



2001 ANNUAL FINANCIAL REPORT



LETTER FROM THE CHAIRMAN AND CEO

For the securities industry as for our nation, a year that witnessed the 9/11 tragedy can only be described in somber terms. On both Wall Street and Main Street, the economic environment was difficult. And the erosion of investor confidence triggered by Enron — which has encompassed serious questions about research analyst independence — only underscores the challenges faced by our industry.

All that notwithstanding, 2001 was a year of substantial progress and accomplishment for NASD. We took major strides forward on budget, business and strategic matters; in furthering our separation from Nasdaq and enabling its exchange registration; in reaffirming and advancing our core regulatory mission; in addressing serious inherited problems in technology; in extending our leadership in dispute resolution; and in moving toward the goal of Amex's successful separation from NASD.

NASD also played a key role in facilitating the industry's recovery from the attacks of September 11. And with the departure of Nasdaq, we began a major effort to clarify our regulatory mission and vision, whose full public launch is coming in the summer of 2002, and which is already visible in the new NASD logo that appears in this report.

NASD'S FINANCES AND STRATEGY

NASD made great progress in aligning its budget with the industry's fiscal realities — not by assuming unrealistic revenues, but by controlling costs. Such fiscal discipline enabled us to set aside an additional \$30 million in cost savings and return \$10 million to the membership in an unscheduled rebate. NASD's strong financial performance exceeded our operating targets and contributed to an increase in members' equity of almost 20 percent. And going forward, we formulated a 2002 budget that controls NASD expenses and is premised not on the one-time Nasdaq sell-off, but on the long-term need to live within our means.

In late 2001, NASD undertook a far-ranging strategic planning process to chart its course independent of Nasdaq. This process culminated in the spring of 2002 with the adoption of a strategic plan that makes plain our commitment to protect investors; ensure market integrity; facilitate market efficiency; and support the self-regulatory efforts of our members.

THE SALE AND EXCHANGE STATUS OF NASDAQ

NASD decided in 2000 to spin off Nasdaq, in order to focus solely on our historic regulatory mission. In 2001, NASD reduced its stake in Nasdaq to roughly 27 percent (on a fully diluted basis) primarily through two successful transactions: the Phase II private placement to members; and the sale of Nasdaq stock back to Nasdaq to facilitate private equity investment by the firm Hellman & Friedman. These steps laid the groundwork for NASD's sale of our remaining common shares in Nasdaq, which was completed in the first quarter of 2002.

With the two companies' operational separation, the post-Nasdaq era at NASD has begun. In 2001 we negotiated the first regulatory budget under which Nasdaq will receive regulatory services from NASD on an outsourced, arms-length basis.

Before Nasdaq can achieve exchange registration with the SEC, NASD is required to build a neutral facility for our members to report quotes and trades. We made great progress last year on this Alternative Display Facility (ADF) — filing the rules and managing the process towards SEC approval, and negotiating a tough, incentivized contract with a leading vendor to build the system by mid-2002.

NASD'S COMMITMENT TO REGULATION

NASD is a private-sector regulatory organization — period. Our regulatory mission is the polestar by which we will always navigate. This unifying focus became more clear than ever in 2001.

So did NASD's ability to safeguard market integrity by addressing important emerging issues. For example, we issued cutting-edge guidance regarding online suitability that today forms the framework for industry operations and policy. NASD wrote and implemented extensive new rules to govern day-trading activities, including such matters as disclosure, suitability and margin. We issued a significant new interpretation governing customer account transfers. We developed a series of new rules needed for single stock futures. And NASD enhanced the offerings of its Office of Individual Investor Services, which produced an unprecedented range of educational materials for investors and members.

Most prominently, NASD charted the course for tough and comprehensive new rules that will increase the disclosures and decrease the conflicts of interest associated with securities research analysts. These rules were greeted with bipartisan praise when announced in February 2002. They will go a long way toward winning back investor confidence — once a given in our industry — that analyst research reports contain useful information, not mere salesmanship. As

our enforcement record demonstrates, NASD will not hesitate to enforce these new rules vigorously — with a full range of disciplinary options ranging from stiff monetary penalties to suspension from the industry. Meanwhile, we will continue our vigilant pursuit of market integrity by completing our ongoing investigations in this area and undertaking any additional rulemaking we find necessary.

Speaking of enforcement, last year NASD successfully pursued enforcement matters of unprecedented magnitude. In one major matter settled in January 2002, acting jointly with the SEC, NASD sanctioned a leading investment bank \$100 million for violations in allocating “hot” initial public offerings (IPOs). We also barred, suspended or expelled more than 800 unfit participants from the broker/dealer industry.

Such tough enforcement is no accident or aberration — but rather, a central part of NASD’s mission and value to the markets, our members and the investing public. That is why we will continue to rein in the market excesses of the late 1990s in such areas as IPOs and research analysts. We will proceed both by issuing new rules and by assembling major new investigative teams. And we will expand and enhance the resources we devote to such efforts.

Our position is clear. NASD is an effective regulator because it is a regulator with teeth. Investors have more confidence in the markets when they know a tough cop is patrolling the beat. Never has this single-minded focus been more clearly needed than it is today.

MAJOR STEPS FORWARD IN TECHNOLOGY

The financial sector is information intensive — as is the business of regulating it. That’s why cutting-edge technology is at the heart of NASD’s strategic vision. It’s why we spend well over a quarter of our annual budget on technology. We know that as regulators, we must also be innovators.

In 2001, NASD tackled serious structural problems and unveiled cutting-edge new systems. We hired a Chief Technology Officer, recaptured the reins of technology development and operations, and strengthened our technology organization. During this same time, we completed development of INSITE — a state-of-the-art system whose advanced analytical engine, data mining and pattern recognition lets us base examinations on compliance risk. We upgraded our Central Registration Depository (CRD) system. And we deployed SONAR — an insider trading and fraud detection system that is already drawing considerable interest and growing in importance.

EXTENDING OUR LEADERSHIP IN DISPUTE RESOLUTION

Although the vast majority of investors will never need to resolve an investment-related problem, all investors need to know that there is a fair and efficient process for handling any dispute that might conceivably arise with their stockbroker or brokerage firm. NASD has filled this role ably for over 30 years. And today, we are known as the largest and most effective dispute resolution forum in the securities industry.

NASD's Dispute Resolution arm experienced a record year in 2001 — with arbitrations alone up by 25 percent. That growth contributed to NASD again handling some 90 percent of securities industry arbitrations and mediations in the United States. Disputes have grown dramatically in recent years, bringing total new case filings to over 7,000 annually. Yet NASD has managed this burgeoning workload without a decrease in our high customer satisfaction.

NASD Dispute Resolution increased the quality and diversity of its roster of arbitrators and mediators. It also achieved efficiencies that enabled it to pass a significant milestone: operating for the first time on a financially self-sustaining basis.

AMERICAN STOCK EXCHANGE

The American Stock Exchange dealt resourcefully with terrorist tragedy, a slowing economy and steadily increasing competitive pressures. Despite being heavily damaged in the 9/11 attacks, the Amex managed to reopen quickly for business. During the year, Amex exceeded its financial goals and attained its primary budget objectives; took cost-effective steps to expand its ETF presence internationally; launched a new brand identity and advertising campaign; completed significant infrastructure and technology initiatives; and enhanced specialist presence on its trading floor.

Through intensive discussions, NASD was able to reach agreement with the Amex Board on a roadmap for the timely separation of Amex from NASD. This will enable Amex to operate under a more suitable ownership arrangement — and allow NASD to focus on regulating markets, not owning them.

9/11 AFTERMATH

For the financial community as for our country, September 11 was the defining event of 2001. From the start — participating in the decisions on closing and reopening the markets, and reaching out to all our most affected members — NASD played its part effectively in the response to the attacks. Our aim was to walk the right line between providing appropriate regulatory relief for the industry, while maintaining appropriate regulatory vigilance for investors. We also communicated with our constituencies throughout the crisis and conducted a systematic effort to capture and carry forward the lessons of the tragedy.

Two of NASD's post-9/11 responsibilities have required noteworthy follow-up in 2002. First, as a result of our major survey of members, NASD has proposed a rule requiring firms to develop business continuity plans (as well as provide enhanced emergency contact information). Second, as required in the USA PATRIOT Act, we issued a rule requiring firms to put in place anti-money laundering compliance programs — and have expanded our compliance education offerings to meet the surging demand in this area. These measures are helping to make the markets more resilient in a disaster and to protect them from illicit uses — both to the benefit of the legitimate investor.

LOOKING AHEAD

NASD's mission demands not only a keen appreciation for the lessons of the past, but a clear strategic vision of the future. Our strategic plan underscores our commitment to protecting investors by fostering fair, efficient markets in which industry members are fully engaged in complying with the rules. And it embodies a clear vision of NASD as the world's preeminent provider of financial regulatory services.

EXTENDING OUR LEADERSHIP

For years, the financial sector was neatly compartmentalized, with clear boundaries between different financial products in different markets, and different regulatory systems. Those days are gone — and NASD's horizons have widened. Today, our activities transcend individual securities markets, financial sectors and even national borders.

- NASD has expanded into futures regulation, by way of a five-year contract to provide a full range of regulatory services to Nasdaq Liffe Markets — the single stock futures joint venture between Nasdaq and the London International Financial Futures and Options Exchange.
- We are likewise playing a regulatory role for the International Securities Exchange, the nation's first entirely electronic options market.

- ➔ We frequently consult with other global and U.S. markets as they explore ways to benefit from NASD's respected experience, techniques and technology.
- ➔ We designed and implemented a system modeled on our Central Registration Depository for the investment adviser industry.
- ➔ NASD is enhancing its education and training programs to be the preeminent provider to the securities industry.
- ➔ We are expanding our role in the fixed income field through a bond trade reporting system — TRACE — which brings needed transparency to investors.

SETTING STANDARDS NASD is an influential voice in shaping standards of conduct across the U.S. financial services industry and worldwide.

- ➔ Following Enron, NASD was widely consulted as a model for how private-sector regulation could help rebuild integrity and investor confidence in the accounting industry.
- ➔ We work for consistently high U.S. and global regulatory standards — to increase regulatory consistency, decrease opportunities for regulatory arbitrage, and protect investors everywhere.

ACTING RESPONSIVELY NASD does not view our members as a captive market. To the contrary, we strive constantly to hone our own performance — as well as the industry's — by finding ways to regulate in the most effective, responsive and cost-effective ways possible.

- ➔ NASD is conducting a systematic review in our Rule Modernization Project — to ensure that the benefits of all our rules fully justify their burdens.
- ➔ We will provide our members with education, training and technology as appropriate to improve their compliance — which advances regulation, focuses NASD resources and supports market integrity.

CONCLUSION

The changes underway at NASD are evolutionary. Yet they are also essential. For in a time when the financial services industry is changing at the speed of an electron, market integrity demands innovation. And in pursuing it, NASD must combine vigilance with vision.

This is a difficult time for our industry and for investor confidence. But NASD faces the challenges ahead with greater resources, independence, unity and focus than ever. Our greatest asset is our people — 2,000 of the finest market-integrity professionals on earth. I want to thank them for making 2001 a year of achievement in the midst of adversity.

No less important, I want to thank our members for their support. I believe they lend it because they know NASD is striving to be not only an effective regulator, but an efficient, responsive one.

Some might think this an inconvenient time for NASD to do its job. But the truth is, the markets have never needed tough, fair private-sector regulation more than they do today. So we look to the future with confidence in our mission. For NASD's return to its roots could not be more timely. And we have prepared ourselves thoroughly for both the challenges and opportunities to come.



Robert R. Glauber

Chairman and Chief Executive Officer

May 24, 2002

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NASD MANAGEMENT REPORT ON FINANCIAL OPERATIONS

OVERVIEW

2001 was a year of great progress and accomplishment for the National Association of Securities Dealers, Inc. ("NASD"). References to NASD and its consolidated subsidiaries throughout are collectively referred to as ("the Company"). NASD continued in its separation from The Nasdaq Stock Market, Inc. ("Nasdaq") through the completion of Phase II of the planned private placement of Nasdaq shares and through the additional sale of shares directly to Nasdaq. In 2001, the Company also met a major challenge to its members, operations, and investor confidence with the events of September 11. Finally, NASD used 2001 to institute significant cost controls, tackle serious inherited technology problems, assess its current operations and establish a defined new focus for NASD and its future.

In terms of financial performance, the Company's consolidated income before a one-time accounting change decreased \$106.9 million or 49% to \$112.0 million in 2001, due largely to growth in expenses at Nasdaq. Despite business interruptions related to September 11, consolidated revenues increased \$57.3 million or 4% to \$1.539 billion. Total consolidated expenses increased \$218.8 million or 18% to \$1.447 billion.

NASDAQ RESTRUCTURING

Continuing with the plan approved by the NASD membership in April 2000, Phase II of the restructuring closed on January 18, 2001. On May 3, 2001, NASD further decreased its ownership through a two-part transaction, which resulted in the issuance of convertible debt by Nasdaq to Hellman & Friedman and the subsequent repurchase of shares by Nasdaq from NASD. The table on the next page summarizes the effect of all NASD and Nasdaq transactions in Nasdaq stock in 2001 and 2000, as well as assumes that the sale of additional shares to Nasdaq in March 2002 occurred on December 31, 2001.

NASD MANAGEMENT REPORT ON FINANCIAL OPERATIONS

EFFECT OF NASDAQ RESTRUCTURING ACTIVITIES (DOLLARS IN MILLIONS)

	NASD OWNERSHIP %	FULLY DILUTED %	NASDAQ SHARES OWNED BY NASD	INCREASE IN CONSOLIDATED EQUITY	(INCREASE) DECREASE IN MINORITY INTERESTS	INCREASE IN LIABILITIES	CONSOLIDATED CASH PROCEEDS
Year Ended 12/31/99	100.0%	100.0%	49,999	-	-	-	-
Stock Split	100.0%	100.0%	100,000,000	-	-	-	-
Phase I – Shares	(19.4)%	(19.4)%	(323,796)	\$ (138.6)	\$ (118.2)	\$ -	\$ 256.8
Phase I – Warrants	-	(20.7)%	-	-	-	(68.7)	68.7
Year Ended 12/31/00	80.6%	59.9%	99,676,204	(138.6)	(118.2)	(68.7)	325.5
Phase II – Shares	(6.4)%	(6.4)%	(4,219,795)	(59.2)	(58.0)	-	117.2
Phase II – Warrants	-	(12.9)%	-	-	-	(59.9)	59.9
Hellman & Friedman	(4.3)%	(13.0)%	(18,461,538)	(40.5)	40.5	(240.0)	240.0
Other Nasdaq	(0.9)%	(2.3)%	-	(9.2)	(4.9)	-	14.1
Year Ended 12/31/01	69.0%	25.3%	76,994,871	(108.9)	(22.4)	(299.9)	431.2
Nasdaq Share Buyback – March 2002	(13.5)%	(25.3)%	(33,768,895)	(66.3)	66.3	-	-
Year Ended 12/31/01 – Proforma	55.5%	-	43,225,976	\$ (175.2)	\$ 43.9	\$ (299.9)	\$ 431.2
Cumulative Impact – all years	55.5%	-	43,225,976	\$ (313.8)	\$ (74.3)	\$ (368.6)	\$ 756.7
Cash Proceeds – NASD*							\$ 730.8
Cash Proceeds – Nasdaq*							25.9
Total Cash Proceeds							\$ 756.7

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

With the completion of the Nasdaq common stock repurchase in March 2002, NASD decreased its ownership in Nasdaq to 55.5%, or 0% if all warrants are exercised. The 55.5% is reserved for sale to holders of warrants which were sold by NASD during the Phase I and II private placements. These warrants become exercisable in four annual tranches, with the first becoming exercisable on June 28, 2002. If all warrants are exercised, cash proceeds to NASD will be approximately \$627 million and NASD's ownership percentage in Nasdaq will be reduced to zero.

The completion of these transactions marks the culmination of an historic period for NASD and the achievement of the goals of the restructuring plan, which were to:

- (i) permit NASD to focus more intently on its primary mission of being a private-sector regulatory services organization;
- (ii) streamline corporate governance and minimize potential regulatory conflicts of interest; and
- (iii) further strengthen the financial position of NASD and Nasdaq.

Until Nasdaq's registration as an exchange is approved by the Securities and Exchange Commission ("SEC") and becomes effective ("Exchange Registration"), NASD continues to exert voting control over Nasdaq and therefore continues to consolidate its operations. Until Exchange Registration, the shares of Nasdaq common stock underlying unexercised and unexpired warrant tranches, as well as the shares of Nasdaq common stock purchased through the exercise of warrants, will be voted by a voting trustee at the direction of NASD.

Upon Exchange Registration, the warrant holders will have the right to direct the voting trustee as to the voting of the shares of Nasdaq common stock underlying the unexercised and unexpired warrant tranches. At that point, NASD will no longer consolidate Nasdaq's operations with NASD's financial results. Exchange Registration is expected to occur in 2002.

A summary of the key dates and sequence of events described in the preceding paragraphs is provided below.

EVENT	DATE
Phase I – Completed	June 28, 2000
Phase II – Completed	January 18, 2001
Nasdaq Submits Exchange Registration Application	March 15, 2001
2001 Nasdaq Share Buyback (Hellman & Friedman) – Completed	May 3, 2001
2002 Nasdaq Share Buyback – Completed	March 8, 2002
Exchange Registration Approval	Pending*
Warrant Exercise Period – 1st Tranche	June 28, 2002 – June 27, 2003
Warrant Exercise Period – 2nd Tranche	June 30, 2003 – June 25, 2004
Warrant Exercise Period – 3rd Tranche	June 28, 2004 – June 27, 2005
Warrant Exercise Period – 4th Tranche	June 28, 2005 – June 27, 2006

* Approval of Nasdaq's registration as an exchange is pending approval of the SEC. Exchange Registration is expected to occur in 2002. However, there can be no assurance at this time that Exchange Registration will occur or that the Exchange Registration will occur in a timely fashion.

NASD MANAGEMENT REPORT ON FINANCIAL OPERATIONS

MEMBER REBATES

With the Phase I and II transactions, NASD committed to reducing its membership fees by \$114.0 million through 2006, assuming enough warrants are exercised. In keeping with this commitment, NASD granted \$7.0 million in fee reductions to its membership in the form of gross income assessment rebates in both 2001 and 2000. In addition to these amounts previously committed, NASD granted an additional one-time discretionary rebate of \$10.0 million to its membership in 2001. The \$10.0 million additional rebate was enabled by NASD's sound fiscal condition and intended to lessen the burden on the NASD membership caused by the economic downturn and the aftereffects of September 11.

RESULTS OF OPERATIONS

Returning to the financial results, the table below provides condensed information on the 2001 and 2000 operations of the Company by major business segment.

NASD CONSOLIDATED FINANCIAL PERFORMANCE BY SEGMENT (DOLLARS IN MILLIONS)

	NASD		NASDAQ		AMEX		CONSOLIDATING ADJUSTMENTS		CONSOLIDATED	
	2001	2000	2001	2000	2001	2000	2001	2000	2001	2000
Revenues	\$409.4	\$396.7	\$859.9	\$832.3	\$281.1	\$262.1	\$(11.4)	\$(9.4)	\$1,539.0	\$1,481.7
Expenses	(383.0)	(337.0)	(781.5)	(633.9)	(289.7)	(251.8)	7.5	(5.2)	(1,446.7)	(1,227.9)
Other income (expense), including provision for income taxes	85.6	53.9	(37.9)	(74.0)	6.0	(2.0)	(34.0)	(12.8)	19.7	(34.9)
Income (loss) before cumulative effect of change in accounting principle	112.0	113.6	40.5	124.4	(2.6)	8.3	(37.9)	(27.4)	112.0	218.9
Cumulative effect of change in accounting principle	-	-	-	(101.1)	-	(4.2)	-	-	-	(105.3)
Net income (loss)	\$112.0	\$113.6	\$40.5	\$23.3	\$(2.6)	\$4.1	\$(37.9)	\$(27.4)	\$112.0	\$113.6

REVENUES

For the year ended December 31, 2001, total consolidated revenues rose \$57.3 million or 4%, with Nasdaq, Amex, and NASD contributing \$27.6 million, \$19.0 million, and \$12.7 million of this increase, respectively, before consolidating adjustments.

Driving Nasdaq revenue increases were trademark and licensing fees associated with the Nasdaq-100 Trust and related products, offset by a decrease in demand for certain per query market information services.

Amex revenues increased due to higher equity, Exchange Traded Funds ("ETFs"), and options transactions charges on increased average daily volumes. Specifically, average daily equities volumes and options volumes increased 24% and 5%, respectively, over 2000 levels. Offsetting increases in Amex revenues were declines in ETF trade market share and lost revenue in the aftermath of September 11.

Total NASD revenues increased \$12.7 million or 3% due to a combination of higher regulatory fees, arbitration fees, and member assessments revenues. NASD regulatory fees increased roughly \$10.0 million over 2000 due to increases in Nasdaq average daily share volumes. In 2001, Nasdaq share volumes averaged 1.9 billion shares per day, an increase of 8% over 2000. NASD member assessments, which were tied to gross income assessment billings on higher 2000 firm FOCUS revenues reported, increased \$14.2 million or 13% over 2000, before the effects of the one-time special member rebate. Corporate Financing revenues declined \$13.2 million from 2000 levels due to declines in initial public offering volumes. Arbitration revenues increased \$8.0 million or 22% with new case volumes soaring to an all-time high with 7,196 new arbitration cases filed in 2001.

EXPENSES

Turning to expenses, consolidated expenses rose \$218.8 million or 18% in 2001, with Nasdaq, Amex, and NASD contributing \$147.6 million, \$37.9 million, and \$46.0 million of this increase, respectively, before consolidating adjustments.

Nasdaq expense increases were tied primarily to steps taken by Nasdaq in becoming an independent company and related increases in headcount and costs required to build critical business functions. Additionally, Nasdaq incurred significant costs in 2001 in support of development of its SuperMontage and Primex products and additional depreciation on technology infrastructure-related expenditures required to support those products. Finally, Nasdaq incurred additional costs associated with the events of September 11 and related costs in moving its headquarters facility from One Liberty Plaza.

NASD MANAGEMENT REPORT ON FINANCIAL OPERATIONS

Amex's increase in expenses was also affected by a combination of growth in infrastructure functions, new product development and disaster-related expenses.

NASD expenses increased \$46.0 million due primarily to increased depreciation expense tied to 2000 capital expenditures. Other contributors to the increase were additional compensation costs tied to a retention program for Regulation employees, and changes in the overall discount rate assumptions for the Company's pension plans. Apart from these increases, NASD instituted cost controls resulting in savings of approximately \$30.0 million against a previously approved budget.

OTHER INCOME (EXPENSE)

Other income (expense) represents the combined impact on net income from non-operating activities, such as interest income, interest expense, net realized investment (losses) gains, net (losses) income from equity investees, income taxes and gains on sale of Nasdaq shares by NASD. Other income (expense) increased \$54.6 million in 2001, due mainly to a reduction in Nasdaq income taxes associated with lower 2001 Nasdaq net income and the \$31.4 million gain on the sale of Nasdaq shares by NASD with the completion of Phase II.

CHANGE IN ACCOUNTING PRINCIPLE

Until 2000, Nasdaq and Amex historically recognized revenue for initial listing fees and listing of additional shares fees in the month the listing occurred or in the period the additional shares were issued, respectively. The SEC Staff Accounting Bulletin 101 ("SAB 101"), effective in 2000, has resulted in a new interpretation of accounting principles when applied to listing fees, relating to the timing of the recognition of such revenue. As a result of Nasdaq's discussions with the SEC, Nasdaq and Amex now recognize revenue relating to these fees on a straight-line basis over the estimated service periods. Because of this change, Nasdaq and Amex recognized the cumulative effect of a change in accounting principle at the beginning of 2000. This adjustment reduced 2000 net income, net of taxes by \$105.3 million, to \$113.6 million.

SEPTEMBER 11

The Company played a significant role in the financial community's recovery after September 11 by providing extensive regulatory relief and support to its membership. The Company participated in decisions regarding closure and reopening of the markets, expedited member admissions, and extended qualification and continuing education windows for more than 35,000 industry professionals. NASD also contributed \$1.0 million to The New York Times 9/11 Neediest Fund and matched employee contributions to other charitable organizations.

The Company also incurred net \$28.6 million in disaster-related costs and realized significant lost revenues through business interruptions caused by the post-September 11 closure of the markets.

OTHER

In 2001, NASD completed the move of its New York headquarters to its current location at One Liberty Plaza. Additionally, major technology development efforts and enhancements were completed in such areas as INSITE, ADS, and SONAR.

In addition to the continued progress of planned restructuring activities for Nasdaq, 2001 saw Amex continue its revitalization in spite of a slowing economy, increased competition and the September 11 tragedy. Excluding the effects of September 11 and other one-time items, Amex attained its primary budget objectives for the year; took cost-effective steps to expand its ETF presence internationally; launched a new brand identity and advertising campaign; completed significant infrastructure and technology initiatives; and enhanced specialist presence on the trading floor. Also in 2001, the NASD and Amex Boards agreed that it was appropriate to begin the process of separating Amex from NASD and in December 2001 the NASD and Amex Boards appointed a committee composed of members of each Board to advise the Boards regarding a separation. Since year-end, NASD and Amex have engaged an investment banker to explore the various alternatives.

In summary, NASD used 2001 to move decisively to control its expenses, reduce capital spending, streamline its operating methods and hone its technology — all while returning to its regulatory roots by moving toward separation of Nasdaq and Amex from NASD. As the year ended, NASD was well prepared to cement its position as the world's leading private-sector regulatory organization.

NASD MANAGEMENT REPORT ON FINANCIAL REPORTING RESPONSIBILITY

Management is responsible for the preparation, integrity, and objectivity of the consolidated financial statements of the National Association of Securities Dealers, Inc. ("NASD"). This responsibility includes the selection of accounting principles generally accepted in the United States. These consolidated financial statements reflect informed judgments and estimates, that management believes to be reasonable, in the determination of certain data used in the accounting and reporting process. The consolidated financial statements have been prepared in conformity with these principles and are free of material misstatement.

NASD maintains an effective system of internal accounting controls that is periodically modified and improved to correspond with changes in NASD's operations. This system of internal controls is designed to provide assurance that the assets of NASD are safeguarded against loss from unauthorized use or disposition and that the books and records, from which the consolidated financial statements were prepared, properly reflect the financial transactions of NASD. Important elements of the internal control system include capital and operating budgets, which are subjected to continuous review and reporting throughout the year; an organizational structure providing segregation of responsibilities; established policies and procedures; careful selection and training of qualified personnel; and an internal audit program developed and carried out by NASD's Internal Audit Department. The Internal Audit Department reports directly to the Audit Committee of the Board of Governors of NASD. It is management's opinion that the system of internal control as of December 31, 2001, is effective in providing reasonable assurance that the consolidated financial statements are free of material misstatement.

The Board of Governors of NASD establishes charters for its Audit and Finance Committees, as applicable. The Audit Committee provides assistance to the Board of Governors in fulfilling its oversight responsibility relating to NASD's financial statements and the financial reporting process, the systems of internal accounting and financial controls, the internal audit function, and the annual independent audit of NASD's financial statements. The Audit Committee consists of five governors, each of whom is independent of management and NASD. The Audit Committee consists of non-employee governors, at least one-half of whom are non-industry members, and the Committee Chair must be a public governor.

The Finance Committee oversees the financial operations and condition of NASD through review and discussion of current financial results; reviews annual operating and capital budgets and material modifications thereto; and reviews all other financial matters related to the operation and financial position of NASD. The Finance Committee, with the exception of the CEO of NASD, consists of non-employee governors, at least one-half of whom are non-industry members.

NASD's independent auditors, Ernst & Young, have conducted an audit of the consolidated financial statements of NASD for the years ended December 31, 2001 and 2000, in accordance with auditing standards generally accepted in the United States. Representatives of Ernst & Young have met with NASD management and with members of the Audit Committee of the Board of Governors with and without management present to discuss the results of their audits and other accounting, auditing and financial matters.

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. The charter gives the Audit Committee responsibility for recommending the appointment of the independent auditors for approval by the Board of Governors and makes clear that the independent auditors are accountable to the Audit Committee and the Board of Governors, as representatives of the members and the public. In all respects, the charter complies with standards applicable to publicly owned companies. In addition, the charter and the By-Laws of NASD make the Director of Internal Audit directly responsible to the Audit Committee and give the Committee exclusive authority to determine the budget of the Internal Audit Department.

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 obtained a written statement from the independent auditors describing all relationships with NASD. The Audit Committee discussed those relationships and satisfied itself that none of the relationships were incompatible with the auditors' independence. The 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 auditors' organization, responsibilities, budget, and staffing.

The Audit Committee also discussed and reviewed with the independent auditors all communications required by generally accepted auditing standards and, with and without management present, discussed the results of the independent auditors' examination of the financial statements. Based on those discussions, the Audit Committee recommended to the Board of Governors that NASD's audited financial statements be included in the annual financial report for the year ended December 31, 2001.

Members of the Audit Committee:

Donald J. Kirk, Chairman

John W. Bachmann

M. LaRae Bakerink

James E. Burton

Sharon P. Smith

REPORT OF INDEPENDENT AUDITORS

Board of Governors

National Association of Securities Dealers, Inc.

We have audited the accompanying consolidated balance sheets of the National Association of Securities Dealers, Inc. as of December 31, 2001 and 2000, 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 auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 the National Association of Securities Dealers, Inc. at December 31, 2001 and 2000, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 3 to the consolidated financial statements, in 2000 the Company changed its method of accounting for certain issuer services revenues.

Ernst + Young LLP

McLean, Virginia
March 29, 2002,
except for note 16, as to which the date is
May 9, 2002

2001 CONSOLIDATED FINANCIAL STATEMENTS

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

CONSOLIDATED BALANCE SHEETS (Dollars in thousands)

	2001	DECEMBER 31,	2000
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 562,086		\$ 574,048
Investments:			
Available-for-sale, at fair value	788,419		517,520
Held-to-maturity, at amortized cost	-		21,968
Receivables, net	279,956		292,968
Deferred tax assets	51,171		26,797
Other current assets	27,802		21,852
Total current assets	1,709,434		1,455,153
 Held-to-maturity investments, at amortized cost	 28,570		 6,612
 Property and equipment:			
Land, buildings and improvements	206,033		202,063
Data processing equipment and software	712,079		571,550
Furniture, equipment and leasehold improvements	365,918		297,700
	1,284,030		1,071,313
Less accumulated depreciation and amortization	(563,710)		(428,082)
Total property and equipment, net	720,320		643,231
 Non-current deferred tax assets	 93,715		 70,228
Other assets	98,705		82,502
 Total assets	 \$ 2,650,744		 \$ 2,257,726

See accompanying notes.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

CONSOLIDATED BALANCE SHEETS (Dollars in thousands)

	DECEMBER 31,	
	2001	2000
LIABILITIES AND MEMBERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 201,919	\$ 278,762
Net SEC fees	91,492	189,285
Accrued personnel costs	122,454	125,314
Deferred revenue	113,232	119,874
Short-term borrowings	-	50,000
Deposits and renewals	58,411	39,141
Capital lease obligation	12,014	8,612
Due to custodial agent	27,910	166
Current deferred taxes	4,582	-
Other current liabilities	65,834	52,775
Total current liabilities	<u>697,848</u>	<u>863,929</u>
Accrued pension costs	31,650	28,765
Long-term debt	288,548	25,000
Accrued other postretirement benefit costs	21,679	21,010
Non-current deferred tax liabilities	68,463	43,875
Non-current capital lease obligation	22,464	11,474
Deferred revenue	134,160	149,310
Warrants to purchase Nasdaq stock from NASD	128,492	68,665
Other liabilities	<u>48,871</u>	<u>35,591</u>
Total liabilities	1,442,175	1,247,619
Minority interests	166,535	141,104
Members' equity	1,054,164	868,952
Unrealized (loss) gain on available-for-sale investments	(6,469)	1,834
Foreign currency translation	(4,700)	(1,783)
Minimum pension liability	(961)	-
Total members' equity	<u>1,042,034</u>	<u>869,003</u>
Total liabilities and members' equity	<u><u>\$ 2,650,744</u></u>	<u><u>\$ 2,257,726</u></u>

See accompanying notes.

2001 CONSOLIDATED FINANCIAL STATEMENTS

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

CONSOLIDATED STATEMENTS OF INCOME (Dollars in thousands)

	YEARS ENDED DECEMBER 31,	
	2001	2000
REVENUES		
Transaction services	\$ 556,115	\$ 519,045
Market information	325,390	353,885
Issuer services	168,703	158,113
Member assessments, net of member rebates of \$17,000 in 2001 and \$7,000 in 2000	132,372	123,680
Regulatory service fees	112,835	101,900
Registration fees	81,412	70,905
Arbitration fees	44,361	36,405
Qualification fees	42,205	49,813
Fines	14,578	11,965
Corporate financing fees	10,198	23,383
Other	50,872	32,590
Total revenues	<u>1,539,041</u>	<u>1,481,684</u>
EXPENSES		
Compensation and benefits	478,052	407,748
Professional and contract services	328,760	324,968
Computer operations and data communications	209,727	173,198
Depreciation and amortization	168,972	112,787
Occupancy	64,996	47,504
Marketing and advertising	39,363	45,855
Publications, supplies and postage	33,177	29,292
Travel, meetings and training	30,187	30,129
Disaster related, net	28,568	-
Other	64,938	56,377
Total expenses	<u>1,446,740</u>	<u>1,227,858</u>
Net operating income	92,301	253,826
OTHER INCOME (EXPENSE)		
Interest income	64,365	57,170
Interest expense	(12,796)	(4,845)
Net realized investment (losses) gains	(12,429)	4,540
Gain on sale of Nasdaq shares by NASD	31,445	2,347
Net (losses) income from equity investees	(4,666)	6,390
Minority interest expense	(4,726)	(5,466)
Income before income taxes and cumulative effect of change in accounting principle	<u>153,494</u>	<u>313,962</u>
Provision for income taxes	(41,495)	(95,077)
Income before cumulative effect of change in accounting principle	111,999	218,885
Cumulative effect of change in accounting principle, net of taxes of \$71,392 (Note 3)	-	(105,292)
NET INCOME	<u>\$ 111,999</u>	<u>\$ 113,593</u>

See accompanying notes.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY (Dollars in thousands)

	MEMBERS' EQUITY	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL
Balance, January 1, 2000	\$ 600,362	\$ 7,431	\$ 607,793
Net income	113,593	-	113,593
Unrealized loss on available-for-sale investments, net of tax of (\$765), net of minority interests of \$62	-	(5,597)	(5,597)
Foreign currency translation, net of minority interests of (\$1,322)	-	(1,783)	(1,783)
Comprehensive income			106,213
Increase in equity attributable to the issuance of Nasdaq stock	136,323	-	136,323
Adjustment to carrying amount of investment in Nasdaq Japan due to its private placement, net of minority interests of \$1,510	6,274	-	6,274
Increase in equity attributable to the formation of Nasdaq Europe Planning Company Limited	12,400	-	12,400
Balance, December 31, 2000	868,952	51	869,003
Net income	111,999	-	111,999
Unrealized loss on available-for-sale investments, net of tax of (\$1,030), net of minority interests of (\$284)	-	(8,302)	(8,302)
Foreign currency translation, net of minority interests of \$2,029 and net of tax of (\$380)	-	(2,918)	(2,918)
Minimum pension liability, net of tax of (\$900), net of minority interests of (\$434)	-	(961)	(961)
Comprehensive income	-	-	99,818
Increase in equity attributable to the issuance of stock by Nasdaq and its subsidiaries	38,998	-	38,998
Increase in equity attributable to Hellman & Friedman transaction	40,535	-	40,535
Decrease in equity attributable to the purchase of minority interests in Nasdaq Europe Planning Company Limited, net of minority interest of \$3,203	(9,197)	-	(9,197)
Increase in equity attributable to amortization of restricted stock awards by Nasdaq, net of minority interest of \$1,238	2,877	-	2,877
Balance, December 31, 2001	\$ 1,054,164	\$ (12,130)	\$ 1,042,034

See accompanying notes.

2001 CONSOLIDATED FINANCIAL STATEMENTS

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Dollars in thousands)

	YEARS ENDED DECEMBER 31,	
	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 111,999	\$ 113,593
Adjustments to reconcile net income to cash provided by operating activities:		
Cumulative effect of change in accounting principle, net of taxes	-	105,292
Depreciation and amortization	168,972	112,787
Gain on sale of Nasdaq shares by NASD	(31,445)	(2,347)
Stock-based compensation	6,883	3,788
Net realized losses (gains) on investments	7,029	(4,540)
Investment impairment charges	5,400	-
Fixed asset impairment charges	8,498	12,789
(Income) losses from equity investees	4,666	(6,390)
Minority interest expense	4,726	5,466
Interest income accretion	(9,436)	(13,732)
Other net non-cash income items	(3,403)	-
Change in operating assets and liabilities, net of effects of acquisitions:		
Receivables, net	13,548	(140,018)
Deferred tax assets	(47,246)	(15,573)
Other current assets	(4,258)	2,211
Other assets	(20,751)	(7,546)
Accounts payable and accrued expenses	(88,978)	123,920
Accrued personnel costs	(3,286)	7,083
Deferred revenue	(21,985)	41,408
Deposits and renewals	19,270	9,742
Due to custodial agent	27,744	-
Other current liabilities	11,078	21,069
Accrued pension and other postretirement costs	820	7,441
Deferred tax liabilities	29,170	17,557
Other liabilities	7,872	10,440
CASH PROVIDED BY OPERATING ACTIVITIES	196,887	404,440
CASH FLOW FROM INVESTING ACTIVITIES		
Proceeds from redemptions of available-for-sale investments	2,932,863	736,840
Purchases of available-for-sale investments	(3,216,726)	(768,231)
Proceeds from maturities of held-to-maturity investments	25,465	10,810
Purchases of held-to-maturity investments	(25,455)	(10,973)
Member equity program payment	-	(15,000)
Net proceeds from the sale of Nasdaq shares by NASD in Phase I and II	53,474	3,459
Net proceeds from the sale of warrants in Nasdaq stock sold by the NASD in Phase I and II	59,827	68,665
Acquisition, net of cash acquired	4,990	(16,979)
Purchases of property and equipment, net	(199,930)	(352,228)
CASH USED IN INVESTING ACTIVITIES	\$ (365,492)	\$ (343,637)

See accompanying notes.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Dollars in thousands)

	YEARS ENDED DECEMBER 31,	
	2001	2000
CASH FLOW FROM FINANCING ACTIVITIES		
Net proceeds from newly issued Nasdaq stock in Phase I and II	\$ 63,688	\$ 253,292
Contributions from minority shareholders in Nasdaq Europe Planning Company Limited	-	30,000
Purchase of minority shareholder interests in Nasdaq Europe Planning Company Limited	(27,361)	-
Net proceeds from the purchase of Nasdaq shares by employees and directors	14,079	-
Proceeds from issuance of debt	251,592	15,000
Debt repayment	(50,000)	-
(Decrease) increase in net SEC fees	(97,793)	75,637
Proceeds from issuance of stock by subsidiaries	16,058	-
Principal payments on capital leases	(13,620)	(1,240)
CASH PROVIDED BY FINANCING ACTIVITIES	156,643	372,689
(Decrease) increase in cash and cash equivalents	(11,962)	433,492
Cash and cash equivalents at beginning of year	574,048	140,556
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 562,086	\$ 574,048

See accompanying notes.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

1. ORGANIZATION AND NATURE OF OPERATIONS

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

NASD oversees the activities of the U.S. broker/dealer profession and regulates Nasdaq and the over-the-counter securities markets. NASDR carries out NASD's regulatory functions, including onsite examinations of member firms, continuous automated surveillance of markets operated by Nasdaq, and disciplinary actions against broker/dealers and their professionals. On July 3, 2000, NASDR spun off its arbitration services into a newly created subsidiary, NASD DR. NASD DR provides arbitration and mediation services to assist in the resolution of disputes between investors and securities firms. NASD Holding holds the Company's interest in Amex. Amex uses a specialist system to operate a floor-based exchange. Nasdaq uses a multiple market maker system to operate an electronic, screen-based equity market. Nasdaq's principal business products are price discovery and trading services, listing of issues, and the sale of related data and information.

At a special meeting of NASD members held on April 14, 2000, more than a majority of NASD members approved a plan to broaden the ownership in Nasdaq through a two-phase private placement of (1) newly issued shares of Nasdaq common stock, and (2) common stock and warrants to purchase shares of Nasdaq common stock owned by NASD (the "Restructuring"), to NASD members, Nasdaq market participants, Nasdaq issuers, institutional investors and other strategic partners. The Restructuring was intended, among other things, to strategically realign the ownership of Nasdaq, minimize potential conflicts of interest between Nasdaq and NASDR and allow Nasdaq to respond to current and future competitive challenges caused by technological advances and the increasing globalization of financial markets.

In connection with Phase I of the Restructuring, (1) NASD separated Amex from The Nasdaq-Amex Market Group ("Market Group"), a holding company which was a subsidiary of NASD; (2) Market Group was then merged with and into Nasdaq; (3) Nasdaq effected a 49,999-for-one stock dividend creating 100 million shares of common stock outstanding (all of which were initially owned by the NASD); (4) Nasdaq authorized the issuance of an additional 30.9 million in new shares to be offered for sale by Nasdaq; and (5) NASD formed a new subsidiary, NASD Holding, to hold NASD's interest in Amex.

Phase I of the Restructuring closed on June 28, 2000, yielding net proceeds to NASD and Nasdaq of approximately \$72.2 million and \$253.3 million, respectively. As of December 31, 2000, NASD owned approximately 81% of Nasdaq. During Phase I of the Restructuring, NASD sold warrants to purchase shares of the common stock of Nasdaq, that if fully exercised, would have decreased NASD's ownership to approximately 60%.

Phase I of the Restructuring consisted of three separate transactions: (1) NASD sold 323,796 NASD-owned common shares of Nasdaq at \$11.00 per share generating net proceeds of \$3.5 million and recorded a gain of \$2.3 million; (2) NASD sold 6,415,349 warrants to purchase an aggregate of 25,661,396 NASD-owned common shares of Nasdaq at \$11.00 per warrant generating net proceeds to NASD of \$68.7 million; and (3) Nasdaq sold 23,663,746 newly issued common shares at \$11.00 per share generating net proceeds to Nasdaq of \$253.3 million. NASD has received a ruling from the Internal Revenue Service stating that the sale of Nasdaq shares and warrants will not result in taxable income to NASD.

Phase II of the Restructuring closed on January 18, 2001, yielding net proceeds to NASD and Nasdaq of approximately \$113.4 million and \$63.7 million, respectively. Phase II of the Restructuring also consisted of three separate transactions: (1) NASD sold 4,219,795 NASD-owned common shares of Nasdaq at \$13.00 per share generating net proceeds of \$53.5 million to NASD and recorded a gain of \$31.4 million; (2) NASD sold 4,391,145 warrants to purchase an aggregate of 17,564,580 NASD-owned common shares of Nasdaq at \$14.00 per warrant generating net proceeds to NASD of \$59.9 million; and (3) Nasdaq sold 5,028,797 newly issued common shares at \$13.00 per share generating net proceeds to Nasdaq of \$63.7 million. After reflecting the repurchase by Nasdaq of 18.5 million shares of its common stock from NASD in May 2001, at December 31, 2001, NASD owned approximately 69% of Nasdaq. Assuming the exercise or conversion of all potentially dilutive securities, NASD's ownership in Nasdaq reduces to approximately 25%.

Each warrant sold by NASD during Phase I and Phase II of the Restructuring entitles the holder to purchase four shares of Nasdaq common stock owned and held by NASD for prices ranging from \$13.00 to \$16.00 per share. Each warrant is exercisable for twelve months in each of four annual tranches, with one share of Nasdaq common stock available for purchase in each tranche. The first annual tranche becomes exercisable on June 28, 2002.

Until Nasdaq's registration as an exchange is approved by the SEC and becomes effective ("Exchange Registration"), the shares of Nasdaq common stock underlying unexercised and unexpired warrant tranches, as well as the shares of Nasdaq common stock purchased through the exercise of warrants, will be voted by a voting trustee at the direction

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

of NASD. Upon Exchange Registration, the warrant holders will have the right to direct the voting trustee as to the voting of the shares of Nasdaq common stock underlying unexercised and unexpired warrant tranches. Additionally, NASD has determined, commencing upon Exchange Registration, to vote its shares of Nasdaq common stock (other than shares underlying then outstanding warrants) in the same proportion as the other common stockholders of Nasdaq. As a result of these conditions, NASD has a controlling interest in Nasdaq until Exchange Registration is effective. As of December 31, 2001, the Exchange Registration has not become effective.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION The consolidated financial statements include the accounts of NASD and its majority owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

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

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. Such investments included in cash and cash equivalents in the consolidated balance sheets totaled \$472.2 million and \$547.8 million at December 31, 2001 and 2000, respectively.

INVESTMENTS Under Statement of Financial Accounting Standards ("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 the 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. 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 securities trades executed prior to the balance sheet date but not yet settled.

The Company periodically reviews its investments to determine whether a decline in fair value below the cost basis is other than temporary. If the decline in the fair value is judged to be other than temporary, the cost basis of the investment is written down to fair value and the amount of the write-down is charged to earnings and a new cost basis for the security is established. In 2001, NASD recorded a charge of approximately \$5.4 million related to declines in the fair value of its investments that were judged to be other than temporary. These write downs are reflected in the net realized investment (losses)/gains line in the consolidated statements of income. In 2000, no investments were identified as having declines in fair value that were other than temporary and no write downs were recorded.

On January 1, 2001, the Company adopted SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS 133, as amended, 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.

The Company places its investment funds with outside investment managers. As of December 31, 2001, the Company's policies with those investment managers do not provide specific authorization to invest in derivative instruments. In addition, the Company periodically reviews its investment portfolio against the provisions of SFAS 133 and 138, to identify any investment products that may have characteristics that qualify the investment as a derivative instrument. The adoption of SFAS 133 in 2001 did not have a significant impact on the Company's operations or financial position as of or for the year ended December 31, 2001.

RECEIVABLES, NET

The Company's receivables are primarily concentrated with NASD members, Amex member firms, market data vendors and Nasdaq issuers. Receivables are shown net of reserves for uncollectable accounts. Reserves are calculated based on the age and source of the underlying receivable and are tied to past collections experience. Total reserves netted against receivables in the consolidated balance sheets were \$19.8 million and \$16.2 million at December 31, 2001 and 2000, respectively.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

CONCENTRATION OF RISK

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

Cash and cash equivalents are maintained principally with financial institutions in the United States which 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 fund managers to manage its investment portfolio and a single custody agent, a domestic company headquartered in New York, to hold and report on those investments. Nasdaq conducts its investment activity through a subsidiary headquartered in Delaware.

The Company is economically dependent on three suppliers to support its operations. Those suppliers provide telecommunications services and information technology services to the Company and support back office functions for Amex trading operations. To the extent that any of these suppliers are 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% of total revenues.

PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost less accumulated depreciation. Equipment acquired under capital leases is recorded at the lower of fair value or the present value of future lease payments. Depreciation and amortization are provided on the straight-line method over estimated useful lives ranging from 10 years to 40 years for buildings and improvements, 2 years to 7 years for data processing equipment and software, and 5 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 related to assets held under capital leases is included in depreciation and amortization expense in the consolidated statements of income. Depreciation and amortization expense for property and equipment totaled \$163.9 million and \$109.2 million for the years ended December 31, 2001 and 2000, respectively.

IMPAIRMENT OF LONG-LIVED ASSETS

In the event that facts and circumstances indicate that long-lived assets or other assets may be impaired, an evaluation of recoverability would be performed. If an evaluation is 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 a write-down is required, the Company would prepare a discounted cash flow analysis to determine the amount of the write-down. During 2001 and 2000, the Company recorded impairment charges of long-lived assets (primarily related to internally developed software) totaling approximately \$8.5 million and \$12.8 million, respectively. These impairment charges were recorded in other operating expenses in the consolidated statements of income.

INVESTMENTS IN AND ADVANCES TO AFFILIATES

The Company carries its various investments in affiliates at cost and under the equity method of accounting depending upon its ability to influence the operation of the affiliate. Investments in and advances to affiliates are included in other assets in the consolidated balance sheets and amount to approximately \$36.2 million and \$30.1 million as of December 31, 2001 and 2000, respectively. See Note 5 for additional information on the Company's significant investments in and advances to affiliates.

NET SEC FEES

NASD and Amex collect a fee based on a percentage of the total dollar value of securities sold in the Nasdaq and Amex markets. These fees are designed to cover costs incurred by the government in the supervision and regulation of securities markets and securities professionals. The Company charges these fees monthly to its members and remits them to the United States Treasury semiannually in March and September. The liability for net SEC fees represents amounts collected from members but not yet remitted to the United States Treasury.

DEFERRED REVENUE

Deferred revenue represents mainly cash received and billed receivables which are unearned until services are provided. Included in deferred revenue are unamortized Initial Listing Fees ("IL") and Listing of Additional Shares Fees ("LAS"). IL fees are recognized over periods ranging from six to seven years and LAS fees are recognized over four years.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

DEPOSITS AND RENEWALS

NASD member firms make deposits into the Company's Central Registration Depository ("CRD") system to pay for services including registration fees charged by states and other self-regulatory organizations. Total CRD deposits included in deposits and renewals in the consolidated balance sheets totaled \$24.4 million and \$21.7 million as of December 31, 2001 and 2000, respectively. CRD renewals included in deposits and renewals in the consolidated balance sheets totaled \$30.3 million and \$14.4 million as of December 31, 2001 and 2000, respectively.

WARRANTS TO PURCHASE NASDAQ STOCK FROM NASD

NASD accounts for the warrants to purchase Nasdaq stock at the amount of the net warrant proceeds received. If and when Nasdaq's shares become publicly traded, the warrants will qualify as a derivative in accordance with the provisions of SFAS 133 and the Company will record the change in the fair value of the warrants in earnings until the warrants expire or are exercised.

ISSUANCE OF SUBSIDIARY STOCK

The Company recognizes gains and losses on issuances of subsidiary stock in members' equity. During 2001, the Company recognized a gain in members' equity totaling \$27.8 million related to Nasdaq's issuance of new shares in connection with Phase II and \$11.2 million related to other issuances of subsidiary stock. During 2000, the Company recognized a gain in members' equity totaling \$136.3 million related to Nasdaq's issuance of new shares in connection with Phase I.

REVENUE RECOGNITION

Market information fees are based on the number of presentation devices in service and quotes delivered through those devices and are recognized in the month that information is provided. These revenues are recorded net of amounts due under revenue sharing arrangements with market participants. Market information services revenue is recognized in the month that information is provided. Transaction service, regulatory service fees, and registration and qualification fees are variable based on service volumes and are recognized as transactions occur. Member assessment fees are recognized evenly over the year to which the fee relates. Initial registration fees for members are recognized once the registration process is completed. Member assessment fees are recognized net of any rebates paid to members. Arbitration fees are recognized as cases are filed and sessions are held. Fines are recognized when the cash is received. Issuer annual listing service revenues are recognized ratably over the following twelve-month period. IL and LAS fees are recognized on a straight-line basis over their estimated service periods (see Note 3 for further discussion).

ADVERTISING COSTS

The Company expenses advertising costs, which include media advertising and production costs, and records the amounts net of costs to be reimbursed from various unit investment trusts for which it sponsors. Advertising costs, as well as the offsetting amounts to be reimbursed, are recorded in the period in which the costs are incurred. Media advertising and production costs included as marketing and advertising in the consolidated statements of income totaled \$18.3 million and \$27.7 million for 2001 and 2000, respectively.

SOFTWARE COSTS

Significant purchased application software, and operational software that is an integral part of computer hardware, are capitalized and amortized on the straight-line method over their estimated useful lives, generally two to five years. All other purchased software is charged to expense as incurred. In accordance with Statement of Position ("SOP") 98-1, 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.

Capitalized software development costs of \$179.8 million and \$104.8 million as of December 31, 2001 and 2000, respectively, are carried in data processing equipment and software in the consolidated balance sheets. Amortization of costs capitalized under SOP 98-1 totaled \$18.4 million and \$6.5 million for 2001 and 2000, respectively, and are included in depreciation and amortization in the consolidated statements of income.

STOCK COMPENSATION

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

INCOME TAXES

NASD, NASDR, and NASD DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). 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.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

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. Translation adjustments resulting from this process are charged or credited to other comprehensive income. Revenue and expenses are translated at average exchange rates during the year. Gains and losses on foreign currency transactions are included in other expenses. Foreign currency translation also includes the translation of gains and losses for non-U.S. equity method investments.

MINORITY INTERESTS

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

CLASSIFICATIONS

Certain amounts for the prior year have been reclassified to conform with the 2001 presentation. The Company has also changed its presentation of the consolidated statement of cash flows from the direct method to the indirect method for all periods presented.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141"), and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets", ("SFAS 142"). SFAS 141 requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting. It also specifies the types of acquired intangible assets that are required to be recognized and reported separately from goodwill. SFAS 142 requires that goodwill and certain intangibles no longer be amortized, but instead tested for impairment at least annually. SFAS 142 is required to be applied starting with fiscal years beginning after December 15, 2001. The Company does not expect the adoption of SFAS 141 and SFAS 142 in fiscal 2002 to have a material impact on the financial statements.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). The provisions of SFAS 144 are effective for fiscal years beginning after December 15, 2001. SFAS 144 addresses the accounting and reporting for the impairment or disposal of certain tangible or intangible long-lived assets. The Company does not expect that the adoption of SFAS 144 in fiscal 2002 will have a material impact on its consolidated financial statements.

3. CHANGE IN ACCOUNTING PRINCIPLE

On August 17, 2001, Nasdaq concluded discussions with the SEC with respect to the implementation in its financial statements of Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements" ("SAB 101"), which became effective for SEC reporting companies in the fourth quarter of 2000. Nasdaq became an SEC public reporting company on June 29, 2001, the effective date of its Registration Statement on Form 10. As a result of their discussions with the SEC, Nasdaq changed its method of accounting for revenue recognition for IL and LAS fees, which are included in issuer services revenues. The Company conformed Amex's accounting for issuer fees to Nasdaq's method.

Although SAB 101 was adopted effective fourth quarter of 2000, the change in accounting principle has been applied as of January 1, 2000. In accordance with applicable accounting guidance prior to SAB 101, the Company recognized revenue for issuer IL fees and LAS fees in the month the listing occurred or in the period additional shares were issued, respectively. The Company now recognizes revenue related to IL fees and LAS fees on a straight-line basis over estimated service periods. Estimated service periods for IL fees range from six to seven years, while LAS fees are recognized over a four year service period.

The Company recognized a one-time cumulative effect of a change in accounting principle as of January 1, 2000. This cumulative effect of a change in accounting principle decreased net income for the year ended December 31, 2000, by \$105.3 million to \$113.6 million. The adjustment to 2000 net income for the cumulative change to prior year's results consists of the following:

Deferred IL fees	\$ 113,095
Deferred LAS fees	63,589
Total deferred fees	<u>176,684</u>
Deferred income tax benefit	<u>(71,392)</u>
Cumulative effect of a change in accounting principle	<u>\$ 105,292</u>

As a result of the change in accounting principle for the year ended December 31, 2000, pro forma net income, assuming the accounting change was applied retroactively, was \$218.9 million.

For the years ended December 31, 2001 and 2000, Nasdaq and Amex recognized an aggregate of \$46.5 million and \$57.3 million in revenue, respectively, that was deferred as part of the cumulative effect adjustment as of January 1, 2000. This revenue contributed \$28.2 million (after income taxes of \$18.3 million) and \$34.2 million (after income taxes of \$23.1 million) to net income for the years ended December 31, 2001 and 2000, respectively.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

Following is a summary of amounts included in the Company's current and non-current deferred revenue as of December 31, 2001, relating to IL and LAS fees, and the years over which those amounts will be recognized:

	IL FEES	LAS FEES	TOTAL FEES
2002	\$ 33,741	\$ 36,388	\$ 70,129
2003	29,101	29,003	58,104
2004	24,375	17,531	41,906
2005	18,059	6,681	24,740
2006 and thereafter	9,410	-	9,410
Total	\$ 114,686	\$ 89,603	\$ 204,289

Following is a summary of activity in the Company's current and non-current deferred revenue for the years ended December 31, 2001 and 2000 relating to IL and LAS fees. The additions reflect the fees charged during the year while the amortization reflects the fees recognized during the year based on the accounting methodology described above.

	IL FEES	LAS FEES	TOTAL FEES
Balance as of January 1, 2001	\$ 136,568	\$ 82,308	\$ 218,876
Additions	15,500	45,546	61,046
Amortization	(37,382)	(38,251)	(75,633)
Balance as of December 31, 2001	\$ 114,686	\$ 89,603	\$ 204,289
	IL FEES	LAS FEES	TOTAL FEES
Balance as of January 1, 2000	\$ 113,095	\$ 63,589	\$ 176,684
Additions	58,560	53,774	112,334
Amortization	(35,087)	(35,055)	(70,142)
Balance as of December 31, 2000	\$ 136,568	\$ 82,308	\$ 218,876

The remainder of issuer service fees primarily relates to issuer annual listing service fees charged by Amex and Nasdaq to listed companies.

4. INVESTMENTS

Investments principally consist of U.S. Treasury securities, obligations of U.S. Government agencies, U.S. corporate debt securities, equity securities and other financial instruments. Following is a summary of investments classified as available-for-sale, which are carried at fair value as of December 31, 2001:

	AMORTIZED COST	GROSS UNREALIZED		FAIR VALUE
		GAIN	LOSS	
U.S. Treasury securities and obligations of U.S. government agencies	\$ 268,593	\$ 2,243	\$ 1,417	\$ 269,419
Obligations of states and political subdivisions	46,142	825	61	46,906
Debt securities issued by foreign governments	3,914	56	-	3,970
Asset-backed securities	54,167	239	163	54,243
U.S. corporate debt securities	126,598	696	1,404	125,890
Other debt securities	29,919	550	479	29,990
Total debt securities	529,333	4,609	3,524	530,418
Mutual funds	92,508	14	3,609	88,913
Equity securities	171,569	7,968	10,449	169,088
Total	<u>\$ 793,410</u>	<u>\$ 12,591</u>	<u>\$ 17,582</u>	<u>\$ 788,419</u>

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

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

As of December 31, 2001, all held-to-maturity investments were U.S. Treasury securities and obligations of U.S. government agencies. The securities had an amortized cost of \$28.6 million and had gross unrealized gains and losses of \$570 thousand and \$31 thousand, respectively. Total estimated fair value of these held-to-maturity investments was \$29.1 million at December 31, 2001.

Following is a summary of investments classified as available-for-sale, which are carried at fair value as of December 31, 2000:

	AMORTIZED COST	GROSS UNREALIZED GAIN LOSS		FAIR VALUE
U.S. Treasury securities and obligations of U.S. government agencies	\$ 123,165	\$ 575	\$ 60	\$ 123,680
Obligations of states and political subdivisions	43,664	55	954	42,765
Asset-backed securities	96,002	293	532	95,763
U.S. corporate debt securities	129,125	87	91	129,121
Other debt securities	647	9	-	656
Total debt securities	392,603	1,019	1,637	391,985
Mutual funds	65,997	-	895	65,102
Equity securities	57,293	5,789	2,649	60,433
Total	\$ 515,893	\$ 6,808	\$ 5,181	\$ 517,520

As of December 31, 2000, all held-to-maturity investments were U.S. Treasury securities and obligations of U.S. government agencies. The securities had an amortized cost of \$28.6 million and had gross unrealized gains and losses of \$46 thousand and \$32 thousand, respectively. Total estimated fair value of these held-to-maturity investments was \$28.6 million as of December 31, 2000.

Following is a summary, by contractual maturity, of investments classified as available-for-sale as of December 31, 2001:

	AMORTIZED COST	GROSS UNREALIZED		FAIR VALUE
		GAIN	LOSS	
Due in one year or less	\$ 114,210	\$ 675	\$ 115	\$ 114,770
Due after one through five years	239,710	2,313	1,575	240,448
Due after five through ten years	67,214	521	996	66,739
Due after ten years	108,199	1,100	838	108,461
Equity securities & mutual funds	264,077	7,982	14,058	258,001
	<u>\$ 793,410</u>	<u>\$ 12,591</u>	<u>\$ 17,582</u>	<u>\$ 788,419</u>

All investments classified as held-to-maturity are carried at amortized cost as of December 31, 2001, and mature between 2003 and 2007.

The net adjustment to unrealized gains (losses) on available-for-sale securities included as a separate component of members' equity due to the sale of securities during 2001 and 2000, which totaled \$3.1 million and \$3.6 million, respectively. The gross realized gains on such sales in 2001 and 2000 totaled \$12.9 million and \$6.2 million, respectively, and the gross realized losses totaled \$19.9 million and \$1.7 million, respectively.

As of December 31, 2001 and 2000, investments with a carrying value of approximately \$28.6 million and \$28.0 million were pledged as collateral for Nasdaq's \$25.0 million note payable.

In connection with the OptiMark, Inc. ("OptiMark") partnership, OptiMark agreed to issue to Nasdaq warrants to purchase up to an aggregate of 11.25 million shares of its common stock, \$0.01 par value per share. The warrants are exercisable in several tranches upon the achievement of certain milestones, which are based primarily upon the average daily share volume of Nasdaq securities traded through the OptiMark Trading System.

In September 2000, OptiMark announced a strategic change in its business that will allow it to focus on providing technology solutions to electronic marketplaces. As part of the change, OptiMark decided to suspend trading operations on the OptiMark System. As a result, Nasdaq management has concluded that its \$33.5 million investment in warrants in OptiMark, as well as the realization of the deferred revenue related to these warrants, was impaired and reduced its investment in warrants and related deferred revenue to zero.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

5. INVESTMENT IN AND ADVANCES TO AFFILIATES AND SUBSIDIARIES

NASDAQ LIFFE MARKETS, LLC

On June 1, 2001, Nasdaq and LIFFE formed Nasdaq LIFFE, a new U.S. joint venture company to list and trade single stock futures. The products of this joint venture are expected to be traded through a modified version of the LIFFE CONNECT™ electronic system. Nasdaq has committed up to \$25.0 million plus the rights to use certain of its trademarks in this venture. Nasdaq contributed \$2.0 million during 2001. On August 21, 2001, the Commodity Futures Trading Commission approved Nasdaq LIFFE as a futures market and self-regulatory organization. Nasdaq accounts for its investment in Nasdaq LIFFE under the equity method of accounting. In 2001, Nasdaq recorded losses of approximately \$6.0 million representing its share of the losses incurred by Nasdaq LIFFE.

NASDAQ JAPAN

In 1999, NASD contributed approximately \$2.6 million for its initial 50.0% interest in Nasdaq Japan. After granting a restricted stock award of 4.0% of its shares, NASD transferred its remaining 46% interest to Nasdaq Global. In October 2000, Nasdaq Japan sold an approximate 15.0% stake for approximately \$48.0 million to a group of 13 major Japanese, U.S. and European brokerages, thereby reducing Nasdaq Global's interest from 46.0% to approximately 39.2%. As a result of the private placement, Nasdaq increased the carrying value of its investment by approximately \$7.8 million, recorded through members' equity, to reflect its adjusted share of the book value of Nasdaq Japan. In 2001, Nasdaq invested an additional \$7.4 million in Nasdaq Japan, increasing its ownership to 39.7%. Nasdaq accounts for its investment in Nasdaq Japan under the equity method of accounting, and recorded losses of \$11.3 million representing its share of the losses incurred by Nasdaq Japan in 2001. Nasdaq has committed to invest up to \$13.0 million in Nasdaq Japan.

A summary of the combined condensed assets, liabilities, and results of operations for Nasdaq LIFFE and Nasdaq Japan for 2001 and Nasdaq Japan for 2000 is provided below:

	2001	DECEMBER 31,	2000
Condensed balance sheet information:			
Current assets	\$ 20,155	\$	29,095
Non-current assets	20,025		7,922
Current liabilities	14,312		9,518
Non-current liabilities	16,352		2,692
	2001	YEARS ENDED DECEMBER 31,	2000
Condensed income statement information:			
Revenue	\$ 1,971	\$	1,144
Expenses	48,464		32,441
Operating loss	(46,493)		(31,297)
Net loss	(47,300)		(31,962)

SECURITIES INDUSTRY AUTOMATION CORPORATION

Amex has a 33% ownership interest in Securities Industry Automation Corporation ("SIAC") and accounts for its ownership in SIAC under the equity method of accounting. Accordingly, Amex recognized \$9.5 million and \$9.0 million in 2001 and 2000, respectively related to its equity method investment in SIAC, and has an investment in and advances to SIAC of \$33.0 million and \$22.8 million at December 31, 2001 and 2000, which is included in other assets in the consolidated balance sheets.

SIAC, which is 67% owned by the New York Stock Exchange, Inc. ("NYSE"), provides clearing and electronic data processing, communications, and systems development services to Amex and NYSE, as well as other unaffiliated customers. Costs charged by SIAC to Amex for these services totaled \$104.4 million and \$87.8 million, in 2001 and 2000, respectively.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

Amex periodically advances funds to SIAC for equipment related to the provision of services to Amex by SIAC. Such advances are applied as a reduction of future invoices from SIAC. Unapplied advances included in investments in and advances to SIAC at December 31, 2001 and 2000 are \$5.0 million and \$4.1 million, respectively.

A summary of the condensed assets, liabilities, and results of operations for SIAC for 2001 and 2000 is provided below:

	2001	DECEMBER 31,	2000
Condensed balance sheet information (unaudited):			
Current assets	\$ 127,286	\$	127,842
Non-current assets	197,018		168,757
Current liabilities	136,318		134,261
Non-current liabilities	103,810		88,049
	2001	YEARS ENDED DECEMBER 31,	2000
Condensed income statement information (unaudited):			
Revenue	\$ 493,868	\$	473,368
Expenses	476,209		448,219
Operating income	17,659		25,149
Net income	10,306		14,802

NASDAQ EUROPE S.A./N.V.

On March 27, 2001, Nasdaq acquired a 68.2% ownership interest in the European Association of Securities Dealers Automated Quotation S.A./N.V., a pan-European market headquartered in Brussels, for approximately \$12.5 million in a purchase transaction. Nasdaq has renamed the company Nasdaq Europe S.A./N.V. ("Nasdaq Europe") and is in the process of restructuring it into a globally linked, pan-European market.

During 2001, Nasdaq Europe consummated a series of transactions that reduced Nasdaq's ownership interest in Nasdaq Europe from 68.2% to approximately 60.0%. As a result of these transactions, the carrying value of these investments was increased by a net \$5.5 million, through members' equity, to reflect the adjusted share of the book value of Nasdaq Europe.

NASDAQ EUROPE PLANNING COMPANY LIMITED

In February 2000, NASD formed a joint venture, Nasdaq Europe Planning, with SOFTBANK Corp. of Japan, Vivendi, and Epartners, whereby each partner contributed \$10.0 million in cash. NASD contributed \$10.0 million cash, licensing of its brand and provided technology expertise and management leadership in exchange for a 56% interest in this venture.

Nasdaq Europe Planning's proposed joint venture did not occur due to a strategic decision to employ a strategy for European expansion that did not include this venture, i.e., the acquisition of a controlling interest of the European Association of Securities Dealers Automated Quotation S.A./N.V. in March 2001. As a result, Nasdaq agreed to repurchase the ownership interests of the three other shareholders in Nasdaq Europe Planning for \$10.0 million each, thereby unwinding the joint venture. Repurchases from two of the shareholders, for a total of \$20.0 million, were completed in the first quarter of 2001. The repurchase from the third shareholder was completed in the fourth quarter of 2001 for aggregate consideration estimated at \$10.0 million, comprised of cash of \$7.4 million, a warrant to purchase up to 479,648 shares of Nasdaq Common Stock, and 7,211 shares of Nasdaq Europe. As of December 31, 2001, Nasdaq owned 100% of Nasdaq Europe Planning. The repurchases during 2001 resulted in a net decrease of \$9.2 million to members' equity.

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company considers cash and cash equivalents, receivables, investments, accounts payable and accrued expenses, due to custodial agent, and short- and long-term borrowings to be its financial instruments. The carrying amounts reported in the balance sheets for cash and cash equivalents, receivables, investments, accounts payable and accrued expenses, due to custodial agent, and short-term borrowings equal or closely approximate their fair values due to the short-term nature of these assets and liabilities. The approximate fair value of Nasdaq's long-term borrowings was estimated using a discounted cash flow analysis, based on Nasdaq's assumed incremental borrowing rates for similar types of borrowing arrangements. This analysis indicates that the fair value of Nasdaq's long-term debt at December 31, 2001 and 2000, approximates its carrying amount.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

7. SHORT AND LONG-TERM BORROWINGS

SENIOR NOTES

Nasdaq has a \$25.0 million note payable (the "Note") with a U.S. financial institution (the "Lender"), which has been outstanding since May 1997. Principal payments are scheduled to begin in 2007 and continue in equal monthly installments until maturity in 2012. The Note requires monthly interest payments at a rate of 7.41% through May 2007. After May 2007, the Company will incur interest equal to the Lender's cost of funds rate, as defined in the agreement, plus 0.5%. Interest expensed and paid under the Note totaled approximately \$1.9 million for each of the years ended December 31, 2001 and 2000.

Nasdaq Europe has \$23.5 million of notes payable outstanding as of December 31, 2001. These notes are denominated in Euros, and mature in 2003 and 2004 or within five days of default of any loan covenant. Nasdaq Europe incurs interest expense at a rate of 6% on approximately \$3.7 million of the notes, and London Inter-Bank Offered Rate plus 1% on the remaining \$19.8 million of the notes. Interest expensed and accrued totaled approximately \$0.8 million for the year ended December 31, 2001.

SUBORDINATED NOTES

On May 3, 2001, Nasdaq issued and sold \$240.0 million in aggregate principal amount of its 4% convertible subordinated debentures due 2006 (the "Subordinated Notes") to Hellman & Friedman Capital Partners IV, L.P. and certain of its affiliated limited partnerships (collectively, "Hellman & Friedman"). The annual 4% coupon is payable in arrears and the Subordinated Notes are convertible at any time into an aggregate of 12.0 million shares of Nasdaq common stock at \$20.00 per share, subject to adjustment, in general, for any stock split, dividend, combination, recapitalization or other similar event. Until Nasdaq becomes registered with the SEC as a national securities exchange ("Exchange Registration"), Hellman & Friedman may only exercise its conversion rights for a number of shares of common stock such that immediately following such conversion, NASD will continue to control greater than 50% of the combined voting power of Nasdaq.

Nasdaq used the proceeds from the sale of the Subordinated Notes to purchase 18,461,538 shares of common stock from NASD for \$13.00 per share. These shares were placed into treasury by Nasdaq. Subsequent to the treasury stock purchase by Nasdaq, NASD's ownership of Nasdaq was reduced to approximately 69% as of December 31, 2001.

While the result of this transaction was to decrease NASD's percentage ownership interest of Nasdaq common stock with a corresponding increase in the minority interest ownership percentage, the aggregate dollar value of Nasdaq equity attributable to the minority interest was reduced by \$40.5 million. This reduction in minority interest is presented as an increase in NASD's members' equity in the accompanying consolidated financial statements.

Holders of the Subordinated Notes currently have no voting rights. However, Nasdaq has agreed to use its best efforts to seek stockholder approval of an amendment to Nasdaq's Restated Certificate of Incorporation (the "Certificate of Incorporation") that would provide for voting debt in order to permit the holders of the Subordinated Notes to vote on an as-converted basis on all matters on which holders of common stock have the right to vote, subject to the current 5.0% voting limitation in the Certificate of Incorporation. In addition, the SEC has approved this proposed charter amendment. Nasdaq has granted Hellman & Friedman certain registration rights with respect to the shares of common stock underlying the Subordinated Notes.

On an as-converted basis, Hellman & Friedman owned an approximate 9.7% equity interest as a result of these Subordinated Notes in Nasdaq as of December 31, 2001. Hellman & Friedman is permitted to designate one person reasonably acceptable to Nasdaq for nomination as a director of Nasdaq for so long as Hellman & Friedman owns Subordinated Notes and/or shares of common stock issued upon conversion thereof representing at least 50% of the shares of common stock issuable upon conversion of the Subordinated Notes initially purchased.

LINE OF CREDIT

In September 1999, NASD entered into an unsecured line of credit agreement (the "Agreement") with the Lender. Under the Agreement, the Company has the ability to borrow up to \$50.0 million at LIBOR plus 0.3% (2.4% and 7.08% as of December 31, 2001 and 2000, respectively). Proceeds received related to borrowings under the Agreement were used to fund operating costs. As of December 31, 2000, NASD had \$50.0 million in outstanding borrowings under the Agreement. This line of credit was paid in full in January 2001 within the terms of the Agreement. No amounts are outstanding under this line of credit at December 31, 2001. The Agreement terminates on October 31, 2002. Interest capitalized and expensed under the Agreement in 2001 was not significant. Interest capitalized and expensed under the Agreement totaled \$2.1 million and \$1.5 million in 2000, respectively.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

8. INCOME TAXES

The income tax provision includes the following amounts:

	YEARS ENDED DECEMBER 31,	
	2001	2000
Current income taxes:		
Federal	\$ 50,625	\$ 77,700
State	10,885	14,782
Total current income taxes	61,510	92,482
Deferred income taxes:		
Federal	(19,618)	2,077
State	(397)	518
Total deferred income taxes	(20,015)	2,595
Provision for income taxes before		
cumulative effect of change in accounting principle	41,495	95,077
Less: deferred tax benefit attributable to		
cumulative effect of change in accounting principle	-	(71,392)
Total provision for income taxes	\$ 41,495	\$ 23,685

Reconciliations of the statutory United States federal income tax rates to the effective tax rates for the Company's taxable entities are as follows:

	YEARS ENDED DECEMBER 31,	
	2001	2000
Federal	35.0%	35.0%
State	6.3	3.8
Foreign losses without U.S. benefit	15.3	2.8
Tax preferred investments	(6.7)	-
State temporary differences at a lower rate	1.8	-
Other, net	(0.9)	0.6
Effective rate	50.8%	42.2%

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

	YEARS ENDED DECEMBER 31,	
	2001	2000
Domestic	\$ 117,509	\$ 243,869
Foreign	(35,845)	(18,774)
Income before income tax expense	<u>\$ 81,664</u>	<u>\$ 225,095</u>

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

	DECEMBER 31,	
	2001	2000
Deferred tax assets:		
Deferred fees	\$ 78,328	\$ 82,600
Foreign net operating losses	31,318	5,043
Net operating loss carryforwards	18,728	3,401
Technology costs	11,765	1,499
Expense accruals	8,242	-
Lease reserve	7,691	-
Deferred capital loss carryforward	6,078	6,078
Bad debts	5,903	5,139
Compensation and benefits	5,133	1,592
Joint ventures	4,754	-
Other	4,342	2,794
Total deferred tax assets	<u>182,282</u>	<u>108,146</u>
Deferred tax liabilities:		
Depreciation	(10,648)	(12,492)
Software development costs	(29,025)	(19,624)
Investment in Amex, LLC	(31,064)	(11,759)
Other	(2,308)	-
Total deferred tax liabilities	<u>(73,045)</u>	<u>(43,875)</u>
Net deferred tax assets, before valuation allowance	109,237	64,271
Valuation allowance	(37,396)	(11,121)
Net deferred tax assets	<u>\$ 71,841</u>	<u>\$ 53,150</u>

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

The deferred tax liability relating to the Company's investment in Amex, LLC arises primarily from Amex, LLC's different treatment for book and tax purposes of software cost, depreciation, equity method investments and other expense-related accruals.

Nasdaq has deferred tax assets related to a deferred capital loss carryforward of \$6.1 million at December 31, 2001 and 2000. Since it is uncertain whether such loss will be realized, a valuation allowance for the full amount of this deferred tax asset has been recorded.

Nasdaq has foreign deferred tax assets of \$31.3 million and \$5.0 million, as of December 31, 2001 and 2000, respectively. The foreign deferred tax assets are composed of net operating losses, of which \$3.6 million expire in 2007, \$4.1 million expire in 2008 and \$23.6 million have no expiration date. The foreign deferred tax assets have been fully reserved by an offsetting valuation allowance as it is not "more likely than not" that these deferred tax assets will be realized. In addition, NASD Holding has approximately \$41.6 million of net operating loss carryforwards which begin expiring in 2020.

9. EMPLOYEE BENEFITS

As of December 31, 2001, the Company provides two non-contributory defined benefit pension plans and one non-contributory postretirement benefit plan for the benefit of eligible employees of its subsidiaries. The non-contributory defined benefit plans consist of a funded Employee Retirement Plan ("ERP") and an unfunded Supplemental Executive Retirement Plan ("SERP"). The benefits are primarily based on years of service and the employees' average salary during the highest 60 consecutive months of employment. The plan assets consist primarily of fixed income and equity securities.

The unfunded postretirement plan provides medical and life insurance benefits to retirees and eligible dependents. Employees become eligible for these benefits if they meet minimum age and service requirements and are eligible for retirement benefits.

In 2000, NASD maintained separate defined benefit pension plans and a separate postretirement benefit plan for employees of its Amex subsidiary from that maintained for employees of all of its other majority-owned subsidiaries. On January 1, 2001, Amex's defined benefit pension plans and postretirement plan were merged into NASD's plans, and as a result, Amex employees now receive the same future benefits as NASD employees.

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

	PENSION BENEFITS		OTHER POSTRETIREMENT BENEFITS	
	2001	2000	2001	2000
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	\$ 201,683	\$ 164,114	\$ 17,157	\$ 20,655
Service cost	17,851	13,779	213	338
Interest cost	14,987	13,051	1,407	1,331
Amendments	2,857	1,864	20	(4,879)
Actuarial losses	25	9,424	1,210	250
Benefits paid	(16,631)	(11,151)	(822)	(538)
Curtailment/settlement (gain) loss	(1,301)	-	-	-
Loss due to change in discount rate	5,880	10,602	620	-
Other benefits/changes	760	-	689	-
Benefit obligation at end of year	<u>\$ 226,111</u>	<u>\$ 201,683</u>	<u>\$ 20,494</u>	<u>\$ 17,157</u>
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	\$ 180,452	\$ 176,509	\$ -	\$ -
Actual return on plan assets	2,827	6,822	-	-
Company contributions	11,905	8,053	822	538
Participant contributions	19	219	-	-
Benefits paid	(16,631)	(11,151)	(822)	(538)
Fair value of plan assets at end of year	<u>178,572</u>	<u>180,452</u>	<u>-</u>	<u>-</u>
Funded status of the plan (underfunded)	<u>(47,539)</u>	<u>(21,231)</u>	<u>\$ (20,494)</u>	<u>\$ (17,157)</u>
Unrecognized net actuarial loss (gain)	40,601	23,447	874	(969)
Unrecognized prior service cost	4,740	2,706	(2,711)	(2,884)
Unrecognized transition obligation/(asset)	(1,275)	(1,500)	652	-
Amount recognized to reflect minimum liability	<u>(3,425)</u>	<u>-</u>	<u>-</u>	<u>-</u>
(Accrued) prepaid benefit cost	<u>\$ (6,898)</u>	<u>\$ 3,422</u>	<u>\$ (21,679)</u>	<u>\$ (21,010)</u>
Purchase price adjustment	<u>(29,096)</u>	<u>(30,018)</u>	<u>-</u>	<u>-</u>
Net accrued benefit cost recorded in the consolidated balance sheets	<u>\$ (35,994)</u>	<u>\$ (26,596)</u>	<u>\$ (21,679)</u>	<u>\$ (21,010)</u>

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

The purchase price adjustment line in the table above relates to the acquisition of Amex in 1998 and represents a component of the allocation of fair value in excess of consideration given. Changes in this adjustment represent adjustments to the purchase price allocation associated with additional contingent consideration provided.

The net accrued pension cost as of December 31, 2001, and net prepaid benefit cost as of December 31, 2000, as reflected above, consists of a net prepaid benefit from Amex's overfunded ERP, offset by the accrued benefit cost from the remaining underfunded ERP plans on all other NASD majority-owned companies, as well as the accrued benefit cost from all companies, unfunded SERP's (including Amex). As of December 31, 2001, although Amex's and NASD's plan assets were not commingled with the merger of the plans in 2001, \$11.5 million in net assets related to the former Amex ERP plan have been netted with the accrued benefit costs from all other plans in the accrued pension cost line in the consolidated balance sheets.

The components of the net (accrued) prepaid benefit cost for the Company's defined benefit pension plans as of December 31, 2001 and 2000, along with the location of these amounts in the consolidated balance sheets, were as follows:

	DECEMBER 31,	
	2001	2000
ERP – Amex (included in other long-term assets)	N/A	\$ 9,828
ERP – NASD current (included in accrued personnel costs)	\$ (4,344)	(7,659)
ERP – NASD non-current (included in accrued pension costs)	(8,741)	(12,362)
SERP – All NASD & Amex (included in accrued pension costs)	(22,909)	(16,403)
Net (accrued) prepaid benefit costs	\$ (35,994)	\$ (26,596)

The Company's other postretirement benefit liability is disclosed separately in the consolidated balance sheets.

As of December 31, 2001 and 2000, the following is the funded status of each of NASD's defined benefit pension plans:

	2001	DECEMBER 31,	2000
ERP – AMEX			
Projected benefit obligations	N/A		\$ 54,213
Accumulated benefit obligations	N/A		45,124
Fair value of plan assets	N/A		79,709
ERP – NASD			
Projected benefit obligations	\$ 197,487		\$ 122,306
Accumulated benefit obligations	131,009		71,549
Fair value of plan assets	178,572		100,743
SERP – ALL NASD & AMEX			
Projected benefit obligations	\$ 28,624		\$ 25,164
Accumulated benefit obligations	22,393		19,218
Fair value of plan assets	-		-

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

Pursuant to the provisions of SFAS No. 87 "Employer's Accounting for Pensions" ("SFAS 87"), related to the SERP, an intangible asset of \$1.0 million and a net adjustment to members' equity of \$1.0 million, were recorded as of December 31, 2001, to recognize a minimum pension liability.

	PENSION BENEFITS		OTHER POSTRETIREMENT BENEFITS	
	2001	2000	2001	2000
WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31:				
Discount rate	7.25%	7.5%	7.25%	7.5%
Expected return on plan assets	9.0	9.0	-	-
Rate of increase (compensation or health care cost)	5.3	5.3	5.5	5.0

	PENSION BENEFITS		OTHER POSTRETIREMENT BENEFITS	
	2001	2000	2001	2000
COMPONENTS OF NET PERIODIC BENEFIT COST, YEARS ENDED DECEMBER 31:				
Service cost	\$ 17,851	\$ 13,779	\$ 213	\$ 338
Interest cost	14,987	13,051	1,407	1,331
Expected return on plan assets	(15,664)	(15,896)	-	-
Amortization of unrecognized transition asset	(225)	(225)	38	-
Recognized net actuarial (gains) losses	267	179	(14)	(36)
Prior service cost (income) recognized	808	2,021	(153)	(189)
Curtailment/settlement loss (gain) recognized	16	1,296	-	(1,806)
Other benefits/changes	760	-	-	-
Benefit cost (income)	\$ 18,800	\$ 14,205	\$ 1,491	\$ (362)

The assumptions for the annual increase in the composite health care cost trend rate are 8% for 2001 and 2000. The health care cost trend rate for 2001 was assumed to decrease gradually to an estimated annual increase of 5% in the year 2007 and thereafter.

The assumed health care cost trend rate has a significant effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	<u>DECEMBER 31, 2001</u>
Effect of a one-percentage-point increase	
Year-end benefit obligation	\$ 2,185
Total service costs and interest components	171
	<u>DECEMBER 31, 2001</u>
Effect of a one-percentage-point decrease	
Year-end benefit obligation	\$ (1,817)
Total service costs and interest components	(143)

The Company also maintains a voluntary savings plan 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% of the first 4% of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from the Company. Savings plan expense for 2001 and 2000 was \$13.3 million and \$10.7 million, respectively. The expense included a discretionary match totaling \$3.1 million for 2001 and \$3.5 million for 2000.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

10. NASDAQ STOCK COMPENSATION, STOCK AWARDS AND CAPITAL STOCK

Effective December 5, 2000, as amended on February 14, 2001, Nasdaq adopted The Nasdaq Stock Market, Inc. Equity Incentive Plan (the "Plan"), under which nonqualified and incentive stock options, restricted stock, restricted stock units, or other stock-based awards may be granted to Nasdaq employees, directors, officers and consultants. A total of 20,000,000 shares of Nasdaq stock are authorized under the plan. At December 31, 2001, 9,779,863 were available for future grants under the Plan.

In 2001, Nasdaq granted 10,795,223 stock options and 630,550 shares of restricted stock to employees and officers pursuant to the Plan. During 2001, 1,169,636 stock options and 36,000 shares of restricted stock awards were forfeited.

Restricted stock awards are awarded in the name of the employee or officer at fair value on the date of the grant. The awards contain restrictions on sales and transfers, are subject to a five-year vesting period, and are expensed over the vesting period. Nasdaq recognized \$4.1 million in compensation expense related to restricted stock during the year ended December 31, 2001.

Stock options are granted with an exercise price equal to the estimated fair market value of the stock on the date of the grant. Nasdaq accounts for stock option grants in accordance with APB 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. All options to date have been granted at fair market value on the date of grant. At December 31, 2001, options for 3,597,430 shares were vested, and exercisable with a weighted-average exercise price of \$12.73.

Stock option activity during the year ended December 31, 2001, is set forth below:

	SHARES	PRICE PER SHARE	
		RANGE	WEIGHTED AVERAGE
Balance, January 1, 2001	-	-	-
Granted	10,795,223	\$ 10.25-13.00	\$ 12.73
Exercised	-	-	
Forfeited	(1,169,636)	10.25-13.00	12.98
Balance, December 31, 2001	9,625,587	\$ 10.25-13.00	\$ 12.70

Unaudited pro forma information regarding net income is required under SFAS No. 123, "Accounting for Stock-Based Compensation," and has been determined as if Nasdaq had accounted for all stock option grants based on the fair value method. The effect of applying SFAS 123 on pro forma net income is not necessarily representative of the effects on reported net income for future years due to, among other things, the changes in fair value of additional stock options in future years. 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%, dividend yield of 0%, and a weighted-average risk free interest rate of 4.68%. The weighted-average fair value of options granted in 2001 was \$4.55. For purposes of the unaudited pro forma information, the fair value of stock option grants are amortized over the vesting period. The unaudited pro forma net income for the year ended December 31, 2001, was \$100.8 million.

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% of the lower of the fair market value on the first or the last day of each Offering Period. Employees may purchase shares having a value not exceeding 10% of their annual compensation, subject to applicable annual Internal Revenue Service ("IRS") limitations. During 2001, employees purchased 326,580 shares at an average price of \$10.63 per share.

In May and July 2000, restricted common stock and options on common stock of Nasdaq Japan were awarded to certain Nasdaq officers and key employees who devote substantial time to the operations of Nasdaq Japan. These awards contain restrictions and are subject to vesting provisions, generally three years. The options were granted at an exercise price of \$125 per share, the estimated fair market value of the common stock at the time of the award. The options are exercisable for a period of seven years and are subject to vesting provisions, generally three years. As of December 31, 2001, there were 784 stock options outstanding to purchase shares of Nasdaq Japan held by Nasdaq Global, 261 of them exercisable with an approximate value of \$6,175 per share. The restricted common stock awards was for 1,900 shares at the estimated fair value of \$125 per share. Approximately one-third of the shares vested immediately while the remaining two-thirds vest over a two-year period. As of December 31, 2001, the restricted common stock had an approximate value of \$6,250 per share. All share and dollar amounts reflect a four-for-one stock split of Nasdaq Japan shares in April 2001.

The options and restricted common stock awards, described in the preceding paragraph, are marked-to-market and the fair value is being expensed over the vesting periods. Nasdaq recorded approximately \$2.8 million and \$3.8 million in compensation expense related to these awards in 2001 and 2000, respectively. Such expense was reflected as an adjustment to the carrying value of the Company's investment in Nasdaq Japan.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

In connection with the repurchase of ownership interest of a shareholder in Nasdaq Europe Planning, Nasdaq issued a warrant to purchase up to an aggregate of 479,648 shares of Common Stock. The warrant is exercisable in four annual tranches ranging from \$13.00 to \$16.00 per share. The issuance of the warrants were recorded at their fair value in members' equity.

On November 12, 2001, Nasdaq sold an aggregate amount of 535,000 shares of its common stock to five members of the Nasdaq Board of Directors and 500,000 shares of its common stock to Hellman & Friedman for an aggregate offering price of \$10.6 million. The shares were sold in a private transaction at the current fair market value, pursuant to section 4(2) of the Securities Act.

11. LEASES

The Company leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was \$39.5 million in 2001 and \$28.7 million in 2000.

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, 2001:

YEAR ENDING DECEMBER 31,

2002	\$	31,467
2003		31,799
2004		31,321
2005		29,997
2006		28,898
Remaining years		231,408
Total minimum lease payments	\$	384,890

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, 2001:

YEAR ENDING DECEMBER 31,

2002	\$ 14,491
2003	12,847
2004	8,163
2005	2,952
2006 and thereafter	-
	38,453
Less: imputed interest	(3,975)
Total minimum lease payments	\$ 34,478

The Company entered into capital leases, extended the terms of existing leases, or assumed through the acquisition, leases that had an initial recorded value totaling \$28.0 million and \$21.3 million for the years ended December 31, 2001 and 2000, respectively.

12. COMMITMENTS AND CONTINGENCIES

In November 1997, Nasdaq entered into a \$600.0 million six-year agreement with WorldCom to replace the existing data network that connects the Nasdaq market facilities to market participants. The contract contains a series of market participant usage-related guarantees. Nasdaq paid a deposit of \$8.0 million related to the agreement. Nasdaq has guaranteed WorldCom that the market participants will generate a minimum of \$300.0 million in usage under the contract from inception through November 2003. Under the contract, the deposit is refundable if certain service usage is achieved. Due to the renegotiation of the current contract, Nasdaq will not generate the minimum level of service usage under the contract, and will not be refunded its deposit. As of December 31, 2001, the deposit has been fully reserved, based on projected usage under the contract. The new contract for WorldCom services will provide for a more efficient and cost-effective network, under more favorable terms.

Nasdaq has a loan commitment to Nasdaq Japan for \$5.0 million, of which \$2.8 million was loaned in 2001, and the remainder is expected to be loaned in 2002. Nasdaq has also made \$2.0 million of capital contributions to Nasdaq LIFFE joint venture in 2001. Other contributions are expected to be made to Nasdaq LIFFE in 2002, up to the approved \$25.0 million.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

In March 2000, Nasdaq entered into an agreement with Primex Trading N.A., LLC ("Primex") in which the Primex Auction System™ would be operated as a facility of The Nasdaq Stock Market for the trading of Nasdaq and exchange listed securities. Under the agreement, Nasdaq is required to pay Primex a monthly licensing fee as well as a transaction fee for each trade executed in the Primex Auction System™ which will commence in 2002.

The transaction agreement entered into by the NASD related to the acquisition of Amex included a Member Equity Program (the "Program") to support the value of Amex members' seats. On October 30, 1998, the closing date, the NASD committed \$30.0 million to support seat prices with an additional \$10.0 million commitment effective on January 1, 1999. This fund can grow without a cap through buying, selling and leasing seats as well as a 5.0% return on the account.

Under the Program, an elected Seat Committee monitors the effectiveness of the Program at 18 months and 60 months from the acquisition date. At the time of the reviews, the Seat Committee determines, subject to a majority vote of the Amex members, the disbursement of portions of the initial commitment amount in one of the following ways: to owners of membership interests in Amex; as a reduction of Amex Exchange fees; and/or for investments in technology. Additionally, the Seat Committee may elect a roll-over option under which it would not disburse funds until the next review date. After five years, the undistributed amount will be eligible for distribution to the Amex members, reduction of Amex fees or investments in technology as determined by a membership vote. Every two years after that, the remainder will be eligible for distribution in the same manner until the commitment has been fully paid. The commitment will be funded from operations of NASD.

As of December 31, 2001, no seats were purchased by the NASD under the Program. At the time of the 18-month review in June 2000, the Seat Committee recommended, and the members approved a disbursement of \$15.0 million to the Amex membership. This \$15.0 million distribution was funded by a capital contribution from NASD to Amex with Amex making the subsequent payments to the Amex membership. As of December 31, 2001, \$25.0 million remains outstanding under this commitment.

In connection with the acquisition of Amex, the Company recognized restructuring accruals of approximately \$23.0 million related to estimated severance, retention and outplacement costs for employees to be terminated. Payments towards this accrual continued into 2001. At December 31, 2001, \$3.5 million of the acquisition accrual remained. Since all anticipated costs had been incurred at that date, this amount was reversed and has been recorded as a reduction of compensation expense in the consolidated statements of income in 2001.

Also, as a condition of the acquisition, a Member Supplement Fund was established under which annual distributions may be made by NASD based upon 15.0% of the amount, if any, that the net income of Amex exceeds established thresholds for the years 1999 through 2008. Funds will be distributed to owners of membership interests in Amex or used to pay for investments in technology as determined by a Member Supplement Fund Committee. No payments were required to be made for 2001 and 2000 under the Member Supplement Fund formula.

Any contingency payments to members made under the Member Equity Program or the Member Supplement Fund are accounted for as contingent consideration through an adjustment of the original purchase price allocation.

NASD and Amex also entered into a Technology Transfer and Development Agreement (the "Technology Agreement") whereby \$110.0 million was committed to be disbursed over the five years subsequent to the acquisition for the purpose of operating and upgrading Amex's trading market and administrative systems. To the extent that Amex's revenues are not sufficient to fund this \$110.0 million program as scheduled, NASD will spend or make available the difference through capital contributions, loans, or guarantees of loans. Management believes that this commitment has been fully met as of December 31, 2001.

At December 31, 2001, the rights to trade on Amex LLC were embodied through The American Stock Exchange, Inc. ("Amex Corp") in the 864 memberships (the "Members"). In accordance with the Limited Liability Company Agreement of Amex LLC, in the event of liquidation of Amex LLC, Amex Corp is entitled to receive a distribution from Amex LLC in an amount not to exceed approximately \$140.0 million. Amex Corp would distribute such amount to the Members as follows: (1) each existing regular member shall receive an equal distribution up to \$26 thousand; (2) each options principal member shall then receive an equal distribution up to \$15 thousand; (3) the remainder shall then be distributed in a manner such that each regular member will receive from such remaining assets two times the amount distributed to each options principal member.

In September 2000, Amex entered into a stipulation with the Department of Justice pursuant to which a decree was entered and an offer of settlement pursuant to which the SEC entered an order which, together, resolved investigations into options listing activity at Amex and other exchanges. Contemporaneous to these investigations, class action lawsuits were filed against Amex, other exchanges, and others. Amex entered into an agreement to settle these class action lawsuits in August 2000, with one-third of the total agreed upon settlement amount paid in August 2000, one-third paid in June 2001, and the remaining one-third to be paid in July 2002. Amex accrued for the remaining settlement payments in 2000 with the signing of the settlement agreement. The exact amount of Amex's settlement is confidential. The settlement is subject to the approval of the court, which declined to grant such approval for jurisdictional reasons in April 2001. That decision is currently on appeal.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

In 1999, Amex entered into an agreement with the trustee of certain unit investment trusts, whereby Amex was compensated for providing certain administrative services to the trusts. Revenues recorded under this agreement aggregated \$1.4 million and \$1.1 million in 2000 and 1999, respectively. In 2001, upon additional reviews of the original agreements, Amex made the decision that the collection of these fees potentially creates the appearance of conflict with the types of fees allowed for in the trust documentation filed with the SEC. Accordingly, Amex agreed to refund all amounts previously collected to the trustee in 2001. In connection with this refund, Amex recognized a \$2.5 million charge to earnings in 2001, which has been recorded as a reduction to other revenue in the consolidated statements of income.

From the \$72.2 million in net proceeds NASD received for the sale of warrants and shares of Nasdaq common stock in Phase I, NASD established a \$25.0 million earmark for the benefit of Amex to support Amex business operations and meet NASD's obligations to Amex arising out of its acquisition of Amex. In October 2000, NASD funded this \$25.0 million to Amex in the form of a capital contribution. Additionally, from the Phase I proceeds, NASD established a \$25.0 million earmark for the benefit of NASDR to fund membership fee reductions. Approximately \$7.0 million in member fee credits were given to NASD members in 2001 and 2000, respectively. In addition, during 2001, NASD paid a discretionary reduction of member assessments totaling \$10.0 million. Future cumulative fee reductions are expected to be \$100.0 million through 2006. NASD established additional earmarks of \$25.0 million each to Amex and NASDR from the \$113.4 million in net proceeds from Phase II. In May 2001, NASD funded \$15.0 million under the Amex earmark in the form of a capital contribution. Additionally, NASD will establish additional earmarks from the proceeds received upon exercise of the warrants.

SIAC, an affiliated company, has a lease agreement for a data processing site. SIAC's performance under the terms of the lease, which has a remaining obligation of approximately \$58.6 million over the next four years, has been guaranteed by the NYSE as majority owner of SIAC. Amex has agreed to indemnify the NYSE for a portion of losses, if any, sustained by the NYSE in the event of a default by SIAC. The Amex's share of potential losses (approximately \$11.7 million, or 20%, at December 31, 2001) is based upon its utilization of SIAC services for the preceding three years, and is adjusted annually. Amex has not made any payments under this indemnification agreement to date.

On June 1, 1999, NASD finalized a ten-year agreement with EDS Corporation (the "EDS Agreement") to establish an alliance, NasTech, through which EDS provides technology services to NASD and NASDR. NASD has an obligation to pay to EDS a minimum of \$51.2 million each year under the term of the EDS Agreement except for 2009 which will be prorated through the ending date of the EDS Agreement on May 31, 2009. Additionally, in the event that NASD terminates the EDS Agreement for convenience, it is subject to a termination fee to EDS. The termination fee is based upon a formula which considers total EDS billings and profit through the date of termination and remaining minimum payments after the date of termination. If the EDS Agreement was terminated effective December 31, 2001, NASD would have been obligated to pay EDS a termination fee estimated at \$85.6 million. NASD has advanced EDS \$28.6 million as of December 31, 2001, which is included in other long-term assets in the consolidated balance sheet, which will be used to satisfy obligations under the EDS Agreement during the years ended December 31, 2005 through 2009.

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. In 2001, the Company recognized a benefit of \$1.1 million in real estate tax abatement and \$1.2 million sales tax abatement under this agreement.

The Company may be subject to claims arising out of the conduct of its business. Currently, there are certain legal proceedings pending against the Company. Management believes, based upon the opinion of counsel, that 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.

13. DISASTER-RELATED EXPENSES

Due to the attacks on September 11, 2001, NASD's New York headquarters at One Liberty Plaza and Amex's principal business locations at 86 Trinity and 22 Thames were damaged and overall business operations halted. Additionally, while no damages were incurred at the leased facility at 65 Broadway, access to that facility was restricted. In connection with these events, certain non-budgeted expenditures were incurred related to repairs, clean-up activities, and other efforts to restore service to these buildings; these expenses totaled \$8.2 million. These expenses and all other September 11 related expenses and recoveries have been reflected as "disaster related" expenses in the consolidated statement of income for the year ended December 31, 2001.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

NASD and its subsidiaries are covered for these events under NASD's property/business interruption insurance policy. Based on correspondence with NASD's insurance company indicating an approved prepayment of claim expenses, Amex recorded a \$2.8 million receivable and reduction in disaster-related costs in 2001.

In addition, Nasdaq's executive offices in New York City were temporarily closed and its New York-based employees relocated. Also, as a result of the attacks, Nasdaq decided to abandon its office space at One Liberty Plaza, which was adjacent to the site where the World Trade Towers stood, and move its employees nearer to its Times Square MarketSite building. Employees returned to One Liberty Plaza on a temporary basis in the first quarter of 2002, and are expected to relocate by January 1, 2003. As of December 31, 2001, the Company has recorded an estimated loss on the sublease of One Liberty Plaza of \$21.5 million. The estimated loss was calculated on an 8% net present value basis, using various assumptions including a 21-year sublease term commencing June 2003 at market rates.

In addition, it has been necessary for Nasdaq to make certain non-budgeted expenditures relating to September 11, including, but not limited to, costs related to the efforts to restore services to market participants; the testing of trading systems; and required reconfiguring of technology, telecommunications and alternative office facilities due to the temporary relocation of employees; these expenses totalled \$1.7 million. Nasdaq is in the process of determining the total loss of revenues and additional expenses incurred as well as any applicable insurance recoveries. Additional expenses and recoveries will be recorded in future periods.

14. BUSINESS SEGMENT INFORMATION

NASD manages three primary business segments: Nasdaq, Amex and NASD. As described in the summary of significant accounting policies, Nasdaq and Amex represent separate identifiable organizations. NASD includes NASD, NASDR, and NASD DR.

SEGMENT INCOME OR LOSS

NASD's accounting policies for segments are the same as those described in the summary of significant accounting policies. Management evaluates segment performance based on net operating income. Prior year segment information has been restated to conform with the current composition of reportable segments. Transfers between segments are accounted for at cost.

	<u>NASDAQ</u>	<u>AMEX</u>	2001 <u>NASD</u>	<u>CONSOLIDATING ADJUSTMENTS</u>	<u>CONSOLIDATED</u>
Revenues, principally from external customers	\$ 859,884	\$ 281,075	\$ 409,431	\$ (11,349)	\$ 1,539,041
Total operating expenses	781,486	289,732	383,053	(7,531)	1,446,740
Net operating income (loss)	78,398	(8,657)	26,378	(3,818)	92,301
Total assets	1,327,630	304,211	1,586,724	(567,821)	2,650,744
Long lived assets	380,213	124,098	216,095	(86)	720,320
Depreciation & amortization	\$ 93,400	\$ 19,851	\$ 55,721	\$ -	\$ 168,972
			2000		
	<u>NASDAQ</u>	<u>AMEX</u>	<u>NASD</u>	<u>CONSOLIDATING ADJUSTMENTS</u>	<u>CONSOLIDATED</u>
Revenues, principally from external customers	\$ 832,315	\$ 262,078	\$ 396,689	\$ (9,398)	\$ 1,481,684
Total operating expenses	633,881	251,773	337,009	5,195	1,227,858
Net operating income (loss)	198,434	10,305	59,680	(14,593)	253,826
Total assets	1,184,665	290,283	1,464,973	(682,195)	2,257,726
Long lived assets	333,051	71,991	237,041	1,148	643,231
Depreciation & amortization	\$ 65,645	\$ 4,821	\$ 40,009	\$ 2,312	\$ 112,787

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

15. PARENT COMPANY ONLY STATEMENTS - CONDENSED

The following condensed consolidated balance sheets, statements of income and statements of cash flows as of and for the years ended December 31, 2001 and 2000 present the information for the entities that Company management consider to be the parent company for NASD. This information includes: 1) the consolidated information for NASD, NASDR and NASD DR (the "Parent Entities"), and 2) NASD's investments in its Nasdaq and Amex subsidiaries (not consolidated). As disclosed in Notes 1 and 16, NASD is in the process of a Restructuring relating to its ownership interests in Nasdaq, which upon completion, will reduce NASD's ownership of Nasdaq to 0%. In addition, NASD has reached agreement with the Amex Board of Directors on the ultimate separation of Amex from NASD. This Amex restructuring is still in its preliminary stages and no definitive actions have taken place to date. Accordingly, the following presentation of "Parent Company Only Statements" reflects the financial position, results of operations and cash flows for the Parent Entities, assuming deconsolidation of its Nasdaq and Amex subsidiaries.

	2001	DECEMBER 31,	2000
BALANCE SHEETS:			
ASSETS			
Cash and cash equivalents	\$ 267,477		\$ 229,747
Investments, available-for-sale	515,744		284,430
Receivables, net	22,315		33,452
Receivable from related parties	84,548		75,354
Other current assets	11,689		4,594
Total current assets	901,773		627,577
Total property and equipment, net	216,095		237,041
Investment in Nasdaq	357,170		519,998
Investment in Amex	73,893		59,577
Other assets	37,793		20,780
Total assets	\$ 1,586,724		\$ 1,464,973
LIABILITIES AND MEMBERS' EQUITY			
Payable to related parties	\$ 72,496		\$ 65,124
Current liabilities	311,853		436,993
Other liabilities	160,341		93,853
Total liabilities	544,690		595,970
Members' equity	1,042,034		869,003
Total liabilities and members' equity	\$ 1,586,724		\$ 1,464,973

STATEMENTS OF INCOME:**REVENUES:**

Revenues, net of member rebates of \$17,000 in 2001
and \$7,000 in 2000

EXPENSES:

Compensation and benefits
Professional and contract services
Depreciation and amortization
Other, including support charge allocated to related parties
Total operating expenses
Net operating income

OTHER INCOME (EXPENSE):

Equity in earnings of Nasdaq
Equity in earnings (losses) of Amex
Other
Gain from Nasdaq shares sold by NASD
Net income

**YEARS ENDED DECEMBER 31,
2001 2000**

\$ 409,431	\$ 396,689
223,555	216,886
135,133	132,709
55,721	40,009
(31,356)	(52,595)
383,053	337,009
26,378	59,680
30,159	16,951
(2,617)	4,063
26,634	30,552
31,445	2,347
\$ 111,999	\$ 113,593

STATEMENTS OF CASH FLOWS:**CASH FLOWS FROM OPERATING ACTIVITIES****CASH FLOWS FROM INVESTING ACTIVITIES****CASH FLOWS FROM FINANCING ACTIVITIES**

Increase in cash and cash equivalents

Cash and cash equivalents at beginning of year

CASH AND CASH EQUIVALENTS AT END OF YEAR**YEARS ENDED DECEMBER 31,
2001 2000**

\$ 120,905	\$ 111,945
65,824	(75,237)
(148,999)	87,062
37,730	123,770
229,747	105,977
\$ 267,477	\$ 229,747

The repurchase of Nasdaq stock held by NASD with the proceeds (\$240.0 million) of the Hellman & Friedman debenture offering resulted in NASD realizing proceeds in excess of its basis in the underlying shares of Nasdaq of approximately \$134.4 million. In addition, as a result of the reduction in Nasdaq equity resulting from this transaction, NASD realized a reduction in their proportionate remaining ownership of Nasdaq of approximately \$93.9 million. This transaction was another element of the continuing plan of corporate reorganization with regard to NASD's investment in Nasdaq. Accordingly, the net effect of this transaction is reflected as a \$40.5 million increase to NASD equity in the consolidated statements of changes in members' equity.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

16. SUBSEQUENT EVENTS

NASDAQ COMMON STOCK REPURCHASE FROM NASD On March 8, 2002, Nasdaq completed a two-stage repurchase of 33,768,895 shares of its common stock owned by NASD, which represented all of the remaining outstanding shares of Nasdaq common stock owned by NASD, except for the 43,225,976 shares of Nasdaq common stock underlying the warrants issued by NASD in Phase I and II. Nasdaq purchased the Nasdaq common stock for \$305,155,435 in aggregate cash consideration, 1,338,402 shares of Nasdaq's Series A Cumulative Preferred Stock (face and liquidation value of \$100 per share, plus any accumulated unpaid dividends), and one share of Nasdaq's Series B Preferred Stock, (face and liquidation value of \$1.00 per share). With this transaction, total combined proceeds to NASD of \$438,995,635 resulted in NASD realizing proceeds in excess of its basis in the underlying shares of Nasdaq of approximately \$277.2 million. In addition, as a result of the reduction in Nasdaq equity from this transaction, NASD realized a reduction in its proportionate remaining ownership of Nasdaq of approximately \$210.9 million. This transaction was another element of the continuing plan of corporate reorganization with regard to NASD's investment in Nasdaq. Accordingly, the net effect of this transaction is reflected as a roughly \$66.3 million increase in the consolidated statement of changes in members' equity in 2002.

NASD owns all of the outstanding shares of Series A and Series B Preferred Stock. All of the shares of Nasdaq common stock repurchased by Nasdaq from the NASD are no longer outstanding. Subsequent to the transaction, NASD's ownership in Nasdaq is approximately 55%. After reflecting this repurchase of shares by Nasdaq and the assumed exercise or conversion of all potentially dilutive securities, NASD's ownership in Nasdaq reduces to 0%. However, as discussed in the next paragraph, until Nasdaq Exchange Registration takes place, NASD will retain voting control of Nasdaq pursuant to the terms of the Series B Preferred Stock.

The Series A Preferred Stock carries a 7.6% dividend rate payable at the discretion of Nasdaq's Board of Directors. Dividends do not begin accruing until March 2003. Shares of Series A Preferred Stock do not have voting rights, except for the right as a class to elect two new directors to the Board of Directors anytime distributions on the Series A Preferred Stock are in arrears for four consecutive quarters and as otherwise required by Delaware law. The Series B Preferred Stock does not pay dividends. Series B Preferred Stock will be entitled to cast the number of votes that, together with all other votes that NASD is entitled to vote by virtue of ownership, proxies or voting trusts, enables NASD to cast one vote more than one-half of all votes entitled to be cast by stockholders. If Nasdaq obtains Exchange Registration, the share of Series B Preferred Stock will lose its voting rights and will be redeemed by Nasdaq. Nasdaq may redeem the shares of Series A Preferred Stock at any time after Exchange Registration and is required to use the net proceeds from an IPO, and upon the occurrence of certain other events, to redeem all or a portion of the Series A Preferred Stock.

NASD, NASDAQ AND AMEX MASTER AGREEMENT

On February 6, 2002, NASD, Nasdaq and Amex (the "Parties") negotiated a Master Agreement that would establish provisions for the ongoing relationships of the Parties. The Master Agreement was submitted to the SEC and Department of Justice for review prior to final agreement among and execution by the parties. The following paragraphs summarize the significant financial provisions contained in the Master Agreement:

NASD and Nasdaq have agreed to fund a portion of the necessary expenses related to the separation of software, hardware, and data under a plan to transition technology applications and support from NASD and Nasdaq to Amex. NASD originally integrated Nasdaq and Amex technology subsequent to the acquisition of Amex by the NASD in October 1998. The total estimated cost of the separation has been set at a maximum of \$29.0 million, and is to be shared evenly between Nasdaq and NASD. In 2001, \$3.8 million of costs were incurred by Amex under this agreement, for which Amex will be reimbursed in 2002 pending approval of the Technology Steering Committee. The Technology Steering Committee consists of one representative each from NASD, Nasdaq and Amex and was established to supervise the performance of the Parties pursuant to the technology transition. NASD and Nasdaq expect to fund this commitment up to its \$29.0 maximum, at the cost of \$14.5 million each.

Beginning in 2002, Amex will pay an annual fee of up to \$5.5 million to Nasdaq for the right to list, trade and market the Nasdaq-100 Index Tracking Stock, otherwise known as QQQ.

As consideration for certain benefits that Nasdaq agreed to provide to Amex, the Parties agreed that Nasdaq (1) will be entitled to realize the approximately \$15.1 million of tax loss carryforwards related to the assignment by Market Group of its interest in Amex to New NASD Holding, Inc. and (2) NASD was required to repay Nasdaq approximately \$5.6 million in cash Nasdaq paid to NASD relating to Nasdaq's use of federal tax losses allocated by Amex to Market Group for the period beginning November 1, 1998 and ending on June 30, 2000. NASD paid Nasdaq the approximately \$5.6 million on February 20, 2002.

FINES RECEIVED

In January 2002, NASDR censured a large investment banking NASD member firm and directed it to pay \$50.0 million to the SEC and \$50.0 million to NASDR in monetary sanctions for taking inflated commissions in what amounted to profit-sharing arrangements on IPOs serviced by that firm. On January 30, 2002, the \$50.0 million was received by NASDR and recorded as fines revenue in 2002.

2001 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in tables in thousands)

POTENTIAL CONTRACT TERMINATION

In December 2000, Amex contracted with OM Technology AB ("OM") to develop software in support of Amex's New Trading Environment. Amex believes that OM has failed to perform its material obligations under the terms of the contract. As a result, on April 19, 2002, Amex sent OM a notice outlining OM's failure to perform and demanded they cure any defaults within 30 days. If the defaults are not corrected within the 30 day period, Amex intends to terminate the contract with OM. In accordance with the terms of the contract, Amex is entitled to a refund of all previous amounts paid to OM if the termination is valid but would owe OM an additional \$3.2 million if the termination were invalid. In addition, if Amex elects to terminate the contract, approximately \$9.0 million of capitalized software development costs under SOP 98-1 and \$0.9 million of prepaid license fees would be written off. At December 31, 2001, Amex had capitalized software development costs and prepaid license fees of \$8.6 million and \$0.9 million, respectively relating to this contract.

ISSUANCE OF SENIOR NOTES

On May 9, 2002, Nasdaq issued and sold \$150.0 million in aggregate principal amount of its 5.8% senior notes due 2007 ("Senior Notes") in a private placement. The Senior Notes are unsecured, pay interest quarterly, and may be redeemed by Nasdaq at any time, subject to a prepayment premium equal to 50 basis points plus the yield on a U.S. Treasury obligation having a final maturity corresponding with the remaining average life of the Senior Notes. The proceeds from the Senior Notes, approximately \$149.0 million after payment of placement agent commissions and expenses of this offering, were used to fund a portion of the cash consideration paid to NASD in the repurchase of common stock and for general corporate purposes.

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