FINRA
Financial Industry Regulatory Authority

2008 Year in Review and Annual Financial Report

Reforming Regulation to Better Protect Investors

From the Chairman and CEO

2008 was a deeply challenging year for everyone who operated in and around the U.S. financial industry. Equity markets plummeted and a number of the nation's largest financial institutions merged, declared bankruptcy or were transformed into bank-holding companies. The liquidation of Lehman Brothers, and the extreme turmoil at AIG, served as potent reminders of the volatility that infected the financial system in 2008.

Amid the market turmoil, the banking system was plunged into crisis. This chain of events led to a severe erosion of confidence among investors and lenders, and deepened the recession that began in December 2007.

While the federal government intervened aggressively to stabilize the financial system, policymakers, regulators and investors recognized that the U.S. regulatory infrastructure was plagued with gaps and in need of modernization. That has sparked a valuable discussion about how to protect investors, and promote market integrity, while preserving the dynamism that makes the financial system an engine of growth and opportunity. The Obama administration's release of a regulatory reform plan in mid-June 2009 helped to focus attention on these important issues.

FINRA TAKES ACTION

Throughout the financial crisis, FINRA has worked closely with other regulators, particularly the Securities and Exchange Commission and the Federal Reserve, to examine firm activities for compliance with FINRA rules and federal securities laws, investigate wrongdoing and, when rules were broken, enforcing those rules.

The instability in the markets, and at a number of financial institutions, heightened investor fears. FINRA helped to allay those fears, and foster confidence, by working to ensure the protection of customer assets at troubled institutions. We also facilitated the orderly transfer of customers and registered representatives from one firm to another. And we committed considerable resources to educating investors and arming them with information they needed to make sound decisions in the difficult environment.

When a prominent money market fund "broke the buck" and saw its net asset value fall below $1 per share, FINRA moved quickly to provide emergency guidance on a possible money market fund collapse and other issues related to protecting customer assets.

Vigorous enforcement of rules and regulations is a cornerstone of FINRA's work to protect investors. In 2008, FINRA focused its efforts in several areas of investor harm—including excessive

Richard G. Ketchum
Chairman and
Chief Executive Officer

commissions, unsuitable mutual fund share class recommendations and sales, penny stock sales and auction rate securities recommendations and sales. Noteworthy actions include fines against Citigroup Global Markets, J.P. Turner and SunTrust Investment Services for excessive commissions and related supervisory violations; and a fine against Banorte Securities International for improper sales of Class B mutual fund shares.

Auction Rate Securities

Auction rate securities (ARS) traditionally had been a valuable source of market liquidity, targeted at investors seeking a cash-like investment that paid a higher yield than money market mutual funds or certificates of deposit. But in February 2008, the ARS market froze, leaving some investors unable to access their holdings. The episode prompted an investigation by FINRA that revealed some firms had sold these securities using advertising, marketing materials or other internal communications with its sales force that were not fair and balanced and therefore did not provide a sound basis for investors to evaluate the benefits and risks of purchasing ARS. FINRA's investigation also found evidence that each firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with the securities laws and FINRA rules with respect to the marketing and sale of ARS.

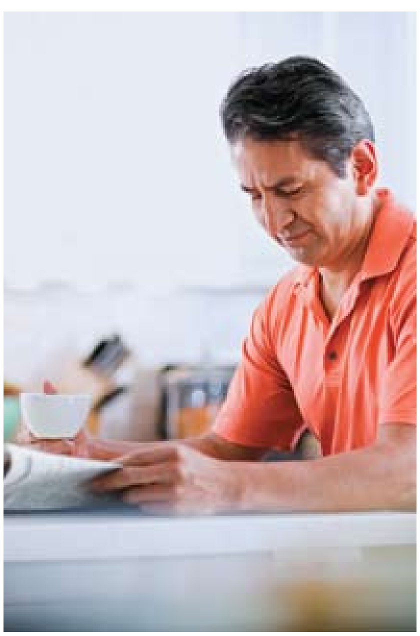
As of May 2009, FINRA had concluded final settlements with nine firms, imposing a total of $2.6 million in fines and guaranteeing the return of more than $1.2 billion to investors. In all of our ARS investigations and settlements, FINRA's primary goal continues to be the restoration of investors' access to the millions of dollars they invested in ARS.

In response to these cases, FINRA launched a special arbitration procedure for investors covered by regulatory settlement agreements. The procedure provided swifter resolution at reduced cost for customers claiming consequential financial harm related to the sudden and widespread inability to liquidate ARS into cash.

Investor Education

FINRA's highest priority is serving investors, and to that end, investor education is one of our core responsibilities. We moved forward on a number of important investor education initiatives in 2008.

In March, we issued an Investor Alert titled *Auction Rate Securities: What Happens When Auctions Fail,* explaining what happens when auctions fail and what options are available to investors. In September, we issued comprehensive guidance to retail investors regarding how their accounts are safeguarded and published *If a Brokerage Firm Closes Its Doors,* an Investor Alert outlining the steps they can take to protect themselves when a brokerage firm fails.

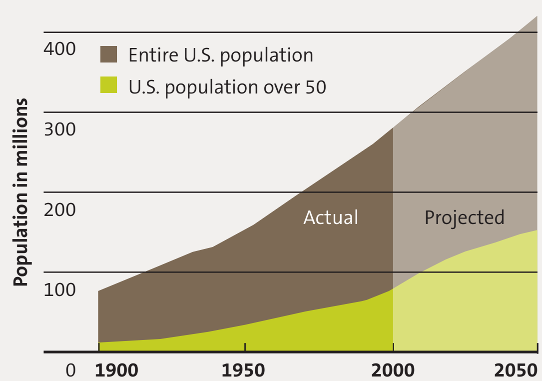


The number of Americans age 50 and above will increase by 40 million over the next 20 years. FINRA is focused on protecting these investors and providing them with information and tools designed to help them avoid fraud.

Source: AARP

Age and Population Growth

The proportion of the U.S. population age 50 and older is steadily increasing.



FINRA's BrokerCheck® service enables users to check the professional background of current and former FINRA-registered securities firms and brokers. In 2008, investors used the service to conduct 11.6 million reviews of broker or firm records—information they could use to make more sound investment choices.

The FINRA Foundation continually updated military- and senior-oriented pages on its Web site, *www.SaveAndInvest.org,* focused on financial education and avoiding predatory loans and outright fraud. In 2008, SaveAndInvest.org received nearly 23,000 visits per month.

In addition to providing senior investors with online resources, FINRA held a number of investor forums geared toward educating senior investors. We also launched and evaluated an eight-week pilot program, called *Outsmarting Investment Fraud,* which sought to teach older investors about fraud detection and prevention behaviors. The pilot reached over 1,000 people in Washington state and Florida. Expanded versions of this program are currently underway.

We continued to help military families learn to manage their money. We conducted 21 Military Financial Education Forums, focused on providing servicemembers with tools and resources to manage credit responsibly, avoid predatory loans and save for their future. From the launch of the military program in early 2006 through year-end 2008, the Foundation reached more than 16,000 servicemembers and their families at 68 forums in 39 locations throughout the world and at sea.

In 2008, the FINRA Investor Education Foundation Board approved 18 new grants totaling approximately $2.9 million. From inception through 2008, the Foundation has approved over $40 million for grant programs and targeted projects.

Finances

2008 proved to be an extremely challenging environment for the global economy and investment markets. Investors experienced one of the worst performance periods in modern times. Like many organizations, FINRA was affected by the credit crisis and the economic downturn in two ways. First, revenues used to fund operations from expected investment returns (less than 10 percent) did not materialize. Second, FINRA's investments were not immune from the unprecedented decline, resulting in investment-related losses of $568 million or 26.5 percent (the average endowment declined approximately 26.2 percent during the same period).[1] While returns from FINRA's investments were quite positive for the four years prior to 2008, the losses incurred in 2008 erased almost all of those gains.

1 *Ennis Knupp & Associates. Median return as of December 31, 2008, from BNY Mellon database of 189 comparable portfolios averaging in excess of $1 billion in assets.*

Investor Protection Principles

Individual investors deserve consistent, basic protections no matter which financial products and services they choose. At FINRA, we believe investors should expect to enter into any financial transaction knowing that:

- **every person who provides financial advice and sells a financial product is tested, qualified and licensed;**
- **the advertising for financial products and services is not misleading;**
- **every product marketed to them is appropriate for recommendation to that investor;**
- **there is full and comprehensive disclosure for the services and products being marketed that address, in plain English, the risks—including the worst-case risks—of the product; and**
- **every person who is in the business of regularly providing financial advice is subject to a federally crafted fiduciary standard.**

With significant fourth-quarter write-downs taken by industry firms for 2008, along with an economy that continues to be highly volatile, revenues and investment returns in 2009 are not expected to return to pre-2008 levels. This has compelled FINRA to stay focused on managing costs, while ensuring that any cost reductions are consistent with our ability to fulfill our mission of protecting investors.

Even in this challenging economic period, FINRA has a strong balance sheet that will enable us to continue to advance our mission and protect investors.

REFORMING REGULATION TO BETTER PROTECT INVESTORS

The events of 2008 led to renewed focus on financial regulation, and the need to address vulnerabilities in the financial system.

In its June 2009 proposal to reform U.S. financial regulation, the Obama administration cited a number of key priorities. These included subjecting all systemically important firms to strong supervision and regulation, tightening regulation of non-bank activities, enhancing consumer protections, providing government with the tools to manage failing financial institutions, and improving regulation throughout the world.

The administration has correctly identified that a critical part of creating this more balanced regulatory environment is addressing the profoundly inconsistent regulatory protections that exist across different financial products and different intermediaries. It cannot continue to be the case that consumer protections vary dramatically depending on whether the customer is sold a security, future, insurance or banking product. Yet our current system of financial regulation has created an environment in which investors are left without those consistent and effective protections.

Whatever is accomplished in creating more consistent consumer protections across financial products, one of the most glaring examples of a regulatory gap that needs fixing is the disparity between oversight regimes for broker-dealers and investment advisers. For while they are distinct entities, the everyday reality is—as the Rand Institute said in a study last year—that “trends in the financial service market since the early 1990s have blurred the boundaries between them.” This underscores the pressing need for a consistent standard that distinguishes between investment advisers and broker-dealers.

The absence of a comprehensive examination program for investment advisers impacts the level of protection for every member of the public that entrusts funds to one of those advisers. The Madoff episode in particular revealed the risks in having two, separate, independent regulatory bodies to oversee investment advisers and broker-dealers, especially when these businesses may exist in the same legal entity, and underscored the need for consistency in regulation.

FINRA Regulatory Actions in 2008

FINRA is empowered by the federal government to protect American investors from fraud and bad practices. In 2008, FINRA took vigorous enforcement action against firms and brokers who harmed investors:

- **Collected more than $28 million in fines from individual brokers and firms.**
- **Ordered or secured agreements to return more than $1 billion to investors.**
- **Expelled or suspended 19 firms, barred 363 individuals from the industry and suspended 321 others.**
- **Reviewed nearly 100,000 individual communications from firms to investors, resulting in 476 investigations.**

It is encouraging that the Obama administration's regulatory reform proposal calls for harmonizing the regulation of investment advisers and broker-dealers. A subject of extensive discussion within the financial sector is the difference between the fiduciary standard for investment advisers and the rule requirements, including suitability, for broker-dealers. We agree with the Obama administration that a fiduciary standard should be established for broker-dealers when they are offering investment advice, as this will benefit investors.

To further enhance investor protections, in March 2009 we created an Office of the Whistleblower, to encourage individuals with first-hand knowledge of, or material information about, potentially illegal or unethical activity to come forward and share it with regulators. In the first three months of operation, the Whistleblower Office received nearly 100 tips. Many of these tips contained highly credible regulatory intelligence of frauds ranging from Ponzi and affinity schemes to test cheating and boiler rooms. A number of these cases resulted in referrals to the SEC.

FINRA is always striving to make our examination and regulatory programs more effective in identifying and fighting fraud. We have stepped up those efforts with the onset of the financial turmoil.

Last year, FINRA completed a landmark agreement with 10 U.S. exchanges that brings insider trading surveillance to a new level—allowing FINRA and the NYSE to implement across markets their state-of-the-art insider trading surveillance and investigation programs for all listed securities in the United States. A focused, consolidated review strengthens our ability to prevent anyone from profiting from insider information.

We're also enhancing our examination programs when it comes to fraud detection. This involves gathering more information—prior to each exam—regarding a firm's ownership and affiliate relationships, identifying indications of fraud concerning the opening of investment advisory accounts at a broker-dealer, and examining the relationship between broker-dealers and/or their affiliates with feeder funds, or master funds that utilize feeder funds.

Another overarching priority for regulatory reform is increased market transparency. Since 2002, when we first introduced the Trade Reporting and Compliance Engine (TRACE) to track OTC corporate bonds, we have seen the benefits of increased transparency—helping regulators identify manipulative activity and providing investors and market participants with access to information enabling them to assess the quality and fairness of pricing and valuation. In March 2009, FINRA proposed a major expansion to TRACE to include debt issued by federal government agencies, government corporations and government-sponsored enterprises (GSEs). More recently, the Obama administration recommended that TRACE be expanded to include asset-backed securities.

The Opportunity Ahead

FINRA stands ready to work with Congress, the SEC and other entities to help reform financial regulation in a manner that leads to enhanced protections for America's investors. We have a proud tradition of working to ensure that the securities industry operates fairly and honestly, and that tradition continues today with a commitment to protecting investors through strong enforcement and effective investor education. Working with the federal government, we are every investor's advocate.

Richard G. Ketchum
Chairman and Chief Executive Officer

Financial Summary

Key Results

(In millions)

	Years Ended December 31,			
	2008	2007	2007	2006
	Actual	Pro forma (Unaudited)[1]	Actual[2]	Actual
Net revenues, excluding fines	**$ 778.6**	$ 760.4	$ 677.1	$ 511.8
Total expenses	**965.4**	903.8	812.2	698.6
Adjustment for one-time Voluntary Retirement Program	**(30.3)**	—	—	—
Expenses sub-total	**935.1**	903.8	812.2	698.6
Interest and dividend income	**56.6**	77.2	77.2	77.3
Operating loss, excluding fines	**(99.9)**	(66.2)	(57.9)	(109.5)
Fines	**25.9**	47.6	47.6	75.0
Comparable loss[3]	**(74.0)**	(18.6)	(10.3)	(34.5)
Adjusted comparable (loss)/earnings[4]	**$ (23.1)**	$ 27.0	$ 30.3	$ 1.6

1 *2007 Pro forma (unaudited) amounts reflect an estimated full year of NYSE member regulation operations to provide comparable year-over-year revenues and expenses for the years ended December 31, 2008 and 2007.*

2 *2007 Actual amounts reflect NYSE member regulation operations from July 30 through December 31, 2007.*

3 *Amounts exclude one-time special payment to member firms of $178.3 million for 2007, income from discontinued operations of NASDAQ of $419.8 million for 2006, as well as net investment (losses)/gains, equity (losses)/earnings, and other income for all years presented.*

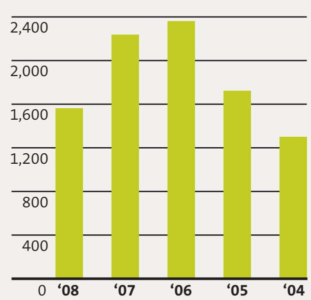
4 *Calculated as comparable (loss)/earnings plus depreciation and amortization.*

FINRA Investment Returns

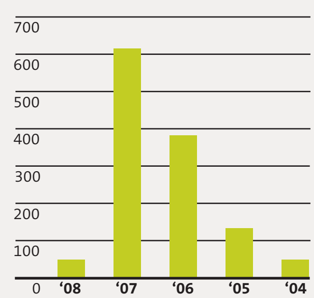
2008 was an extremely challenging year for FINRA's investment portfolio. While investment returns overall from the portfolio were quite positive for the four years prior to 2008, the losses incurred in 2008 erased almost all those gains. FINRA's investments declined 26.5 percent in calendar year 2008, commensurate with average comparable portfolio declines. As such, FINRA's consolidated financial statements reflect significant investment related losses in 2008 of approximately $568 million, net, primarily due to fair value accounting.

In April 2009, based on a comprehensive Investment Committee review of FINRA's investment policy, strategy and risk tolerance, the Board of Governors decided to shift FINRA's investment assets to a lower volatility with the objective of a lower risk portfolio. With the new policy, FINRA will continue to maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return.

Portfolio Balance at 12/31
(In millions)



Cumulative Return on Portfolio
(In millions)



Contents

Management Report on Financial Operations

OVERVIEW

The Financial Industry Regulatory Authority, Inc. (FINRA) is the largest non-governmental regulator of securities firms doing business in the United States. As of December 31, 2008, FINRA oversaw nearly 4,900 brokerage firms, about 172,000 branch offices and approximately 665,000 registered securities representatives. Created on July 30, 2007, through the consolidation of the National Association of Securities Dealers, Inc. (NASD) and the member regulation, enforcement and arbitration functions of the New York Stock Exchange (NYSE), FINRA is dedicated to investor protection and market integrity through effective and efficient regulation.

With 2,800 employees, FINRA augments and deepens the reach of the federal securities laws with detailed and enforceable ethical rules and a host of comprehensive regulatory oversight programs. FINRA regulates the population of both firms and individuals in the industry; regulates securities markets and provides market information; adopts and enforces rules to protect investors and the financial markets; examines broker-dealers for compliance with its own rules as well as federal securities laws and rules of the Municipal Securities Rulemaking Board (MSRB); informs and educates the investing public; provides industry utilities; and administers the largest dispute resolution forum for investors, registered firms and firm employees.

This Management Report should be read in connection with the consolidated financial statements and accompanying notes included elsewhere in this Annual Financial Report. The 2008 consolidated financial statements reflect the activities of FINRA and its consolidated subsidiaries, collectively referred to as "we," "our," "us," "FINRA" or the "Company" throughout this Management Report. FINRA's consolidated subsidiaries are primarily FINRA Regulation, Inc. (FINRA REG), FINRA Dispute Resolution, Inc. (FINRA DR) and the FINRA Investor Education Foundation (the Foundation), as of and for the periods ended December 31, 2008, 2007 and 2006, and FINRA's ownership interest in the operations and cash flows of The Nasdaq Stock Market, Inc. (NASDAQ) prior to December 20, 2006. On February 27, 2008, NASDAQ and OMX AB combined their businesses and NASDAQ was renamed The NASDAQ OMX Group, Inc. (NASDAQ OMX).

2008 YEAR IN REVIEW

In 2008, the United States confronted its most serious financial crisis since the Great Depression. As the financial industry was transformed by market turmoil, FINRA was steadfast in fulfilling its mission of investor protection and market integrity through execution of its rigorous examination and enforcement program. As events unfolded, we worked closely with other regulators, providing guidance to firms, examining firm activities for compliance with FINRA rules and federal securities laws, and, when rules were broken, investigating and enforcing those rules. FINRA staff actively worked with the Securities and Exchange Commission (SEC) and the Federal Reserve to monitor the financial health of broker-dealer firms, to ensure that customer assets were protected and, if necessary, to facilitate the orderly transfer of customers and registered representatives from one firm to another. We also committed considerable resources to educating investors and arming them with the information they need to make sound decisions in this difficult environment; this included issuing guidance to retail investors regarding how their accounts are safeguarded and the steps they can take to protect themselves when a brokerage firm fails.

This last year proved to be extremely challenging for the global economy and investment markets. Investors experienced one of the worst performance periods in modern times, marked by record market declines and volatility, massive financial failures and the beginning of a painful deleveraging process. FINRA's investments declined 26.5 percent in calendar year 2008, commensurate with average comparable portfolio declines of approximately 26.2 percent for the same time period. The portfolio, however, remains highly liquid, with 74 percent available in 30 days or less.

FINRA is dedicated to vigorous and evenhanded enforcement of the federal securities laws and FINRA and MSRB rules. FINRA brings disciplinary actions against firms and their employees that may result in sanctions ranging from cautionary actions for minor offenses to fines, suspensions from the business and, in egregious cases, expulsion from the industry. FINRA frequently requires firms to provide restitution to harmed investors and often imposes other conditions on a firm's business to prevent repeated wrongdoing. In 2008, FINRA issued 200 formal complaints and 1,007 decisions in formal disciplinary cases. FINRA collected over $28.1 million in fines, either ordered or secured agreements in principle for restitution in excess of $1.0 billion, expelled or suspended 19 firms, barred 363 individuals from the industry and suspended 321 others.

We also made significant progress in our efforts to complete the NASD/NYSE integration. During 2008, we completed enforcement integration efforts through the implementation of a new procedures manual; implemented a collaborative examination program so that firms receive a single examination; completed the arbitration rules and procedures comparison, integrated two arbitrator rosters into a single, unified roster, and merged the neutral training programs; and retired or transferred over 70 percent of the NYSE member regulation, enforcement and arbitration technology applications to the FINRA technology platform.

We also made substantive progress on the consolidated FINRA rulebook in 2008, bringing over 70 percent of the total rules to the FINRA Board of Governors (the Board) and moving the first two tranches of the rules for comment through Regulatory Notices or direct filing with the SEC.

We launched a new, completely redesigned *www.FINRA.org* Web site, with improved navigation, layout and design. The new Web site is more clearly organized for its primary users — industry professionals and investors — with new and updated educational material for investors. In today's marketplace, the need for educational outreach and financial information and tools for investors has never been greater, and our dedication to financial literacy has never been stronger. Through the use of grants and targeted programs, the funding of studies, online initiatives and media relations efforts, FINRA, through the Foundation, continued to position itself as the leader among investor education organizations in 2008.

RESULTS OF OPERATIONS

Net (loss) income from operations, excluding the 2007 special payment to firms and 2006 NASDAQ discontinued operations, for the years ended December 31, 2008, 2007 and 2006, was $(696.3) million, $151.3 million and $137.6 million, respectively. The Company's consolidated net (loss) income for the years ended December 31, 2008, 2007 and 2006, was $(696.3) million, $(27.0) million, and $557.4 million, respectively. Included in the consolidated net loss for the year ended December 31, 2008 is the impact of NYSE integration costs for a full year versus only five months for the year ended December 31, 2007. Included in the consolidated net loss for the year ended December 31, 2007, was the $178.3 million special payment made to firms on August 1, 2007. Included in consolidated net income for the year ended December 31, 2006, was $419.8 million of income from the discontinued operations of NASDAQ.

The Company's consolidated net loss of $(696.3) million for 2008 was driven primarily by investment related losses, including impairment charges for other-than-temporary declines in market value related to our available-for-sale investments and investments in limited partnerships, equity losses from our other investments, and mark-to-market holding losses on our trading portfolio as a result of the market downturn during 2008. Net realized losses on the sale of investments on a cash basis were $43.0 million for 2008. Further details concerning the performance of our investment portfolio follow in this report.

In April 2009, based on a comprehensive Investment Committee review of FINRA's investment policy, strategy and risk tolerance, the Board decided to shift FINRA's investment assets to a lower volatility with the objective of a lower risk portfolio. A new policy and detailed transition plan were put into place, and investment managers and consultants were engaged to assist with the new strategy. With the new policy, FINRA will continue to maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return.

Management Report on Financial Operations (continued)

FINRA manages and budgets routine business operations using operating cash flows as its key metric. Operating cash flows for the years ended December 31, 2008, 2007 and 2006, were $(182.4) million, $544.5 million and $229.9 million, respectively.

The following table sets forth our actual consolidated results of operations for the three years ended December 31, 2008 and unaudited pro forma information for the year ended December 31, 2007, which reflects NYSE's member regulation operations for a full year.

	Years ended December 31,			
	2008 Actual	2007 Pro Forma (Unaudited)	2007 Actual	2006 Actual
		(in millions)		
Revenues				
Regulatory fees	$ 453.4	$ 416.3	$ 345.0	$ 222.0
User fees	157.4	180.3	170.1	158.7
Dispute resolution fees	42.3	43.8	42.5	55.7
Transparency services fees	44.7	55.8	55.8	43.6
Contract services fees	72.0	63.0	62.7	27.2
Other	9.2	4.7	4.5	4.4
Total operating revenues	779.0	763.9	680.6	511.6
Fines	25.9	47.6	47.6	75.0
Activity assessment	154.8	281.6	281.6	185.0
Total revenues	959.7	1,093.1	1,009.8	771.6
Activity assessment cost of revenues	(155.2)	(285.1)	(285.1)	(184.8)
Net revenues	804.5	808.0	724.7	586.8
Expenses				
Compensation and benefits	541.7	499.1	446.1	395.1
Professional and contract services	214.4	210.3	199.2	148.4
Computer operations and data communications	30.5	32.0	30.8	26.1
Depreciation and amortization	50.9	45.6	40.6	36.1
Occupancy	56.1	57.4	40.2	30.2
General and administrative	71.8	59.4	55.3	62.7
Total expenses	965.4	903.8	812.2	698.6
Interest and dividend income	56.6	77.2	77.2	77.3
Operating loss	(104.3)	(18.6)	(10.3)	(34.5)
Special payment to firms in connection with the consolidation of NASD and the member regulation operations of NYSE	—	(178.3)	(178.3)	—
Net investment (losses) gains	(479.2)	113.8	113.8	131.5
Equity (losses) earnings from other investments	(144.9)	42.1	42.1	40.6
Other	32.1	5.7	5.7	—
Income from discontinued operations	—	—	—	419.8
Net (loss) income	**$(696.3)**	**$ (35.3)**	**$ (27.0)**	**$ 557.4**

The 2008 Actual consolidated results of operations reflect a full year of NYSE member regulation operations while the 2007 Actual reflects five months of NYSE member regulation operations. The 2007 pro forma (unaudited) consolidated results of operations reflect a full year of NYSE member regulation operations to provide comparable year-over-year revenues and expenses for the years ended December 31, 2008 and 2007.

The unaudited 2007 pro forma consolidated statement of operations is not intended to represent or be indicative of the consolidated results of operations that would have been reported had the consolidation of NASD's and NYSE's member regulation operations been completed as of the date presented and should not be construed as representative of the future consolidated results of operations of the consolidated entity.

Actual 2008 net revenues of $804.5 million remained flat compared to pro forma 2007 net revenues of $808.0 million. Actual 2008 expenses of $965.4 million increased by $61.6 million from total pro forma 2007 expenses of $903.8 million. The increase in compensation and benefits expense was driven primarily by severance and other benefit costs of $30.3 million related to the implementation of a Board-approved Voluntary Retirement Program (VRP) and increased retiree medical and savings plan expenses. General and administrative expense increased $12.4 million, driven by a $10.3 million increase in bad debt reserves for fines and arbitration activities.

Results of Operations, 2008 versus 2007

Revenues

Operating revenues were $779.0 million in 2008, compared with $680.6 million in 2007 — an increase of $98.4 million, or 14.5 percent, due to higher regulatory, contract services and other revenues, offset by lower user fees and transparency services revenues. Of this increase, $60.1 million related to an increase in assessments based on gross revenue (Gross Income Assessment) of firms, personnel (principals and registered representatives) and branch offices, resulting from the consolidation of NASD and the member regulation operations of NYSE.

Regulatory fees fund our regulatory activities, including the supervision and regulation of firms through examination, policy making, rulemaking and enforcement activities. Regulatory fees include the transaction-based Trading Activity Fee and Gross Income Assessments. Regulatory fees were $453.4 million in 2008, compared with $345.0 million in 2007 — an increase of $108.4 million, or 31.4 percent, due primarily to a $70.0 million increase in Gross Income Assessments. Of this $70.0 million increase, $60.1 million relates to the transfer of NYSE's Gross Focus Fee to FINRA effective July 30, 2007. The Trading Activity Fee increased by $37.3 million due to an increase in trading activity volumes from 2007 to 2008. Additionally, we issued rebates to firms of $5.9 million and $6.1 million in 2008 and 2007, respectively. We recorded these rebates as a reduction of regulatory fees.

User fees include initial and annual registration fees, fees for qualification exams, fees associated with FINRA-sponsored educational programs and conferences, processing of membership applications and charges related to the review of advertisements and corporate financing filings. User fees totaled $157.4 million in 2008, compared with $170.1 million in 2007 — a decrease of $12.7 million, or 7.5 percent, due to a decrease in the Central Registration Depository (CRD) system registration and annual fees, decreased branch office fees and decreased volumes in corporate financing filings. CRD and branch office fees decreased due to the elimination of duplicative registration fees for NYSE firms for branch offices and registered representatives.

Dispute resolution fees represent fees earned during the arbitration and mediation processes. Dispute resolution fees remained consistent with the prior year totaling $42.3 million in 2008 and $42.5 million in 2007.

Transparency services fees represent amounts charged for services offered through our Trade Reporting and Compliance Engine (TRACE), our Alternative Display Facility (ADF), the Over-the-Counter Bulletin Board (OTCBB) and the OTC Reporting Facility (ORF). Transparency services fees were $44.7 million in 2008 compared with $55.8 million in 2007 — a decrease of $11.1 million, or 19.9 percent, primarily due to decreased OTC and ADF volumes driving a decrease in trade reporting fees and market data revenues.

Contract services fees represent amounts charged for regulatory services provided primarily to NASDAQ OMX, NYSE Amex LLC (NYSE Amex) (formerly known as the American Stock Exchange LLC), the Trade Reporting Facilities (TRFs), and other exchanges for services including surveillance, monitoring, technology development, legal and enforcement activities. Contract services fees also include fees for the mortgage licensing system FINRA developed and deployed to the State Regulatory Registry, LLC (SRR). Contract services fees were $72.0 million in 2008, compared with $62.7 million in 2007 — an increase of $9.3 million, or 14.8 percent, due mainly to an increase in mortgage licensing system fees charged to SRR and TRF regulatory charges.

Other revenues were $9.2 million in 2008, compared with $4.5 million in 2007 — an increase of $4.7 million, primarily due to the recognition of deferred contribution revenue attributable to the Foundation's use of funds received from the Global Analyst Settlement (the Settlement). FINRA recognizes the related revenue as the Foundation makes grant payments and incurs expenses against Settlement funds pursuant to guidelines under the SEC's investor education plan. Grant payments and expenses incurred in 2008 and 2007 were $6.2 million and $2.0 million, respectively.

Fines represent amounts levied as sanctions for rule violations. We do not view fines as part of our operating revenues. Fine revenues totaled $25.9 million in 2008 and $47.6 million in 2007 — a decrease of $21.7 million, or 45.6 percent, due to a decrease in the number of fines levied. The process that we have in place regarding the use of fines is designed to guard against potential conflicts in the organization's collection and use of fine monies. Our fine guidelines provide that:

1) All fine monies are accounted for separately;
2) Fine monies collected or anticipated are not included in operating revenues and play no role in developing the operating budget;
3) Fine monies are not used to fund employee compensation;
4) The use of fine monies is limited to capital expenditures and regulatory projects; and
5) Capital expenditures and regulatory projects for which we plan to and have used fine monies, such as the integration of NYSE member regulation, enforcement and arbitration technology applications into the FINRA technology platform, are reported to the Board.

Activity assessment revenues represent amounts billed to firms to cover our obligation to the SEC under Section 31 of the Securities Exchange Act of 1934. Activity assessment cost of revenues represents the amounts owed and remitted to the SEC under this obligation. Activity assessment revenues were $154.8 million in 2008, compared to $281.6 million in 2007 — a decrease of $126.8 million, or 45.0 percent. Activity assessment cost of revenues was $155.2 million in 2008, compared to $285.1 million in 2007 — a decrease of $129.9 million, or 45.6 percent. Rate reductions in the first and second quarters of 2008, partially offset by an increase in the dollar volume of contracts traded, drove the decrease in both activity assessment revenues and activity assessment cost of revenues.

Expenses

Total expenses were $965.4 million in 2008, compared to $812.2 million in 2007 — an increase of $153.2 million, or 18.9 percent, of which $77.2 million related to NYSE operations consolidated in 2007.

Compensation and benefits increased to $541.7 million in 2008 from $446.1 million in 2007 — an increase of $95.6 million, or 21.4 percent, primarily attributable to the inclusion of NYSE employees in 2008 operating results for the entire year versus only five months in 2007. The addition of these employees led to increased compensation and benefit costs of $31.1 million. In addition, on September 29, 2008, FINRA announced the implementation of the Board-approved VRP. Severance and other benefit costs related to the VRP totaled $30.3 million. The remaining increase in compensation expense is due to annual merit and promotion compensation increases, as well as increased retiree medical and savings plan and employee insurance benefit costs, offset by a Board-approved decrease in incentive compensation in response to the market downturn during 2008.

Professional and contract services increased to $214.4 million in 2008 from $199.2 million in 2007 — an increase of $15.2 million or 7.6 percent, due primarily to increases in application development for technology-related initiatives and application maintenance. An increase of $13.8 million in application development charges over last year was driven primarily by work to complete the integration of former NASD and NYSE technology platforms. Application maintenance and production services expenses increased $4.8 million over last year. Application maintenance increases are the result of projects moving from development to in-service status, such as the Firm Gateway, Member Data Repository, and Reporting and Business Intelligence applications, as well as support of the NYSE member regulation legacy applications. Other technology costs increased $3.2 million as a result of continuing technology-related services provided by NYSE and helpdesk and support services provided by Electronic Data Systems Corporation (EDS). These increases were offset by a decrease of $6.5 million in legal expenses due to decreased spending for NYSE consolidation-related legal services.

All other operating expenses (computer operations and data communications, depreciation and amortization, occupancy and general and administrative) increased to $209.3 million in 2008 from $166.9 million in 2007 — an increase of $42.4 million, or 25.4 percent. This change was primarily driven by an increase of $15.7 million in occupancy, security and facilities administration charges related to FINRA personnel working in buildings subleased from NYSE as a result of the consolidation of NASD and the member regulation operations of NYSE. Depreciation and amortization increased $10.3 million due primarily to asset additions during the year and software and intangible assets acquired as a result of the consolidation of NASD and the member regulation operations of NYSE. The consolidation-related occupancy and intangible asset charges were included in 2008 operating results for the entire year versus only five months in 2007. Bad debt expense increased $10.3 million, driven by an increase in reserves for fines and arbitration activities.

Interest and Dividend Income

Interest and dividend income primarily reflects income earned on our operating cash accounts and investments. Interest and dividend income was $56.6 million in 2008, compared with $77.2 million in 2007 — a decrease of $20.6 million or 26.7 percent. The decline was driven by decreases in interest rates and dividends declared, as well as a decrease in the asset base on which interest is earned. The decrease in the asset base was due to a decline in the market performance of our investment portfolio during 2008.

Special Payment to Firms

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

Investment (Losses) Gains

Net investment (losses) gains in the consolidated statements of operations are primarily net realized gains and losses on sales of available-for-sale securities and mark-to-market holding gains and losses on our trading portfolio. Net investment losses were $479.2 million in 2008, compared with net investment gains of $113.8 million in 2007, due to impairment charges for other-than-temporary declines of $273.2 million and $35.4 million related to our available-for-sale investments and investments in limited partnerships, respectively, as a result of the market downturn during 2008. Also driving the change were net realized losses related to our available-for-sale investments of $60.8 million and holding losses related to our trading portfolio of $71.2 million in 2008. The remainder of the change relates primarily to net realized losses on our trading portfolio during 2008. Net realized losses on the sale of investments on a cash basis were $43.0 million for 2008.

Equity (Losses) Earnings from Other Investments

Equity (losses) earnings from other investments represent our share in the earnings and losses from our ownership interests in hedge funds, funds of hedge funds and four limited partnerships accounted for under the equity method. Equity losses were $144.9 million in 2008, compared with equity gains of $42.1 million in 2007. The losses in 2008 were driven by the market downturn during 2008. Our weighted ownership interest in the net assets of all equity method investees was 1.7 percent at December 31, 2008.

Other Income

Other income primarily consists of fees that were previously collected by firms but not remitted to us as part of the SEC self-reporting process. We provided a six-month amnesty period during which these accumulated funds could be remitted, beginning December 11, 2007, and ending June 11, 2008.

Results of Operations, 2007 versus 2006

Revenues

Operating revenues were $680.6 million in 2007, compared with $511.6 million in 2006 — an increase of $169.0 million, or 33.0 percent, due to higher regulatory, user, transparency services and contract services revenues offset by lower dispute resolution fees.

Regulatory fees were $345.0 million in 2007, compared with $222.0 million in 2006 — an increase of $123.0 million, or 55.4 percent, due primarily to a $70.5 million increase in Gross Income Assessments, driven primarily by the transfer of NYSE's Gross Focus Fee to FINRA effective July 30, 2007. The Trading Activity Fee increased by $8.8 million due to an increase in trading activity volumes from 2006 to 2007. Additionally, we issued rebates to firms of $6.1 million and $50.0 million in 2007 and 2006, respectively. We recorded these rebates as a reduction of regulatory fees.

User fees totaled $170.1 million in 2007, compared with $158.7 million in 2006 — an increase of $11.4 million, or 7.2 percent, due to the inclusion of registration fees for NYSE firms for branch offices and registered representatives after the consolidation of NASD and the member regulation operations of NYSE, as well as increased volumes in corporate financing filings.

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

Transparency services fees were $55.8 million in 2007, compared with $43.6 million in 2006 — an increase of $12.2 million, or 28.0 percent, primarily due to additional ADF volume driving an increase in market data revenue.

Contract services fees were $62.7 million in 2007, compared with $27.2 million in 2006 — an increase of $35.5 million, due mainly to the final divestiture of NASDAQ in December 2006. Prior to divestiture, the NASDAQ revenues were eliminated from our consolidated financial results. In 2007, regulatory services fees charged to NASDAQ totaling $28.7 million were included in contract services fees in our consolidated financial results.

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

Fine revenues totaled $47.6 million in 2007 and $75.0 million in 2006 — a decrease of $27.4 million, or 36.5 percent, due to a decrease in the number of fines levied.

Activity assessment revenues were $281.6 million in 2007, compared to $185.0 million in 2006 — an increase of $96.6 million, or 52.2 percent. Activity assessment cost of revenues was $285.1 million in 2007, compared to $184.8 million in 2006 — an increase of $100.3 million, or 54.3 percent. An increase in the dollar volume of contracts traded, partially offset by a rate reduction in the first quarter of 2007, drove the increase in both activity assessment revenues and activity assessment cost of revenues.

Expenses

Total expenses were $812.2 million in 2007, compared to $698.6 million in 2006 — an increase of $113.6 million, or 16.3 percent, of which $56.7 million is related to the consolidation of NASD and the member regulation operations of NYSE effective July 30, 2007.

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

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

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

Interest and Dividend Income

Interest and dividend income remained consistent with the prior year totaling $77.2 million in 2007, compared with $77.3 million in 2006.

Special Payment to Firms

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

Investment Gains and Equity Earnings from Other Investments

Net investment gains in the consolidated statements of operations are primarily net realized gains and losses on sales of available-for-sale securities and mark-to-market holding gains and losses on our trading portfolio. Equity earnings from other investments represent our share in the earnings from our ownership interests in hedge funds, funds of hedge funds and one limited partnership accounted for under the equity method. Our weighted ownership interest in all equity method investees was 1.6 percent at December 31, 2007.

Management Report on Financial Operations (continued)

Provision for Income Taxes

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

Discontinued Operations

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

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

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

LIQUIDITY AND CAPITAL RESOURCES

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

FINRA's investment portfolio (the Fund) is governed by a policy based on best practices as applied to its investment objectives. The FINRA Investment Committee (Investment Committee), whose members have extensive background and experience in the investment community, provides overall guidance and advice in determining the appropriate policy and allocation for these investments. In accordance with our Investment Policy, FINRA may invest in illiquid assets, defined as assets that cannot be liquidated for cash in 52 weeks or less, so long as the aggregate market value of all such illiquid assets does not exceed 45 percent of the aggregate market value of the Fund. As of December 31, 2008, the Fund remains highly liquid, with 74 percent available in 30 days or less.

See the separate Investment Committee Report on page 29 of the 2008 Annual Financial Report for further discussion of liquidity and capital resources.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT RISK

Market risk represents the risk of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates, equity prices and other factors. As of December 31, 2008, investments in the Company's consolidated financial statements consisted of: (i) global government (including state and local) securities; (ii) corporate and asset-backed securities; (iii) equity securities; (iv) exchange-traded funds; (v) mutual and commingled funds; (vi) other investments (hedge funds, funds of hedge funds and private investments), and (vii) other financial instruments or structures.

Our primary market risk relates to our investment portfolio. Our investments are impacted by fluctuations in the securities markets.

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

In addition, FINRA has potential risk exposure from its short positions in its trading and other investments. Securities that are sold short represent obligations of the Company to deliver specific securities, and thereby create liabilities to repurchase the securities in the open market at the then prevailing prices. Accordingly, these transactions may result in off-balance sheet risk as our satisfaction of the obligations may exceed the amount recognized in the balance sheet. At December 31, 2007, FINRA's short positions totaled $41.6 million and were included with investments payable in the consolidated balance sheet.

FINRA management believes that other-than-temporary fluctuations in market indices could have a significant impact on our available-for-sale investment portfolio, earnings and cash flows. We review our available-for-sale investment portfolio for other-than-temporary declines on an annual basis. Based on these reviews, we record impairment charges for other-than-temporary declines on our available-for-sale investments. We recorded impairment charges for other-than-temporary declines of $273.2 million in 2008 related to our available-for-sale investments as a result of the market downturn during 2008. Impairment charges in 2007 were not material. We recorded impairment charges for other-than-temporary declines of $31.2 million in 2006 primarily related to our available-for-sale investments. We consider and evaluate year-end fair value estimates for the impairment assessment on our private investments. In reviewing this information, we evaluate current financial statements and subsequently verify valuations from annual audited statements obtained from each fund. We also review valuation procedures used by the funds. We recorded impairment charges for other-than-temporary declines of $35.4 million and $2.0 million in 2008 and 2007, respectively, related to our investments in limited partnerships. No impairment charges related to our investments in limited partnerships were recorded in 2006.

FINRA is exposed to credit risk from third parties, including NASDAQ OMX, NYSE Euronext and FINRA firms. These parties may default on obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons.

CASH FLOWS

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

	Years Ended December 31						
	2008	2007			2006		
	Total	Continuing	Special Firm Payment	Total	Continuing	Discontinued Operations	Total
Operating	$(182.4)	$ 722.8	$(178.3)	$ 544.5	$ 149.3	$ 80.6	$ 229.9
Investing	(34.3)	(321.6)	—	(321.6)	(729.7)	(931.5)	(1,661.2)
Financing	(14.9)	10.8	—	10.8	49.7	1,335.1	1,384.8
Total	$(231.6)	$ 412.0	$(178.3)	$ 233.7	$(530.7)	$ 484.2	$ (46.5)

FINRA used $182.4 million of cash from operating activities in 2008 to fund the purchase of securities to be sold in the near term. Net cash used in investing activities was $34.3 million in 2008, primarily used to fund purchases of available-for-sale securities and property and equipment, offset by net redemptions of other investments (hedge funds) and proceeds from the payment of the revolving credit facility receivable between FINRA and NYSE Amex. Net cash used by financing activities was $14.9 million in 2008, primarily representing the distribution of funds held in escrow related to a FINRA enforcement case and recognition of deferred contribution revenue as a result of the Foundation's disbursement of Settlement funds.

FINRA generated cash inflows from operating activities of continuing operations of $722.8 million in 2007, driven by the sale of securities in our trading portfolio during the first quarter of 2007. Net cash used in investing activities was $321.6 million in 2007, consisting primarily of net purchases of available-for-sale securities and other investments, as well as payments related to the consolidation of NASD and the member regulation operations of NYSE. Net cash provided by financing activities was $10.8 million in 2007, representing contributions to the Foundation from external parties.

FINRA generated cash inflows from operating activities of continuing operations of $149.3 million in 2006, driven by the sale of securities in our trading portfolio. Net cash used in investing activities of continuing operations was $729.7 million in 2006, due to investing the majority of proceeds generated from the sales of NASDAQ common stock and exercise of warrants. Cash inflows from financing activities of continuing operations were $49.7 million in 2006 due to contributions to the Foundation from external parties.

Overall cash and cash equivalents, trading investments and available-for-sale investments totaled $1,077.6 million as of December 31, 2008, and $1,711.2 million as of December 31, 2007. The decrease of $633.6 million or 37.0 percent was driven primarily by overall market declines impacting the trading and available-for-sale portfolios during 2008.

FINRA's working capital was $846.1 million as of December 31, 2008, and $1,430.2 million as of December 31, 2007. We have been able to generate sufficient funds from operations, including interest and dividend income, to meet working capital requirements. We had a line of credit of up to $50.0 million through March 24, 2009, replaced by a line of credit of up to $100.0 million effective March 25, 2009, both having a variable interest rate. No amounts were outstanding under this credit agreement as of December 31, 2008, and December 31, 2007. We believe that the liquidity provided by existing cash and cash equivalents, investments and cash generated from operations will provide sufficient capital to meet current and future operating requirements.

CONTRACTUAL OBLIGATIONS AND CONTINGENT COMMITMENTS

FINRA has contractual obligations to make future payments for limited partnership investments, minimum rental commitments under non-cancelable operating leases and other obligations. The following table summarizes those contractual obligations:

	Total	Less than 1 Year	1–3 Years	3–5 Years	More than 5 Years
			(in millions)		
Commitments to investments in limited partnerships	$166.1	$ 55.5	$ 80.2	$ 30.4	$ —
Minimum rental commitments under non-cancelable operating leases	237.8	30.0	59.8	43.0	105.0
Commitments related to facility operations and security in New York, NY	74.8	19.9	42.4	12.5	—
Information and technology services agreement	70.0	19.0	35.0	16.0	—
Total	$548.7	$124.4	$217.4	$101.9	$105.0

Commitments to investments in limited partnerships represent the expected funding of our total commitment to 29 investments in limited partnerships. The majority of the non-cancelable operating leases contain escalation clauses based on increases in property taxes and building operating costs. Commitments related to operations in New York include facilities and security costs for personnel employed by us working in buildings subleased from NYSE due to the consolidation of NASD and the member regulation operations of NYSE. Information and technology services agreement commitments relate to our minimum annual spending requirements under an agreement with EDS. EDS provides application development and maintenance services to us under that agreement, which expires on December 31, 2012.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP). We are required to adopt accounting principles and make estimates and judgments to develop amounts reported in the financial statements and accompanying notes.

We periodically review the application of our accounting policies and evaluate the appropriateness of the estimates that are required to prepare the financial statements. We believe our estimates and judgments are reasonable; however, actual results and the timing of recognition of such amounts could differ from those estimates.

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

INVESTMENTS

Debt and Marketable Equity Securities

FINRA accounts for its investments in debt and marketable equity securities in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which requires that, at the time of purchase, individual securities be classified as trading, available-for-sale or held-to-maturity based on the type of security and the Company's intent and ability to hold these securities. Such designations are re-evaluated annually. We have designated our investments in debt and marketable equity securities as either trading or available-for-sale. Trading securities are carried at fair value, with changes in fair value recorded as a component of net investment gains/

(losses) in the consolidated statements of operations. We carry available-for-sale securities at fair value and recognize temporary changes in fair value as an unrealized gain/(loss), which is presented as a separate component of equity in the consolidated balance sheets.

Fair value is determined based on quoted market prices, when available, or on estimates provided by external pricing sources or dealers who make markets in such securities. Realized gains and losses on sales of securities are included in earnings using the average cost method. Investments receivable or payable relate to security trades executed prior to the balance sheet date, but not yet settled, as we follow trade date accounting. Also included within investments payable are short securities, which represent obligations of the Company to deliver certain contracted securities at a future time.

Other Investments

We have investments in hedge funds and funds of hedge funds, all of which we have elected to account for under the equity method. We are also a limited partner in a number of private investment funds. We account for investments in private investment limited partnerships under the cost or equity method in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 78–9, *Accounting for Investments in Real Estate Ventures*, as clarified by Emerging Issues Task Force (EITF) No. D-46, *Accounting for Limited Partnership Investments*. Additionally, we retain the specialized accounting for other investments accounted for under the equity method pursuant to EITF Issue No. 85–12, *Retention of Specialized Accounting for Investments in Consolidation*. We assess fair value estimates from fund managers to determine year-end fair values for investments in private investments, hedge funds and funds of hedge funds, and compare those values through the review of audited financial statements, additional due diligence procedures and follow-up discussions with the fund managers.

Other-Than-Temporary Impairment

FINRA periodically monitors and evaluates the realizability of its available-for-sale and cost-method investments. When assessing realizability, including other-than-temporary declines in value, we consider such factors as:

- the extent of the decline in value;
- the duration of unrealized losses; and
- the potential for recovery in the near term.

We also review the financial statements of our cost and equity method investments for potential indicators of impairment. If events and circumstances indicate that a decline in the value of these assets has occurred, and we deem that the decline is other-than-temporary, we reduce the carrying value of the investment to its fair value and charge the impairment to earnings.

FAIR VALUE MEASUREMENTS

FINRA adopted SFAS No. 157, *Fair Value Measurements*, effective January 1, 2008. The adoption of this statement, as amended, did not have a material effect on our financial position or results of operations. SFAS No. 157 provides a framework for measuring fair value under U.S. GAAP, as well as expanded disclosures about assets and liabilities measured at fair value, including the effect of fair value measurements on earnings. SFAS No. 157 establishes a valuation hierarchy that prioritizes inputs to valuation techniques used to measure fair value and requires companies to disclose the fair value of their financial instruments according to a three-level hierarchy (*i.e.*, Level 1, 2 and 3 inputs, as defined). The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Additionally, companies are required to provide enhanced disclosure regarding instruments in the Level 3 category (which have inputs to the valuation techniques that are unobservable and require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities.

Accordingly, financial instruments measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access as of the reporting date.
Level 2	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, through corroboration with observable data.
Level 3	Unobservable inputs, such as internally developed pricing models for the asset or liability due to little or no market activity for the asset or liability.

Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. In determining fair value, the Company obtains valuations from investment fund managers who use various valuation approaches, including the use of counterparty pricing services and external or third-party pricing sources.

REVENUE RECOGNITION AND COST OF REVENUE

Regulatory Fees

Regulatory fees represent fees to fund our regulatory activities, including the supervision and regulation of firms through examination, policy making, rulemaking and enforcement activities. Regulatory fees are recorded net of any rebates to firms. Regulatory fees include the Trading Activity Fee, Gross Income Assessment, Personnel Assessment and Branch Office Assessment. The Trading Activity Fee is calculated on the sell side of all transactions by firms in all covered securities, regardless of where the trade is executed, and is assessed directly on the firm responsible for clearing the transaction. The Trading Activity Fee is self-reported to us by firms, and the revenue is recognized in the month the transactions occur. As the Trading Activity Fee is a self-reported revenue stream, subsequent adjustments by firms may occur and are recognized as an adjustment to revenue in the period the adjustment becomes known to us. The Gross Income Assessment and Personnel Assessment represent annual fees charged to firms. The Branch Office Assessment has an initial fee component in addition to annual fees. The initial fee is recognized over the estimated business relationship period and the annual fee over the related annual period.

User Fees

User fees consist of fees charged for initial and annual registrations, qualification exams, FINRA-sponsored educational programs and conferences, reviews of advertisements and corporate filings (corporate financing fees). Registration fees primarily include both initial and annual fees charged on all registered representatives and investment advisers. The initial fee is recognized over the estimated business relationship period and the annual fee over the related annual period. Qualification fees consist of examination and continuing education fees. Qualification fees are recognized as examinations or continuing education programs are administered. FINRA-sponsored meeting and conference fees include fees paid by financial services industry participants for participating in our educational programs. We recognize these fees when the program or conference takes place. Advertising fees represent fees charged for the review of firms' communications to ensure that they are fair, balanced and not misleading. Advertising fees are recognized as revenue when we complete the review. Corporate financing fees consist of fees charged by us for reviewing proposed public offerings; thus, we recognize these fees when we complete our review.

Dispute Resolution Fees

Dispute resolution fees consist of fees earned during the arbitration and mediation processes. Certain arbitration fees, such as initial, counterclaim, cross claim and other filing fees, and surcharge fees relate to the entire period covered by an arbitration case, and as such are recognized as revenue over the average life of an arbitration case. Mediation filing fees are recognized over the average life of a mediation case. All other arbitration- and mediation-related fees, such as pre-hearing and hearing processing fees, adjournment fees, hearing session fees and mediation session fees, which are event driven, are recognized as the service is provided. Dispute resolution fees also include arbitrator and mediator application and training fees. These fees are recognized when the associated service is provided.

Transparency Services Fees

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

Contract Services Fees

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

Fines

Fines represent sanctions for rule violations. We recognize fines upon issuance of a written consent or litigation decision.

Activity Assessment

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

We recover the cost of the Section 31 fees and assessments through an activity assessment billed to clearing and self-clearing firms based on the aggregate dollar amount of sales of covered securities transacted by or through any firm other than on a national securities exchange. The assessments billed to securities firms are recognized when the transactions are reported. FINRA, as the primary obligor to the SEC, reports the activity assessment on a gross basis within revenues in accordance with EITF No. 99–19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. We report the amounts due to the SEC as an activity assessment cost of revenue.

We rely on third party providers and securities firms to report activity in a complete, accurate and timely manner for purposes of determining the activity assessment revenues and cost of revenues. Given these factors, subsequent adjustments may occur. We recognize any resulting activity assessment adjustments in the period they become known to us.

PENSION AND OTHER POSTRETIREMENT BENEFITS

As of December 31, 2008, and December 31, 2007, the Company provided two non-contributory defined benefit pension plans for the benefit of eligible employees. The non-contributory defined benefit plans consist of a qualified Employees Retirement Plan and a non-qualified Supplemental Executive Retirement Plan (collectively referred to as “pension benefits”). On January 1, 2007, we implemented an employer-funded defined contribution Retiree Medical Plan to assist our employees and retirees with the cost of health care expenses during retirement (“other benefits”). Several statistical and other factors, which attempt to anticipate future events, are used in calculating the expenses and liability related to the plans. Key factors include assumptions about the expected rates of return on plan assets and discount rates as determined by the Company, within certain guidelines, as well as assumptions regarding future salary increases, mortality, turnover, retirement ages and the medical expense trend rate. We consider market conditions, including changes in investment returns and interest rates, in making these assumptions. The discount rate used in the calculations is developed considering changes in a hypothetical bond portfolio or specific bond matching approach. We determine the long-term rate of return based on an analysis of historical and projected returns as prepared by the Company's actuary and external investment consultant. The Company's Pension Plan Committee approves both the expected long-term rate of return and the discount rate assumptions, which were 7.75 percent and 6.50 percent, respectively, as of December 31, 2008.

The actuarial assumptions that we use in determining pension and other benefits may differ materially from actual results due to changing market and economic conditions, as well as early withdrawals by terminating plan participants. While we believe that the assumptions used are appropriate, differences in actual experience or changes in assumptions may materially affect our financial position or results of operations. A 25 basis point increase (decrease) in the discount rate assumption as of December 31, 2008, would cause the projected benefit obligation for pension benefits to decrease (increase) by approximately $12.5 million. A 25 basis point increase (decrease) in the discount rate assumption as of December 31, 2007, would have caused the 2008 pension benefits expense to decrease (increase) by approximately $2.1 million. A 25 basis point increase (decrease) in the discount rate assumption as of December 31, 2008, would cause the projected benefit obligation for other benefits to decrease (increase) by approximately $0.6 million. A 25 basis point increase (decrease) in the discount rate assumption would not have a material impact on 2008 other benefits expense.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115*. SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply SFAS No. 157 early. We evaluated SFAS No. 159 and elected not to measure any applicable financial assets or liabilities at fair value pursuant to the provisions of SFAS No. 159 as of January 1, 2008.

In February 2008, the FASB also issued FASB Staff Position (FSP) 157–2, *Effective Date of FASB Statement No. 157*, which deferred the SFAS No. 157 requirements for certain non-financial assets and liabilities until January 1, 2009. We do not expect the adoption of FSP 157–2 to have a material impact on our consolidated results of operations and financial position.

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement 109*. Among other things, FIN 48 provides guidance to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing a minimum recognition threshold which income tax positions must achieve before being recognized in the financial statements. In addition, FIN 48 requires expanded annual disclosures, including a rollforward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. FIN 48 is effective for nonpublic enterprises, such as FINRA, on January 1, 2009. FIN 48 is not expected to have a material impact on our consolidated results of operations and financial position.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133*, which requires enhanced qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk contingent features in derivative agreements. We plan to adopt SFAS No. 161 on January 1, 2009. Since SFAS No. 161 only requires additional disclosures concerning derivatives and hedging activities, this standard is not expected to have a material impact on our consolidated results of operations and financial position.

In December 2008, the FASB issued FSP 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*, which requires additional disclosures about assets held in an employer's defined benefit pension or other postretirement benefit plan. FSP 132(R)-1 replaces the requirement to disclose the percentage of the fair value of total plan assets with a requirement to disclose the fair value of each major asset category and for companies to consider providing additional disclosures about major asset categories based on the disclosure objectives in the FSP. Also, FSP 132(R)-1 requires disclosure of the level within the fair value hierarchy in which each major category of plan assets falls, using the guidance in SFAS No. 157. Furthermore, FSP 132(R)-1 requires companies to reconcile the beginning and ending balances of plan assets with fair values measured using significant unobservable inputs (Level 3 in the hierarchy). FSP 132(R)-1 is effective for FINRA on January 1, 2009. We are currently assessing the potential impact that FSP 132(R)-1 will have on our financial statements.

Management Report on Internal Control Over Financial Reporting

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

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

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

Under the supervision of the Chairman and Chief Executive Officer and Chief Financial Officer, FINRA's management assessed the effectiveness of FINRA's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. This evaluation included reviews of the documentation of controls, evaluations of the design effectiveness of controls, tests of the operating effectiveness of controls and a conclusion on management's evaluation. Based on this assessment, we assert that FINRA maintained effective internal control over financial reporting as of December 31, 2008.

FINRA's financial statements included in this annual report have been audited by Ernst & Young LLP, an independent registered public accounting firm. Ernst and Young LLP has also issued an attestation report on FINRA's internal control over financial reporting as of December 31, 2008.

June 24, 2009

Richard G. Ketchum
Chairman and Chief Executive Officer

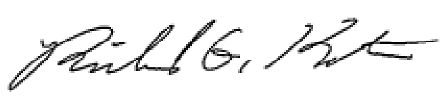
Todd T. Diganci
Executive Vice President and Chief Financial Officer

Certification of 2008 Annual Financial Report

We, Richard G. Ketchum and Todd T. Diganci, certify that:

1. We have reviewed this annual financial report of the Financial Industry Regulatory Authority, Inc. (FINRA);
2. The purpose of this report is principally to set forth management's report on financial operations with respect to FINRA during the year ended December 31, 2008, together with the consolidated financial statements of FINRA as of December 31, 2008, and 2007, and for the years ended December 31, 2008, 2007 and 2006. This report is not intended to comply with the substantive or form requirements for periodic reports under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated there under required of issuers of securities subject to the periodic reporting requirements under Sections 12, 13 and 15;
3. Based on our knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
4. Based on our knowledge, the financial statements and financial information set forth under the caption "Management Report on Financial Operations" fairly present in all material respects the financial condition, results of operations and cash flows of FINRA as of, and for, the periods presented in this report;
5. FINRA has established disclosure controls and procedures to ensure that material information relating to FINRA, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
6. FINRA has established internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
7. FINRA has carried out its evaluation of the effectiveness of the design and operation of FINRA's disclosure controls and procedures as of December 31, 2008. Based upon that evaluation, we have concluded that the disclosure controls and procedures are effective;
8. We have disclosed, based on FINRA's most recent evaluation of internal control over financial reporting, to FINRA's auditors and the Audit Committee of FINRA's Board of Governors:
   a) Any significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect FINRA's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in FINRA's internal control over financial reporting.

June 24, 2009



Richard G. Ketchum
Chairman and Chief Executive Officer

Todd T. Diganci
Executive Vice President and Chief Financial Officer

Audit Committee Report

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

During 2008, the Committee met five times, with the Committee members having a 100 percent attendance rate.

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

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

Independent Registered Public Accountant (IRPA) Fees

	FINRA (1)	
	2008	2007
Audit services (2)	$ 896,950	$1,058,400
Audit-related services (3)	326,500	449,335
Tax services (4)	90,000	—
Total	$1,313,450	$1,507,735

(1) FINRA based its fees reported for 2008 on fees approved by FINRA's Audit Committee as of March 31, 2009. The 2008 audit services, audit-related services, and tax services include estimates to complete the current work in process. FINRA has updated the 2007 fees from the prior year's report to reflect final amounts paid for the 2007 approved services.

(2) For 2008 and 2007, audit services represent the year-end financial statement audit and the attestation on internal control under Section 404 of the Sarbanes-Oxley Act of 2002.

(3) Audit-related services in 2008 and 2007 reflect fees associated with the special-purpose audit of the Investment Advisers Registration Depository, agreed-upon procedures over the Central Registration Depository, and the audit of the FINRA Investor Education Foundation and the Company's employee benefit plans. In 2008, audit-related services also included a review of the implementation of MATRICS and accounting advisory services related to the Voluntary Retirement Program. In 2007, audit-related services also include accounting advisory services associated with the consolidation of NASD and the member regulation operations of NYSE and agreed-upon procedures over the Continuing Education Program.

(4) Tax services represent fees related to tax return preparation services in connection with the 2008 Form 990 and related Form 990-T, as well as tax compliance, advice and planning.

Audit Committee Report (continued)

The Audit Committee discussed and reviewed with the independent auditor all communications required by Statement on Auditing Standard No. 114, *The Auditor's Communication with Those Charged with Governance*. Further, the Committee has reviewed and discussed with management and with E&Y, with and without management present, the audited financial statements as of December 31, 2008; management's assessment of the effectiveness of FINRA's internal control over financial reporting; and E&Y's report on the financial statements and on FINRA's internal control over financial reporting. Based on those discussions, the Audit Committee recommended to the Board of Governors that FINRA's audited financial statements and related reports on internal control be included in the Annual Report for the year ended December 31, 2008.

Members of the Audit Committee:

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

June 24, 2009

Investment Committee Report

Year Ended December 31, 2008

The FINRA investment portfolio is a fund principally created from the proceeds of the sale of its prior interests in The NASDAQ Stock Market. The purpose of the portfolio is to support FINRA's operations and fulfill its mission of investor protection and market integrity by providing FINRA with supplemental financial resources to allow it to implement long-range plans. FINRA's investment policy is set forth to preserve principal over the long-term (in real terms) while seeking to maximize returns within acceptable levels of risk, and to do so in a manner consistent with portfolio management best practices for producing long-term returns. Distributions from the portfolio are determined annually by the FINRA Board of Governors as part of the operating budget. In addition to the annual distribution to support operations, other strategic and non-recurring distributions may arise subject to prior approval by the Board.

This last year proved to be an extremely challenging environment for the global economy and investment markets. Investors experienced one of the worst performance periods in modern times, marked by record market declines and volatility, massive financial failures and the beginning of a painful deleveraging process. FINRA's investments declined 26.5 percent in calendar year 2008, commensurate with average comparable portfolio declines of approximately 26.2 percent for the same time period. At the end of the year, FINRA's investment portfolio totaled approximately $1.6 billion. While investment returns overall from the portfolio were quite positive for the four years prior to 2008, the losses incurred in 2008 erased almost all those gains. The portfolio, however, remains highly liquid, with $1.2 billion or 74 percent available in 30 days or less.

	FINRA Investment Returns*				
	2004	2005	2006	2007	2008
			in millions		
Total return	$ 49.3	$ 83.9	$ 249.5	$ 233.1	$ (567.5)
Total return (%)		7.4%	12.9%	8.5%	(26.5)%
Portfolio balance 12/31	$1,300.6	$1,726.8	$2,360.7	$2,240.5	$1,565.3

* Annual percentage returns calculated from inception of investment policy in October 2004.

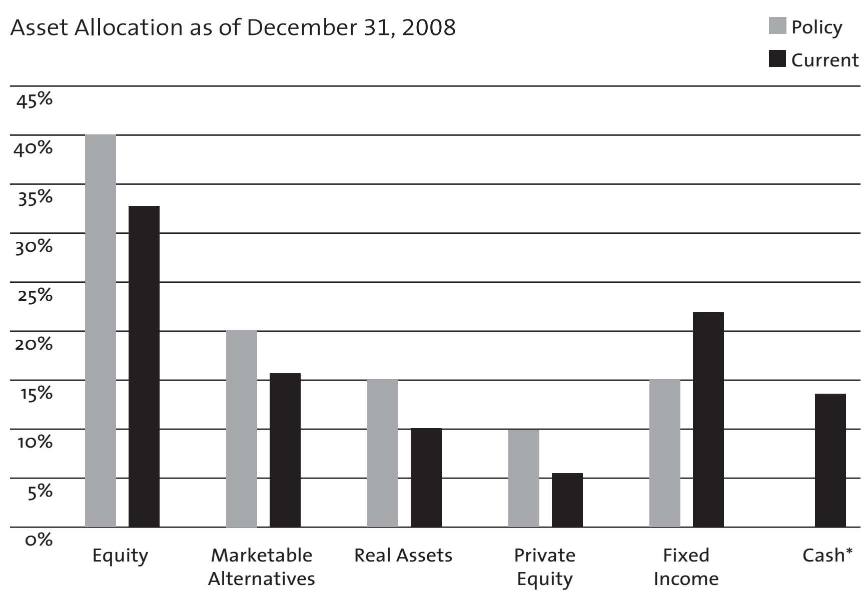
The FINRA Board of Governors is responsible for FINRA's investments and approved the charter that guides the FINRA Investment Committee. The committee, which is comprised of Board members and other investment professionals, advises the FINRA Board and provides guidance in determining the appropriate policy, guidelines and allocation for FINRA's investments. The FINRA Investments Office is responsible for management of the investments within the framework of the investment policy. FINRA engages investment managers and consultants to support the Investments Office as needed. The Investment Committee formally met four times during 2008. In addition, staff and Committee members met on a regular and recurring basis in response to the market declines during the second half of 2008.

FINRA bases its investment policy on best practices as applied to its investment objectives. The Investment Committee reviews the policy annually and recommends changes subject to approval by the Board of Governors.

In April 2009, based on a comprehensive Investment Committee review of FINRA's investment policy, strategy and risk tolerance, the Board of Governors decided to shift FINRA's investment assets to a lower volatility with the objective of a lower risk portfolio. A new policy and detailed transition plan were put into place, and investment managers and consultants were engaged to assist with the new strategy. With the new policy, FINRA will continue to maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return.

Investment Committee Report (continued)

As noted in the chart below, as of December 31, 2008, the portfolio asset allocation was overweighted in fixed income and cash equivalent securities versus the policy, pending the likelihood of potential changes resulting from the new policy.



* Policy was to be fully invested with 0% in Cash. Cash represents FINRA's operating reserve.

FINRA's investment policy continues to prohibit the purchase of any debt or equity interest in a broker-dealer, exchange, contract market, regulatory client, alternative trading system or electronic communications network, as well as the purchase of any debt or equity interest in an entity that derives more than 25 percent of its gross revenue from stock exchanges and the combined broker-dealer and/or investment advisory businesses of all its subsidiaries and affiliates. The guidelines also prohibit the purchase of any security during its initial public offering or distribution, unless this is an opportunity made available to a similarly situated asset manager or institutional investor. All prohibited investments are monitored by the FINRA Investments Office. Furthermore, the investment policy contains a proxy-voting policy and provisions related to conflicts of interest and professional conduct and ethics. Annually, the Investment Committee reviews the investment policy to ensure the relevance of its content to current capital market conditions.

Members of the Investment Committee:

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

June 24, 2009

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

Board of Governors

Financial Industry Regulatory Authority, Inc.

We have audited the Financial Industry Regulatory Authority, Inc.'s (FINRA) internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). FINRA's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, FINRA maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of FINRA as of December 31, 2008 and 2007, and the related consolidated statements of operations, changes in equity, and cash flows for each of the three years in the period ended December 31, 2008, and our report dated June 24, 2009 expressed an unqualified opinion thereon.

Ernst & Young LLP

McLean, Virginia
June 24, 2009

Report of Independent Registered Public Accounting Firm

Board of Governors

Financial Industry Regulatory Authority, Inc.

We have audited the accompanying consolidated balance sheets of the Financial Industry Regulatory Authority, Inc. (FINRA) as of December 31, 2008 and 2007, and the related consolidated statements of operations, changes in equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of FINRA at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), FINRA's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 24, 2009 expressed an unqualified opinion thereon.

Ernst & Young LLP

McLean, Virginia
June 24, 2009

FINRA Consolidated Balance Sheets

(In millions)

	December 31, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 85.0	$ 316.6
Investments:		
Trading, at fair value	581.7	591.7
Available-for-sale, at fair value	387.6	780.6
Foundation available-for-sale, at fair value	23.3	22.3
Receivables, net	95.2	143.9
Investments receivable	27.8	54.1
Other current assets	34.0	24.1
Total current assets	1,234.6	1,933.3
Property and equipment:		
Land, buildings and improvements	105.9	101.0
Data processing equipment and software	206.7	192.2
Furniture, equipment and leasehold improvements	102.8	96.3
	415.4	389.5
Less accumulated depreciation and amortization	(258.3)	(233.2)
Total property and equipment, net	157.1	156.3
Goodwill and other intangible assets, net	40.1	43.4
Revolving credit facility receivable	—	22.3
Other investments	499.3	655.7
Other assets	59.0	71.3
Total assets	$1,990.1	$2,882.3

See accompanying notes.

FINRA Consolidated Balance Sheets (continued)

(In millions)

	December 31,	
	2008	2007
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 35.3	$ 44.7
Accrued personnel and benefit costs	151.7	138.7
Deferred revenue	57.8	63.3
Deferred contribution income	9.5	5.2
Deposits and renewals	68.4	62.4
Investments payable	3.0	64.5
Other current liabilities	20.0	15.6
SEC fee payable	42.8	108.7
Total current liabilities	388.5	503.1
Accrued pension and other postretirement benefit costs	154.9	153.6
Deferred revenue	16.8	17.5
Deferred contribution income	41.6	51.3
Other liabilities	43.4	40.7
Total liabilities	645.2	766.2
Equity	1,455.1	2,151.4
Unrealized (loss) gain on available-for-sale investments	(0.1)	51.0
Net unrecognized employee benefit plan amounts	(110.1)	(86.3)
Total equity	1,344.9	2,116.1
Total liabilities and equity	$1,990.1	$2,882.3

See accompanying notes.

FINRA Consolidated Statements of Operations

(In millions)

	Years Ended December 31,		
	2008	2007	2006
Revenues			
Operating revenues			
Regulatory fees, net of firm rebates of $5.9 in 2008, $6.1 in 2007 and $50.0 in 2006	$ 453.4	$ 345.0	$ 222.0
User fees	157.4	170.1	158.7
Dispute resolution fees	42.3	42.5	55.7
Transparency services fees	44.7	55.8	43.6
Contract services fees	72.0	62.7	27.2
Other	9.2	4.5	4.4
Total operating revenues	779.0	680.6	511.6
Fines	25.9	47.6	75.0
Activity assessment	154.8	281.6	185.0
Total revenues	959.7	1,009.8	771.6
Activity assessment cost of revenues	(155.2)	(285.1)	(184.8)
Net revenues	804.5	724.7	586.8
Expenses			
Compensation and benefits	541.7	446.1	395.1
Professional and contract services	214.4	199.2	148.4
Computer operations and data communications	30.5	30.8	26.1
Depreciation and amortization	50.9	40.6	36.1
Occupancy	56.1	40.2	30.2
General and administrative	71.8	55.3	62.7
Total expenses	965.4	812.2	698.6
Interest and dividend income	56.6	77.2	77.3
Operating loss	(104.3)	(10.3)	(34.5)
Other income (expense)			
Special payment to firms in connection with the consolidation of NASD and the member regulation operations of NYSE	—	(178.3)	—
Net investment (losses) gains	(479.2)	113.8	131.5
Equity (losses) earnings from other investments	(144.9)	42.1	40.6
Other	32.1	5.7	—
(Loss) income from continuing operations	(696.3)	(27.0)	137.6
Income from discontinued operations (net of tax of $2.6)	—	—	419.8
Net (loss) income	$(696.3)	$ (27.0)	$ 557.4

See accompanying notes.

FINRA Consolidated Statements of Changes in Equity

(In millions)

	Equity	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2006	$1,526.3	$ 84.9	$1,611.2
Net income	557.4	—	557.4
Unrealized loss on available-for-sale investments	—	(5.1)	(5.1)
Foreign currency translation	—	(0.3)	(0.3)
Minimum pension liability	—	4.4	4.4
Comprehensive income			556.4
Adjustment to initially record net unrecognized employee benefit plan amounts	—	(77.3)	(77.3)
Increase in equity attributable to the minority partners share of Preferred Stock Dividends	0.6	—	0.6
Increase in equity attributable to the issuance of stock by NASDAQ and its subsidiaries, net of minority interest of ($940.6)	94.1	—	94.1
Balance, December 31, 2006	2,178.4	6.6	2,185.0
Net loss	(27.0)	—	(27.0)
Unrealized loss on available-for-sale investments	—	(37.0)	(37.0)
Employee benefit plan adjustments	—	(4.9)	(4.9)
Comprehensive loss			(68.9)
Balance, December 31, 2007	2,151.4	(35.3)	2,116.1
Net loss	(696.3)	—	(696.3)
Unrealized loss on available-for-sale investments	—	(51.1)	(51.1)
Employee benefit plan adjustments	—	(23.8)	(23.8)
Comprehensive loss			(771.2)
Balance, December 31, 2008	$1,455.1	$(110.2)	$1,344.9

See accompanying notes.

FINRA Consolidated Statements of Cash Flows

(In millions)

	Years Ended December 31,		
	2008	2007	2006
Reconciliation of net income to cash provided by operating activities			
Net (loss) income	$(696.3)	$ (27.0)	$ 557.4
Net income from discontinued operations	—	—	419.8
(Loss) income from continuing operations	$(696.3)	$ (27.0)	$ 137.6
Adjustments to reconcile net (loss) income to cash provided by operating activities:			
Depreciation and amortization	50.9	40.6	36.1
Net investment losses (gains)	479.2	(113.8)	(131.5)
Equity in losses and undistributed (earnings) from other investments	144.9	(39.6)	(38.0)
Bad debt expense (recovery)	4.7	(5.6)	12.3
Other net non-cash income items	(7.4)	(1.5)	(4.2)
Net change in operating assets and liabilities, net of acquisitions and dispositions:			
Receivables, net	43.9	(20.1)	1.9
Net (purchases) sales of trading securities	(130.4)	719.9	200.8
Other current assets	(5.4)	(5.3)	(14.8)
Other assets	15.6	(17.6)	(76.4)
Accounts payable and accrued expenses	(8.7)	3.5	8.7
Accrued personnel and benefit costs	13.0	30.9	(14.5)
Deferred revenue	(6.2)	(4.5)	7.5
Deferred contribution income	(5.4)	1.7	1.6
Deposits and renewals	6.1	7.7	(0.8)
SEC fee payable	(65.9)	(48.5)	—
Other current liabilities	4.2	1.4	0.5
Accrued pension and other postretirement costs	(22.5)	21.2	23.3
Other liabilities	3.3	1.1	(0.8)
Net cash (used in) provided by continuing operations	(182.4)	544.5	149.3
Cash provided by discontinued operations	—	—	80.6
Net cash (used in) provided by operating activities	$(182.4)	$ 544.5	$ 229.9

See accompanying notes.

FINRA Consolidated Statements of Cash Flows (continued)

(In millions)

	Years Ended December 31,		
	2008	2007	2006
Cash flow from investing activities			
Proceeds from redemptions of available-for-sale investments	$ 181.0	$ 321.3	$ 1,275.6
Purchases of available-for-sale investments	(204.8)	(388.3)	(1,920.0)
Purchases of other investments	(128.0)	(388.9)	(76.0)
Return of capital and proceeds from redemptions from other investments	130.4	215.3	21.1
Proceeds from the sale of DTCC common stock	—	—	3.0
Purchase of NYSE member regulation operations	(0.2)	(48.4)	—
Proceeds from the payment of the revolving credit facility	29.5	—	—
Purchases of property and equipment	(44.2)	(32.6)	(41.7)
Proceeds from sales of property and equipment	2.0	—	8.3
Cash used in investing activities — continuing operations	(34.3)	(321.6)	(729.7)
Cash used in investing activities — discontinued operations	—	—	(931.5)
Net cash used in investing activities	(34.3)	(321.6)	(1,661.2)
Cash flow from financing activities			
Change in donor-restricted cash	(9.6)	11.1	49.8
Change in other restricted cash	(4.8)	—	—
Contributions and net investment income temporarily restricted	—	—	0.8
Other	(0.5)	(0.3)	(0.9)
Cash (used in) provided by financing activities — continuing operations	(14.9)	10.8	49.7
Cash provided by financing activities — discontinued operations	—	—	1,335.1
Net cash (used in) provided by financing activities	(14.9)	10.8	1,384.8
(Decrease) increase in cash and cash equivalents	(231.6)	233.7	(46.5)
Cash and cash equivalents at beginning of year	316.6	82.9	129.4
Cash and cash equivalents at end of year	$ 85.0	$ 316.6	$ 82.9

See accompanying notes.

FINRA 2008 Notes to Consolidated Financial Statements

1. ORGANIZATION AND NATURE OF OPERATIONS

References to the terms "we," "our," "us," "FINRA" or the "Company" used throughout these Notes to the Consolidated Financial Statements refer to the Financial Industry Regulatory Authority, Inc. (FINRA), a Delaware corporation, and its wholly owned subsidiaries. FINRA wholly owns the following significant subsidiaries: FINRA Regulation, Inc. (FINRA REG), FINRA Dispute Resolution, Inc. (FINRA DR) and FINRA Investor Education Foundation (the Foundation).

We are the largest non-governmental regulator of securities firms doing business in the United States. Through our subsidiary FINRA REG, we regulate the activities of the U.S. securities industry and perform market regulation under contract for The Nasdaq Stock Market, LLC (NASDAQ LLC); NYSE Amex LLC (NYSE Amex), formerly known as the American Stock Exchange LLC; the International Securities Exchange and the Chicago Climate Exchange. We also regulate and operate the over-the-counter (OTC) securities markets. FINRA REG carries out our regulatory functions, including onsite examinations of securities firms, continuous automated surveillance of markets operated by NASDAQ LLC and NYSE Amex, and disciplinary actions against firms and registered representatives. FINRA DR provides arbitration and mediation services to assist in the resolution of monetary and business disputes between and among investors, securities firms and registered representatives. The Foundation is a tax-exempt membership corporation incorporated in the State of Delaware with FINRA as the sole member. The Foundation provides investors with high-quality, easily accessible information and tools to better understand the markets and the basic principles of saving and investing. The Foundation funds innovative research and educational projects aimed at segments of the investing public who could benefit from additional resources.

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

Prior to December 20, 2006, we maintained voting control over The Nasdaq Stock Market, Inc. (NASDAQ) through our ownership of the only share of Series D Preferred Stock. On December 20, 2006, NASDAQ redeemed the share of Series D Preferred Stock that had been issued to us. As a result, we no longer maintain voting control over NASDAQ and ceased consolidating NASDAQ operations effective December 20, 2006. On February 27, 2008, NASDAQ and OMX AB combined their businesses and NASDAQ was renamed The NASDAQ OMX Group, Inc. (NASDAQ OMX). *See* Note 4, "Discontinued Operations" for additional information.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of FINRA, its wholly-owned subsidiaries and discontinued operations. We have eliminated all significant intercompany balances and transactions in consolidation.

USE OF ESTIMATES

The preparation of these consolidated financial statements requires management to make estimates and assumptions, including estimates of other-than-temporary impairment and assumptions related to our benefits plans, that affect the amounts reported in the financial statements and accompanying notes. Actual results could materially differ from those estimates.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

SEGMENTS

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

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include demand cash, cash held in banks and all non-restricted, highly liquid investments with original maturities of 90 days or less. At December 31, 2008, the Company's cash equivalents included $7.7 million of a fixed-income security with an original maturity of less than 90 days. At December 31, 2007, there were no fixed income securities included in cash equivalents.

INVESTMENTS

Debt and Marketable Equity Securities

We account for our investments in debt and marketable equity securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* which requires that, at the time of purchase, individual securities be classified as trading, available-for-sale or held-to-maturity based on our intent and ability to hold these securities. Such designations are re-evaluated annually. We have designated our investments in debt and marketable equity securities as either trading or available-for-sale. Trading securities are carried at fair value, with changes in fair value recorded as a component of net investment (losses)/gains in the consolidated statements of operations. We carry available-for-sale securities at fair value and recognize temporary changes in fair value as an unrealized (loss)/gain as a separate component of equity in the consolidated balance sheets.

Fair value is determined based on quoted market prices, when available, or on estimates provided by external pricing sources or dealers who make markets in such securities. Realized gains and losses on sales of securities are included in earnings using the average cost method. Investments receivable or payable relate to security trades executed prior to the balance sheet date, but not yet settled, as we follow trade date accounting. Also included within investments payable are short securities, which represent obligations of the Company to deliver certain contracted securities at a future time. At December 31, 2007, FINRA's short positions totaled $41.6 million.

Other Investments

We have investments in hedge funds and funds of hedge funds, all of which we have elected to account for under the equity method. We are also a limited partner in a number of private investment funds. We account for investments in private investment limited partnerships under the cost or equity method in accordance with AICPA Statement of Position (SOP) No. 78–9, *Accounting for Investments in Real Estate Ventures,* as clarified by Emerging Issues Task Force (EITF) No. D-46, *Accounting for Limited Partnership Investments.* Additionally, we retain the specialized accounting for our investments accounted for under the equity method pursuant to EITF Issue No. 85–12, *Retention of Specialized Accounting for Investments in Consolidation*.

Other-Than-Temporary Impairment

FINRA periodically monitors and evaluates the realizability of its available-for-sale and cost method investments. When assessing realizability, including other-than-temporary declines in value, we consider such factors as the extent of the decline in value, the duration of unrealized losses and the potential for recovery in the near term. We also review the financial statements of our cost and equity method investments for potential indicators of impairment. If events and circumstances indicate that a decline in the value of these assets has occurred and is deemed other-than-temporary, the carrying value of the investment is reduced to its fair value and the impairment is charged to earnings.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FAIR VALUE MEASUREMENTS

FINRA adopted SFAS No. 157, *Fair Value Measurements,* effective January 1, 2008. SFAS No. 157 provides a framework for measuring fair value under U.S. GAAP, as well as expanded disclosures about assets and liabilities measured at fair value, including the effect of fair value measurements on earnings. SFAS No. 157 defines fair value as an "exit price" in an orderly transaction and as a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. SFAS No. 157 establishes a hierarchy for inputs (*i.e.,* Level 1, 2 and 3 inputs, as defined) used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. Accordingly, the fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The three levels of inputs within the fair value hierarchy are defined as follows:

Level 1	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access as of the reporting date.
Level 2	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, through corroboration with observable data.
Level 3	Unobservable inputs, such as internally developed pricing models for the asset or liability due to little or no market activity for the asset or liability.

Additionally, companies are required to provide enhanced disclosure regarding instruments in the Level 3 category (which have inputs to the valuation techniques that are unobservable and require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. Furthermore, SFAS No. 157 requires certain qualitative disclosures about the valuation techniques (*i.e.,* market approach, income approach, cost approach) used to measure fair value on a recurring basis. In determining fair value, the Company obtains valuations from investment fund managers who use various valuation approaches, including the use of counterparty pricing services and external or third-party pricing sources. *See* Note 7, "Fair Value Disclosures," for further detail.

RECEIVABLES, NET

The Company's receivables are primarily concentrated with our firms, associated persons, NYSE, NASDAQ OMX, NYSE Amex and other exchanges. The financial statements show receivables net of reserves for uncollectible accounts of $9.7 million and $6.5 million as of December 31, 2008, and 2007, respectively. We calculate reserves based on the age, source of the underlying receivable and past collections. We maintain the reserve for bad debts at a level that management believes to be sufficient to absorb estimated losses inherent in our accounts receivable portfolio. The reserve balance as of December 31, 2008, included specific adjustments related to fines and arbitration activities. The reserve balance as of December 31, 2007, included specific adjustments related to fines activity. The reserve is increased by the provision for bad debts, which is charged against operating results and decreased by the amount of charge-offs, net of recoveries. We base the amount charged against operating results on several factors, including a periodic assessment of the collectibility of each account. In

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

circumstances where a specific firm's inability to meet its financial obligations is known (*i.e.,* bankruptcy filings), we record a specific provision for bad debts to reduce the receivable to the amount we reasonably believe will be collected.

PROPERTY AND EQUIPMENT

FINRA records property and equipment at cost less accumulated depreciation. We expense repairs and maintenance costs as incurred. We calculate depreciation and amortization using the straight-line method over estimated useful lives ranging from 10 years to 40 years for buildings and improvements, two years to five years for data processing equipment and software, and five years to 10 years for furniture and equipment. We amortize leasehold improvements using the straight-line method over the lesser of the useful life of the improvement or the term of the applicable lease. Depreciation and amortization expense for property and equipment, including amortization of capitalized software costs, totaled $40.3 million, $33.6 million and $30.6 million for the years ended December 31, 2008, 2007 and 2006, respectively.

SOFTWARE COSTS

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

The financial statements reflect unamortized, capitalized software development costs of $36.9 million and $34.7 million as of December 31, 2008, and 2007, respectively, within data processing equipment and software in the consolidated balance sheets. Net additions to capitalized software were $21.9 million and $20.4 million in 2008 and 2007, respectively. Amortization of costs capitalized under SOP No. 98–1 totaled $19.7 million, $15.0 million and $12.7 million for the years ended December 31, 2008, 2007 and 2006, respectively, and is included in depreciation and amortization in the consolidated statements of operations.

GOODWILL AND INTANGIBLE ASSETS

FINRA's goodwill balance of $15.0 million and $14.8 million as of December 31, 2008, and 2007, respectively, represents the excess of consideration paid for the acquired member regulation operations of NYSE over the fair value of the net assets acquired. The goodwill balance as of December 31, 2008, incorporates final estimates of contingencies during the allocation period, which ended in 2008. Our acquired intangible assets apart from goodwill as a result of the consolidation of NASD and the member regulation operations of NYSE were recognized at fair value as of the date acquired. The accounting for goodwill and intangible assets is governed by the provisions of SFAS No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires the evaluation of goodwill and intangibles with indefinite lives for impairment at least annually or more frequently if events and circumstances indicate that the asset might be impaired. In 2008 and 2007, there were no indicators of impairment related to goodwill and intangibles with indefinite lives. Intangible assets with finite lives are amortized over their useful lives and tested for impairment when events or circumstances warrant. Intangible assets related to the consolidation of NASD and the member regulation operations of NYSE totaled $22.2 million, net of accumulated amortization of $8.3 million as of December 31, 2008, and $28.0 million, net of accumulated amortization of $2.5 million as of December 31, 2007. We also have intangible assets related to software licenses that are not related to the NYSE transaction in the amount of $2.9 million, net of accumulated amortization of $0.8 million as of December 31, 2008, and $0.6 million, net of accumulated amortization of $0.3 million as of December 31, 2007. See Note 3, "Consolidation of NASD and the Member Regulation Operations of NYSE" for additional information.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IMPAIRMENT OF LONG-LIVED ASSETS

We review our long-lived assets for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. In the event facts and circumstances indicate that long-lived assets or other assets may be impaired, we perform an evaluation of recoverability, which compares the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount to determine if a write-down is required. If the evaluation indicates impairment, we prepare a discounted cash flow analysis to determine the amount of the impairment. In 2008 and 2007, there were no indicators of long-lived asset impairment, and no write-downs were recorded.

REVOLVING CREDIT FACILITY RECEIVABLE

In February 2005, the American Stock Exchange LLC borrowed $25.0 million from FINRA under a revolving credit facility. We recorded an initial discount of $8.6 million related to this receivable, representing the difference between the stated rate of interest of 5.0 percent and the estimated market rate of 11.2 percent. We recognize interest using the effective interest method. For the years ended December 31, 2008, 2007 and 2006, we recognized interest on the note and accretion of the discount of $7.3 million, $2.3 million and $2.0 million, respectively, within interest and dividend income in the consolidated statements of operations. On October 3, 2008, we received approximately $29.5 million from NYSE Amex in settlement of the revolving credit facility. Included in the $7.3 million of interest and accretion recognized during 2008 is approximately $5.4 million of accretion of discount recognized upon settlement.

OTHER ASSETS

Included in other current assets and other long-term assets in the consolidated balance sheets are funds from the Global Research Analyst Settlement (the Settlement), including the interest earned on these funds. The Settlement funds are included in other assets because their use is restricted to the Foundation. The Foundation invests the Settlement funds in a U.S. Treasury money market fund in accordance with the terms of the Settlement, which stipulates that funds received must be invested in money market funds or securities with maturities of less than six months and backed by the full faith and credit of the Federal government. The current and long-term portions of the Settlement funds as of December 31, 2008, were $9.5 million and $41.8 million, respectively. The current and long-term portions of the Settlement funds as of December 31, 2007, were $5.2 million and $51.6 million, respectively. See Note 2, *"Deferred Contribution Income"* for more information related to the Settlement.

DEFERRED REVENUE

Deferred revenue represents cash received and billed receivables for which we have not yet provided the related services. Included in deferred revenue is the unearned portion of registration fees, arbitration fees and firm application fees. We recognize revenue from the upfront initial components of these fees on a straight-line basis over estimated business relationship periods, determined based on historical experience, ranging from 14 months to 11 years. The estimated service period for registration fees is four years, with the annual portion recognized over 12 months. The estimated service period for arbitration fees is 14 months. The estimated service period for firm application fees is 11 years.

DEFERRED CONTRIBUTION INCOME

On September 2, 2005, the Federal District Court for the Southern District of New York issued an order (the Order) approving the Securities and Exchange Commission's (SEC's) new investor education plan, whereby all funds collected in connection with the Settlement, less expenses previously approved by the Court, would be remitted to the Foundation. Pursuant to the final judgments against each of the defendants under the Settlement, a total of $55.0 million was to be collected in equal annual installments of $11.0 million beginning in October 2003.

During 2007, the Foundation received the final installment of $11.0 million. During the years ended December 31, 2007 and 2006, the Foundation recorded additional income on the Settlement funds of $0.4 million and $1.6 million, respectively, which represented interest from the SEC and accretion of the interest on the receivable.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

As mentioned in Note 1, the Foundation is a consolidated subsidiary of FINRA. At the consolidated level, FINRA has recorded the amounts the Foundation received in relation to the Order, including interest and dividends earned on these funds, as deferred contribution income in the consolidated balance sheets, and recognizes the related revenue, net of interest and dividends earned on the funds, as the Foundation makes grant payments and incurs expenses pursuant to the guidelines in the Order. For the years ended December 31, 2008, 2007 and 2006, FINRA recognized revenue and expenses as the Foundation incurred grant payments and expenses against the Settlement funds of $6.2 million, $2.0 million and $0.4 million, respectively. Interest and dividends earned on the Settlement funds for the years ended December 31, 2008, 2007 and 2006, were $0.8 million, $2.2 million and $1.1 million, respectively.

Per the Order, to the extent that any of the Settlement funds are not used by the Foundation within 10 years of the date of the Order, FINRA may be required to return any unused funds to the SEC. Additionally, in the event of a proposed dissolution of the Foundation, the SEC shall file an application with the Court setting forth a plan for the disposition of any remaining Settlement funds in the Foundation.

DEPOSIT AND RENEWAL LIABILITIES

FINRA-registered firms make deposits into our Central Registration Depository (CRD) system to pay for services, including registration fees charged by states and other self-regulatory organizations (SROs). Total CRD-related deposits were $68.4 million and $58.2 million as of December 31, 2008, and 2007, respectively. Also included in deposits and renewals in the consolidated balance sheets as of December 31, 2007, was $4.2 million to be distributed in connection with a FINRA enforcement case. The distribution occurred during the third quarter of 2008.

OTHER LIABILITIES

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

FINRA REG administers the IARD program. IARD is an electronic filing system for investment advisers regulated by the SEC under the Investment Advisers Act of 1940, and by the states, represented by the North American Securities Administrators Association. The IARD system collects and maintains the registration and disclosure information for investment advisers and their associated persons. As administrator of the IARD program, FINRA REG collects all fees and incurs expenses, and tracks and reports them to the SEC on a quarterly basis. FINRA records fees that it has collected but not yet earned as deferred revenue in the consolidated balance sheets.

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

As of December 31, 2008, and 2007, FINRA recorded the cumulative cash basis surplus for the IARD program in its consolidated financial statements as follows:

	As of December 31,	
	2008	2007
	(in millions)	
Current deferred revenue	$ 0.4	$ 7.8
Non-current deferred revenue	1.5	1.9
Other long-term liabilities	29.5	25.4
Total	$31.4	$35.1

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION AND COST OF REVENUE

Regulatory Fees

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

User Fees

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

Dispute Resolution Fees

FINRA DR earns fees during the arbitration and mediation processes. Certain arbitration fees, such as initial, counterclaim, cross claim and other filing fees, and surcharge fees relate to the entire period covered by an arbitration case, and as such are recognized as revenue over the average life of an arbitration case. Mediation filing fees are recognized over the average life of a mediation case. All other arbitration- and mediation-related fees, such as pre-hearing and hearing processing fees, adjournment fees, hearing session fees and mediation session fees, which are event driven, are recognized as the service is provided. Dispute resolution fees also include arbitrator and mediator application and training fees that FINRA DR recognizes as the service is provided.

Transparency Services Fees

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

are eligible for quotation on the OTCBB. In addition, fees are earned for the sale of market data from the OTCBB and the ORF. We recognize transparency services fees as the transactions occur and when the market data is sold.

Contract Services Fees

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

Interest and Dividend Income

We recognize interest and dividend income from cash, trading investments, available-for-sale investments and private investments as they are earned.

Fines

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

1) All fine monies are accounted for separately;
2) Fine monies collected or anticipated are not included in operating revenues and play no role in developing the operating budget;
3) Fine monies are not used to fund employee compensation;
4) The use of fine monies is limited to capital expenditures and regulatory projects; and
5) Capital expenditures and regulatory projects for which we plan to and have used fine monies, such as the integration of NYSE member regulation, enforcement and arbitration technology applications into the FINRA technology platform, are reported to our Board of Governors.

Activity Assessment Revenues and Cost of Revenues

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

We recover the cost of the Section 31 fees and assessments through an activity assessment billed to clearing and self-clearing firms based on the aggregate dollar amount of sales of covered securities transacted by or through any firm other than on a national securities exchange. The assessments billed to securities firms are recognized when the transactions are reported. We report the activity assessment on a gross basis within revenues in accordance with EITF No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. Amounts due to the SEC are reported as a cost of revenue. We report amounts pending remittance to the SEC in SEC fee payable in the accompanying consolidated balance sheets.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In connection with a review that we performed to ensure that firms were properly self-reporting transactions in accordance with Schedule A of FINRA's By-Laws for the periods of 1997 through 2004, we determined that certain transactions were not properly self-reported to us. The activity assessment fees related to these transactions have been reflected in the accompanying consolidated balance sheet in receivables, net and SEC fee payable as of December 31, 2007. During 2007, we notified the SEC of our final findings related to the improperly reported transactions and the matter was settled during the third quarter of 2008. We reflected the related amounts in the consolidated statements of operations as activity assessment revenues and cost of revenues for the years ended December 31, 2007 and 2006.

We also provided a six-month amnesty period during which other SEC fees that were previously collected by firms, but not remitted to us as part of the SEC self-reporting process, could be remitted beginning December 11, 2007, and ending June 11, 2008. These accumulated funds are included in other income in the consolidated statements of operations.

ADVERTISING COSTS

We expense advertising costs, which include media and production costs. Advertising costs are recorded in the period in which the costs are incurred. Advertising costs totaled $6.7 million, $2.9 million and $3.1 million for the years ended December 31, 2008, 2007 and 2006, respectively, and are included in general and administrative expense in the consolidated statements of operations.

PENSION AND OTHER POSTRETIREMENT BENEFITS

The Company provides two non-contributory defined benefit pension plans for the benefit of eligible employees. The non-contributory defined benefit plans consist of a qualified Employees Retirement Plan (ERP) and a non-qualified Supplemental Executive Retirement Plan (SERP). On January 1, 2007, we implemented an employer-funded defined contribution Retiree Medical Account Plan (the Plan) to assist our employees and retirees with the cost of health care expenses during retirement. Under the Plan, Retiree Medical Accounts are created for eligible employees and retirees and fixed annual credits are applied to those accounts for each year of FINRA service beginning at age 40. We use several statistical and other factors, which attempt to anticipate future events, in calculating the expense and liability related to these plans. Key factors include assumptions about the expected rates of return on plan assets and the discount rate as determined by the Company, within certain guidelines, as well as assumptions regarding future salary increases, mortality, turnover, retirement ages and the medical expense trend rate. We consider market conditions, including changes in investment returns and interest rates, in making these assumptions. The discount rate used in the calculations is developed considering changes in a hypothetical bond portfolio or specific bond matching approach. We determine the long-term rate of return based on analysis of historical and projected returns as prepared by our actuary and external investment consultant. The Company's Pension Plan Committee approves both the expected long-term rate of return and the discount rate assumptions.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INCOME TAXES

FINRA, FINRA REG and FINRA DR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). The remaining consolidated subsidiaries of FINRA are taxable entities. We determine deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (*i.e.*, temporary differences). We measure these assets and liabilities at the enacted rates that we expect will be in effect when we will realize these differences. If necessary, we establish a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized.

ISSUANCE OF SUBSIDIARY STOCK

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

MINORITY INTEREST IN DISCONTINUED OPERATIONS

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

CONCENTRATION OF RISK

Financial instruments that potentially subject us to concentrations of risk consist of cash and cash equivalents, trading investments, available-for-sale investments, other investments and accounts receivable. We do not require collateral on these financial instruments.

We maintain cash and cash equivalents in excess of federally insured limits, principally with financial institutions located in the U.S. Although these funds do not fall under FDIC insurance parameters, the financial institutions have high credit ratings. Risk on accounts receivable is reduced by the large number of entities comprising our firm base and through ongoing evaluation of collectibility of amounts owed to us. We use multiple outside investment managers to manage our investment portfolio and a custody agent, a publicly traded company headquartered in New York, to hold our trading securities.

We are dependent on a supplier that provides many of our infrastructure-related information technology services. To the extent this supplier is not able to perform, it could have an adverse effect on our business.

We transact business with multiple firms, with no individual firm providing in excess of 10 percent of total revenues.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115*. SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply SFAS No. 157 early. We have evaluated SFAS No. 159 and elected not to measure any applicable financial assets or liabilities at fair value pursuant to the provisions of SFAS No. 159 as of January 1, 2008.

In February 2008, the FASB also issued FASB Staff Position (FSP) 157-2, *Effective Date of FASB Statement No. 157*, which deferred the SFAS No. 157 requirements for certain non-financial assets and liabilities until January 1, 2009. We do not expect the adoption of FSP 157-2 to have a material impact on our consolidated results of operations or financial position.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement 109*. Among other things, FIN 48 provides guidance to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing a minimum recognition threshold which income tax positions must achieve before being recognized in the financial statements. In addition, FIN 48 requires expanded annual disclosures, including a rollforward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. FIN 48 is effective for nonpublic enterprises, such as FINRA, on January 1, 2009. FIN 48 is not expected to have a material impact on our consolidated results of operations and financial position.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133*, which requires enhanced qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk contingent features in derivative agreements. We plan to adopt SFAS No. 161 on January 1, 2009. Since SFAS No. 161 only requires additional disclosures concerning derivatives and hedging activities, this standard is not expected to have a material impact on our consolidated results of operations and financial position.

In December 2008, the FASB issued FSP 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets,* which requires additional disclosures about assets held in an employer's defined benefit pension or other postretirement benefit plan. FSP 132(R)-1 replaces the requirement to disclose the percentage of the fair value of total plan assets with a requirement to disclose the fair value of each major asset category and for companies to consider providing additional disclosures about major asset categories based on the disclosure objectives in the FSP. Also, FSP 132(R)-1 requires disclosure of the level within the fair value hierarchy in which each major category of plan assets falls, using the guidance in SFAS No. 157. Furthermore, FSP 132(R)-1 requires companies to reconcile the beginning and ending balances of plan assets with fair values measured using significant unobservable inputs (Level 3 in the hierarchy). FSP 132(R)-1 is effective for FINRA on January 1, 2009. We are currently assessing the potential impact that FSP 132(R)-1 will have on our financial statements.

RECLASSIFICATIONS

Certain 2007 amounts have been reclassified to conform to the current year's presentation. Specifically, certain investment amounts have been reclassified within the balance sheet between trading investments, available-for-sale investments, other investments, investments payable and cash and cash equivalents. Corresponding reclassifications have been made in the statement of cash flows. There was no effect on the consolidated statements of operations or changes in equity as a result of these reclassifications.

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

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

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

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

We paid $48.6 million in cash related to the consolidation, including $6.0 million of direct transaction costs incurred by us. We acquired assets totaling $6.2 million, consisting of capitalized software, furniture and fixtures and information technology equipment. Additionally, we identified separate intangible assets arising from the transaction totaling $30.5 million, consisting of our access to NYSE Group Membership Lists ($10.3 million), transferred copyrights ($6.5 million) and an executory contract related intangible asset ($13.7 million). The executory contract related intangible asset in the amount of $13.7 million relates to the SFSA and represents the difference between the net present value of the payment stream at cost versus fair value. This asset will be amortized over the five-year life of the contract. We also assumed certain liabilities in connection with the transaction totaling $3.1 million.

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

Total cash consideration paid		$ 48.6
Less:	Fair value of acquired assets	(6.2)
	Fair value of intangible assets	(30.5)
Add:	Assumed liabilities	3.1
Goodwill		$ 15.0

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

A detail of the separately identified intangibles we acquired is as follows (dollars in millions):

		2008			2007		
Description	Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Membership lists	11 years	$10.3	$(1.3)	$ 9.0	$10.3	$(0.4)	$ 9.9
Copyrights	3 years	6.5	(3.1)	3.4	6.5	(0.9)	5.6
Executory contract related	5 years	13.7	(3.9)	9.8	13.7	(1.2)	12.5
Total		$30.5	$(8.3)	$22.2	$30.5	$(2.5)	$28.0

As of December 31, 2008, estimated amortization expense for each of the next five years is as follows: 2009, $5.9 million; 2010, $4.9 million; 2011, $3.7 million; 2012, $2.5 million; and 2013, $0.9 million.

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

4. DISCONTINUED OPERATIONS

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

In accordance with SFAS No. 144, we reflected NASDAQ as a discontinued operation for the year ended December 31, 2006. Accordingly, the revenues, costs and expenses of NASDAQ for the year ended December 31, 2006, are presented separately as "income from discontinued operations, net of tax" and the cash flows associated with NASDAQ are presented as "cash provided by (used in) discontinued operations." Previously, we reported NASDAQ as a separate segment under the provisions of SFAS No. 131.

Our income from discontinued operations relates to our disposition of NASDAQ, as summarized below.

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

4. DISCONTINUED OPERATIONS (CONTINUED)

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

	Common Stock	Preferred Stock	Net Proceeds	Gain
		(in millions)		
2006				
Secondary offerings — February/March	4.5	—	$ 169.1	$ 156.6
Repayment of Series C Preferred Stock — February	—	1.0	104.7	—
Rule 144 sale — July	0.3	—	7.2	4.4
Exercise of warrants	10.5	—	166.7	54.9
Total	15.3	1.0	$ 447.7	$ 215.9
2005 and Prior				
Rule 144 sales — November 2005	4.5	—	$ 161.3	$ 154.4
Secondary offering — February 2005	16.6	—	140.4	133.0
Pay down of Series C Cumulative Preferred Stock	—	0.4	40.0	—
Phase I — stock and warrants	0.3	—	72.2	2.3
Phase II — stock and warrants	4.2	—	113.4	31.4
Hellman & Friedman	18.5	—	240.0	134.4
NASDAQ share buyback	33.8	—	305.2	277.5
Exercise of warrants	6.8	—	103.1	97.1
Total	84.7	0.4	$1,175.6	$ 830.1
Grand Total	100.0	1.4	$1,623.3	$1,046.0

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

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

Net revenues	$668.0
Income from discontinued operations	$ 20.7

FINRA and NASDAQ OMX have several agreements that remain in effect after completion of the divestiture. FINRA evaluated these relationships in accordance with EITF Issue No. 03-13, *Applying the Conditions in Paragraph 42 of SFAS No. 144 in Determining Whether to Report Discontinued Operations*, and concluded that they do not represent significant continuing involvement. Below is a summary of the services that continue between FINRA and NASDAQ OMX and the related fees.

We provide regulatory services including surveillance, examination, investigation and enforcement for NASDAQ OMX. Regulatory charges from FINRA to NASDAQ OMX were $20.2 million, $21.8 million and $30.2 million for the years ended December 31, 2008, 2007 and 2006, respectively, and are presented within contract services fees in the consolidated statements of operations. As the SRO for the NASDAQ OMX TRF, we provide operational services, including governance, rulemaking and market operations and regulatory services, including surveillance, examination, investigation and prosecution. Operational and regulatory charges from FINRA to the NASDAQ OMX TRF were $6.8 million, $6.9 million and $3.1 million for the years ended December 31, 2008, 2007 and 2006, respectively, and are presented within contract services fees in the consolidated statements of operations.

4. DISCONTINUED OPERATIONS (CONTINUED)

NASDAQ OMX and FINRA have a contractual agreement for NASDAQ OMX to provide support services for the TRACE system. TRACE charges from NASDAQ OMX to us were $2.6 million, $2.6 million and $2.9 million for the years ended December 31, 2008, 2007 and 2006, respectively, and are presented within professional and contract services in the consolidated statements of operations.

NASDAQ OMX and FINRA have a contractual agreement for NASDAQ OMX to provide support services for the OTCBB and OTC Equities businesses. OTCBB and OTC Equities charges from NASDAQ OMX to us were $13.1 million, $14.3 million and $14.6 million for the years ended December 31, 2008, 2007 and 2006, respectively, and are presented within professional and contract services in the consolidated statements of operations.

5. DEFERRED REVENUE

FINRA accounts for revenue on its registration, arbitration and application fees in accordance with EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables*. The first year's registration and application fees consist of two elements, an upfront initial fee and an annual fee. We segregate the initial and annual components of this fee using the residual value approach within EITF No. 00-21, and defer and amortize the initial fee element for firms over an estimated business relationship period of 11 years. The initial fee element for individual representatives is amortized over an estimated customer relationship period of four years. Certain arbitration fees, such as initial, counterclaim, cross claim and other filing fees, and surcharge fees relate to the entire period covered by an arbitration case. We defer and amortize these fees over the average life of an arbitration case, or 14 months. Registration and application fees are included within user fees, and arbitration fees are included within dispute resolution fees in the consolidated statements of operations.

The following is a summary of amounts that we included in current and non-current deferred revenue as of December 31, 2008, and the years over which we will recognize those amounts:

	Registration	Arbitration	Annual	Total
		(in millions)		
Year ending December 31,				
2009	$10.3	$11.7	$35.8	$57.8
2010	7.7	—	—	7.7
2011	4.9	—	—	4.9
2012	1.9	—	—	1.9
2013 and thereafter	2.3	—	—	2.3
	$27.1	$11.7	$35.8	$74.6

5. DEFERRED REVENUE (CONTINUED)

The following is a summary of activity in our current and non-current deferred revenue for the years ended December 31, 2008, and 2007, for all revenue arrangements. The additions reflect the fees charged during the period while the amortization reflects the revenues recognized during the period based on the accounting methodology described above:

	Registration	Arbitration	Annual	Total
		(in millions)		
Balance as of January 1, 2008	$ 27.4	$ 10.1	$ 43.3	$ 80.8
Additions	11.2	21.9	347.9	381.0
Amortization	(11.5)	(20.3)	(355.4)	(387.2)
Balance as of December 31, 2008	$ 27.1	$ 11.7	$ 35.8	$ 74.6

	Registration	Arbitration	Annual	Total
		(in millions)		
Balance as of January 1, 2007	$ 26.2	$ 17.0	$ 42.1	$ 85.3
Additions	11.3	19.1	237.0	267.4
Amortization	(10.1)	(26.0)	(235.8)	(271.9)
Balance as of December 31, 2007	$ 27.4	$ 10.1	$ 43.3	$ 80.8

6. INVESTMENTS

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

FINRA's investment policy is set forth to preserve principal, in real terms, while seeking to maximize returns within acceptable levels of risk in a manner consistent with comparable portfolio best practices for producing long-term returns. We execute our investment strategy through separately-managed accounts (SMAs) and direct investments. We have SMAs with several investment managers that have the authority to buy and sell investments within FINRA-determined, pre-established parameters. We control the buying and selling decisions of our direct investments.

In April 2009, based on a comprehensive Investment Committee review of FINRA's investment policy, strategy and risk tolerance, the Board of Governors decided to shift FINRA's investment assets to a lower volatility with the objective of a lower risk portfolio. A new policy and detailed transition plan were put into place, and investment managers and consultants were engaged to assist with the new strategy. With the new policy, FINRA will continue to maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return.

6. INVESTMENTS (CONTINUED)

Our investment portfolio consisted of the following as of:

	December 31, 2008	December 31, 2007
	(in millions)	
Trading investments	$ 581.7	$ 591.7
Available-for-sale investments	410.9	802.9
Other investments:		
Equity method investments	360.4	550.1
Cost method investments	138.9	105.6
Total other investments	499.3	655.7
Grand total	$1,491.9	$2,050.3

Trading Investments

As of December 31, 2008, and 2007, our trading investments consisted of SMAs with a fair value of $581.7 million and $591.7 million, respectively. The total mark-to-market holding loss on trading securities held at December 31, 2008, and 2007, was $71.2 million and $20.1 million, respectively.

During 2006, we re-evaluated the designation of our investments and re-designated certain debt and marketable equity securities in SMAs from available-for-sale to trading with a market value of $601.9 million. We recognized a net realized gain of $47.3 million, representing the net unrealized gain on securities in SMAs as of July 31, 2006. We recognized an additional $26.4 million through the remainder of the year to bring the total mark-to-market gain on trading securities to $73.7 million for the year ended December 31, 2006. From July 31, 2006, the date of re-designation to trading, through December 31, 2006, we recognized gross realized gains and losses on sales of investments in SMAs of $22.8 million and $7.4 million, respectively.

Available-for-Sale Investments

As of December 31, 2008, FINRA's available-for-sale investments (excluding those of the Foundation) consisted of the following:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
Mutual/commingled/exchange-traded funds	$387.6	$—	$(—)	$387.6

As of December 31, 2007, FINRA's available-for-sale investments (excluding those of the Foundation) consisted of the following:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
		(in millions)		
Mutual/commingled/exchange-traded funds	$730.5	$56.8	$(6.7)	$780.6

For the year ended December 31, 2008, we recognized gross investment gains and losses from our investments in mutual and commingled funds of $18.7 million and $79.5 million, respectively, including reclassifications from unrealized gains and losses on investments in mutual and commingled funds of $1.0 million.

6. INVESTMENTS (CONTINUED)

For the year ended December 31, 2007, we recognized gross investment gains and losses from our investments in mutual and commingled funds of $95.9 million and $1.3 million, respectively, including reclassifications from unrealized gains and losses on investments in mutual and commingled funds of $47.3 million.

For the year ended December 31, 2006, we recognized gross realized gains and losses on sales of our investments in our SMAs through July 31, 2006 — the date of re-designation to trading — of $44.0 million and $7.0 million, respectively. For the year ended December 31, 2006, we recognized net investment gains from our investments in mutual and commingled funds of $33.8 million, including reclassifications from unrealized gains and losses on investments in SMAs, prior to their redesignation to trading in July 2006, of $9.9 million for the year ended December 31, 2006.

As of December 31, 2008, the Foundation had investments in mutual funds with a cost of $23.4 million and a fair market value of $23.3 million. As of December 31, 2007, the cost and fair market value of these investments was $21.5 million and $22.3 million, respectively. Of the Foundation's investments, there were no restricted amounts as of December 31, 2008, as the remaining restricted amounts were utilized during the year, while $0.8 million was restricted as of December 31, 2007. These investments were restricted since their use was limited to financial education programs for military personnel and their families. FINRA intends to use the remaining Foundation funds of $23.3 million, as of December 31, 2008, to continue to fund future Foundation research and educational projects.

Other-Than-Temporary Declines in Fair Market Value

For the year ended December 31, 2008, FINRA recorded impairment charges of $272.8 million related to 17 mutual/commingled funds. The Foundation recorded impairment charges of $0.4 million related to one mutual fund. For the year ended December 31, 2007, FINRA did not record any impairment charges related to its mutual/commingled funds. The Foundation recorded approximately $0.1 million in impairment related to one mutual fund. For the year ended December 31, 2006, FINRA recorded impairment charges of $25.4 million related to 400 publicly traded equity and fixed income securities that were included in available-for-sale securities prior to their re-designation to trading in July 2006. In 2006, FINRA also recorded $5.1 million in impairment charges related to three mutual/commingled funds. In addition, the Foundation recorded impairment charges of $0.7 million related to its mutual funds. Impairment charges relate to other-than-temporary declines in the fair value of available-for-sale investments and are reflected in net investment (losses) gains in the consolidated statements of operations.

Temporary Declines in Fair Market Value

As of December 31, 2008, the Foundation had one mutual/commingled/exchange-traded fund with a fair market value of $11.8 million and aggregate unrealized losses of $0.1 million for one month or less. As of December 31, 2007, FINRA had five mutual/commingled/exchange-traded funds with a fair market value of $323.1 million and aggregate unrealized losses of $16.3 million for two months or less.

Other Investments

As of December 31, 2008, the Company had investments of $86.0 million in four limited partnerships accounted for under the equity method, and $138.6 million of investments in 29 limited partnerships accounted for under the cost method. These investments are included in other investments in the consolidated balance sheets. We have total outstanding commitments of $166.1 million to 29 partnerships as of December 31, 2008. We also have investments in hedge funds and funds of hedge funds that we account for under the equity method and include in other investments in the consolidated balance sheets. As of December 31, 2008, we had hedge fund investments of $274.4 million. Also included within other investments are $0.3 million of other cost-based investments. FINRA has an ownership interest in equity method investments with total net assets of $21.4 billion and total net losses from operations of $10.2 billion as of and for the year ended December 31, 2008. Our weighted ownership interest in all equity method investees was 1.7 percent at December 31, 2008.

6. INVESTMENTS (CONTINUED)

For the year ended December 31, 2008, we recognized equity losses related to hedge funds of $90.5 million and equity losses related to four limited partnerships of $54.4 million. We recorded impairment charges of $35.4 million related to our investment in seven limited partnerships for the year ended December 31, 2008.

As of December 31, 2007, the Company had investments of $118.9 million in two limited partnerships accounted for under the equity method, and $105.3 million of investments in 21 limited partnerships accounted for under the cost method. These investments are included in other investments in the consolidated balance sheets. We had total outstanding commitments of $166.5 million to 24 partnerships as of December 31, 2007, including three for which the initial funding took place in 2008. As of December 31, 2007, we had hedge fund investments of $431.2 million. Also included within other investments as of December 31, 2007, were $0.3 million of other cost-based investments. Our weighted ownership interest in all equity method investees was 1.6 percent at December 31, 2007.

For the year ended December 31, 2007, we recognized equity in earnings related to hedge funds of $39.6 million and equity in earnings of a limited partnership of $2.5 million. We recorded impairment charges of $2.0 million related to our investment in one limited partnership for the year ended December 31, 2007.

For the year ended December 31, 2006, we recognized equity in earnings of hedge funds of $38.1 million and equity in earnings of a limited partnership of $2.5 million. No impairment charges related to our investments in limited partnerships were recorded in 2006.

7. FAIR VALUE DISCLOSURES

Effective January 1, 2008, we adopted SFAS No. 157, which requires additional disclosures about our assets and liabilities that are measured at fair value. Our assessment of the level of input that is significant to the fair value measurement in its entirety requires judgment and consideration of factors specific to the asset. *See* Note 2, “*Fair Value Measurements,*” for a discussion of our accounting policies regarding this hierarchy.

The following table presents information about our financial assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2008, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

		Fair Value Measurements at 12/31/08 Measured Using		
Description	Total carrying amount in balance sheet 12/31/08	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		(in millions)		
Assets:				
Trading securities	$ 581.7	$225.9	$355.8	$—
Available-for-sale securities	410.9	258.5	152.4	—
Derivative assets	8.0	—	8.0	—
Total Assets	$1,000.6	$484.4	$516.2	$—
Liabilities:				
Derivative liabilities	$ 11.1	$ —	$ 11.1	$—
Total Liabilities	$ 11.1	$ —	$ 11.1	$—

7. **FAIR VALUE DISCLOSURES (CONTINUED)**

Changes in fair value of trading securities and derivatives in other current assets and other current liabilities are recorded as a component of net investment (losses)/gains in the consolidated statements of operations. Temporary changes in the fair value of available-for-sale securities are recognized as an unrealized (loss)/gain as a separate component of equity in the consolidated balance sheets.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value and the general classification of these instruments pursuant to the fair value hierarchy.

Trading Investments:

The Company's trading investment portfolio includes investments in various marketable securities including equity securities and debt securities. We rely on pricing inputs from the Fund Managers for valuing the investment securities held in the SMAs. Accordingly, we have established certain valuation procedures to ensure consistency, timeliness and reliability of the valuation data provided in accordance with the requirements of SFAS No. 157.

Trading instruments are generally valued using quoted market prices in active markets for identical assets, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include most U.S. government and sovereign obligations, active listed equities, and most money market securities. The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources include most government agency securities, investment-grade corporate bonds, certain mortgage products, less liquid listed equities, and state and municipal bonds. Accordingly, the valuation of these securities is categorized in Level 1 and Level 2 of the fair value hierarchy.

Available-for-Sale Investments:

The Company's available-for-sale investment portfolio includes investments in mutual funds, commingled funds and one exchange-traded fund. We rely on pricing inputs from the Fund Managers for valuing the Company's investment interests in the various fund vehicles. Accordingly, we have established certain valuation procedures to ensure consistency, timeliness and reliability of the valuation data provided in accordance with the requirements of SFAS No. 157. Available-for-sale securities are valued based on quoted market prices for either identical or comparable securities in active markets and are classified within Level 1 or 2 of the fair value hierarchy.

Derivative Assets and Liabilities:

At December 31, 2008, other current assets and other current liabilities in the consolidated balance sheet included approximately $8.0 million and $11.1 million, respectively, of derivatives, including interest rate swaps, forward contracts and foreign currency future contracts, and written put and call options. These investment positions are marked to market with the appreciation or depreciation recorded in earnings as a component of net investment (losses)/gains in the consolidated statement of operations. The Company values these derivatives by using inputs which can generally be corroborated by market data and by considering counter-party credit risk. Therefore, these instruments are classified within Level 2 of the fair value hierarchy.

7. FAIR VALUE DISCLOSURES (CONTINUED)

The following table presents information about our financial assets and liabilities that are measured at fair value on a nonrecurring basis as of December 31, 2008, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

		Fair Value Measurements at 12/31/08 Measured Using			
Description	Total carrying amount in balance sheet 12/31/08	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total gains (losses)
		(in millions)			
Assets:					
Other investments	$74.2	$—	$—	$74.2	$(35.4)
Total Assets	$74.2	$—	$—	$74.2	$(35.4)

Other Investments:

The Company's other investments include seven limited partnerships accounted for under the cost method with a carrying amount of $109.6 million which were written down to their estimated fair value of $74.2 million. As a result, impairment charges of $35.4 million were included in net investment losses for the year ended December 31, 2008.

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company considers cash and cash equivalents, trading, available-for-sale and cost method investments, receivables, investments receivable, the revolving credit facility receivable and investments payable to be its financial instruments. The carrying amounts reported in the consolidated balance sheets for these financial instruments equal or closely approximate fair value. We have investments in 29 limited partnerships accounted for under the cost method with a carrying amount of $138.6 million and an estimated fair value of $140.2 million based on net asset values.

9. FINRA CREDIT FACILITY

FINRA maintained an unsecured line of credit agreement and had the option to borrow up to $50.0 million at the one-month LIBOR plus 0.3 percent (0.74 percent at December 31, 2008). The line of credit agreement contained both financial and non-financial covenants. As of December 31, 2008, and December 31, 2007, no amounts were outstanding under this line of credit. This line of credit agreement was replaced on March 25, 2009. Under the terms of the amended unsecured line of credit agreement, we have the option to borrow up to $100.0 million at one-month LIBOR plus 0.3 percent (0.82 percent as of March 25, 2009). As of June 24, 2009, no amounts were outstanding under the amended agreement. The amended line of credit agreement, which also contains both financial and non-financial covenants, will expire on August 31, 2009.

10. INCOME TAXES

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

As of December 31, 2008, and 2007, New NASD Holding, Inc., a wholly-owned taxable subsidiary of FINRA, had net operating loss carry forwards of $105.6 million. These operating loss carry forwards will begin to expire in 2015. The amount of the deferred tax asset relating to these net operating loss carry forwards as of December 31, 2008, and 2007, was $47.5 million.

As of December 31, 2008, and 2007, FINRA and FINRA REG had unrelated business loss carry forwards of $27.8 million and $23.4 million, respectively, primarily related to our ADF, OTCBB and OTC Equities operations. The unrelated business loss carry forwards expire through 2028. There are no other significant deferred tax assets or liabilities related to unrelated business income activity.

Under SFAS No. 109, *Accounting for Income Taxes*, to record a deferred tax asset without a valuation allowance, it must be more likely than not that the deferred tax asset will be realized. We do not believe it is more likely than not that we will realize the net operating loss and unrelated business loss carry forwards and, therefore have recorded a full valuation allowance as of December 31, 2008, and 2007 for all of our deferred tax assets.

11. EMPLOYEE BENEFITS

Defined Benefit Pension Plans

As of December 31, 2008, and 2007, we provided two non-contributory defined benefit pension plans for the benefit of our eligible employees, consisting of a qualified ERP and a non-qualified SERP. The benefits are based primarily on years of service and the employees' average compensation, as defined, during the highest 60 consecutive months of employment. The SERP is frozen with respect to new participants.

We established an irrevocable rabbi trust amount equal to our SERP obligation and consolidate this trust in accordance with EITF No. 97-14. As of December 31, 2008, and 2007, $14.6 million and $16.1 million of investments are included in available-for-sale securities and cash and cash equivalents, respectively, in the consolidated balance sheets, representing the amounts contributed by FINRA, plus earned income and market value gains, less distributions to retirees and market value losses.

The investment policy and strategy of the plan assets, as established by the FINRA Pension/401(k) Plan Committee (the Pension Committee), is to provide for preservation of principal, both in nominal and real terms, in order to meet the long-term spending needs of the pension plan by investing assets per the target allocations stated below. Asset allocations are reviewed quarterly and adjusted, as appropriate, to remain within target allocations. The Pension Committee reviews the investment policy annually, under the guidance of an investment consultant, to determine if we should change the policy or asset allocation targets. The plan assets consisted of the following as of December 31:

	Target Allocation	2008	2007
Equity securities	55.0%	30.3%	59.4%
Debt securities and cash equivalents	20.0%	54.3%	24.5%
Real assets	10.0%	3.9%	0.0%
Other investment strategies	15.0%	11.5%	16.1%
Total	100.0%	100.0%	100.0%

11. EMPLOYEE BENEFITS (CONTINUED)

The target allocations were revised in 2007. The allocation percentages at December 31, 2008 vary from the targets as a result of a $45.0 million contribution (30.9 percent of assets) made in December 2008 and initially invested in cash equivalents, along with variable market declines in other asset classes during 2008.

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

Postretirement and Retiree Medical Benefit Plans

As of December 31, 2008, and 2007, the Company provided a non-contributory postretirement life insurance benefit plan for the benefit of eligible employees. The postretirement benefit plan provides a specified life insurance benefit to eligible retired employees. The postretirement benefit plan is frozen with respect to new participants.

On January 1, 2007, we implemented an employer-funded defined contribution Retiree Medical Account Plan (the Plan) to assist our employees and retirees with the cost of health care expenses during retirement. Under the Plan, Retiree Medical Accounts are created for eligible employees and retirees and fixed annual credits are applied to those accounts for each year of FINRA service beginning at age 40. Active employees may also accrue credits for a portion of their unused vacation and personal leave. The credits can be accessed only in retirement and may be used only toward paying a portion of monthly premiums under FINRA-sponsored retiree health plans.

Voluntary Retirement Program

On September 29, 2008, FINRA announced that its Board of Governors had approved the implementation of a Voluntary Retirement Program (the Program). The Program was 100 percent voluntary, and was designed for those employees who, as of October 2, 2008, were retirement-eligible (minimum age of 55 as of December 26, 2008) and who, when combined with years of service, reached a minimum combined age/years of service of 65 as of December 26, 2008. The Program included provisions for benefits in the form of severance payments; medical, dental and vision benefits; outplacement services; eligibility and payout for various bonus programs; and additional service credits for the various FINRA pension and other postretirement benefits programs (if eligible).

SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, provides the accounting guidance related to special termination benefits provided under the Program. As of December 31, 2008, we have accrued $19.4 million of severance benefits related to the Program and this amount is included in compensation and benefits in the consolidated statement of operations.

11. EMPLOYEE BENEFITS (CONTINUED)

Settlements and/or special termination benefits with respect to pension and retiree medical benefits under the Program are included in the plan disclosures below.

Plan Disclosures

The following tables disclose "pension benefits," which include the defined benefit pension plans described above, and "other benefits," which include the postretirement and retiree medical plans described above. The reconciliation of the projected benefit obligation, the change in the fair value of plan assets for the years ended December 31, 2008, and 2007, and the accumulated benefit obligation at December 31, 2008, and 2007, are as follows:

	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
		(in millions)		
Change in benefit obligation				
Benefit obligation at beginning of year	$ 270.8	$ 255.1	$ 22.5	$ 0.3
Service cost	28.0	23.8	1.7	1.6
Interest cost	16.3	14.2	1.3	1.2
Plan initiation	—	—	—	20.0
Actuarial (gains) losses	(29.1)	(13.3)	(2.0)	(0.6)
Benefits paid	(19.5)	(9.0)	(0.6)	(0.5)
Amendments	—	—	—	0.5
Special termination benefits	21.5	—	2.2	—
Benefit obligation at end of year	$ 288.0	$ 270.8	$ 25.1	$ 22.5
Change in plan assets				
Fair value of plan assets at beginning of year	$ 133.8	$ 123.9	$ —	$ —
Actual return on plan assets	(43.7)	6.4	—	—
Company contributions	75.2	12.5	0.6	0.5
Benefits paid	(19.5)	(9.0)	(0.6)	(0.5)
Fair value of plan assets at end of year	$ 145.8	$ 133.8	$ —	$ —
Underfunded status of the plan	$(142.2)	$(137.0)	$(25.1)	$(22.5)
Accumulated benefit obligation (ABO)	$ 199.4	$ 165.4		

11. EMPLOYEE BENEFITS (CONTINUED)

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

	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
	(in millions)			
Current	$ 10.2	$ 5.0	$ 2.2	$ 0.9
Noncurrent	132.0	132.0	22.9	21.6
Net amount at December 31	$142.2	$137.0	$25.1	$22.5

The Company does not expect any plan assets to be returned to it during the year ending December 31, 2009.

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

	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
	(in millions)			
Unrecognized net actuarial (loss) gain	$(92.1)	$(65.6)	$ 1.3	$ 0.2
Unrecognized prior service cost	(2.0)	(2.2)	(17.2)	(18.6)
Unrecognized net transition (obligation) asset	—	—	(0.1)	(0.1)
Net amount at December 31	$(94.1)	$(67.8)	$(16.0)	$(18.5)

The following amounts were included in other comprehensive income (loss) during the year ended December 31, 2008, in accordance with SFAS No. 158:

	Incurred but Not Recognized	Reclassification Adjustment for Prior Period Amounts Recognized
	(in millions)	
Actuarial (loss) gain		
Pension benefits	$(34.3)	$7.8
Other benefits	1.1	—
	(33.2)	7.8
Prior service cost		
Pension benefits	—	0.2
Other benefits	—	1.4
	—	1.6
	$(33.2)	$9.4

11. EMPLOYEE BENEFITS (CONTINUED)

Estimated amounts to be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost during 2009 based on December 31, 2008, plan measurements are as follows:

	Pension Benefits	Other Benefits
	(in millions)	
Unrecognized prior service costs	$0.2	$1.4
Unrecognized actuarial losses	4.6	—

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

	Pension Benefits			Other Benefits		
	2008	2007	2006	2008	2007	2006
Discount rate	6.50%	6.00%	5.75%	6.50%	6.00%	5.75%
Rate of compensation increase	4.90%	5.34%	5.34%	—	—	—
Expected return on plan assets	7.75%	8.50%	8.50%	—	—	—

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

	Pension Benefits			Other Benefits		
	2008	2007	2006	2008	2007	2006
			(in millions)			
Service cost	$ 28.0	$ 23.8	$24.2	$1.7	$1.6	$—
Interest cost	16.3	14.2	13.4	1.3	1.2	—
Expected return on plan assets	(11.5)	(10.4)	(9.9)	—	—	—
Recognized net actuarial losses	7.8	3.8	5.1	—	—	—
Prior service cost recognized	0.2	0.3	0.3	1.4	1.4	—
Amortization of unrecognized transition asset	—	(0.1)	(0.1)	—	—	—
Curtailment/settlement loss recognized	4.2	0.2	4.5	—	—	—
Special termination benefits	9.1	—	—	1.3	—	—
	$ 54.1	$ 31.8	$37.5	$5.7	$4.2	$—

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

We measure our plans as of the end of each fiscal year. The ERP's funding policy targets a funded ratio of the greater of the Funding Target or 100 percent of the ABO, the latter measure including a corridor between 95 percent and 110 percent of the ABO. In 2009, we expect to contribute $20.1 million to the ERP and $7.0 million to the SERP. In addition, we expect to make the following benefit payments to participants over the next 10 years:

	Pension Benefits	Other Benefits
	(in millions)	
Year ending December 31,		
2009	$ 58.0	$ 2.2
2010	7.9	2.3
2011	15.1	2.2
2012	14.4	2.3
2013	19.5	2.3
2014 through 2018	135.9	13.0
Total	$250.8	$24.3

11. EMPLOYEE BENEFITS (CONTINUED)

All Other Benefit Plans

FINRA also maintains a voluntary contributory savings plan for eligible employees. Employees are immediately eligible to make elective contributions to the plan up to specified plan limits. Employees are also eligible to receive a corresponding dollar-for-dollar matching contribution from us on any elective contribution made by the participant to the savings plan, up to a maximum of 6 percent of base compensation effective January 1, 2008. Prior to January 1, 2008, the limit on amounts eligible for the basic dollar-for-dollar matching contribution was 4 percent. Effective January 1, 2008, the plan also added the retiree medical match equal to 25 cents on the dollar for elective contributions in excess of 6 percent of compensation, up to an annual maximum match of $1,000. Savings plan expense for 2008, 2007 and 2006, was $18.0 million, $14.0 million and $11.8 million, respectively, and is included within compensation and benefits expense in the consolidated statements of operations. The retiree medical match for 2008 totaled $1.4 million and is included within compensation and benefits expense in the consolidated statements of operations. Prior to January 1, 2008, eligible plan participants could also receive an additional discretionary matching contribution from FINRA. The savings plan expense amounts referred to above for 2007 and 2006 included a discretionary 2 percent match totaling $4.2 million and $3.6 million, respectively, included within compensation and benefits expense in the consolidated statements of operations.

12. LEASES

FINRA 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 $26.5 million, $22.1 million and $19.6 million for the years ended December 31, 2008, 2007 and 2006, respectively, and is included in occupancy expense in the consolidated statements of operations.

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, 2008 (amounts are in millions):

Year ending December 31,	
2009	$ 30.0
2010	30.0
2011	29.8
2012	23.5
2013	19.5
Remaining years	105.0
Total minimum lease payments	$237.8

13. COMMITMENTS AND CONTINGENCIES

Series 7 Exam

On January 6, 2006, FINRA announced that 1,882 individuals who took the Series 7 broker qualification exam between October 1, 2004, and December 20, 2005, incorrectly received a failing grade due to a software error. This error caused some test takers to score just below the minimum passing grade. A consolidated amended complaint seeking damages from us and one of our contractors for breach of contract was filed in October 2006. We filed a motion to dismiss in December 2006, and oral argument was heard in April 2007. In September 2007, our motion to dismiss was granted. In October 2007, the plaintiffs filed a notice of appeal, with oral argument held in September 2008. In November 2008, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the dismissal of the lawsuit.

13. COMMITMENTS AND CONTINGENCIES (CONTINUED)

General Litigation

The Company may be subject to claims arising out of the conduct of its business. Currently, there are certain legal proceedings pending against us. Management believes, based on the opinion of counsel, we have adequately provided for any liabilities or settlements arising from these proceedings and does not believe the results of such proceedings would have a material adverse effect on our financial position and results of operations. Management is not aware of any unasserted claims or assessments that would have a material adverse effect on our financial position and the results of operations. Litigation settlements are included in professional and contract services in the consolidated statements of operations.

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