FAIR MARKETS ARE NOT AN OPTION. THEY ARE A NECESSITY.
OUR 2004 PERFORMANCE

EACH YEAR NASD WRITES RULES, EXAMINES, ENFORCES, EDUCATES, RESOLVES DISPUTES AND ENSURES MARKET TRANSPARENCY TO PROTECT INVESTORS AND KEEP OUR MARKETS FAIR.

OPERATIONAL HIGHLIGHTS
Broker-dealers regulated by NASD 5,191
Broker-dealer branch offices 96,970
Registered representatives 659,212
NASD employees 2,384

INVESTOR COMPLAINTS
Customer complaints received 4,687
Customer complaints resolved 5,101

NASD BROKERCHECK
Successful searches for an individual or a firm over 3.7 million
Reports generated 190,000

REGULATORY ACTIONS
Firms expelled from the industry 22
Firms suspended 4
Individuals barred from the industry 454
Individuals suspended 379
New disciplinary actions filed 1,396
Formal actions resolved 1,336
Advertisements and sales communications reviewed 88,301

TESTING AND CONTINUING EDUCATION
Qualification exams NASD exams 89,963
Other 176,655
Continuing education sessions 178,256

TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)
Corporate bond volume reported to the system 4.9 trillion dollars
Corporate bond trades reported to the system 6.1 million trades
Percent of investment grade volume reported to the public 89.5%
Percent of investment grade trades reported to the public 97.5%

MARKET SURVEILLANCE
Quotes, orders and trades monitored each day 150 million
Shares monitored in 2004 2.4 trillion

CORPORATE FINANCING
Equity filings 783
Debt filings 80
Other corporate filings 85
Total corporate filings 948
Other filings 132
Grand total 1,080

DISPUTE RESOLUTION—ARBITRATION
Cases filed 8,201
Cases closed 9,209

HOW ARBITRATION CASES WERE CLOSED
Closed after hearing 1,915
Closed after review of documents 508
Settled by the parties 3,700
Settled by mediation 1,201
Withdrawn 677
All other (including stipulated awards, bankruptcies, deficient claims, etc.) 1,073

NOTES: This breakout does not include cases closed and later reopened.

DISPUTE RESOLUTION—MEDIATION
Cases brought 1,217
Cases closed 2,063
Cases settled 1,741
THE WORK WE DO AT NASD IS A POWERFUL FORCE BEHIND MAINTAINING THE FAIRNESS OF THE U.S. SECURITIES MARKETS AND PROTECTING INVESTORS EVERYWHERE. FAIR MARKETS ARE NOT AN OPTION, THEY ARE A NECESSITY—AND WHEN IT COMES TO THIS CRITICAL WORK, PERFORMANCE MATTERS.
ROBERT R. GLAUBER  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER

INNOVATION AND RESOLVE. These are qualities that characterized NASD’s performance in 2004. Last year, the 2,000-plus people of NASD pursued the core component of our mission—finding and punishing wrongdoing—with undiminished vigor and dedication. Measured in terms of disciplinary fines assessed or brokers and firms suspended or barred from the industry, our enforcement results equaled or exceeded those of any previous year.

To do less was not an option—and would have poorly served the cause of restoring investor faith and confidence in the fairness of the capital markets. Today, more than ever before, investors need to know that a strong benefactor is defending their interests, is alert and vigilant, and has the power to protect them against brokers who violate the rules. That is why we’re here. At the same time, though, we know that regulation and enforcement are only parts of a large tapestry. We continued to emphasize other activities that protect investors and promote market integrity. In 2004, we devoted ourselves to supporting regulatory compliance of securities firms and brokers we oversee by providing the resources firms need to avoid the problems that cause run-ins with regulators. It is far better for customers when salespeople get it right the first time than for us to arrive after the damage is done to help clean up the mess.

In this effort to support compliance by firms, we provided “report cards” measuring conformity with our market operations, bond reporting, and CRD reporting rules; offered webcasts explaining mutual fund sales rules; held call-in workshops; developed compliance templates; and continued our diverse series of conferences, seminars, and workshops, including a new series of Fixed Income Conferences. And we are working to provide brokers with Web-based tools to access mutual fund “breakpoint” information to ensure that investors get the mutual fund fee discounts to which they are entitled.

We also protect investors by providing investment education and by ensuring that the markets in which they transact are open and transparent. Better-informed investors can do more to avoid mistakes. And open, transparent, and competitive markets provide another important layer of investor protection. This year we took a number of important steps to provide investor education and information. The Investor Education Foundation, born in 2003, completed its first grant cycle, issuing 11 grants for a total of $1.1 million. Grant proposals were evaluated for their potential to improve the financial literacy of investors, particularly young people, women, and the elderly.

We also issued seven Investor Alerts in 2004 on topics ranging from identity theft to investing in college savings plans. And we proposed new rules that would measurably increase the quantity and clarity of information presented at the point of sale to buyers of mutual funds, Section 529 college savings plans, and variable annuities. As the number of individual bond investors has continued to increase substantially, NASD has continued to work to move corporate bond trade and price information out of the shadows and into the light of day. Our Trade Reporting and Compliance Engine, or TRACE, evolved substantially in 2004 and now provides investors with easy access to essential data on virtually all 28,000 corporate debt securities within 30 minutes of any trade. And this price information appears in The New York Times, Reuters, Bloomberg, and other publications.

BrokerCheck, another system we support to provide investors with crucial information to aid them in an important decision, continues to attract more use. This online service for checking the background and regulatory history of any U.S. broker was used more than 3.7 million times in 2004, up markedly from 2.8 million in 2003.

Regulation and enforcement, support of compliance by securities firms, investor education and information. These are the three main pillars of NASD’s investor protection mission, and we tried hard in 2004 to make them stronger, to better complement one another, and to better serve the interests of investors. This report describes and illustrates our work toward those ends. I hope you find it useful and illuminating.
EDUCATION MATTERS.
MORE AMERICANS ARE PARTICIPATING IN THE MARKET than ever before, through mutual funds, individual stocks, 401(k)s, and college savings plans. In today’s complex and fast-moving marketplace, many of these investors, particularly new ones, need a better sense of what they should be doing and why. Education is essential as investors realize that their financial security depends on making fully informed decisions. The more knowledgeable individuals and families are about investing, the more control they have over their financial futures. At NASD, a critical part of our job is to provide comprehensive information, educational tools, and resources investors need to make effective use of all that the securities industry offers.

The NASD Investor Education Foundation was founded to help bridge the investor literacy gap in our society by reaching out to people with little exposure to investing, but an increasing need to save for their families and retirement. In 2004, the Foundation announced its first round of grants, awarding more than $1 million to fund initiatives such as research on educating women and programs to help small investors with their securities arbitration needs. Other groups identified as being underserved by the investment industry—notably minority groups and Americans entering retirement age—have also been targeted by Foundation giving. First Nations Development Institute in Fredericksburg, VA, for example, received a grant from the Foundation to develop and deliver educational materials on investing and the markets to Native American communities.

In addition to awarding grants from the Foundation for investor education, NASD offers educational materials that provide guidance on the wide range of investment vehicles now available to investors. Our online 401(k) Learning Center delivers straightforward, practical information on 401(k) investing and saving for retirement. We also provide a dedicated online resource for 529 college savings plans, including a 529 Expense Analyzer that allows investors to calculate fee comparisons among competing 529 plans. In 2004, we continued to offer our Investor Alert series, covering topics such as “Net Asset Value Transfers: Look Before You Leap Into Another Mutual Fund,” and “Betting the Ranch: Risking Your Home to Buy Securities.” NASD materials are written in “plain English,” not the jargon that investors too often receive.

At NASD, educating industry professionals is also an important part of our business. Our job is not simply to inform the industry about new rules, but to explain them and facilitate their effective implementation. NASD conferences and preventive compliance meetings bring firms together with regulators to discuss both the challenges and the benefits of compliance. Tools like our online Report Center provide firms with compliance statistics and peer group comparisons. To further promote a culture of compliance within firms, we also offer industry professionals a broad range of educational and professional development programs. These range from courses on suitability and supervision to a 120-Hour Certified Regulatory and Compliance Professional designation offered jointly with the University of Pennsylvania’s Wharton School. E-Learning courses and webcasts on topics such as anti-money laundering, mutual fund breakpoints, and variable annuity suitability are designed to provide easy access to online compliance training. In 2004, the number of industry professionals participating in our education initiatives more than doubled, as did the percentage of securities firms.
VIGILANCE MATTERS.
OUR NATION'S TROOPS MAKE ENOUGH SACRIFICES—THEIR FINANCIAL FUTURE SHOULDN'T BE ONE OF THEM. IN 2004, NASD FINED FIRST COMMAND FINANCIAL PLANNING INC. $12 MILLION FOR USING MISLEADING INFORMATION TO SELL MUTUAL FUNDS TO MILITARY OFFICERS AND THEIR FAMILIES.

AT NASD, OUR MISSION TO PROTECT INVESTORS rests on the vigorous, fair, and meaningful enforcement of the rules that govern the industry. In 2004, we collected $103 million in disciplinary fines—our highest total ever—and suspended or expelled 833 individuals, also a record number. Our impact has been significant because our authority is significant—all 5,191 brokerage firms and 659,212 stockbrokers and registered representatives come under our jurisdiction.

In 2004, our vigilance mattered to the soldiers and families who invested with First Command Financial Planning Inc., a firm controlled by former military personnel. Through First Command's marketing techniques, former military personnel were tapped to sell to current military personnel and their families. For making misleading statements and omitting important information when selling mutual fund investments to thousands of U.S. soldiers and their families, First Command was fined $12 million in 2004. Of these fines, restitution will be paid to First Command customers—and, as of March 31, 2005, $3.6 million had already been returned. NASD will invest all remaining money in investor education programs designed for members of the military and their families.

Our effectiveness as a regulator depends on our own self-scrutiny. In October 2004, we launched Examiner University, an entirely new model for examiner training. This six-week intensive training program starts by engaging new examiners both in the classroom and in the field—and helps us ensure that our examination process is the most thorough in the industry. Beyond the initial program, examiners are mentored for a full year on the job, and during that period they return for another six weeks of classroom instruction. Designed to help our professionals prepare for the challenges of regulating a complex and evolving securities industry, this program gives them the tools they need to examine firms more thoroughly and efficiently than ever before. The standard we are shooting for is high: the examiner of tomorrow should know more about a firm before starting an examination than the examiner of today knows upon leaving a firm.

Events of recent years point to the importance of vigilance in supervisory controls and business continuity and disaster planning. Top rulemaking initiatives in 2004 included requiring CEOs to certify firms' supervisory procedures and issuing a rule to require firms of all sizes to have a business continuity plan. At the same time, we set out to ease the burden of compliance as much as possible, particularly for the small firm community on which the weight of regulatory requirements often falls most heavily. Working with our Small Firm Advisory Board, we conducted seminars and workshops on disaster recovery and business continuity strategies to help small firms develop plans that were right for them. We created a template that small firm managers could follow as they did their planning, and arranged off-site electronic data storage for firms.
TRANSPARENCY MATTERS.
IN THE MARKETPLACE, INFORMATION IS POWER. And the free and open flow of information promotes fair and competitive markets that help protect investors against abuse. In 2004, NASD brought greater transparency to the U.S. corporate bond market. Bond markets—including corporate bonds, U.S. Treasuries, municipal bonds, and other fixed income instruments—receive much less attention than the stock market, but they are far larger by comparison: $23 trillion in capitalization versus $15 trillion, with 10 times the daily dollar turnover. Roughly two thirds of corporate bond transactions reported to NASD last year were in quantities of 100 bonds or fewer, indicating a significant presence of individual investors in this market—and underscoring the need to level the playing field for all bond investors.

With 76 million baby boomers nearing retirement and allocating their investments accordingly, the need for accurate price information in the fixed income markets is particularly acute. NASD began delivering TRACE—our Trade Reporting and Compliance Engine—in 2003 and has been steadily increasing the number of bonds reportable to the public while decreasing the amount of time firms have to report their trades. In addition, in March 2004 we organized our Corporate Debt Market Panel, which made recommendations to address improved information disclosure for retail bond investors.

TRACE achieved the most recent milestone in its evolution on February 7, 2005. On that day, investors gained access to accurate price information on the full universe of publicly traded U.S. corporate bonds—that’s over 29,000 bonds. In July 2005, we will reduce the reporting time by half, from 30 minutes to 15 minutes. Major publications such as The New York Times now publish NASD TRACE corporate bond data in their financial pages.

Beyond bonds, our work to increase transparency for mutual fund investors continues. About half of all American households now have money in at least one mutual fund, either directly or through their employer’s retirement plans. These investors deserve to know not only how they stand to gain from these investments, but how much they can expect to pay their broker in fees and costs—and why. In 2004, NASD formed the Mutual Fund Task Force—a group comprising leaders from the mutual fund and brokerage industries—to provide input on regulation of mutual fund fees and costs. In a report to the SEC, the Task Force recommended changes in treatment of soft-dollar services and enhanced disclosure of portfolio transaction costs to both fund boards and investors. In addition, the Task Force recommended improved point-of-sale disclosure to investors, including the costs of fund distribution and front-end loads. Both the Task Force and NASD strongly support increased reliance on instantaneous communication through the Internet as the most effective means to provide investors with the right information at the right time. The Task Force findings were submitted for use by both NASD and the SEC as we consider new rules and policies on mutual fund marketing and sales practices.
Most investors who have brokerage accounts have signed an agreement with their broker-dealer to resolve any disputes through arbitration rather than the courts. And although the majority of business in the securities industry is completed without problems, disputes and controversies occasionally arise. NASD offers both arbitration and mediation services to assist in the resolution of disputes between investors and securities firms. These alternatives to litigation often save the parties substantial time and expense. NASD’s mediation program results in settlements more than 80 percent of the time.

Compared to litigation, the advantages of arbitration and mediation are many. The process is fair, and more affordable and faster than a court proceeding. Arbitration offers streamlined discovery and a greater emphasis on equitable procedures than on the strict rules of evidence. The voluntary mediation program offers parties a more collaborative way to resolve disputes themselves. NASD has also made our dispute resolution services more accessible by increasing the number of hearing locations. By early 2005, we had established 68 hearing locations, with at least one location in every state and two abroad.

The foundation of fair dispute resolution is the roster of fair and unbiased individuals who act as NASD arbitrators or mediators. In 2004, we made training more accessible for arbitrators and more efficient for NASD. We now provide online training on matters such as “managing discovery disputes” and “fulfilling arbitrator disclosure obligations.” For new arbitrators, training includes real-life simulations, where NASD professionals observe individuals in their new role.

At NASD, we work hard to ensure that decisions made in the investor’s favor are paid in full and on time. Any brokerage firm or individual broker who fails to demonstrate prompt payment is subject to expedited suspension procedures. In addition, NASD Enforcement plays a role to ensure that the arbitration process takes place on a level playing field. For example, in 2004, NASD levied several large fines against three major retail firms for abuse of the discovery process during arbitration cases.

Last year, our Mediation Department completed the administration of a $21 million restitution program in partnership with the Manhattan District Attorney’s Office. The program benefited clients of a broker-dealer that was barred from the industry.

Taken together, these measures added to the integrity of the marketplace by helping parties fairly and efficiently resolve more than 9,200 cases in 2004.
AGILITY MATTERS.
LARGE PROBLEMS IN THIS INDUSTRY rarely develop completely without warning—they build over time and, if not dealt with proactively, gain momentum with great speed. This is when NASD’s agility as a regulator truly matters. Our role demands far greater anticipation in how we solve the problems of tomorrow today. In 2004, our Ahead of the Curve Task Force established a network of research analysts who track the brokerage industry to advise us on industry trends. We also issued several Notices to Members and Best Practices on proper sales procedures, and we conducted sweeps on a range of issues—including 529 plan sales, abusive short selling, variable annuity sales, and B-share sales of mutual funds, as well as sales of non-conventional products such as hedge funds.

Last year we also undertook several new and innovative approaches to sanctioning firms, and began doing much more than issuing fines. We removed some firms temporarily from particular lines of business, and we prohibited firms from registering new brokers or issuing research for a certain period of time. NASD has the power to do much more than levy fines—and we seek to be just as creative in tailoring our response to wrongdoing as we are in uncovering it.

For NASD, our systems and technologies—and the data they house—are all critical assets. In 2004, we continued to refine our use of data-mining techniques to prevent wrongdoing. We are also working on advanced pattern detection technology designed to give us an early warning or alert us to problems in firms on a near real-time basis. For example, in one initiative, in conjunction with the University of Massachusetts, we are analyzing data already available to us to create a statistical model that predicts which brokers warrant additional supervisory or regulatory scrutiny. In 2005, we created a new role within the organization—our Chief Data Officer will be responsible for managing NASD data as a strategic asset across the entire organization.
WE DON’T OPERATE MARKETS, WE REGULATE THEM. And in 2004, we furthered our goal of structural separation between owner and regulator by completing our divestiture from the American Stock Exchange and lessening our stake in NASDAQ. At NASD, we are guided by a clear calculation of fair interaction between investors and their brokers and, ultimately, the fairness of the markets themselves. We were one of the first organizations to fully comprehend the now increasingly evident conflict between owning markets and regulating them.

As the world’s preeminent private-sector regulator, we are focused on defining this model for the U.S. securities industry. Of course, we will never reduce our watchfulness for wrongdoing, but in our efforts to protect investors we will play many different roles—as educators of investors and investment professionals, as forecasters of future trends, and as innovators of new technologies. We will also provide abundant support to the industry to avoid abuses in the first place. Most firms understand that it is in their best interest to do business by the rules. And investors clearly are better off if the brokerage industry gets things right the first time, rather than relying on NASD to come in after the problems emerge, clean up the mess, and then work to make them whole.

As much as focus matters to our external role as a regulator, it’s key to our internal operations, as well. At NASD, we operate efficiently and on budget. We have controlled the costs of our organization in the face of rising regulatory demands. We are stronger than we have ever been, with a deep bench of highly trained, experienced, and motivated professionals across our organization. In short, we measure our success by what we accomplish rather than just how hard we work—in the manner of any well-run private-sector organization.
LEADERSHIP MATTERS.
Add up the many ways in which NASD has taken a leadership position in this industry—in our investor educational and information initiatives, in our efforts to stay ahead of issues facing the industry, in our systems and technology—and you see how we’re changing the very role of a “regulator” in this new century. Not only are we defining what this new vision of a regulator is, but we’re acting to make that vision a reality. We will always be vigilant in dealing with fraud and abuses within the industry, but the role of regulator as we define it will change in the years ahead, with a greater emphasis on stopping abuses before they happen. Investors are better served by preventing problems than by reacting after they occur.

The U.S. capital markets are among the most important resources this country has. This is true not because money and finance are to be valued above all other things, but because the financial strength of this country and its people are what fuel our shared national endeavors, at home and abroad. What drives our work at NASD is the strong desire to develop regulatory policy that will promote market integrity, allow markets to flourish, and make sure that investors’ interests do not take a backseat to commercial interests. We work with compliance professionals throughout the industry to ensure that the financial services industry stands on a sound and solid foundation that is not undermined by any lack of trust, integrity, or ethical conduct.

By our definition, the “private-sector” in private-sector regulator means we have the power to innovate and tackle regulatory issues using multiple techniques. When we took on the challenge of transparency in the corporate debt markets, we used all the tools in our arsenal. We engineered our revolutionary TRACE system to shine light on a formerly opaque market. We pursued major enforcement cases in fixed income. We created the Corporate Debt Market Panel to examine issues of transparency and accessibility among retail investors. We wrote rules around fixed income point-of-sale disclosure. To support firms’ compliance, we developed TRACE report cards and educational programs on fixed income. Once we identify an issue, we use our considerable regulatory resources to address that issue and affect real, meaningful change.

At NASD, our people are on the job every day protecting investors and keeping the markets fair. We are on target with our strategy to consistently deliver on that mission. In 2004, we continued to pursue ways to strategically improve and measure the quality and efficiency of our operations. As you know, Wall Street has always been known for its talent and energy. Well, these are our touchstones, too. At NASD, we operate with a fundamental belief in the importance of our work: that fairness and integrity should always be defended, and that our actions as professionals truly benefit investors. We help set the standards of conduct and behavior for securities firms, and because of that, we are helping to shape the future of this industry.

NASD’s financial health is a clear reflection of our role as a private-sector regulator. This mandate requires us to look at our business with the same financial discipline as a for-profit business. At a time when the market environment has demanded more, not less, regulation, NASD has carefully managed its expense growth commensurate with revenue growth. Operating in the private sector also means a responsibility to acknowledge and comply with certain rules. As a result, NASD has decided to voluntarily adopt many of the principles embodied in the Sarbanes-Oxley Act of 2002, including those in Sections 302 and 404. Looking ahead, we are taking a prudent and strategic view toward how we will build on our mission in terms of headcount and deployment of capital.
**FINANCIAL HIGHLIGHTS**

**NASD’S FINANCIAL PERFORMANCE** remained strong in 2004. The results exceeded expectations and remained in line with prior years. Strict cost controls kept operating expenses under budget, in spite of increased regulatory responsibilities.

Based on this strong performance, NASD granted and distributed $30 million in rebates to its membership in 2004, as compared with $25 million and $24 million in 2003 and 2002, respectively.

The financial information provided herein represents the results of operations of the NASD business segment excluding the operations of The Nasdaq Stock Market, Inc. (NASDAQ) and the loss on disposal of the American Stock Exchange, LLC (Amex).

www.nasd.com/annual_report
**Operating Results**

NASD’s operating revenues were $522.0 million in 2004 compared with $472.0 million in 2003, an increase of $50.0 million or 10.6%. Operating expenses increased $45.8 million, or 8.8%, to $564.0 million in 2004. As a result, cash flow, as measured by earnings before interest, taxes, depreciation and amortization (EBITDA) less fines remained near break-even levels at ($2.5) million and $1.1 million in 2004 and 2003, respectively.

### NASD Operating Results (in millions) Years Ended December 31

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<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
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<tr>
<td>Operating Revenues</td>
<td>$522.0</td>
<td>$472.0</td>
<td>$450.4</td>
</tr>
<tr>
<td>Expenses</td>
<td>564.0</td>
<td>518.2</td>
<td>502.8</td>
</tr>
<tr>
<td>Contribution Margin</td>
<td>(42.0)</td>
<td>(46.2)</td>
<td>(52.4)</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>39.5</td>
<td>47.3</td>
<td>54.7</td>
</tr>
<tr>
<td>Cash Flow (EBITDA)</td>
<td>($2.5)</td>
<td>$1.1</td>
<td>$2.3</td>
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1 Excludes fines and activity assessment revenues, which NASD does not view to be part of operating revenues.

### NASD Financial Summary (in Millions)

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<tr>
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<td>($2.5)</td>
<td></td>
<td></td>
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OPERATING REVENUES  Regulatory fees were $222.8 million in 2004 compared with $174.2 million in 2003, an increase of $48.6 million. Regulatory fees include assessments based on the gross income and the number of member firm personnel, as well as the transaction-based Trading Activity Fee. These fees are used to fund NASD’s member regulatory activities, including examinations, processing of membership applications, financial monitoring, policymaking, rulemaking, and enforcement activities. In November 2004, Trading Activity Fee rates were reduced as part of this three-year phase-in of regulatory fee pricing changes.

User fees include fees charged for initial and annual registrations, qualifications exams, fees associated with NASD-sponsored meetings and conferences, and charges associated with the review of underwriting arrangements in corporate filings. User fees were $137.3 million in 2004 compared with $128.4 million in 2003, an increase of $8.9 million or 6.9%, due primarily to an increase in the number of corporate filings and the average size of filings reviewed. Dispute resolution fees, which consist primarily of fees earned in the administration of the arbitration and mediation process, increased $4.7 million or 6.2%, based on record case volumes.

Contract service fees represent amounts charged for regulatory services provided primarily to NASDAQ and Amex, as well as other exchanges. These services include mainly surveillance, monitoring, legal, and enforcement activities. Contract services totaled $58.1 million in 2004 compared with $63.1 million in 2003, a decrease of $5.0 million or 7.9%, due primarily to lower depreciation charges and lower spending on NASDAQ initiatives.

TRANSPARENCY AND OTHER FEES  Transparency and other fees represent mainly fees charged for services offered through NASD’s Trade Reporting and Compliance Engine (TRACE) and Alternative Display Facility (ADF). Transparency and other fees were $23.6 million in 2004 compared with $30.8 million in 2003, a decrease of $7.2 million or 23.4%. This decrease was due primarily to the loss of ADF’s largest customer in February of 2004.
Increases in operating expenses from last year are primarily the result of increases in compensation and benefits expenses associated with additional employees to service the Amex contract awarded in 2004, as well as moderate increases in member regulation, enforcement, and dispute resolution headcount. Offsetting these increases were declines in contract services and depreciation and amortization expenses. Professional and contract services declined slightly due to a continued disciplined approach to the review and approval of new initiative spending. Depreciation and amortization declined due to several assets becoming fully depreciated in the prior year and significantly curtailed capital spending with the reduction in the cost of technology equipment and efficient management of the existing technology environment.

Nasdaq Expenses by Year (in Millions) Years Ended December 31

<table>
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<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation &amp; Benefits</td>
<td>$ 306.8</td>
<td>$ 267.8</td>
<td>$ 234.0</td>
</tr>
<tr>
<td>Professional &amp; Contract Services</td>
<td>118.5</td>
<td>116.6</td>
<td>134.1</td>
</tr>
<tr>
<td>Computer Operations &amp; Data Comm</td>
<td>24.8</td>
<td>19.1</td>
<td>19.7</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>39.5</td>
<td>47.3</td>
<td>54.7</td>
</tr>
<tr>
<td>Occupancy</td>
<td>30.4</td>
<td>30.1</td>
<td>24.0</td>
</tr>
<tr>
<td>Other</td>
<td>44.0</td>
<td>37.3</td>
<td>36.3</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td><strong>$ 564.0</strong></td>
<td><strong>$ 518.2</strong></td>
<td><strong>$ 502.8</strong></td>
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</tbody>
</table>
OTHER INCOME (EXPENSE)  NASD’s total other income (expense) was $72.0 million in 2004 compared with $82.6 million in 2003, a decrease of $10.6 million or 12.8%. This reduction is primarily attributable to a reduction in the gain recognized on the change in value of warrants to purchase NASDAQ stock from NASD.

2004 NASD OTHER INCOME (EXPENSE)

BALANCE SHEET  Total assets for NASD have risen steadily over the last three years due principally to proceeds generated from the sale of NASD’s interest in NASDAQ. Current assets at December 31, 2004, were approximately $1.4 billion, up approximately $135.3 million over 2002. Working capital as of December 31, 2004, remained strong at $995.7 million. NASD’s equity position also continues to remain strong totaling $1.3 billion. NASD continues to invest balance sheet surpluses wisely to reduce the need to raise fees to cover increasing member regulation costs. In developing its investment strategy, NASD is guided by a committee of experts, including industry members, and an external investment consultant that assists the committee in both policy making and monitoring the performance of the portfolio.

NASD SUMMARY BALANCE SHEET (IN MILLIONS) YEARS ENDED DECEMBER 31

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$1,366.6</td>
<td>$1,456.6</td>
<td>$1,231.3</td>
</tr>
<tr>
<td>Other Assets</td>
<td>338.1</td>
<td>246.1</td>
<td>425.5</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$1,704.7</td>
<td>$1,701.7</td>
<td>$1,656.8</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>$370.9</td>
<td>$495.0</td>
<td>$431.8</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>72.8</td>
<td>49.8</td>
<td>50.4</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>443.7</td>
<td>544.8</td>
<td>482.2</td>
</tr>
<tr>
<td>Equity</td>
<td>$1,261.0</td>
<td>$1,156.9</td>
<td>$1,174.6</td>
</tr>
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