5.4	$ 0.9	$ 6.3
Cash payments	(0.7)	(0.5)	(1.2)
Other	–	0.7	0.7
Accrued liabilities associated with the strategic review, as of December 31, 2005	$ 4.7	$ 1.1	$ 5.8

6. DEFERRED REVENUE

NASD

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

As a result of this review, NASD changed its method of accounting for revenue recognition for these fees. The first year's registration fee consists of two elements, an upfront initial fee and an annual fee. NASD has segregated the initial and annual components of this fee using the residual value approach within EITF No. 00-21 and defers and amortizes the initial fee element over an estimated customer relationship period of 10 years for firms and three and a half years for individual representatives. Fees received on open arbitration cases also include multiple elements. These fees are deferred and amortized over the average life of an arbitration case, or 15 months. Registration fees are included within user fees and arbitration fees are included within dispute resolution fees in the consolidated statements of income.

6. DEFERRED REVENUE (CONTINUED)

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

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

In 2005 and 2004, NASD recognized an aggregate of $8.6 million and $40.4 million, respectively, in revenue that was deferred as part of the cumulative effect adjustment as of January 1, 2004.

Following is a summary of amounts included in NASD's current and non-current deferred revenue as of December 31, 2005, and the years over which those amounts will be recognized:

	Registration	Arbitration	Annual and Other	Total
		(in thousands)		
Fiscal year ended:				
2006	$ 10,713	$ 21,470	$ 28,868	$ 61,051
2007	7,467	556	–	8,023
2008	4,266	–	–	4,266
2009	1,536	–	–	1,536
2010 and thereafter	2,950	–	–	2,950
	$ 26,932	$ 22,026	$ 28,868	$ 77,826

Following is a summary of activity in NASD current and non-current deferred revenue for the year ended December 31, 2005 and 2004 for all revenue arrangements. The additions reflect the fees charged during the year while the amortization reflects the revenues recognized during the year based on the accounting methodology described above.

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

6. DEFERRED REVENUE (CONTINUED)

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

NASDAQ

NASDAQ's deferred revenue at December 31, 2005 was primarily related to Corporate Client Group fees and will be recognized in the following years:

	Initial	LAS	Annual and Other	Total
		(in thousands)		
Fiscal year ended:				
2006	$ 21,199	$ 31,226	$ 1,168	$ 53,593
2007	16,173	24,957	–	41,130
2008	13,504	14,704	–	28,208
2009	10,173	3,879	–	14,052
2010 and thereafter	8,629	–	–	8,629
Total	$ 69,678	$ 74,766	$ 1,168	$ 145,612

NASDAQ's deferred revenue for the years ended December 31, 2005 and 2004 is reflected in the following tables. The additions reflect Corporate Client Group revenues charged during the year, while the amortization reflects Corporate Client Group revenues recognized during the year in accordance with U.S. generally accepted accounting principles.

	Initial	LAS	Annual and Other	Total
		(in thousands)		
Balance at January 1, 2005	$ 74,300	$ 75,058	$ –	$ 149,358
Additions	24,570	37,411	116,807	178,788
Amortization	(29,192)	(37,703)	(115,639)	(182,534)
Balance at December 31, 2005	$ 69,678	$ 74,766	$ 1,168	$ 145,612

6. DEFERRED REVENUE (CONTINUED)

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

7. INVESTMENTS

NASD

Available-for-Sale Investments

NASD's investments principally consist of mutual/commingled funds, auction rate securities, equity securities, U.S. Treasury securities, obligations of government-sponsored enterprises, U.S. corporate debt securities, and other financial instruments. The following is a summary of investments classified as available-for-sale, which are carried at fair value as of December 31, 2005:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
U.S. Treasury securities	$ 45.4	$ 0.3	$ 0.7	$ 45.0
Debt securities issued by government-sponsored enterprises	69.9	0.2	0.8	69.3
Obligations of states and political subdivisions	2.0	0.2	–	2.2
Debt securities issued by foreign governments	4.4	0.3	0.2	4.5
Asset-backed securities	4.1	0.2	0.1	4.2
U.S. corporate debt securities	59.3	0.4	1.0	58.7
Other debt securities	22.5	0.1	0.5	22.1
Auction rate securities	291.0	–	–	291.0
Total debt securities	498.6	1.7	3.3	497.0
Mutual/commingled funds	863.5	69.7	2.3	930.9
Equity securities	274.9	46.2	4.1	317.0
Total	$ 1,637.0	$ 117.6	$ 9.7	$ 1,744.9

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

NASD 2005 Notes to Consolidated Financial Statements

7. INVESTMENTS (CONTINUED)

Following is a summary of investments classified as available-for-sale, which are carried at fair value as of December 31, 2004:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
U.S. Treasury securities	$ 25.3	$ 0.5	$ –	$ 25.8
Debt securities issued by government-sponsored enterprises	11.8	–	0.1	11.7
Obligations of states and political subdivisions	2.1	0.1	–	2.2
Debt securities issued by foreign governments	4.7	0.1	–	4.8
Asset-backed securities	31.7	0.2	0.2	31.7
U.S. corporate debt securities	61.1	0.9	0.3	61.7
Other debt securities	30.9	0.6	0.6	30.9
Auction rate securities	173.1	–	–	173.1
Total debt securities	340.7	2.4	1.2	341.9
Mutual/commingled funds	561.9	40.2	1.3	600.8
Equity securities	229.6	37.3	2.7	264.2
Total	$ 1,132.2	$ 79.9	$ 5.2	$ 1,206.9

Following is a summary, by contractual maturity, of investments classified as available-for-sale as of December 31, 2005:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
Due in one year or less	$ 12.5	$ –	$ 0.3	$ 12.2
Due after one through five years	77.2	0.6	1.4	76.4
Due after five through 10 years	23.1	0.2	0.2	23.1
Due after 10 years	385.8	0.9	1.4	385.3
Total debt securities	498.6	1.7	3.3	497.0
Mutual/commingled funds	863.5	69.7	2.3	930.9
Equity securities	274.9	46.2	4.1	317.0
Total	$ 1,637.0	$ 117.6	$ 9.7	$ 1,744.9

The gross realized gains on sales in 2005 and 2004 totaled $36.6 million and $51.7 million, respectively, and the gross realized losses totaled $10.1 million and $19.1 million, respectively. Included within gross realized gains (losses) are reclassifications from unrealized gains (losses) after taxes on available-for-sale securities of $21.0 million and $39.9 million in 2005 and 2004, respectively. These reclassifications represent the recognition of amounts previously recorded as unrealized gain (loss) as of the end of the previous year. For the years ended December 31, 2005 and 2004, NASD recognized net investment gains from its investments in mutual/commingled funds of $17.6 million and ($4.7) million, respectively. These gains are included in net realized investment gains in the consolidated statements of income.

NASD 2005 Notes to Consolidated Financial Statements

7. INVESTMENTS (CONTINUED)

Temporary Declines in Fair Market Value

For the year ended December 31, 2005, NASD recorded impairment charges of $10.6 million related to 38 publicly traded equity securities, and $12.7 million on two investments in mutual/commingled funds. For the year ended December 31, 2004, NASD recorded impairment charges of $3.1 million related to 12 publicly traded equity securities. The impairment charges related to declines in the fair value of its investments that were judged to be other-than-temporary and are reflected in net realized investment gains (losses) in the consolidated statements of income.

The following table shows the fair value of NASD's available-for-sale investments with an unrealized loss position deemed to be temporary for less than 12 months and greater than 12 months as of December 31, 2005 and 2004.

	2005			2004		
		Gross Unrealized Loss			Gross Unrealized Loss	
	Fair Market Value	Less Than 12 Months	Greater Than 12 Months	Fair Market Value	Less Than 12 Months	Greater Than 12 Months
	(in millions)					
U.S. Treasury securities	$ 36.1	$ 0.7	$ –	$ –	$ –	$ –
Debt securities issued by government-sponsored enterprises	45.8	0.6	0.2	6.4	0.1	–
Debt securities issued by foreign governments	2.5	0.2	–	–	–	–
Asset-backed securities	3.4	0.1	–	10.2	0.1	0.1
U.S. corporate debt securities	36.5	0.8	0.2	18.5	0.2	0.1
Other debt securities	15.2	0.2	0.3	18.8	0.3	0.3
Total debt securities	139.5	2.6	0.7	53.9	0.7	0.5
Mutual/commingled funds	92.1	1.2	1.1	122.7	1.3	–
Equity securities	55.4	4.1	–	51.0	2.7	–
Total	$ 287.0	$ 7.9	$ 1.8	$ 227.6	$ 4.7	$ 0.5

As of December 31, 2005 and 2004, NASD had 280 and 172 securities in an unrealized loss position, respectively. For securities with unrealized losses greater than 12 months as of December 31, 2005, the fair market values were $2.2 million, $6.6 million, $2.2 million, and $26.1 million for investments in debt securities issued by government-sponsored enterprises, U.S. corporate debt securities, other debt securities, and mutual/commingled funds, respectively. For securities with unrealized losses greater than 12 months as of December 31, 2004, the fair market values were $1.1 million, $1.3 million and $3.0 million for asset-backed securities, U.S. corporate debt securities, and other debt securities, respectively.

7. INVESTMENTS (CONTINUED)

NASDAQ

Available-for-Sale Investments

NASDAQ's available-for-sale investments consist of U.S. Treasury securities, obligations of U.S. government-sponsored enterprises, municipal bonds, auction rate securities and other financial instruments. The following is a summary of investments classified as available-for-sale, which are carried at fair market value as of December 31, 2005:

	Amortized Cost	Gross Unrealized Loss	Fair Value
		(in millions)	
Debt securities issued by government-sponsored enterprises	$ 50.4	$ 0.8	$ 49.6
Obligations of states and political subdivisions	6.0	–	6.0
Auction rate securities	123.9	0.1	123.8
Total securities	$ 180.3	$ 0.9	$ 179.4

Following is a summary of investments classified as available-for-sale, which are carried at fair market value as of December 31, 2004:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
U.S. Treasury securities	$ 5.0	$ –	$ –	$ 5.0
Debt securities issued by government-sponsored enterprises	52.9	–	0.7	52.2
Obligations of states and political subdivisions	53.2	0.1	0.9	52.4
U.S. corporate debt securities	19.2	–	0.1	19.1
Auction rate securities	46.1	–	–	46.1
Total securities	$ 176.4	$ 0.1	$ 1.7	$ 174.8

7. INVESTMENTS (CONTINUED)

The cost and estimated fair market value of debt securities classified as available-for-sale that are carried at fair market value at December 31, 2005, by contractual maturity, are shown below.

	Cost	Gross Unrealized Loss	Fair Market Value
		(in millions)	
Due in one year or less	$ 54.5	$ 0.3	$ 54.2
Due after one through five years	125.8	0.6	125.2
Total	$ 180.3	$ 0.9	$ 179.4

During the years ended December 31, 2005 and 2004, debt available-for-sale securities with a fair market value at the date of sale of $51.3 million and $173.2 million, respectively, were sold. For the years ended December 31, 2005 and 2004, the gross realized gains on such sales totaled $0.1 million for both years, and the gross realized losses totaled $1.6 million and $0.3 million, respectively. The net adjustment, after tax, to unrealized holding losses on available-for-sale securities included as a separate component of members' equity totaled $1.2 million and $1.0 million for 2005 and 2004, respectively. The net adjustment after tax to unrealized (gains) losses on available-for-sale securities included as a separate component of members' equity due to the sale of securities totaled ($0.4) million and $0.1 million for 2005 and 2004, respectively.

Temporary Declines in Fair Market Value

The following table shows the fair value of NASDAQ's available-for-sale investments with an unrealized loss position deemed to be temporary for less than 12 months and greater than 12 months as of December 31, 2005 and 2004.

	2005			2004		
		Gross Unrealized Loss			Gross Unrealized Loss	
	Fair Market Value	Less Than 12 Months	Greater Than 12 Months	Fair Market Value	Less Than 12 Months	Greater Than 12 Months
			(in millions)			
Debt securities issued by government-sponsored enterprises	$ 49.5	$ –	$ 0.8	$ 52.2	$ 0.7	$ –
Obligations of states and political subdivisions	–	–	–	50.6	0.9	–
U.S. corporate debt securities	–	–	–	15.0	0.1	–
Auction rate securities	18.1	0.1	–	–	–	–
Total securities	$ 67.6	$ 0.1	$ 0.8	$ 117.8	$ 1.7	$ –

Held-to-Maturity Investments

As of December 31, 2004, all held-to-maturity investments consisted of U.S. Treasury securities and obligations of government-sponsored enterprises. The cost of the securities was $30.6 million and had gross unrealized losses of $0.4 million and a total

NASD 2005 Notes to Consolidated Financial Statements

7. INVESTMENTS (CONTINUED)

estimated fair value of $30.2 million. Of the investments having $0.4 million of gross unrealized losses, 98.9 percent had been in an unrealized loss position for less than 12 months and are deemed to be temporary.

In conjunction with the financing of the Instinet acquisition, NASDAQ was obligated to repay in full the $25.0 million senior notes. As a result, in November 2005, held-to-maturity investments consisting of U.S. Treasury securities and obligations of government-sponsored agencies with a carrying value of $14.8 million were sold. The gross realized losses on such sales totaled $0.2 million. These funds along with cash on hand were used to repay the $25.0 million senior notes.

As of December 31, 2004, held-to-maturity investments with a carrying value of approximately $30.6 million were pledged as collateral for its $25.0 million senior notes. Collateral was limited to U.S. government and agency securities with a margined value of not less than 100.0 percent of the loan and was invested in accordance with the note agreement.

NASD INVESTOR EDUCATION FOUNDATION

Available-for-Sale Investments

The Foundation's investments include only domestic mutual funds with a cost and fair market value of $30.0 million as of December 31, 2005, and a cost and fair market value of $10.2 million as of December 31, 2004. The Foundation had temporarily restricted investments as of December 31, 2005 of $5.9 million.

Other than Temporary Declines in Fair Market Value

For the year ended December 31, 2005, the Foundation recorded impairment charges of $0.5 million on its mutual fund. The impairment charge related to declines in the fair value of its investments that was judged to be other-than-temporary and is reflected in net realized investment gains in the consolidated statements of income.

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company considers cash and cash equivalents, receivables, investments, the note and revolving credit facility receivables from Amex, accounts payable and accrued expenses, accrued personnel costs, due to custodial agent, short- and long-term debt, and warrants to purchase NASDAQ common stock from NASD to be its financial instruments. The carrying amounts reported in the balance sheets for these financial instruments equal or closely approximate fair value due to the short-term nature of these assets and liabilities. The initial fair value of the revolving credit facility receivable from Amex and the fair value of the warrants to purchase NASDAQ common stock from NASD were determined based on third-party valuations.

The approximate fair value of NASDAQ's total debt was estimated using discounted cash flow analyses, based on NASDAQ's assumed incremental borrowing rates for similar types of debt arrangements and a Black-Scholes valuation technique was utilized to calculate the convertible option value for the convertible notes. As of December 31, 2005, the carrying value of NASDAQ's debt obligations was approximately $730.4 million less than fair value due to the stock appreciation on the convertible option feature from $14.50 at time of issuance to $35.18 at December 31, 2005. At December 31, 2004, the fair value of these obligations approximates their carrying amounts.

9. LONG-TERM DEBT

NASD CREDIT FACILITY

In September 1999, NASD entered into an unsecured line of credit agreement. Under this agreement, NASD has the option to borrow up to $50.0 million at the London Inter-Bank Offered Rate (LIBOR) plus 0.3 percent. As of December 31, 2005 and 2004, no amounts were outstanding under this line of credit. The latest amendment to this line of credit agreement expires on November 30, 2006.

NASDAQ

The following table summarizes NASDAQ's debt obligations:

	DECEMBER 31, 2005	DECEMBER 31, 2004
	(in thousands)	
Senior notes	$ 750,000	$ 25,000
Convertible notes (net of premium and discount)	442,428	240,000
Total debt obligations	1,192,428	265,000
Less current portion	(7,500)	–
Total long-term debt obligations	$ 1,184,928	$ 265,000

Senior Notes

In order to finance the INET transaction, NASDAQ entered into a credit agreement dated as of December 8, 2005, with J.P. Morgan Securities, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated acting as co-lead arrangers and joint bookrunners. The credit agreement provides for up to $825.0 million of senior secured financing. The $825.0 million available under the credit agreement includes (1) a five-year $75.0 million revolving credit facility, with a letter of credit sub-facility and swingline loan sub-facility, and (2) a six-year $750.0 million senior-term loan facility. The interest rate on loans made under the revolving credit facility varies depending upon NASDAQ's leverage ratio and LIBOR, and the interest rate on NASDAQ's senior term facility is LIBOR plus 150 basis points. Accordingly, the interest rate will vary over time. On December 8, 2005, NASDAQ drew the full $750.0 million senior-term debt. As of December 31, 2005, NASDAQ had not drawn any funds under the revolving credit facility. As of December 31, 2005, borrowings under the $750.0 million senior term debt bore interest at an average rate of 6.14 percent per annum. NASDAQ pays customary fees and expenses related to the credit facility, including a commitment fee of 0.5 percent per annum on the average daily unused portion of the revolving credit facility. Interest expensed and paid on the $750.0 million senior term debt totaled approximately $3.1 million and $0.8 million, respectively, for the year ended December 31, 2005.

NASDAQ's obligations under the credit facility are secured by a security interest in and liens upon substantially all of the assets of NASDAQ and its subsidiaries. All NASDAQ's domestic subsidiaries are guarantors of NASDAQ's obligations under the credit agreement (excluding the regulated broker-dealer subsidiaries and the insurance-related subsidiaries).

The credit agreement contains customary covenants that restrict NASDAQ's ability to take on new debt, sell assets, issue stock, make loans and declare dividends. The credit agreement also requires NASDAQ to maintain a minimum interest expense coverage ratio and a maximum leverage ratio. The credit agreement also contains customary events of default, as well as cross-defaults with the convertible notes, as discussed below, and described fully in the credit agreement.

NASD 2005 Notes to Consolidated Financial Statements

9. LONG-TERM DEBT (CONTINUED)

Upon consummation of the INET transaction, and in conjunction with the issuance of the $750.0 million senior-term debt, NASDAQ was obligated to repay in full the $25.0 million senior notes. On November 30, 2005, NASDAQ repaid in full the $25.0 million senior notes and paid and recorded a loss on the early extinguishment of the $25.0 million senior notes of approximately $1.1 million and used proceeds from the sale of held-to-maturity investments and cash on hand to finance the redemption. The $25.0 million senior notes were issued in May 1997 and were to mature in 2012. These notes required monthly interest payments through May 2007 at an annual rate of 7.41 percent. After May 2007, NASDAQ would have incurred interest equal to the lender's cost of funds rate, as defined in the agreement, plus 0.5 percent. Interest expensed and paid on the $25.0 million senior notes totaled approximately $1.7 million and $1.9 million, respectively, for the year ended December 31, 2005 and totaled approximately $1.9 million for the year ended December 31, 2004.

In conjunction with the financing of the INET transaction, NASDAQ incurred debt issuance costs of $15.0 million. These debt issue costs related to the $75.0 million credit facility, the $205.0 million convertible notes and the restructuring of the $240.0 million convertible notes. These costs were capitalized and are included in other assets in the consolidated balance sheets and are being amortized over the life of each debt obligation. Beginning December 8, 2005, NASDAQ began amortizing these costs and recorded $0.2 million as additional interest expense in the consolidated statements of income.

Convertible Notes

In order to finance the INET transaction, NASDAQ also issued $205.0 million convertible notes to affiliates of Silver Lake Partners (SLP) ($145.0 million) and Hellman & Friedman (H&F) ($60.0 million) on April 22, 2005. The $205.0 million convertible notes, which were issued at a discount of $4.5 million, carry a coupon of 3.75 percent and will be convertible into NASDAQ common stock at a price of $14.50 per share or 14,137,931 shares subject to adjustment, in general, for any stock split, dividend, combination, recapitalization, or similar event. The $205.0 million convertible notes are being amortized over 7.5 years to face value. In 2005, NASDAQ recorded accretion of $0.4 million, which is recorded as interest expense in the consolidated statements of income. SLP and H&F also received 1.56 and 0.65 million warrants, respectively, to purchase NASDAQ common stock at a price of $14.50. The warrants cannot be exercised on or before April 22, 2006 and expire on December 8, 2008, the third anniversary of the closing of the INET acquisition. The cash received from the issuance of the $205.0 million convertible notes was held in a restricted cash account until the closing of the acquisition. NASDAQ earned interest income on this cash account of approximately $4.4 million in 2005 and interest expensed and paid totaled approximately $5.3 million and $4.8 million, respectively, for the year ended December 31, 2005.

In order to facilitate the transaction, H&F also restructured the terms of NASDAQ's original convertible $240.0 million subordinated notes, extending the maturity date from May 2006 to October 2012, lowering the interest coupon rate to 3.75 percent from 4.0 percent and lowering the conversion price to $14.50 from $20.00 or 16,551,724 shares, subject to adjustment, for stock splits, dividends, combinations, recapitalizations, or similar events. The $240.0 million convertible notes were issued at a premium of $1.6 million and are being amortized over 7.5 years to face value. In 2005, NASDAQ recorded accretion of $0.1 million, which was recorded as a reduction to interest expense in the consolidated statements of income. H&F also received an additional 2.75 million warrants to purchase NASDAQ common stock at a price of $14.50 per share. These warrants also cannot be exercised on or before April 22, 2006 and will expire on December 8, 2008, the third anniversary of the acquisition closing date. In accordance with EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," a substantial modification of terms should be accounted for and reported in the same manner as an extinguishment of debt. NASDAQ considered the modification of the terms of NASDAQ's original convertible $240.0 million subordinated notes to be substantial and therefore recorded a pre-tax

NASD 2005 Notes to Consolidated Financial Statements

9. LONG-TERM DEBT (CONTINUED)

charge of $7.4 million related to the restructuring of the $240.0 million convertible notes. The pre-tax charge is included in general and administrative expense in the consolidated statements of income for the year ended December 31, 2005. Interest expensed and paid on the $240.0 million convertible notes totaled approximately $6.2 million and $4.5 million, respectively, for the year ended December 31, 2005. Interest expensed and paid on the $240.0 million subordinated notes totaled $3.0 million and $3.4 million, respectively, for the year ended December 31, 2005 and totaled $9.6 million for 2004.

On an as-converted basis at December 31, 2005, H&F owned an approximate 22.9 percent equity interest in NASDAQ as a result of H&F's ownership of the $240.0 million convertible notes, $60.0 million of the $205.0 million convertible notes, 3,400,000 shares underlying warrants and 500,000 shares of common stock purchased from NASDAQ in a separate transaction. On an as-converted basis at December 31, 2005, SLP owned an approximate 12.2 percent equity interest in NASDAQ as a result of SLP's ownership of $145.0 million of the $205.0 million convertible notes and 1,562,500 shares underlying warrants.

Both the $205.0 million convertible notes and $240.0 million convertible notes are senior unsecured obligations of NASDAQ and rank pari passu in right of payment with all existing and any future senior unsecured indebtedness of NASDAQ, are senior in right of payment to any future subordinated indebtedness of NASDAQ and are junior in right of payment to any senior secured indebtedness. The indenture governing the notes limits NASDAQ's ability to incur senior secured indebtedness and is limited to the $750.0 million senior-term debt and $75.0 million five-year revolving credit facility that was used to finance the INET acquisition, the $25.0 million senior notes and any future senior secured indebtedness provided that at the time of incurrence, NASDAQ maintains a ratio of aggregate senior secured indebtedness to EBITDA (as defined in the indenture) for the most recent four consecutive quarters of not greater than 4.0 to 1.0.

If a default under one or more of these financial agreements causes amounts outstanding under the applicable financial agreement or agreements to be declared to be immediately due and payable, NASDAQ will be required to expend the funds to pay such amounts. If NASDAQ does not have sufficient available cash to pay all amounts that become due and payable, NASDAQ would have to seek additional debt or equity financing, which may not be available on acceptable terms, or at all.

Before the restructuring of H&F's $240.0 million convertible notes, NASDAQ's original convertible $240.0 million subordinated notes held by H&F did not contain any financial maintenance covenants, but a default under any outstanding financing agreement that would have resulted in the acceleration of any debt having a principal amount in excess of $50.0 million would have caused a cross default under the $240.0 million subordinated notes.

At December 31, 2005 and 2004, NASDAQ was in compliance with the covenants of all debt agreements.

10. INCOME TAXES

NASD

As of December 31, 2005 and 2004, NASD Holding had net operating loss carryforwards of $105.6 million, which begin to expire in 2020. As of December 31, 2005 and 2004, NASD had unrelated business loss carryforwards of $28.0 million and $21.2 million, respectively, primarily related to TRACE, ADF and the OTC Equities. The unrelated business losses expire in 2006 through 2025.

Under SFAS No. 109, to record a deferred tax asset without a valuation allowance, it must be more likely than not that the deferred tax asset will be realized. NASD does not believe the net operating loss and unrelated business loss carryforwards will be realized. Therefore, a full valuation allowance has been recorded as of December 31, 2005 and 2004.

10. INCOME TAXES (CONTINUED)

NASDAQ

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

	YEARS ENDED DECEMBER 31,	
	2005	2004
	(in thousands)	
Current income tax provision (benefit):		
Federal	$ 39,502	$ (24,741)
State	577	208
Foreign	554	3,908
Total current income taxes	40,633	(20,625)
Deferred income tax provision (benefit):		
Federal	(2,059)	22,506
State	5,998	68
Foreign	—	(1,200)
Total deferred income taxes	3,939	21,374
Total income tax provision (benefit)	$ 44,572	$ 749

Reconciliations of the statutory U.S. federal income tax provision (benefit) from continuing operations, based on the U.S federal statutory rate, to NASDAQ's actual income tax provision (benefit) from continuing operations for the years ended December 31, 2005 and 2004 are as follows:

	YEARS ENDED DECEMBER 31,	
	2005	2004
	(in thousands)	
Federal income tax provision (benefit) at the statutory rate	$ 37,192	$ 894
State income tax provision (benefit), net of federal effect	4,274	179
Change in valuation allowance	720	(1,051)
Foreign taxes	178	872
Tax preferred investments	(1,195)	(601)
Nondeductible expenses	2,560	926
Prior year tax payable	417	(496)
Other	426	26
Actual income tax provision (benefit)	$ 44,572	$ 749

NASD 2005 Notes to Consolidated Financial Statements

10. INCOME TAXES (CONTINUED)

The temporary differences give rise to NASDAQ's deferred tax assets and (liabilities), consisting of the following:

	DECEMBER 31,	
	2005	2004
	(in thousands)	
Deferred tax assets:		
Deferred revenues	$ 35,232	$ 33,217
Acquired net operating loss (1)	74,690	—
Foreign net operating loss	1,244	1,506
State net operating loss	1,395	4,911
Compensation and benefits	12,806	12,365
Lease reserves	8,634	14,022
Capital loss carryforwards	7,584	6,903
Strategic review charges	2,484	3,113
Provision for bad debts	6,144	—
Other	1,225	4,366
Gross deferred tax assets	151,438	80,403
Deferred tax liabilities:		
Depreciation	(6,811)	(2,591)
Software development costs	(18,542)	(26,923)
Amortization of acquired intangible assets	(69,664)	—
Other	(2,242)	(373)
Gross deferred tax liabilities	(97,259)	(29,887)
Net deferred taxes before valuation allowance	54,179	50,516
Valuation allowance	(8,149)	(7,429)
Net deferred tax assets	$ 46,030	$ 43,087

(1) NASDAQ recorded a non-current deferred tax asset of $74.7 million on the sale of Instinet's Institutional Brokerage division. NASDAQ and SLP have an agreement to share the deferred tax benefit on the sale of the Institutional Brokerage division. To the extent the $74.7 deferred tax benefit is realized, approximately $40.0 million will be paid to SLP. NASDAQ has recorded a liability for the SLP share of the tax benefits in other liabilities in the consolidated balance sheets.

Of the $77.3 million net operating losses, federal losses of $62.3 million will expire in 2025, state losses of $13.8 million will expire through 2025, foreign losses of $0.4 million will expire 2007 through 2012 and foreign losses of $0.8 million have no expiration date. Of the $7.6 million of capital loss carryforwards, $0.7 million will expire 2006 through 2008, $6.3 million will expire in 2009 and $0.6 million will expire in 2010.

10. INCOME TAXES (CONTINUED)

The change in the valuation allowance from December 31, 2004 to December 31, 2005 is as follows:

	(in thousands)
Balance December 31, 2004	$ (7,429)
Foreign net operating loss carryforwards	(39)
Capital loss carryforwards	(681)
Balance December 31, 2005	$ (8,149)

Not included in the deferred tax assets for the year ended December 31, 2005 is a capital loss carryforward of $15.8 million generated through discontinued operations. The carryforward will expire in 2008. NASDAQ believes that it is more likely than not that it will not realize a benefit on this asset, therefore, NASDAQ established a valuation allowance of $15.8 million.

The following represents the domestic and foreign components of income (loss) from continuing operations before income tax provision (benefit):

	YEARS ENDED DECEMBER 31,	
	2005	2004
	(in thousands)	
Domestic	$ 104,556	$ (1,122)
Foreign	1,706	3,675
Income (loss) before income tax provision (benefit)	$ 106,262	$ 2,553

In 2005, NASDAQ recorded an income tax benefit of $21.5 million primarily related to employee stock option exercises. The benefit was recorded to additional paid-in-capital in the consolidated balance sheets.

NASDAQ is subject to examination by federal, state, local and foreign tax authorities. NASDAQ regularly assesses the likelihood of additional assessments by each jurisdiction and has established tax reserves that we believe are adequate in relation to the potential for additional assessments. During 2005, NASDAQ settled a New York City audit with additional tax assessed of $1.2 million. This amount has been previously reserved and had no impact on 2005 net income. NASDAQ believes that the resolution of tax matters will not have a material effect on the firm's financial condition but may be material to the firm's operating results for a particular period and upon the effective tax rate for that period.

11. EMPLOYEE BENEFITS

As of December 31, 2005 and 2004, the Company provided three non-contributory defined benefit pension plans and one non-contributory post-retirement benefit plan (Post-Retirement Plan) for the benefit of eligible employees of its subsidiaries. The non-contributory defined benefit plans consist of a funded ERP plan and two unfunded SERP plans. The benefits are primarily based on years of service and the employees' average salary during the highest 60 consecutive months of employment. The Post-Retirement Plan represents a life insurance benefit available to eligible retired employees.

11. EMPLOYEE BENEFITS (CONTINUED)

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

	Target Allocation	2005	2004
Equity securities	45.0-75.0%	65.5%	65.5%
Debt securities and cash equivalents	10.0-40.0%	19.5	26.0
Other investment strategies	10.0-20.0%	15.0	8.5
Total		100.0%	100.0%

The expected long-term rate of return for the plan's total assets is based on the expected return of each of the above categories, weighted based on the current target allocation for each class. Equity securities are expected to return 8.5 percent to 10.5 percent over the long term, other investment strategies are anticipated to yield 8.0 percent to 9.5 percent, while cash and fixed income is expected to return between 6.0 percent and 6.5 percent. Based on historical experience, the committee expects that the plan's asset managers overall will provide a modest (1.0 percent per annum) premium to their respective market benchmark indexes.

NASD 2005 Notes to Consolidated Financial Statements

11. EMPLOYEE BENEFITS (CONTINUED)

NASD

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

	2005			2004		
	ERP	SERP	Total	ERP	SERP	Total
			(in thousands)			
Change in benefit obligation						
Benefit obligation at beginning of year	$ 178,524	$ 19,900	$ 198,424	$ 137,275	$ 9,598	$ 146,873
Service cost	16,308	4,503	20,811	12,756	3,498	16,254
Interest cost	10,127	1,412	11,539	8,705	929	9,634
Actuarial losses (gains)	128	6,175	6,303	6,828	(86)	6,742
Benefits paid	(7,203)	(1,788)	(8,991)	(8,816)	(1,432)	(10,248)
Loss due to change in discount rate	11,094	1,232	12,326	17,032	1,919	18,951
Change in retirement age assumption	4,456	–	4,456	–	5,474	5,474
Transfers from Amex	–	–	–	4,744	–	4,744
Benefit obligation at end of year	$ 213,434	$ 31,434	$ 244,868	$ 178,524	$ 19,900	$ 198,424
Change in plan assets						
Fair value of plan assets at beginning of year	79,547	–	79,547	68,429	–	68,429
Transfers from Amex	–	–	–	4,198	–	4,198
Actual return on plan assets	6,943	–	6,943	7,688	–	7,688
Company contributions	12,463	1,788	14,251	8,048	1,432	9,480
Benefits paid	(7,203)	(1,788)	(8,991)	(8,816)	(1,432)	(10,248)
Fair value of plan assets at end of year	91,750	–	91,750	79,547	–	79,547
Funded status of the plan (underfunded)	(121,684)	(31,434)	(153,118)	(98,977)	(19,900)	(118,877)
Unrecognized net actuarial loss	75,795	18,260	94,055	63,618	12,837	76,455
Unrecognized prior service cost	883	97	980	1,151	269	1,420
Unrecognized transition asset	(288)	–	(288)	(445)	–	(445)
Amount recognized to reflect minimum pension liability	–	(8,131)	(8,131)	–	(7,645)	(7,645)
Net accrued benefit cost	$ (45,294)	$ (21,208)	$ (66,502)	$ (34,653)	$ (14,439)	$ (49,092)
Accumulated benefit obligation	$ 123,594	$ 21,208	$ 144,802	$ 103,082	$ 14,439	$ 117,521
Weighted-average assumptions, as of December 31,						
Discount rate	5.5%	5.5%		5.75%	5.75%	
Expected return on plan assets	8.5	–		8.75	–	
Rate of compensation increase	5.5	4.0		5.5	4.0	

11. EMPLOYEE BENEFITS (CONTINUED)

The components of the accrued benefit cost for NASD's defined benefit pension plans and post-retirement benefit plan as of December 31, 2005 and 2004, and the location of these amounts in the consolidated balance sheets, were as follows:

	DECEMBER 31, 2005	DECEMBER 31, 2004
	(in thousands)	
Current (included in accrued personnel and benefit costs):		
ERP	$ (31,844)	$ (12,463)
SERP	(4,209)	(180)
Total current	(36,053)	(12,643)
Non-current (included in accrued pension and other post-retirement benefit costs):		
ERP	(13,450)	(22,190)
SERP	(16,999)	(14,259)
Total non-current pension	(30,449)	(36,449)
Post-retirement plan	(301)	(383)
Total non-current	(30,750)	(36,832)
Accrued benefit costs	$ (66,803)	$ (49,475)

Pursuant to the provisions of SFAS No. 87, related to the SERP, intangible assets of $0.1 million and $0.3 million were recorded as of December 31, 2005 and 2004, respectively. In addition, as of December 31, 2005 and 2004, minimum pension liabilities of $8.0 million and $7.4 million, respectively, were recorded in the consolidated balance sheets.

	YEARS ENDED DECEMBER 31, 2005	YEARS ENDED DECEMBER 31, 2004
	(in thousands)	
Components of net periodic benefit cost:		
Service cost	$ 20,811	$ 16,254
Interest cost	11,539	9,634
Expected return on plan assets	(6,730)	(5,779)
Amortization of unrecognized transition asset	(157)	(157)
Recognized net actuarial losses	5,271	3,218
Prior service cost recognized	442	469
Benefit cost (included in compensation expense)	$ 31,176	$ 23,639

11. EMPLOYEE BENEFITS (CONTINUED)

The plan is measured at the beginning of each fiscal year. NASD expects to contribute $31.8 million to the ERP plan in 2006 and $4.2 million to the SERP plan. In addition, NASD expects to make the following benefit payments to participants over the next ten fiscal years:

	ERP	SERP	Total
		(in thousands)	
Fiscal year ended			
2006	$ 7,844	$ 4,209	$ 12,053
2007	9,657	6,410	16,067
2008	10,387	1,222	11,609
2009	12,559	1,584	14,143
2010	13,777	13,471	27,248
2011 through 2015	104,883	26,138	131,021
Total	$ 159,107	$ 53,034	$ 212,141

NASD also maintains voluntary savings plans for eligible employees of its subsidiaries. Employees are immediately eligible to make contributions to the plan and are also eligible for an employer contribution match at an amount equal to 100 percent of the first 4 percent of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from NASD. Savings plan expense for 2005 and 2004 was $10.7 million and $9.4 million, respectively, and is included within compensation expense in the consolidated statements of income. The expense included a discretionary match totaling $3.2 million for 2005 and $2.8 million for 2004.

In April 2004, NASD established a deferred compensation plan for certain eligible employees under the provision of Section 457(b) of the IRC. Eligible employees may make contributions to the plan and NASD may, at its discretion, make additional contributions to the plan. The assets of this plan are maintained within an irrevocable rabbi trust. NASD 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, 2005, $1.3 million of investments and $1.3 million of amounts due to plan participants are included in the available-for-sale investments and accrued personnel costs, respectively, in the consolidated balance sheet, representing participant contributions to this plan. As of December 31, 2004, $0.5 million of investments and $0.5 million payables to plan participants are included in the available-for-sale investments and accrued personnel costs, respectively, in the consolidated balance sheet. As of December 31, 2005 and 2004, NASD made no additional contributions to this plan.

In December 2005, NASD fully funded its SERP obligation through an irrevocable rabbi trust. NASD consolidates this trust in accordance with EITF No. 97-14. As of December 31, 2005, $24.5 million of investments are included in cash and cash equivalents in the consolidated balance sheets, representing the amounts contributed by NASD.

On January 1, 2006, NASD established a new defined contribution SERP plan for senior officers of NASD. Annual contributions are made based on salary and a portion of incentive compensation. Contributions and earnings vest at the end of each third-year and are fully vested at the age of 62.

NASD 2005 Notes to Consolidated Financial Statements

11. EMPLOYEE BENEFITS (CONTINUED)

NASDAQ

As of December 31, 2005, NASDAQ was a participating employer in a noncontributory, defined-benefit pension plan that NASD sponsors for the benefit of its eligible employees and the eligible employees of its subsidiaries. Benefits are primarily based on years of service and the employees' career-average salary during employment, subject to a phase-in period.

As part of NASDAQ's separation from NASD, effective January 1, 2006, NASDAQ adopted its own contributory, defined pension plan and transferred NASDAQ participants in NASD's pension plan to its pension plan. NASDAQ's adoption of a new plan did not have an impact on its consolidated financial position or results of operations.

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

During 2003, NASDAQ also changed the accrual of benefits from age 65 to 10 years of service or age 55, whichever comes first, except in the case of an executive who has a contract with a SERP provision, then benefits are accrued in accordance with the contract terms.

NASD 2005 Notes to Consolidated Financial Statements

11. EMPLOYEE BENEFITS (CONTINUED)

The following table sets forth the ERP and SERP plans funded status as of December 31:

	2005			2004		
	ERP	SERP	Total	ERP	SERP	Total
			(in thousands)			
Change in benefit obligation						
Benefit obligation at beginning of year	$ 57,366	$ 16,135	$ 73,501	$ 60,961	$ 18,881	$ 79,842
Service cost	4,555	1,739	6,294	5,106	1,361	6,467
Interest cost	3,093	965	4,058	3,440	921	4,361
Actuarial (gains) losses	(2,802)	1,253	(1,549)	(5,659)	(499)	(6,158)
Benefits paid	(7,924)	(580)	(8,504)	(9,215)	(4,984)	(14,199)
Loss due to change in discount rate	–	–	–	5,922	455	6,377
Change in salary scale	–	–	–	(3,189)	–	(3,189)
Change in mortality rate	1,214	–	1,214	–	–	–
Benefit obligation at end of year	$ 55,502	$ 19,512	$ 75,014	$ 57,366	$ 16,135	$ 73,501
Change in plan assets						
Fair value of plan assets at beginning of year	32,284	–	32,284	32,988	–	32,988
Actual return on plan assets	(471)	–	(471)	2,467	–	2,467
Company contributions	8,936	580	9,516	6,044	4,984	11,028
Benefits paid	(7,924)	(580)	(8,504)	(9,215)	(4,984)	(14,199)
Fair value of plan assets at end of year	32,825	–	32,825	32,284	–	32,284
Funded status of the plan (underfunded)	(22,677)	(19,512)	(42,189)	(25,082)	(16,135)	(41,217)
Unrecognized net actuarial loss	19,336	4,099	23,435	18,754	3,545	22,299
Unrecognized prior service cost	(7,457)	(56)	(7,513)	(8,100)	318	(7,782)
Unrecognized transition asset	(106)	–	(106)	(164)	–	(164)
Amount recognized to reflect minimum pension liability	–	(3,814)	(3,814)	–	(3,360)	(3,360)
Net accrued benefit cost	$ (10,904)	$ (19,283)	$ (30,187)	$ (14,592)	$ (15,632)	$ (30,224)
Accumulated benefit obligation	$ 42,817	$ 19,283	$ 62,100	$ 43,011	$ 15,632	$ 58,643
Weighted-average assumptions, as of December 31,						
Discount rate	5.75%	5.75%		5.75%	5.75%	
Expected return on plan assets	8.50	–		8.75	–	
Rate of compensation increase	4.5	4.0		4.5	4.0	

11. EMPLOYEE BENEFITS (CONTINUED)

The components of the accrued benefit cost for NASDAQ's defined benefit pension plans and post-retirement benefit plan as of December 31, 2005 and 2004, and the location of these amounts in the consolidated balance sheets, were as follows:

	DECEMBER 31, 2005	DECEMBER 31, 2004
	(in thousands)	
Current (included in accrued personnel and benefit costs):		
ERP	$ (5,119)	$ (8,935)
SERP	(7,167)	(571)
Total current	(12,286)	(9,506)
Non-current (included in accrued pension and other post-retirement benefit costs):		
ERP	(5,785)	(5,657)
SERP	(12,116)	(15,061)
Total non-current pension	(17,901)	(20,718)
Post-retirement plan	(405)	(244)
Total non-current	(18,306)	(20,962)
Accrued benefit costs	$ (30,592)	$ (30,468)

The following table sets forth the combined plans' amounts recognized in the consolidated statements of income:

	YEARS ENDED DECEMBER 31, 2005	YEARS ENDED DECEMBER 31, 2004
	(in thousands)	
Components of net periodic benefit cost:		
Service cost	$ 6,294	$ 6,467
Interest cost	4,057	4,361
Expected return on plan assets	(2,655)	(2,974)
Amortization of unrecognized transition asset	(57)	(58)
Recognized net actuarial losses	1,655	902
Prior service cost recognized	(270)	(319)
Curtailment/settlement loss recognized	—	207
Benefit cost (included in compensation expense)	$ 9,024	$ 8,586

The ERP and SERP plans are measured at the beginning of each fiscal year. Based on the current Internal Revenue Service regulations, NASDAQ expects to contribute approximately $5.1 million to the ERP plan and $7.2 million to the SERP plan in 2006. This includes $1.2 million for the 2005 plan year contribution and $3.9 million for the 2006 plan year. The SERP is an unfunded plan.

11. EMPLOYEE BENEFITS (CONTINUED)

NASDAQ expects to make the following benefit payments to participants in the next ten fiscal years:

	ERP	SERP	Total
		(in thousands)	
Fiscal year ended			
2006	$ 2,965	$ 7,167	$ 10,132
2007	2,754	4,192	6,946
2008	3,494	761	4,255
2009	3,488	747	4,235
2010	3,232	733	3,965
2011 through 2015	25,958	5,284	31,242
	$ 41,891	$ 18,884	$ 60,775

During 2004, there were settlement losses of $0.2 million for employees included within the SERP plan due to early retirements. There were no settlement losses in 2005.

Beginning in 2001, pursuant to the provisions of SFAS 87, "Employers' Accounting for Pensions" related to the SERP, NASDAQ recorded an intangible asset and an adjustment to stockholders' equity to recognize the minimum pension liability. During 2004, the intangible asset and the minimum pension liability were adjusted to $0.3 million and $1.8 million (net of tax of $1.2 million), respectively. As of December 31, 2005, the intangible asset was reduced to zero and the minimum pension liability was $2.3 million (net of tax of $1.5 million).

Prior to April 1, 2002, NASDAQ participated in a voluntary savings plan for eligible employees of NASD and its subsidiaries. As of April 1, 2002, NASDAQ formed its own voluntary savings plan and all amounts were transferred to this new plan. This voluntary savings plan is a defined-contribution plan. Employees are immediately eligible to make contributions to the plan and are also eligible for an employer contribution match at an amount equal to 100.0 percent of the first 4.0 percent of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from NASDAQ; however, there was no discretionary match for 2005 and 2004. Savings plan expense included in compensation and benefits expense in the consolidated statements of income for the years ended December 31, 2005 and 2004 was $2.7 million and $3.1 million, respectively.

12. NASDAQ STOCK COMPENSATION, STOCK AWARDS AND CAPITAL STOCK

Effective December 5, 2000, as amended on February 14, 2001 and January 23, 2002, NASDAQ adopted The Nasdaq Stock Market, Inc. Equity Incentive Plan (the "Plan"), under which nonqualified and qualified incentive stock options, restricted stock, restricted stock units or other stock based awards may be granted to employees, directors, officers and consultants. A total of 24,500,000 shares are authorized under the Plan. As of December 31, 2005, 8,090,874 shares were available for future grants under the Plan. In 2005 and 2004, there were no issuances outside of the Plan.

In 2005, NASDAQ granted 439,650 stock options to employees and officers, 305,000 shares of restricted stock to employees and officers and 25,756 shares of restricted stock to non-employee directors under the Plan. During 2005, 788,213 stock options and 64,353 shares of restricted stock awards were forfeited.

NASD 2005 Notes to Consolidated Financial Statements

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

In November 2002, the NASDAQ's Board of Directors approved a modification to the Non-Employee Directors Compensation Policy to allow non-employee directors to receive a compensation package valued at $40,000. Later, on April 28, 2004, NASDAQ's Board of Directors approved a modification to the Non-Employee Directors Compensation Policy whereby all non-employee directors would receive a base compensation package valued at $50,000. Each non-employee director may elect to receive the base compensation package in cash, payable in equal quarterly installments, shares of restricted stock or a combination of cash and restricted stock. The shares of restricted stock will vest two years from the date of grant and unvested shares are forfeited in certain circumstances upon termination of the director's service on the NASDAQ Board. During 2005, 25,756 shares of restricted stock were awarded to non-employee directors. Directors who serve as committee chairs or as members of the Audit Committee and the chairman of the board are entitled to additional compensation beyond the base compensation package. These additional amounts are paid in cash rather than restricted stock.

Restricted stock awards are awarded in the name of the employee or officer at fair market value on the date of the grant. In 2005, NASDAQ granted 305,000 shares of restricted stock to employees and officers with a weighted-average grant price of $17.70. Restricted stock awards contain restrictions on sales and transfers, are generally subject to a five-year vesting period and are expensed over the vesting period. Beginning in 2005, NASDAQ also granted performance based restricted stock awards. The number of awards that vest is based on meeting certain performance conditions. NASDAQ recognized $1.4 million and $0.5 million in amortization expense related to restricted stock during the years ended December 31, 2005 and December 31, 2004, respectively.

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

Options granted generally vest over three years and expire 10 years from the date of grant. Beginning in 2004, the NASDAQ Board of Directors approved the issuance of Performance Accelerated Stock Options (PASO) and granted 4,919,000 PASOs during 2004 and an additional 52,500 in 2005. The PASOs include a performance-based accelerated vesting feature based on NASDAQ achieving specific levels of performance in fiscal years 2004 and 2005. The vestings of the PASO awards are no longer than six years from the grant date. All options to date have been granted at fair market value on the date of grant. As of December 31, 2005, options for 5,316,755 shares were vested (including grants outside of the Plan), and exercisable with a weighted-average exercise price of $10.30. As of December 31, 2004, options for 8,368,901 shares were vested (including grants outside of the Plan), and exercisable with a weighted-average exercise price of $11.92. The weighted-average remaining contract life was 7.2 years and 7.6 years at December 31, 2005 and 2004, respectively.

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

Stock option activity, including shares from outside of the Plan, during the year ended December 31, 2005, is summarized below:

		PRICE PER SHARE	
	Shares	Range	Weighted-Average
Balance, January 1, 2005	17,056,763	$ 5.28 — $ 19.70	$ 9.75
Granted	439,650	$ 8.30 — $ 42.28	$ 20.59
Exercised	4,131,058	$ 6.55 — $ 19.70	$ 12.48
Canceled	1,253,252	$ 6.15 — $ 25.96	$ 9.46
Balance, December 31, 2005	12,112,103	$ 5.28 — $ 42.28	$ 9.23

The following table presents the options outstanding as of December 31, 2005, by range of exercise prices:

Range of Exercise Prices	Outstanding as of December 31, 2005	Weighted-Average Exercise Price
$ 5.28 — $ 7.34	2,360,050	$ 5.99
$ 7.35 — $ 8.49	3,696,075	$ 7.38
$ 8.50 — $ 10.24	2,830,966	$ 8.77
$ 10.25 — $ 12.99	140,880	$ 10.44
$ 13.00 — $ 13.38	2,724,432	$ 13.00
$ 13.39 — $ 19.69	54,300	$ 16.06
$ 19.70 — $ 25.01	127,300	$ 21.08
$ 25.02 — $ 30.09	117,450	$ 25.95
$ 30.10 — $ 36.07	39,900	$ 31.00
$ 36.08 — $ 42.28	20,750	$ 41.56
	12,112,103	$ 9.23

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

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

NASDAQ has an employee stock purchase plan for all eligible employees. Under the plan, shares of common stock may be purchased at six-month intervals (each, an offering period) at 85.0 percent of the lower of the fair market value on the first or the

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

last day of each offering period. Employees may purchase shares having a value not exceeding 10.0 percent of their annual compensation, subject to applicable annual Internal Revenue Service limitations. During 2005 and 2004, employees purchased an aggregate of 106,437 and 110,408 shares at a weighted-average price of $11.29 and $5.45 per share, respectively.

Pro forma information regarding net income is required under SFAS No. 148 and has been determined as if NASDAQ had accounted for all stock option grants based on a fair value method. The fair value of each stock option grant was estimated at the date of grant using the Black-Scholes valuation model assuming a weighted-average expected life of five years, weighted-average expected volatility of 30.0 percent and a weighted-average risk-free interest rate of 4.05 percent and 3.43 percent for 2005 and 2004, respectively. The weighted-average fair value of options granted in 2005 and 2004 was $7.05 and $2.49, respectively.

Pro forma net income includes the amortization of the fair value of stock options over the vesting period and the difference between the fair value and the purchase price of common shares purchased by employees under the employee stock purchase plan. The pro forma net income also includes a reduction in option expense due to the true-up of actual forfeitures. The pro forma information for the years ended December 31, 2005 and 2004 is as follows:

	2005	2004
	(in thousands)	
Income from continuing operations	$ 293,715	$ 105,135
Compensation expense (net of minority interest of $2,639 in 2005 and $1,784 in 2004)	(1,107)	(2,152)
Pro forma income from continuing operations	$ 292,608	$ 102,983

13. LEASES

NASD

NASD leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was $21.8 million in 2005 and $21.6 million in 2004, and is included in occupancy expense in the consolidated statements of income.

Future minimum lease payments under non-cancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 2005:

	(in thousands)
Year ending December 31,	
2006	$ 19,104
2007	17,428
2008	17,151
2009	16,640
2010	16,497
Remaining years	116,000
Total minimum lease payments	$ 202,820

13. LEASES (CONTINUED)

Future minimum lease payments under non-cancelable capital leases with initial or remaining terms of one year or more consisted of the following at December 31, 2005:

	(in thousands)
Year ending December 31,	
2006	$868
2007	88
Total minimum lease payments	956
Less: imputed interest	(10)
Total present value of minimum lease payments	$946

NASDAQ

NASDAQ leases office space and equipment under non-cancelable operating leases with third parties and also subleases office space from NASD in New York City. Some of NASDAQ's leases contain renewal options and escalation clauses based on increases in property taxes and building operating costs.

As of December 31, 2005, future minimum lease payments under non-cancelable operating leases (net of sublease income) are as follows:

	Gross Lease Commitment	Sublease Income	Net Lease Commitment
		(in thousands)	
Year ending December 31,			
2006	$ 35,938	$ 2,691	$ 33,247
2007	27,450	2,729	24,721
2008	22,556	2,804	19,752
2009	21,705	2,771	18,934
2010	20,866	2,432	18,434
Remaining years	135,475	12,957	122,518
Total minimum lease payments	$ 263,990	$ 26,384	$ 237,606

Rent expense for operating leases (net of sublease income of $2.2 million and $0.4 in 2005 and 2004, respectively) was $18.5 million and $18.3 million for the years ended December 31, 2005 and 2004, respectively.

In October 2004, NASDAQ entered into an agreement for technology equipment and also renegotiated related operating leases with a major vendor. NASDAQ also entered into a three-year lease agreement, which included new upgraded equipment. The future minimum lease payments associated with these agreements are included in the table above.

14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

NASD

EDS

On April 1, 2003, NASD and EDS entered into a service agreement (2003 EDS Agreement) that superseded an existing agreement with NASD. The 2003 EDS Agreement expires on December 31, 2012. Under the 2003 EDS Agreement, NASD was obligated to pay EDS a minimum of $24.0 million for the first year, (prorated for a nine-month period during 2003 commencing on the effective date), which is reduced ratably to $16.0 million in the final year for both applications development and maintenance services. NASD is also required to use EDS for all its production services needs. As consideration for the 2003 EDS Agreement, NASD agreed to forgive a $35.3 million deposit with EDS related to the previous EDS agreement. This deposit is being amortized on a straight-line basis over the remaining term of the 2003 EDS Agreement. As of December 31, 2005 and 2004, NASD recorded other assets of $25.4 million and $29.0 million, respectively, representing the unamortized balance of the deposit with EDS. Amortization expense of $3.6 million was recorded during both years ended December 31, 2005 and 2004, respectively, and is included within depreciation and amortization in the consolidated statements of income.

New York City

In 2001, NASD entered into a series of incentive agreements with the City of New York resulting in potential incentives aggregating $53.6 million on a net present value basis to NASD, NASDAQ and Amex. The terms of this agreement required NASD, NASDAQ and Amex together to maintain a set number of full-time employees within New York City annually until December 31, 2020. If NASD does not meet the required headcount, it will be required to pay back either all or a portion of the benefits recognized. In 2004, NASD amended this agreement to separate the benefits among NASD, NASDAQ and Amex individually. As of December 31, 2005, NASD met the headcount requirements as stipulated in the agreement.

New York State Grant

In April 2003, NASD received $3.0 million of a capital grant from the New York State Urban Development Corporation d/b/a Empire State Development Corporation (ESDC). The terms of this grant required NASD, NASDAQ and Amex together to maintain a set number of full-time employees within New York City annually until January 1, 2009. If the required headcount as summarized in this grant are not maintained, NASD, NASDAQ and Amex will be required to pay back to ESDC either all or a portion of the grant received. In 2004, NASD amended this agreement to separate the benefits among NASD, NASDAQ and Amex individually. As of December 31, 2005, NASD met the headcount requirements as stipulated in the agreement.

Series 7 Exam

On January 6, 2006, NASD announced that 1,882 individuals who took the Series 7 broker qualification exam between October 1, 2004 and December 20, 2005, incorrectly received a failing grade due to a software error. This error caused some test takers to score just below the minimum passing grade. As of April 19, 2006, there are 10 class action cases and one individual case pending in federal courts in the District of Columbia, New York, Ohio and Arkansas. NASD has requested the Judicial Panel on Multidistrict Litigation (MDL Panel) to consolidate these cases in the Southern District of New York. A hearing on NASD's motion will be heard on May 25, 2006. Most of these cases are stayed pending action by the MDL Panel. At this time, NASD is not able to reasonably estimate a potential loss on these lawsuits or any additional unasserted claims. As a result, no accrual has been recorded in accordance with SFAS No. 5, "Accounting for Contingencies," other than $1.6 million accrued as of December 31, 2005,

14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

representing estimated refunds for exam fees and travel costs for those who incorrectly failed the exam. This amount is included in other current liabilities in the consolidated balance sheets.

NASDAQ

Acquisition of Instinet Group

As a result of the acquisition of Instinet, NASDAQ amended the original execution and clearing services agreement between INET and ICS, an affiliate of SLP. Under this amended agreement, ICS will provide INET with clearing and execution services for approximately $6.2 million for a period not to exceed six months, unless the parties agree otherwise.

Also as a result of the acquisition, NASDAQ entered into an agreement with a former affiliate of Instinet to have the former affiliate provide transition services for a period of up to six months after the closing date of the acquisition. Under this agreement, the former affiliate will provide INET with office space, and provide INET and NASDAQ with desktop support, finance support and access to the FIX engines and Smart routers. This agreement has a maximum fee of $0.2 million per month and could be lower depending on whether or not the services are provided. This agreement can be terminated early with a minimum of thirty days notice.

Brut Agreements

Brut contracted with a subsidiary of SunGard, SunGard Financial Systems Inc., for SunGard Financial to provide Brut online processing report services and related services in connection with Brut's clearance of trades. The term of this agreement is five years and began in September 2004, and is automatically renewed at yearly intervals thereafter until terminated by Brut or SunGard Financial. The annual service fee is $10.0 million in the first year, declining to $8.0 million in the second year, and $6.0 million in the third year of the agreement. The annual service fee is subject to price review in years four and five based on market rates, but will not be less than $4.0 million per year. Some additional fees may be assessed based on services needed or requested.

Brut also contracted with SunGard to host certain software on designated equipment at a SunGard facility for a transitional period beginning in September 2004. SunGard developed and operated the computer software programs that enable Brut to operate and provide order entry and execution over its ECN. Under the terms of the original agreement, which ran from September 2004 through May 2005, Brut was obligated to pay SunGard approximately $0.1 million per month. An amendment was signed on November 29, 2004, that extended the original agreement through June 30, 2006. Beginning November 30, 2005, Brut has the option to cancel the agreement within thirty days written notice to SunGard. An additional amendment, which was effective August 1, 2005, reduced the monthly payment to a nominal amount ($0.7 million in 2006) for the remainder of the term of the agreement, which now expires in December 2006. After May 1, 2006, Brut may cancel the agreement upon providing SunGard sixty days written notice.

Brokerage Activities

Brut and INET provide guarantees to securities clearinghouses and exchanges under standard membership agreements, which require members to guarantee the performance of other members. If a member becomes unable to satisfy its obligations to the clearinghouses, other members would be required to meet its shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral, as well as meet certain minimum financial standards. Brut's and INET's

14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

maximum potential liability under these arrangements cannot be quantified. However, NASDAQ believes that the potential for Brut and INET to be required to make payments under these arrangements is unlikely. Accordingly, no contingent liability is recorded in the consolidated balance sheets for these arrangements. NASDAQ has received inquiries from NASD regarding compliance with Brut's obligations regarding short sales, firm quotes and other reporting and disclosure requirements. At this time, NASDAQ cannot estimate the amount of any potential fines or penalties associated with these matters, but NASDAQ does not believe that any potential fines or penalties would be significant.

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. Management is not aware of any unasserted claims or assessments that would have a material adverse effect on the financial position and the results of operations of the Company.

15. DISCONTINUED OPERATIONS

AMEX

On December 31, 2004, NASD sold its Class B interest in Amex to Amex Membership Corporation. As a result of this transaction, NASD recognized a cumulative loss on sale of $225.0 million, of which $0.3 million and $6.8 million was recognized in 2005 and 2004, respectively. The remaining $217.9 loss on Amex was recognized as of December 31, 2003. Amex was previously reported by NASD as a separate segment under SFAS No. 131.

In accordance with SFAS No. 144, Amex is reflected as a discontinued operation. As a discontinued operation, the revenues, costs and expenses, and cash flows of Amex have been excluded from the respective captions in the consolidated statements of income and consolidated statements of cash flows, and have been presented separately as "income (loss) from discontinued operations, net of tax" and as "cash provided by (used in) discontinued operations." There were no assets and liabilities of Amex as of December 31, 2005 and 2004 included in the consolidated balance sheets.

As of December 31, 2005 and 2004, NASD had accrued liabilities of $5.6 million and $7.5 million, respectively, representing transaction and employee costs incurred as part of the sale agreement. These amounts are included in other current liabilities in the consolidated balance sheet.

The following table presents condensed results of operations for Amex for the year ended December 31, 2004.

	(in thousands)
Revenues	$ 218,258
Income from discontinued operations	$ 10,139

As part of the sale of Amex, NASD and Amex entered into several other agreements, including a term loan agreement for $25.0 million, a revolving credit facility for $25.0 million, a Transition Services Agreement, and a Regulatory Services Agreement. See Note 2, "Summary of Significant Accounting Policies," for additional information on the loan agreements.

NASD 2005 Notes to Consolidated Financial Statements

15. DISCONTINUED OPERATIONS (CONTINUED)

Under the Transition Services Agreement, NASD will provide certain administrative and other support services to Amex for a period of up to five years. The services to be provided by NASD include accounting, purchasing, internal audit and other administrative services. For the year ended December 31, 2005, NASD recognized $4.4 million of revenue, which is included in other revenue in the consolidated statements of income, from this agreement. For the year ended December 31, 2004, NASD recognized intercompany revenues of $5.4 million for administrative and other support services provided to Amex. These intercompany revenues have been eliminated in consolidation. As of December 31, 2005, Amex reintegrated all functions under this agreement into its operations and had provided NASD notification of its intent to terminate the internal audit service.

NASD provides certain regulatory services and develops certain regulatory technologies for Amex. If Amex requires additional services or technologies beyond the initially agreed scope of work, Amex is generally required to give NASD the opportunity to perform such additional services. Further, NASD may extend financing to Amex for the costs of technology and related matters that may be required to be implemented by the SEC, but NASD will not extend financing for any fines or penalties imposed on Amex by the SEC. For the year ended December 31, 2005, NASD recognized $20.1 million of revenue related to regulatory services provided to Amex and is included in contract service fees in the consolidated statements of income. For the year ended December 31, 2004, NASD recognized intercompany revenue of $6.6 million related to regulatory services provided to Amex. These intercompany revenues have been eliminated in consolidation.

NASDAQ EUROPE

On December 18, 2003, NASDAQ transferred its interest in NASDAQ Europe to one of that company's original investors for nominal cash consideration. In the fourth quarter of 2004, NASDAQ recognized a gain on the release of a reserve for potential claims against NASDAQ that management established at the time of the transfer of NASDAQ's shares of NASDAQ Europe. In the fourth quarter of 2004, Easdaq reached agreements with certain of its creditors to settle these creditors' existing claims against Easdaq. NASDAQ was the third-party beneficiary of these creditor agreements and released the $15.1 million reserve management established.

In accordance with SFAS No. 144, NASDAQ Europe is reflected as a discontinued operation. As a discontinued operation, the revenues, costs and expenses, and cash flows of NASDAQ Europe have been excluded from the respective captions in the consolidated statements of income and consolidated statements of cash flows and have been presented separately as "income (loss) from discontinued operations, net of tax" and as "cash provided by (used in) discontinued operations." There were no assets and liabilities of NASDAQ Europe at December 31, 2005 and 2004.

The following table presents condensed results of operations for NASDAQ Europe for the year ended December 31, 2004.

	(in thousands)
Revenues	$ –
Pre-tax income (loss)	15,154
(Provision) benefit for income taxes	(5,596)
Income (loss) from discontinued operations	$ 9,558

NASD 2005 Notes to Consolidated Financial Statements

16. BUSINESS SEGMENT INFORMATION

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

SEGMENT INCOME OR LOSS

The Company's accounting policies for segments are the same as those described in Note 2, "Summary of Significant Accounting Policies." Management evaluates segment performance based on net revenue less expenses. Consolidating adjustments represent the elimination of intercompany transactions.

	2005			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in thousands)			
Revenues	$ 1,057,456	$ 879,919	$ (63,011)	$ 1,874,364
Cost of revenues	(413,483)	(353,908)	12,827	(754,564)
Net revenues	643,973	526,011	(50,184)	1,119,800
Total expenses	652,473	411,727	(48,830)	1,015,370
Net revenue less expenses	(8,500)	114,284	(1,354)	104,430
Total assets	2,418,249	2,046,738	(154,449)	4,310,538
Depreciation and amortization	37,555	66,986	–	104,541
Interest and dividend income	66,578	12,735	(6,596)	72,717
Purchases of property and equipment	$ 40,998	$ 25,402	$ (18,000)	$ 48,400

	2004			
	NASD	NASDAQ	Consolidating Adjustments	Consolidated
	(in thousands)			
Revenues	$ 872,653	$ 540,441	$ (71,777)	$ 1,341,317
Cost of revenues	(230,853)	(55,845)	–	(286,698)
Net revenues	641,800	484,596	(71,777)	1,054,619
Total expenses	569,342	476,413	(49,001)	996,754
Net revenue less expenses	72,458	8,183	(22,776)	57,865
Total assets	1,704,679	814,820	(164,781)	2,354,718
Depreciation and amortization	39,531	76,336	–	115,867
Interest and dividend income	42,682	5,854	(13,188)	35,348
Purchases of property and equipment	$ 28,526	$ 26,029	$ –	$ 54,555

NASD 2005 Notes to Consolidated Financial Statements

16. BUSINESS SEGMENT INFORMATION (CONTINUED)

GEOGRAPHIC DATA

The following table presents revenues and property and equipment, net by geographic area for 2005 and 2004. Revenues are classified based upon the location of the customer. Property and equipment information is based on the physical location of the assets.

	Revenues	Property and equipment, net
	(in thousands)	
2005:		
United States	$ 1,823,072	$ 268,816
All other countries	51,292	552
Total	$ 1,874,364	$ 269,368
2004:		
United States	$ 1,292,446	$ 313,088
All other countries	48,871	757
Total	$ 1,341,317	$ 313,845

INTER-SEGMENT TRANSACTIONS

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

Surveillance and Other Regulatory Services

NASDR incurs costs associated with monitoring, legal and enforcement activities related to the regulation of NASDAQ. These costs are charged to NASDAQ based upon NASD management's estimated percentage of costs incurred by each NASDR department that are attributable directly to The NASDAQ Stock Market surveillance. Inter-segment charges from NASDR to NASDAQ for surveillance and other regulatory services were $41.7 million and $45.6 million for the years ended December 31, 2005 and 2004, respectively.

TRACE

NASDAQ Technology was established in 2004 and provides software, hosting and disaster recovery services to third parties. Effective November 1, 2004, NASDAQ Technology and NASD entered into a contract for technology development support services for a fixed income trade reporting platform, TRACE. Inter-segment charges were $3.9 million and $1.8 million for the years ended December 31, 2005 and 2004, respectively.

Transfer of the OTC Equities Business to NASD

On September 2, 2005, NASD executed the OTCBB and OTC Equities Revocation of Delegation and Asset Transfer and Services Agreement (OTC Equities Agreement) with NASDAQ related to the OTC Equities. The OTC Equities includes OTCBB and is an electronic screen-based quotation service for securities that, among other things, are not listed on The NASDAQ Stock Market or any U.S. national securities exchange. Under the OTC Equities Agreement, effective October 1, 2005, NASDAQ transferred

16. BUSINESS SEGMENT INFORMATION (CONTINUED)

responsibility for the OTC Equities back to NASD. This transfer is designed to address concerns expressed by the SEC regarding NASDAQ continuing to operate the OTC Equities after Exchange Registration. As consideration for this agreement, NASD has agreed to outsource the operation of the OTC Equities to NASDAQ for an initial two-year period, subject to one-year renewals upon mutual consent. NASD will pay NASDAQ $14.2 million in the first year and $14.7 million in the second year for NASDAQ's services under the OTC Equities Agreement, with payments in any subsequent periods to be subject to agreement between NASD and NASDAQ. Any enhancements directed by NASD to the OTC Equities system will be billed to NASD on a time and materials basis as described in the OTC Equities Agreement. Inter-segment charges from NASDAQ to NASD for OTC Equities were $3.8 million for the year ended December 31, 2005.

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

Sale of Building

In June 2005, NASDAQ completed the sale of the building it owned in Rockville, Maryland, located at 9513 Key West Avenue, to NASD for $18.0 million. This transaction has been eliminated in consolidation.

Preferred Stock

In March 2002, NASDAQ issued 1,338,402 shares of Series A Cumulative Preferred Stock and one share of Series B Preferred Stock to NASD. The Series A Cumulative Preferred Stock carried a 7.6 percent dividend rate for the year commencing March 2003, and carried a 10.6 percent dividend rate in all subsequent years. The Series B Preferred Stock does not pay dividends. On September 30, 2004, NASD waived a portion of the dividend for the third quarter of 2004 of $2.5 million and accepted an aggregate amount of $1.0 million (calculated based on an annual rate of 3.0 percent) as payment in full of the dividend for this period. On November 29, 2004, NASDAQ entered into an exchange agreement with NASD, pursuant to which NASD exchanged 1,338,402 shares of NASDAQ's Series A Cumulative Preferred Stock, representing all the outstanding shares of Series A Cumulative Preferred Stock, for 1,338,402 shares of newly issued Series C Cumulative Preferred Stock. The Series C Cumulative Preferred Stock accrues quarterly dividends at an annual rate of 3.0 percent for all periods until July 1, 2006, and at an annual rate of 10.6 percent for periods thereafter.

On April 21, 2005, NASD entered into a Stock Repurchase and Waiver Agreement with NASDAQ, whereby NASD consented to the financing used in connection with NASDAQ's acquisition of Instinet. In exchange for the waiver, NASDAQ repurchased 384,932 shares of its Series C Cumulative Preferred Stock owned by NASD for approximately $40.0 million. On December 20, 2005, NASD exchanged its one share of NASDAQ's Series B Preferred Stock for one newly issued share of Series D Preferred Stock, which had terms substantially similar to the terms of the Series B Preferred Stock.

The Series C Cumulative Preferred Stock was paid in full on February 15, 2006.

17. SUBSEQUENT EVENTS

NASDAQ Exchange Registration

On January 13, 2006, the SEC approved NASDAQ's application to operate as a national securities exchange. NASDAQ will begin operating as an exchange once it meets conditions imposed by the SEC. Upon effectiveness of Exchange Registration, NASDAQ will redeem the Series D Preferred Stock and NASD will no longer exert voting control over NASDAQ. As a result of the redemption of

17. SUBSEQUENT EVENTS (CONTINUED)

the Series D Preferred Stock, NASD will cease consolidating NASDAQ and will have reduced its ownership of NASDAQ to the number of shares underlying the unexercised warrants for Tranche IV.

NASDAQ's Acquisition of Shareholder.com

On February 6, 2006, NASDAQ completed the acquisition of Shareholder.com, a privately held, Massachusetts-based firm specializing in shareholder communications and investor relations intelligence services, for $40.0 million in cash, subject to post-closing adjustments. Shareholder.com will operate as a wholly owned subsidiary of NASDAQ. Shareholder.com currently serves over 1,000 clients, including companies listed on both domestic and foreign exchanges. Shareholder.com will continue to offer its comprehensive suite of services to all publicly held companies who wish to optimize investor relations capabilities.

Sales of NASDAQ Common Stock

On February 15, 2006, NASDAQ completed another common stock offering of 13,895,229 shares of its common stock. The offering consisted of 7,000,000 primary shares, 3,505,886 shares of NASDAQ's common stock offered by NASD, and 3,389,343 shares of NASDAQ common stock offered by other stockholders who received shares through the exercise of warrants they purchased in NASDAQ's 2000 and 2001 private placements. In addition, on February 15, 2006, NASDAQ redeemed all outstanding shares of Series C Cumulative Preferred Stock from NASD.

On March 2, 2006, the underwriters for NASDAQ's public offering exercised their option and purchased an additional 2,084,284 shares of common stock from NASD and NASDAQ. NASD and NASDAQ contributed equally to the over-allotment option. The completion of the offering, including the exercise of the over-allotment, resulted in a total sale of 15,979,513 shares, of which 8,042,142 were sold by NASDAQ, 4,548,028 shares were sold by NASD, and the remainder sold by certain other stockholders. As a result of these transactions, NASD's ownership in NASDAQ common stock decreased to 11.4 percent.

On May 2, 2006, NASDAQ completed a public offering of 18,500,000 shares of its common stock, generating net proceeds of $664.5 million after deducting offering expenses. NASDAQ also granted the underwriters an option to purchase up to an additional 2,775,000 shares of its common stock to cover over allotments, if any, which the underwriters may exercise within 30 days of the date of the final prospectus. The net proceeds from the above offering were used to repay a portion of the amount outstanding under the $1.1 billion secured term loan of NASDAQ's April 2006 Credit Facility and for general corporate purposes, including possible acquisitions by NASDAQ of further London Stock Exchange plc (LSE) shares or other acquisitions by NASDAQ unassociated with the LSE. See "NASDAQ's Agreement to Acquire Minority Stake in the LSE" and "NASDAQ's April 2006 Credit Facility" below for additional information. Amounts repaid under the secured term loan of NASDAQ's April 2006 Credit Facility will constitute permanent reductions in availability.

Sale of Depository Trust & Clearing Corporation

On March 27, 2006, NASD sold its investment in the Depository Trust & Clearing Corporation for $3.0 million, and recognized a gain of $2.8 million.

Series 7 Exam

As of April 17, 2006, there are 10 class action cases and one individual case pending in federal courts in the District of Columbia, New York, Ohio and Arkansas. NASD has requested the MDL Panel to consolidate these cases in the Southern District of New York. A hearing on NASD's motion will be heard on May 25, 2006. Most of these cases are stayed pending action by the MDL Panel.

17. SUBSEQUENT EVENTS (CONTINUED)

NASDAQ's Agreement to Acquire Minority Stake in the LSE

On March 9, 2006, NASDAQ submitted a non-binding indication of interest to acquire all of the shares of the LSE, which was rejected by the LSE on March 10, 2006. On March 30, 2006, NASDAQ announced that it no longer intended to make an offer for the LSE. At that time, NASDAQ reserved the right to announce an offer or possible offer or make and participate in an offer or possible offer for the LSE and/or take any other action which would otherwise be restricted under the rules of the United Kingdom City Code on Takeovers and Mergers, or the City Code, within the next six months with the consent of the United Kingdom Takeover Panel should one of the following events occur:

- an agreement or recommendation from the Board of the LSE;
- an announcement by a third party of an offer for or a merger with the LSE;
- the LSE undertakes or announces an intention to undertake any acquisition or disposal of a material amount, or any material recapitalization other than the LSE's announced return of capital to shareholders of up to GBP 510 million (where "material" is defined as 10.0 percent or more of the LSE's equity market capitalization as at the close of business on March 30, 2006);
- the LSE announces a proposal for shareholder approval that would result in another person acquiring a 30.0 percent or greater shareholding without being required to make an offer for the remaining share capital or reverse takeover; or
- there is a material change in circumstances.

On April 18, 2006, NASDAQ acquired 38,100,000 shares, or 14.9 percent, of the issued share capital of the LSE, at a price of GBP 11.75 per share. The total consideration was GBP 447.7 million, or $784.8 million. In connection with this purchase, NASDAQ entered into a credit facility that provides for credit of up to $1.925 billion of secured financing and NASDAQ currently has approximately $385.1 million available to drawdown under this facility.

On May 8, 2006, NASDAQ acquired an additional 9,790,280 shares, or 3.8 percent, of the issued share capital of the LSE, at a price of GBP 12.18 per share. Total consideration was GBP 119.2 million, or $220.7 million. NASDAQ paid for the shares with cash on hand. Also, on May 10, 2006, NASDAQ announced it acquired an additional 13,791,440 shares of the issued share capital of the LSE, at a price of GBP 12.48 per share. Total consideration for this purchase was GBP 172.1 million, or $320.7 million. In addition to the 47,890,280 shares previously owned, this acquisition takes NASDAQ's holding in the LSE to 61,681,720 shares, or 24.1 percent, of the issued share capital of the LSE. NASDAQ purchased the above shares from LSE shareholders. NASDAQ plans to pay for these shares using $310.1 million of funds available under its April 2006 Credit Facility and $10.6 million from cash on hand.

NASDAQ continues to explore and evaluate its position with respect to the LSE and the purchase of additional LSE shares. NASDAQ may purchase additional LSE shares at any time based on numerous factors, including strategic transactions and potential transactions in its industry, market conditions, LSE share trading prices and the availability of LSE shares for sale. If NASDAQ chooses to purchase additional LSE shares, NASDAQ may incur additional debt.

17. SUBSEQUENT EVENTS (CONTINUED)

NASDAQ's April 2006 Credit Facility

NASDAQ entered into the April 2006 Credit Facility, effective on April 18, 2006, to finance its initial purchase of the LSE shares. The April 2006 Credit Facility replaced NASDAQ's former credit agreement obtained in connection with the financing of the INET acquisition and provides for credit of up to $1.925 billion of secured financing. The $1.925 billion available under the April 2006 Credit Facility includes (1) a five-year $75.0 million revolving credit facility, with a letter of credit sub-facility and swingline loan sub-facility; (2) a six-year $750.0 million senior term loan facility; and (3) a six-year $1.1 billion secured term loan facility structured as a delayed-draw term loan (which is limited in use to purchasing LSE shares). The interest rate on loans made under the April 2006 Credit Facility is expected to be either (1) a rate per annum equal to the greater of (a) the rate announced from time to time by Bank of America, N.A. as its "prime rate" and (b) the federal funds effective rate plus 1/2 of 1.0 percent or (2) at the "LIBO Rate" set by the British Banker's Association at 11:00 a.m. two days prior, in each case, plus an applicable margin that varies depending upon the ratings of the loans under the April 2006 Credit Facility most recently received by Moody's Investors Service, Inc. and Standard & Poor's Ratings Group, Inc. NASDAQ has also agreed to pay customary fees and expenses related to the April 2006 Credit Facility and to provide customary indemnities.

NASDAQ's obligations under the April 2006 Credit Facility are secured by a security interest in and liens upon substantially all of its assets and its subsidiaries. All of NASDAQ's domestic subsidiaries are guarantors of its obligations under the April 2006 Credit Facility, excluding the regulated broker-dealer subsidiaries, the insurance-related subsidiaries and The Trade Reporting Facility LLC, or TRF, a joint venture with NASD, which was formed in April 2006.

The April 2006 Credit Facility contains customary negative covenants which will affect NASDAQ's and its consolidated subsidiaries, including the following:

- limitations on the payment of dividends and redemptions of capital stock;
- limitations on loans, guarantees, investments, incurrence of debt and hedging arrangements;
- limitations on issuance and amendment of preferred stock and amendment of subordinated debt agreements;
- prohibition of prepayments, redemptions and repurchases of debt other than debt under the credit facility;
- limitations on liens and sale-leaseback transactions;
- limitations on mergers, recapitalizations, acquisitions and asset sales;
- limitations on transactions with affiliates;
- limitations on restrictions on liens and other restrictive agreements; and
- limitations on changes in its business.

17. SUBSEQUENT EVENTS (CONTINUED)

In addition, the April 2006 Credit Facility contains financial covenants, specifically, maintenance of minimum interest expense coverage ratio and maximum leverage ratio, as defined in the April 2006 Credit Facility and pursuant to the following schedules:

Interest Expense Coverage Ratio

Period	Ratio
Effective Date to June 30, 2006	1.50 to 1.00
July 1, 2006 to September 30, 2006	1.50 to 1.00
October 1, 2006 to March 31, 2007	1.75 to 1.00
April 1, 2007 to September 30, 2007	2.00 to 1.00
October 1, 2007 to March 31, 2008	2.50 to 1.00
April 1, 2008 to September 30, 2008	2.75 to 1.00
October 1, 2008 to March 31, 2009	3.00 to 1.00
April 1, 2009 to September 30, 2009	3.50 to 1.00
Thereafter	4.00 to 1.00

Under the terms of the April 2006 Credit Facility, the Interest Coverage Ratio for the period from April 1, 2006 to June 30, 2006 may be less than 1.50 to 1.00 under certain circumstances, but will not be less than 1.35 to 1.00.

Leverage Ratio

Period	Ratio
Effective Date to June 30, 2006	5.75 to 1.00
July 1, 2006 to September 30, 2006	5.50 to 1.00
October 1, 2006 to December 31, 2006	5.00 to 1.00
January 1, 2007 to March 31, 2007	4.25 to 1.00
April 1, 2007 to June 30, 2007	4.00 to 1.00
July 1, 2007 to September 30, 2007	3.75 to 1.00
October 1, 2007 to December 31, 2007	3.50 to 1.00
January 1, 2008 to March 31, 2008	3.25 to 1.00
April 1, 2008 to December 31, 2008	3.00 to 1.00
January 1, 2009 to September 30, 2009	2.75 to 1.00
Thereafter	2.50 to 1.00

The $1.1 billion secured term loan facility is excluded from the calculation of the Leverage Ratio until October 2007. The April 2006 Credit Facility also contains customary affirmative covenants, including access to financial statements, notice of trigger events and defaults, and maintenance of business and insurance, and events of default, as well as cross-defaults on material indebtedness.

NASD 2005 Notes to Consolidated Financial Statements

17. SUBSEQUENT EVENTS (CONTINUED)

NASDAQ is permitted to repay borrowings under the credit facility at any time in whole or in part, subject to NASDAQ remaining in compliance with the covenants discussed above and its obligation to pay additional fees in certain circumstances. Beginning in 2007, NASDAQ also is required to use a percentage of its excess cash flow to repay loans outstanding under the April 2006 Credit Facility. The percentage of cash flow NASDAQ is required to use for repayments varies depending on its leverage ratio at the end of the year for which cash flow is calculated, with the maximum repayment percentage set at 50.0 percent of excess cash flow.

Sale of Building

As part of NASDAQ's real estate consolidation plans, in April 2006, NASDAQ decided to sell the building it currently owns and occupies in Trumbull, Connecticut. An estimated loss on the sale of the building of approximately $5.0 million will be recorded in the second quarter of 2006.

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