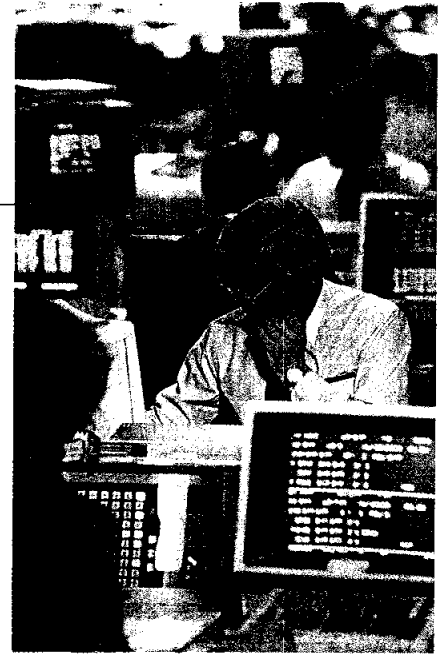


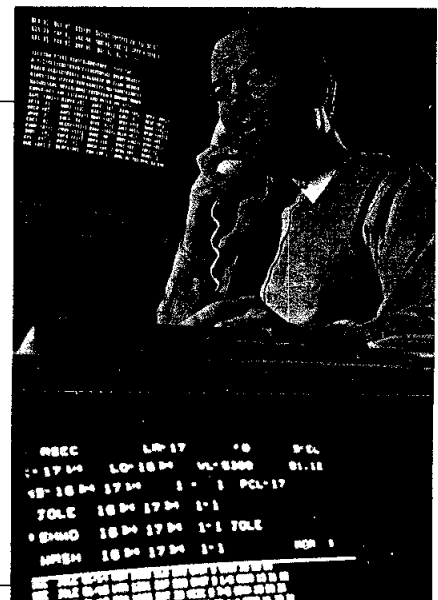
1984 ANNUAL REPORT

COMPETITION



INNOVATION

TECHNOLOGY



The National Association of Securities Dealers, Inc. is the not-for-profit, self-regulatory organization for the over-the-counter securities market. More than 5,700 broker-dealer firms, or virtually all firms which do a securities business with the public, belong to the NASD and agree to abide by its rules as a condition of membership. Some 330,000 registered representatives of these organizations are subject to NASD regulation.

As a regulatory organization whose activities are geared to protect investors and to promote fair business practices, the NASD determines the compliance of its broker-dealer members with applicable governmental regulations and its own Rules of Fair Practice. The NASD also provides a number of key services, such as cooperating with the government and federal agencies on policies and legislation that affect the investment banking and securities business.

The NASD also has two subsidiaries. NASDAQ, Inc. operates the nationwide electronic NASDAQ System that collects price quotations from more than 450 dealers in over 4,700 NASDAQ securities and it disseminates this data to NASDAQ subscribers and information vendors worldwide. NASD Market Services, Inc. provides a variety of market-related services. The principal services offered include systems for the automatic execution of orders, computerized facilities for comparison of trades and for reconciliation of uncompleted trades, and last-sale information reports. Also, subject to SEC approval, NASD Market Services, Inc. will soon offer a NASDAQ Options Program.

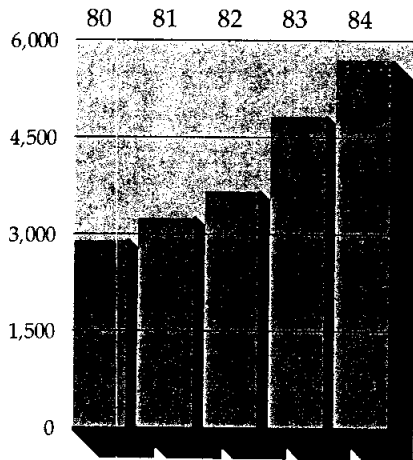
ABOUT THE COVER:

Competition . . . Innovation . . . Technology . . . These are the 1984 hallmarks of the NASDAQ market and the many services and programs offered by the NASD. On the front cover, "competition" is depicted by a scene from the trading room of a typical NASDAQ market maker, "innovation" by a close-up view of a member firm subscriber using the newly enhanced Trade Acceptance and Reconciliation Service, and "technology" by a look at a trader who is handling a customer's order using the new Small Order Execution System.

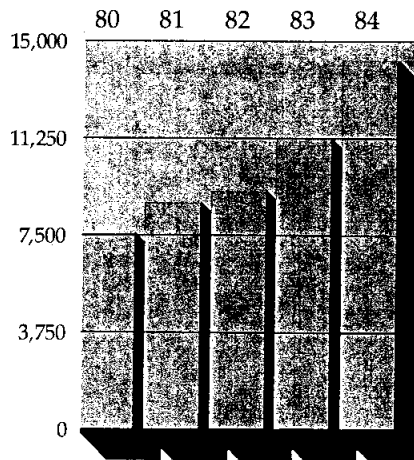
NASD AND THE NASDAQ MARKET

FIVE-YEAR STATISTICAL REVIEW

MEMBER FIRMS

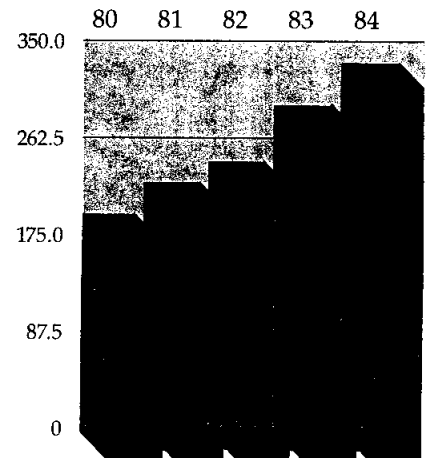


BRANCH OFFICES

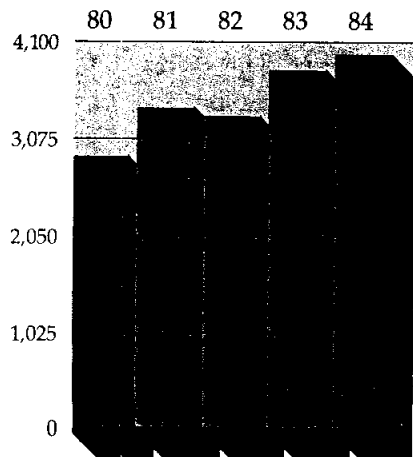


REGISTERED REPRESENTATIVES

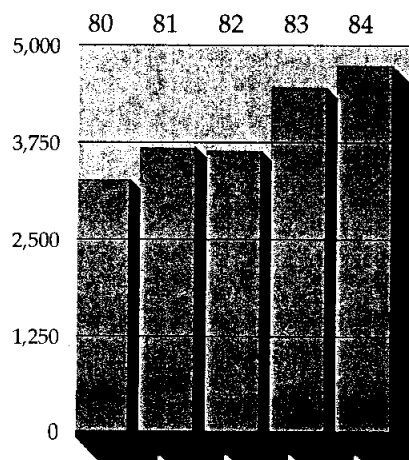
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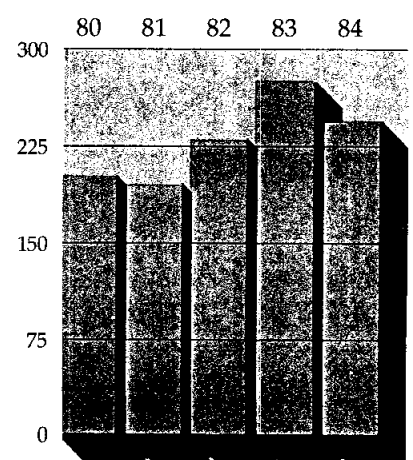
NASDAQ COMPANIES



NASDAQ ISSUES

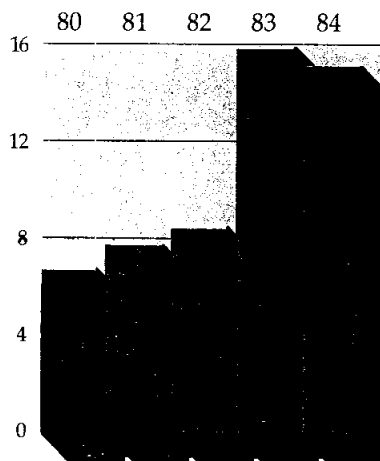


NASDAQ COMPOSITE INDEX



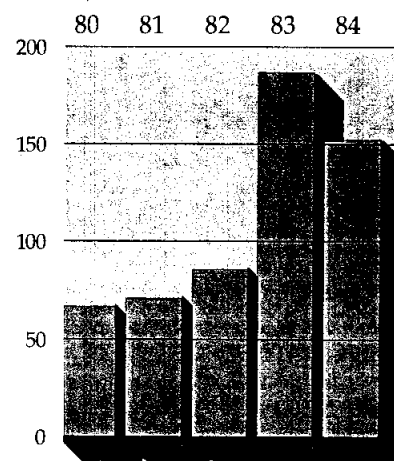
NASDAQ SHARE VOLUME

(in billions)

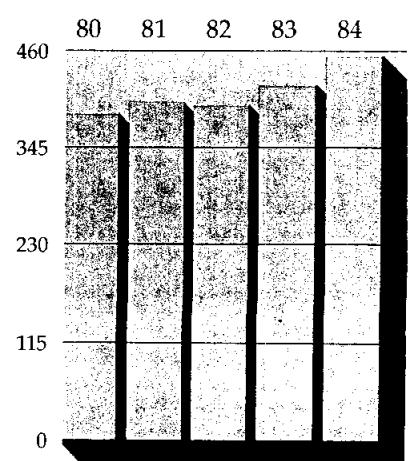


NASDAQ DOLLAR VOLUME

(in billions)



NASDAQ MARKET MAKERS



2

- *NASD membership reaches an all-time high of 5,726 member firms, branch offices climb to an unprecedented 14,296, and the number of registered representatives soar to 330,000.*
- *The Securities and Exchange Commission adopts a far-reaching NASD proposal, without modification, amending the criteria for admitting stocks into the NASDAQ National Market System.*
- *The Federal Reserve Board approves automatic margin for all NASDAQ/NMS securities.*
- *Georgia grants NASDAQ/NMS securities an exemption from blue-sky registration giving them parity with exchange-listed securities.*
- *122.2 million shares are traded in the NASDAQ market on August 3, setting a new single-day trading record.*
- *The NASD launches the Small Order Execution System, a pioneering system for rapid, automatic execution of customer orders up to 500 shares in NASDAQ stocks.*
- *All 48 contiguous states, plus Alaska, the District of Columbia and Puerto Rico, now participate in the Central Registration Depository.*
- *More than 150 firms participate in the Firm Access Query System enabling them to update their registration records and schedule qualification exams by computer.*
- *The NASD enhances its regulatory programs with new, sophisticated automated surveillance systems.*

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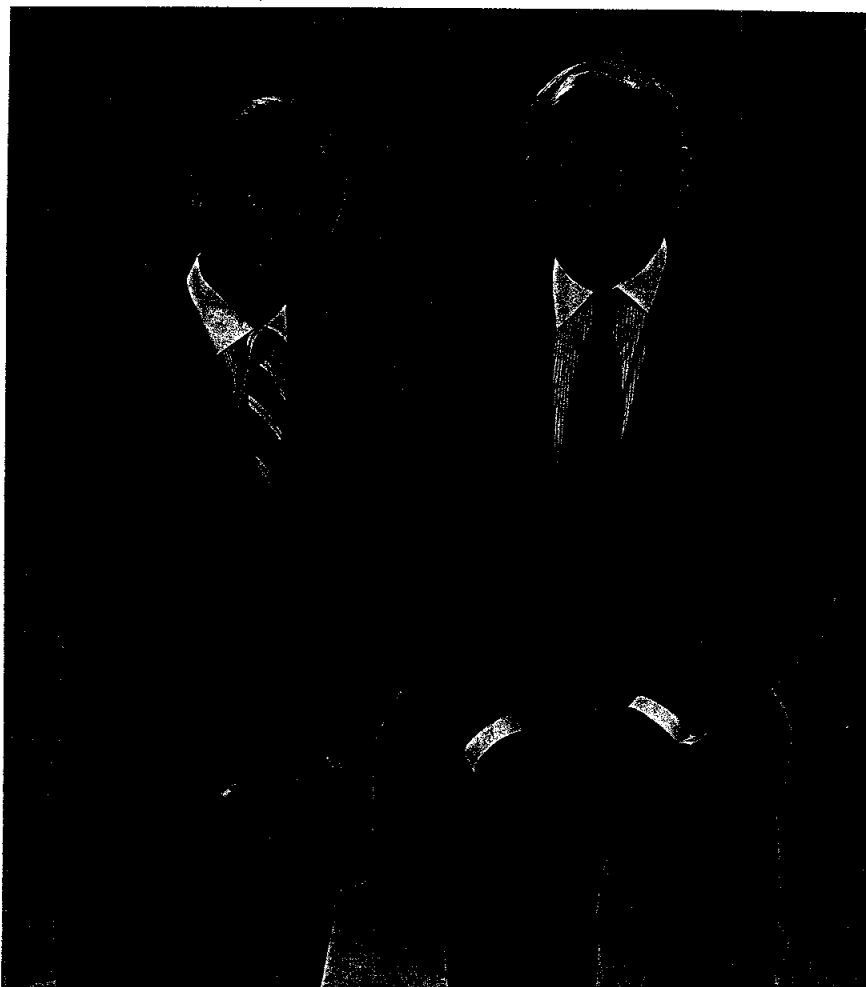
To Members, Issuers and Friends:

Your organization and market achieved dimensions of growth, vitality, prominence and promise in 1984 that few of us would have thought likely a decade ago.

At year-end 1984, the number of NASD member firms totaled 5,726, highest in the NASD's 45-year history and a 17 percent increase over year-end 1983. The number of branch offices reached a record 14,296, up 22 percent since last year. NASD firms employed nearly 330,000 registered representatives – another record, and a 12 percent gain over 1983.

An all-time high of 4,097 companies were represented in the NASDAQ market in 1984, a gain of 196 over 1983, and the number of NASDAQ securities rose to 4,723, up 256 over 1983. NASDAQ logged the second-highest annual volume in its 14-year history – 15.2 billion shares – compared to 15.9 billion in 1983, the record year. On August 3, 122.2 million shares were traded, the largest single-day volume in this, the world's fastest-growing stock market.

Most dynamic and far-reaching was the growth of the NASDAQ National Market System, which combines last-sale reporting characteristics of the major stock exchanges with the competing market maker system unique to NASDAQ. NASDAQ National Market System issues almost doubled to 1,180 and volume totaled 7.6 billion shares, or about half of total NASDAQ volume.



Gordon S. Macklin, President (left) and Carl P. Sherr, Chairman.

U.S. and international recognition of the NASDAQ market grew substantially. Greater investor interest, evidenced by the 9.2 percent growth in ownership of NASDAQ stocks between mid-1981 and mid-1983, continued also to be reflected in the dramatically expanding coverage of the NASDAQ market by the print and broadcast media. Overseas, the London Stock Exchange announced a decision to model its new equity trading system after the NASDAQ market, with competing multiple market makers connected by a computerized network.

Critical decisions affecting our market by regulators reflected

recognition of the quality of corporations represented on NASDAQ – companies that formerly listed on exchanges. In September, the Federal Reserve Board determined to grant automatic marginability to all securities designated for inclusion in the NASDAQ National Market System. In November, the SEC approved, without change, an NASD proposal to amend the voluntary inclusion criteria for issues in the NASDAQ National Market System, making about 1,500 additional securities in the NASDAQ National Newspaper List eligible for admission to the NASDAQ National Market System.

Georgia, in a precedent-setting action, adopted an exemption from its "blue-sky" registration for NASDAQ/NMS securities, thus putting them on a par with exchange-listed securities.

4

The NASD contributed significantly to the administrative and operational efficiency of the securities industry through the introduction and expansion of several key labor-saving and cost-effective member services. All 48 contiguous states plus Alaska, the District of Columbia and Puerto Rico now participate in the Central Registration Depository (CRD), a computerized system which has streamlined the registration and licensing procedures for industry professionals. Participants in the Firm Access Query System (FAQS), which permits firms to update their registration records and to schedule qualification examinations for their employees by remote computer terminals, grew considerably in 1984. Also, a greater percentage of the qualification examinations administered by the NASD were administered on the Association's automated testing system.

Subscribers accounting for almost 75 percent of all cleared OTC trades are now participating in the Trade Acceptance and Reconciliation Service (TARS). This on-line data base of trade information assists members in resolving uncompleted trades promptly. In December, the Small Order Execution System

(SOES), a system that automates the execution of all small orders handled between broker-dealers in NASDAQ securities, was inaugurated for transactions of 500 or fewer shares. SOES provides faster executions at the best available price for investors and at substantial savings for securities firms. At the end of the year, 50 NASDAQ National Market System stocks were being traded in SOES and, by early 1985, all NMS stocks are scheduled to be added to the system.

Amid this growth, an excellent degree of compliance was maintained by member firms with federal securities regulations and the NASD's own Rules of Fair Practice. 1984 marked the establishment of a special Surveillance Committee, consisting of NASD Governors and former Governors. This Committee administers Section 38 of the NASD's Rules of Fair Practice, a new rule which empowers the Association to limit the activities of members who are in or approaching financial or operational difficulties.

Regulation of the NASDAQ market was also strengthened by the creation of a new Market Surveillance Committee. This Committee is now the single disciplinary authority for the review of all trading-related complaints. Responsibility for these matters was formerly divided among the Trading Committee and the various District Committees.

Reflecting the growth in the Association's activities and responsibilities, the full-time staff of the NASD was increased by 107 to

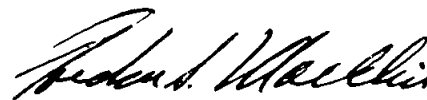
1,121 in 1984, and the operating budgets for Fiscal Year 1985 for the NASD and its two subsidiary companies amounted to \$83.5 million. Due mainly to higher levels of activity in the NASDAQ market, the NASD was able to accommodate this added growth while providing members with a discount of 50 percent in the existing rate of membership assessments.

Our objectives for 1985 are to continue to promote the explosive growth of the NASDAQ market domestically and internationally, believing as we do that it is a market of almost unlimited potential, and to enhance our operational and regulatory services to NASD firms and investors in an increasingly competitive investment environment.

We are confident that the NASD will address the challenges of 1985 as it has those in years past because it is guided by a corps of dedicated volunteers — on the Board, on its national committees and District Committees — augmented by a skilled professional staff.



Carl P. Sherr
Chairman



Gordon S. Macklin
President

With the addition of 841 new member firms in 1984, the NASD's membership climbed to an all-time record of 5,726 firms, up 17.2 percent over 1983. The number of registered personnel also increased dramatically — to 330,000 from 296,000 in 1983 — as did the number of branch offices — to 14,296 from 11,681 in 1983. At year-end, another 699 firms had submitted applications and were awaiting approval of their membership in the NASD.

Although firms of virtually every type and size joined the NASD in 1984, the major categories of firms added to the membership rolls were those selling securities with flow-through tax benefits and general securities firms which clear their trades through others. Also, the greatest influx of registered representatives came from national full-line firms and insurance company members. National full-line firms also accounted for the largest number of branch offices opened during the year.

MEMBER SERVICES

In 1984, the NASD expanded and enhanced many of its regulatory-related member services and it introduced several new ones. Among the more significant of these are:

CRD

The Central Registration Depository (CRD) is the computerized system of the NASD and the North American Securities Administrators Association which has streamlined the application and licensing procedures for registered industry personnel.

one form with one check to effect multiple registrations and licenses with the NASD and the states. In 1984, CRD's coverage was expanded to include Alaska, Arizona, California, Maine, Puerto Rico, Tennessee and Vermont. A total of 49 states, the District of Columbia and Puerto Rico now participate in the CRD. Also, 31 states now use the CRD for their year-end renewal of the licenses of securities salesmen and principals. CRD has significantly simplified what had been a burdensome process for members.

FAQS

The Firm Access Query System (FAQS) is a relatively new NASD service which permits members to access their registration and accounting records in the CRD and to schedule qualification examinations through remote terminals. In 1984, participation in FAQS grew dramatically — from 51 firms in 1983 to 151 firms by year-end 1984.

TAT

The Temporary Agent Transfer program (TAT), launched in 1984, permits a member to effect the immediate transfer, by telephone or FAQS service message, of a registered person if his break in service was for seven days or less. During a 21-day period following the transfer, the registered individual is permitted to handle customer accounts for his new employer while the paperwork transferring him on a permanent basis is processed.

Qualification Examinations

During 1984, the NASD administered over 216,000 qualification

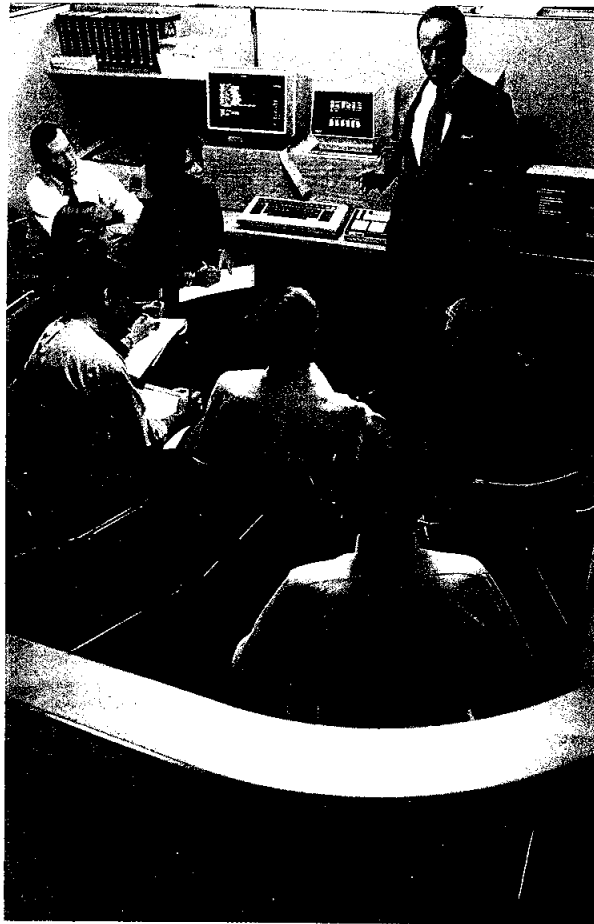
examinations for itself, other self-regulatory organizations, the states, a number of the commodity exchanges and other certifying organizations. This was 7.6 percent higher than in 1983 and 75 percent higher than the number of examinations in 1982.

To handle the sharp rise in qualification examinations, the NASD has increased the amount of testing done through its automated system and has integrated the operation of this network with the recordkeeping functions of the CRD. Fully automated testing accounted for 74 percent of examinations administered in 1984. Use of the NASD automated testing system expedites the process by providing daily test administration on an appointment basis, video display of the examination questions and immediate scoring at the conclusion of each candidate's examination session.

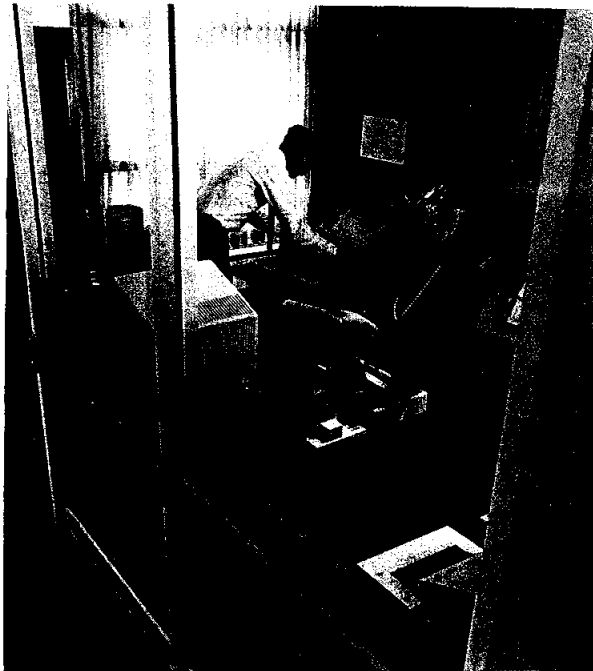
Arbitration Services

The NASD Arbitration facilities are increasingly being used by both investors and members as a more prompt and less expensive alternative to the courts. In 1984, member firms and public customers filed 810 regular claims and 298 small claims. The cases — 1,108 — reflect a 44 percent increase in filings over 1983 and represent more than \$61 million in amounts claimed. A total of 503 regular and 244 small claims were closed in 1984.

To incorporate changes recommended by the Securities Industry Conference on Arbitration (an industry committee with public representatives in which the NASD participates), the NASD's Code of Arbitration Procedure was amended

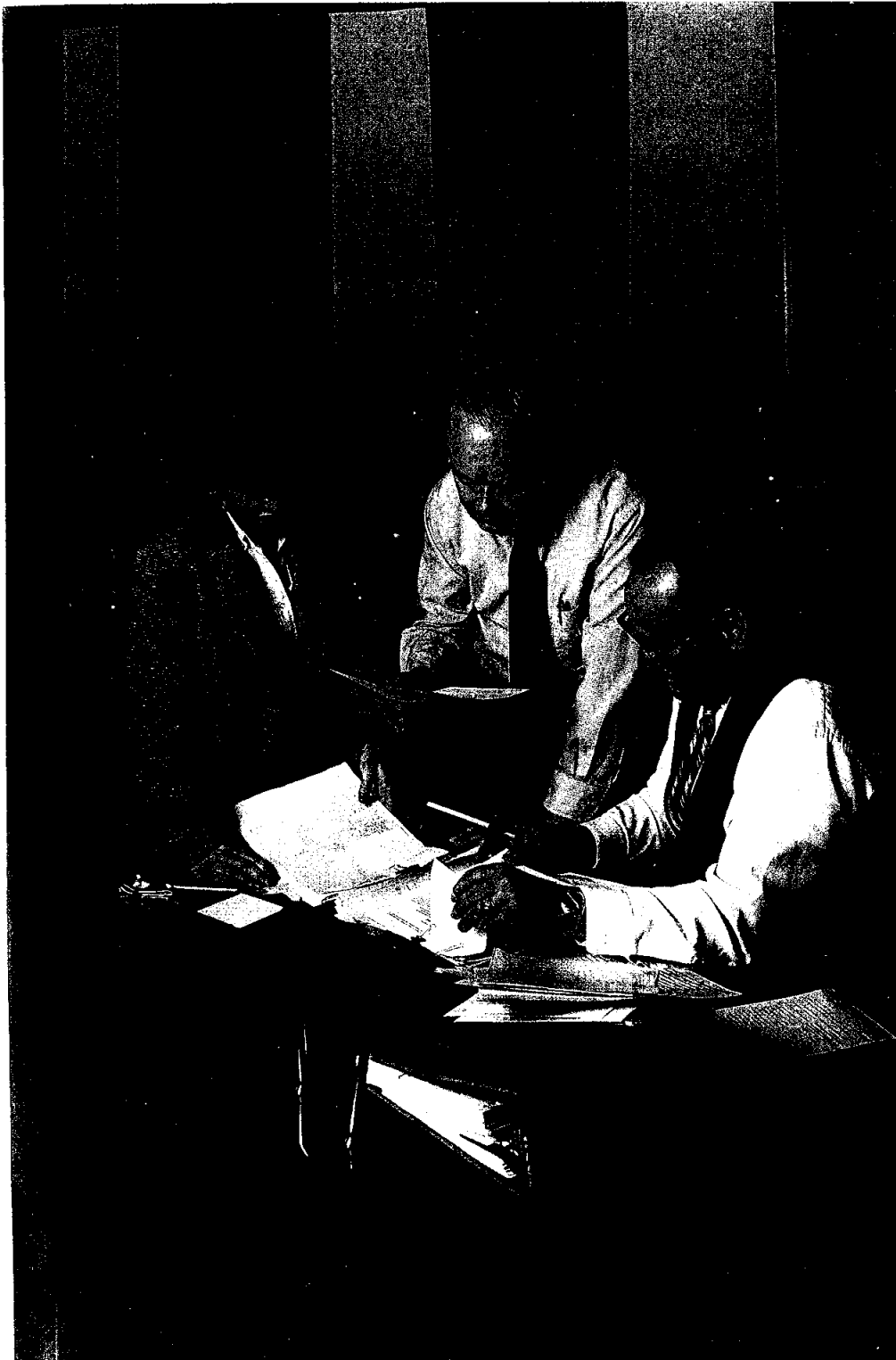


Washington, D.C. — An NASD employee demonstrates NASDAQ's state-of-the-art Market Surveillance systems.



Washington, D.C. — Market Surveillance staff monitor newswires.

The NASD adopts, administers and enforces Rules of Fair Practice to promote high standards of commercial honor and the observance of just and equitable principles of trade by its members. Member compliance with requirements is determined through a comprehensive, nationwide field-inspection program carried out by staff in 14 District Offices and by centralized, computer-based monitoring of the NASDAQ market by Market Surveillance personnel in the NASD's Washington, D.C. headquarters.



New York – NASD District 12 staff review examination reports of members.

on October 1, 1984. The amendments accomplished two purposes: They increase from \$2,500 to \$5,000, the dollar amount of claims eligible for submission under the Code's small claims provisions; and, they modify the procedural rights afforded the parties to an arbitration proceeding.

Advertising Reviews

The volume of advertising and sales literature reviewed by the Association continued an eight-year upward spiral. Members filed 15,164 items for review, representing a 6 percent increase over 1983. Another 2,905 items were reviewed in response to spot checks.

Group Fidelity and Surety Bond Programs

Since their inception in 1983, the NASD's two group bond-buying programs have continued to attract considerable member interest. At the end of 1984, some 2,800 members were participating in the fidelity bond program, while 1,800 firms had obtained surety bonds. On the November 1, 1984, renewal date, the premium rate of the fidelity bonds program was increased by 20 percent, which favorably compares to industry-wide rate increases of 100 percent or more.

REGULATORY DEVELOPMENTS

Improved Automated Surveillance

Among the improvements in regulatory programs in 1984 was the decision of the NASD's Board to proceed with the development of a NASDAQ equity audit trail. A multi-phased project, the audit trail will, for the first time, provide a

fully integrated data base of second-by-second quotation, transaction and clearing detail for all NASDAQ securities on a firm-by-firm basis. This historical record of trading in NASDAQ securities will be used in a broad range of NASD surveillance systems and will result in an even more efficient and effective means of overseeing trading activity in the NASDAQ market.

Other automated surveillance system enhancements implemented in 1984:

The Insider Exception System a monitoring system designed to detect insider trading;

Volumewatch an automation enhancement that monitors real-time, intra-day volume fluctuations in NASDAQ/NMS securities; and,

Blockwatch a system that provides real-time notifications of block-size trades complete with trade detail.

New Committees

A Market Surveillance Committee was established in 1984 to function as the central review body for matters developed by the Market Surveillance Section. Composed of industry representatives with expertise in areas such as trading, options, corporate finance and compliance, the Committee has the responsibility of determining member compliance with NASDAQ market-related NASD and SEC rules. As a disciplinary committee, the Market Surveillance Committee's authority is identical to that of the District Business Conduct Committees. It is empowered to authorize all forms of disciplinary actions, including formal and summary

complaints, Letters of Acceptance, Waiver and Consent, and Offers of Settlement.

The Board of Governors also created a National Surveillance Committee during the year. Its purpose is to intervene, when necessary, and guide and direct the activities of members experiencing financial or operational difficulties. The authority to provide this direction is derived from newly adopted Section 38 to the NASD's Rules of Fair Practice. Under this rule, the NASD may restrict a member from expanding its business activities when certain early-warning financial criteria are exceeded. The rule also empowers the NASD to compel a member to reduce or eliminate certain business activities when other criteria with lower tolerances are exceeded.

Two other policy-level advisory groups were formed: an Ad Hoc Committee on Limit Orders, which is examining members' responsibilities in the handling of customers' limit orders, and a new subcommittee of the National Business Conduct Committee, which is examining order flow arrangements among members.

Improved Field Surveillance

As part of its program of automating various regulatory and administrative functions, the NASD completed the installation of micro-computers in each of its 14 District Offices. These computers are being used to assist the staff in the monitoring of the financial and operational condition of members through such functions as the automated analysis of the monthly FOCUS Report.

The NASD also did extensive work during the past year in strengthening its regulatory procedures and staff training programs.

Corporate Financing Regulatory Developments

In the corporate financing area, the Association took several steps, some of which include:

- proposing amendments to liberalize regulations applied to venture capital activities of NASD members;
- developing a proposal, subsequently published for comment by the SEC, permitting brokers and dealers to distribute public offerings of direct participation programs with installment payment provisions;
- working with the SEC to publish interpretations clarifying federal regulations on handling of escrow accounts in contingent direct participation program offerings;
- adopting new standards for sales incentive arrangements in public direct participation programs;
- entering into an agreement with the State of Georgia to expedite the registration of NASD/SEC issues in that state by processing required filings of public offerings.

Various legislative proposals were introduced in 1984. The bill, proposed Rule 144 and the Investment Company Act of 1940, providing the use of readily convertible variable life insurance, also covered universal variable life insurance. The committee reported a policy review of investment insurance products in one of

more funds - typically money market, common stock and bond funds - and, on the basis of the fund's performance, to vary his premiums within certain limits.

NASD Comments on Hill Proposals

The Association commented on three bills introduced in 1984 affecting the securities industry.

- H.R. 559 The Insider Trading Sanctions Act of 1984. The NASD applauded the legislation's intent and direction - imposing more severe penalties for trading on inside information. However, the Association requested that the bill specify that the proposed double damage provisions apply only to those who profit directly by insider trades.

- S. 2575 Amendments to the Small Business Act to improve the secondary market for loans guaranteed by the Small Business Administration. The NASD identified specific concerns about the legislation's impact on the overall economic picture for small businesses and NASD jurisdiction.

- H.R. 1100 The Dealer Protection Act of 1984. The NASD supported a strong legislative proposal to protect investors' interests in the event of

unfair or advantage over unlisted stock options. The Association's concerns were addressed in the legislation's final language.

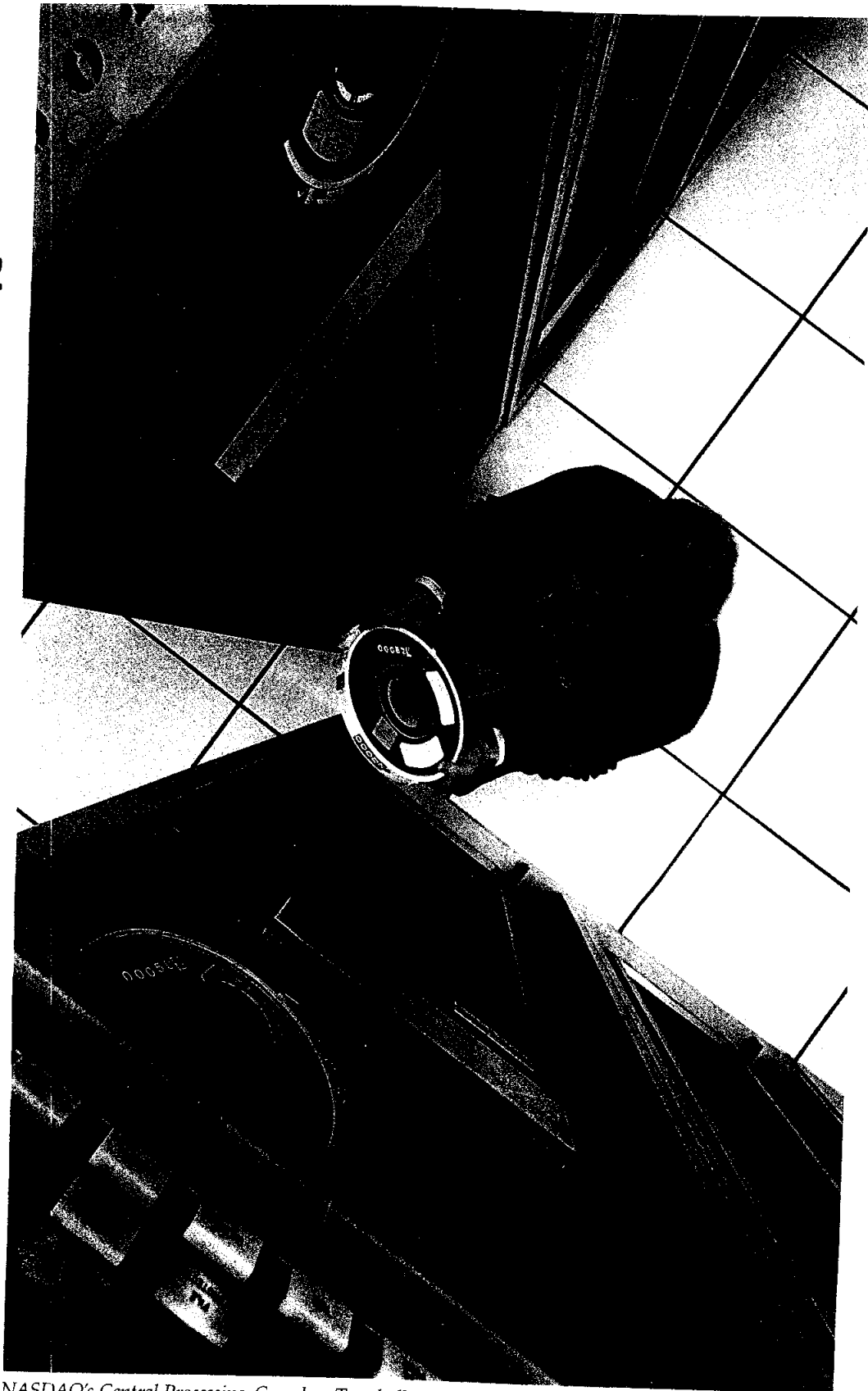
REGULATORY ACTIVITIES

Market Surveillance Section

During the year, a total of 8,123 real-time price and volume alerts were reviewed by the online Stock Watch Unit. These and another 909 reviews triggered by other monitoring systems led to 259 formal investigations, of which 131 were referred to the SEC. In NASD District Office or the Anti-Fraud Section, instances of possible insider trading, manipulation or other questionable activity were generally the subject of these referrals.

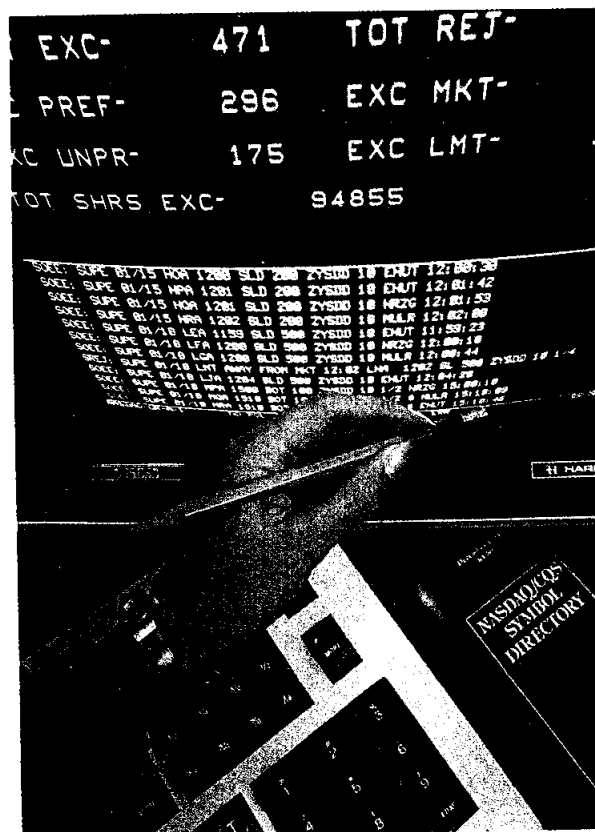
Through its fully automated Order Trade Comparison System, the NASD continued to monitor members' compliance with the NASD's CTS/MS trade reporting rules. There were a total of 1,011 referrals to NASD/CATS/MS. Fifty-six of which 39 referrals were submitted in person and 17 by mail. The resulting market activity was reviewed by the NASD's Market Activity Review Unit. The unit's review of 1,011 referrals resulted in 1,011 referrals to the SEC.

With the addition of 841 new member firms in 1984, the NASD's membership climbed to an all-time record of 5,726 firms, up 17.2 percent over 1983. The number of registered personnel also increased dramatically - to 330,000 from 296,000 in 1983 - as did the number of branch offices - to 14,296 from 11,681 in 1983. At year-end, another 699 firms had submitted applications and were awaiting membership approval.

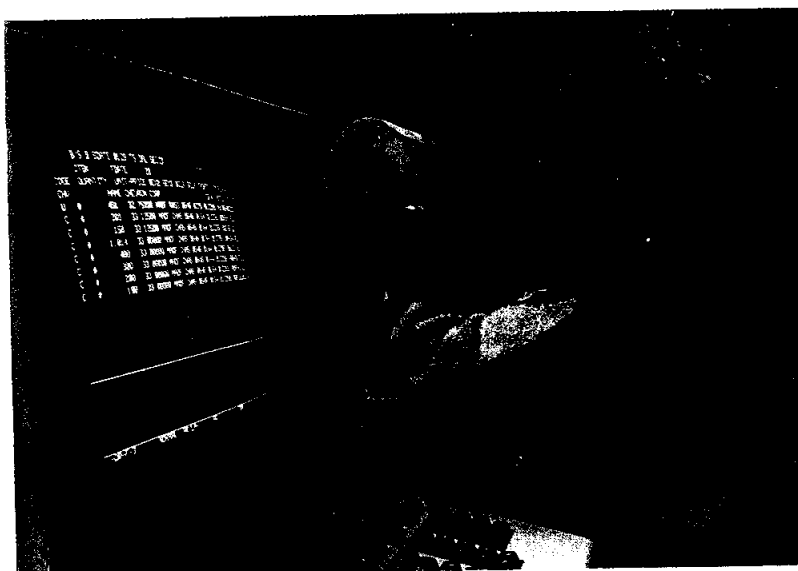


NASDAQ's Central Processing Complex, Trumbull, Connecticut.

Through its subsidiary companies, NASDAQ, Inc. and NASD Market Services, Inc., the NASD provides its members and the NASDAQ market with a variety of technology-based services. They include the nationwide, electronic NASDAQ System which serves the fastest-growing and second-largest stock market in the nation; SOES which provides for the automatic execution of customers' agency orders; and TARS which automates the comparison of trades and the reconciliation of uncom-
 pared trades.



The Small Order Execution System is used to automatically execute customers' agency orders of 500 shares or less.



Barbara Tringali of Bernard L. Madoff Securities resolves an uncom-
 pared trade using the Trade Acceptance and Reconciliation Service.

intermarket trading cases as part of its continuing participation in the Intermarket Surveillance Group.

A total of 811 quotation halts were also instituted by Market Surveillance in 1984. Quotations are typically halted in the NASDAQ System to allow a company sufficient time to disseminate material news that may affect the price of its stock.

Broker-Dealer Surveillance

In 1984, a total of 841 firms were admitted to membership in the NASD. As a result of this increase in regulatory responsibilities, the NASD Board of Governors authorized an increase of 44 supervisors and examiners, bringing the nationwide total of professional field staff to 341.

In 1984, the NASD Districts reviewed 3,087 customer complaints as well as 1,600 other special sales practice-related situations. The examining staff conducted 3,973 routine and special examinations of members. These included 3,657 main office and 316 branch office examinations, an overall 13.9 percent increase over 1983.

In addition to the 13,322 written complaint actions, the 14 NASD Districts' Executive Councils Committee's issued 177 formal actions, rendered 371 disciplinary decisions, and accepted 61 Summary Complaints and 24 Letters of Acceptance, Waiver and Consent. These actions led to the expulsion of 10 firms, the barring of 58 individuals, and the suspension of three firms and 54 individuals.

SIPC Liquidations

Nine firms designated to the NASD were placed in SIPC liquidation

during the year. The dollar amount of SIPC advances for these firms was \$11,424,726. The exposure of SIPC was minimized, in part, by the Association's program of imposing limitations and restrictions on the operations of certain financially troubled firms well before SIPC involvement. In one case, pursuant to the authority granted under new Section 38 of the Rules of Fair Practice, the NASD directed a firm to distribute to customers approximately \$12,600,000 in cash and securities.

Self-Liquidation Program Continues

The NASD's self-liquidation program continues to be an extremely important component of its financial monitoring and early-warning systems. In 1984, 16 firms were self-liquidated under NASD supervision with a total of \$97 million in cash and securities being distributed to customers and broker-dealers. Since this program was launched in 1975, approximately \$288 million has been distributed to other members and the customers of 101 members designated to the NASD. All of this was done on an expedited basis, without need for approval of the SIPC trustee.

Arbitrated System

The NASD Arbitration Committee also received 111 complaints in 1984, both on its own and with the Securities and Exchange Commission. These investigations resulted primarily in disciplinary action in new issues of low priced stocks that advanced to an immediate premium in after-market trading.

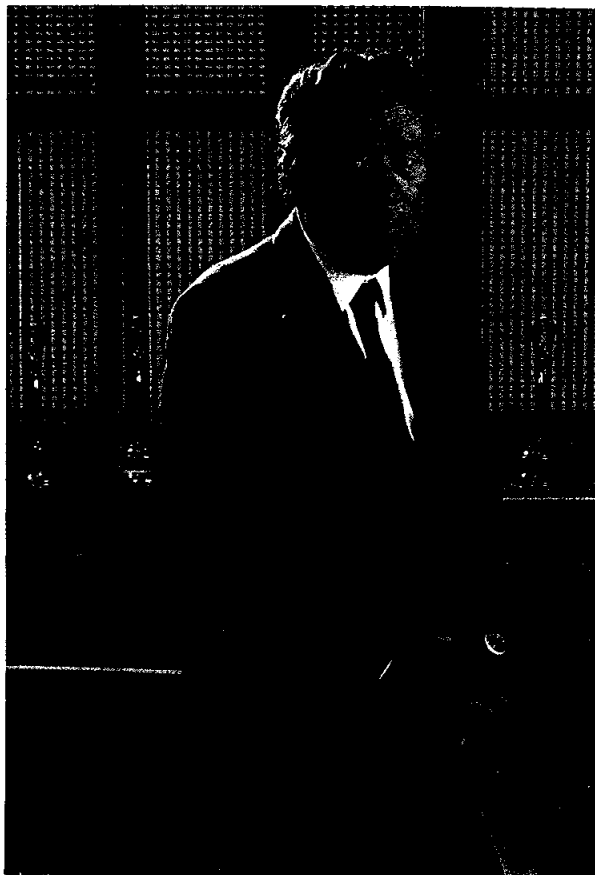
Corporate Financing Reviews

Public offerings of corporate securities and direct participation programs continued at historically high levels throughout 1984. The aggregate registered amount of financings filed with the Association for the review of underwriting arrangements totaled \$61.9 billion in 2,211 filings. Although this represents a decrease of 32 percent in the number of offerings and a 27 percent decline in aggregate amounts over 1983, it nonetheless placed 1984 as the second-most-active year in NASD history. The components of these financings are as follows: 1,748 corporate equity and debt offerings amounting to \$42.7 billion; and 463 direct participation programs and REITs having an aggregate value of \$19.1 billion.

NASDAQ

NASDAQ, the second-largest stock market in the U.S. in terms of share volume, is by far the largest in the number of companies represented. In 1984, it reached a record 4,697 companies, a net gain of 19 over 1983. NASDAQ's membership base increased 4.7% in 1984 over 1983. NASDAQ's 1984 membership base of 1984 was an increase of 10 percent over 1983. The total volume of trading in NASDAQ's 1984 market was \$1.2 billion, an increase of 1.2% over 1983. The total volume of trading in NASDAQ's 1984 market was \$1.2 billion, an increase of 1.2% over 1983.

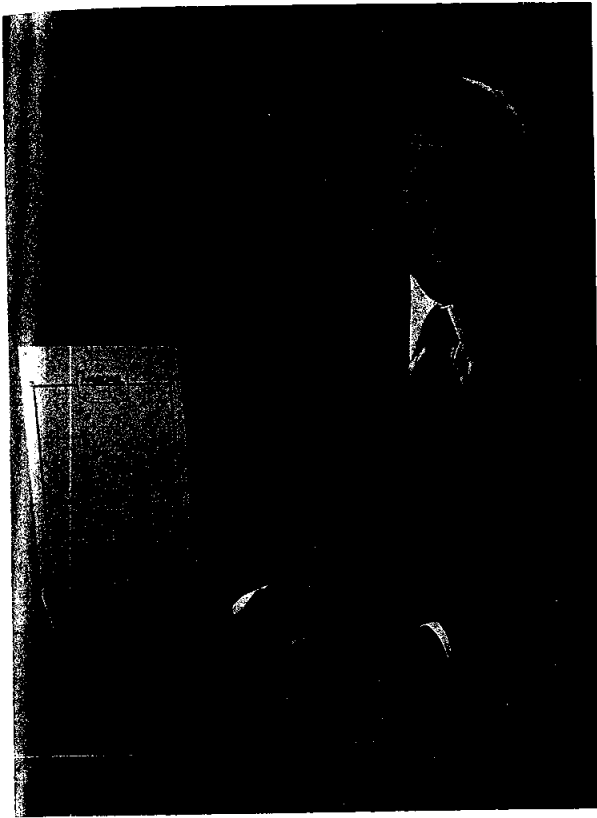
NASDAQ's market share within the U.S. stock market of the New York Stock Exchange and about 100 other exchanges combined volume of the American, Boston, Cincinnati, Midwest, Pacific and Philadelphia Stock Exchanges.



William G. McGowan, left, is Chairman and Chief Executive Officer of MCI Communications Corporation, an innovative provider of telecommunications-based services. With over 360 million shares traded, MCI Communications was the most actively traded stock in the NASDAQ market in 1984.

John Sculley, right, is President and Chief Executive Officer of Apple Computer, Inc., an established leader in the personal computer industry. The \$5.4 billion volume of trading in Apple Computer's stock in 1984 topped all others in the NASDAQ market.





William E. Phillips is the Chairman-Chief Executive of Ogilvy & Mather International Inc., one of the world's largest advertising agencies. In July 1984, Ogilvy & Mather became the 1,000th company to enter the NASDAQ National Market System.



“. . . NASDAQ companies represent the fastest-growing segments of the world economy. They are the innovators, the challengers and the changers. Much of NASDAQ's record-breaking performance is a direct reflection of the rapid growth of the companies in our market. Added growth by these companies and further improvements in the market for their securities will insure a continuation of NASDAQ's dramatic growth.”

—Gordon S. Macklin
NASD President

New NASDAQ/NMS Indices

To coincide with the addition of the 1,000th company to the NASDAQ/NMS, on July 10, the NASDAQ National Market System introduced two new indices of its own — a NASDAQ/NMS Composite Index and a NASDAQ/NMS Industrial Index. Both indices are market-value weighted and began at 100. They closed the year at 104.72 and 98.03, respectively.

Also, in July, additional intra-day information about the NASDAQ/NMS market became available via NASDAQ terminals. This information includes, at the time of inquiry, aggregate NASDAQ/NMS volume, the 10 most active, the top 10 leading gainers, and the 10 leading decliners.

Academic Research

A new, independently prepared academic study published in the Winter 1984 edition of Georgetown University's *The Journal of Financial Research* concluded that securities moving from NASDAQ to either the New York or American Stock Exchanges suffer a marked decline in liquidity. The authors, who have published their findings in the *Journal of Applied Corporate Finance*, also note that the decline in liquidity is not limited to their findings. "Considering the results of SEC studies, the impact of the SEC's automatic and voluntary inclusion criteria, and the fact that securities that voluntarily registered specialists

This analysis measured the liquidity of stocks, both before and after listing, of 122 companies which moved from NASDAQ to the American Stock Exchange and 128 companies which moved from NASDAQ to the New York Stock Exchange during the period 1975 to 1981.

As a long-range effort to both encourage and support academic research of the NASDAQ market, the NASD began co-funding a project in 1984 at the University of Chicago's Center for Research in Security Prices (CRSP). The purpose of this project is to develop a database of historical prices for all NASDAQ securities. When completed in 1988, a research-quality data file containing prices, volume, and shares outstanding for all NASDAQ securities, going back to start-up of the system in 1971, will be available to approximately 150 colleges and other subscribers to the CRSP historical prices service.

Annual NASDAQ CEO Conference

The NASD continued its commitment for NASDAQ to remain in contact with its users. In 1984, the NASD held its annual CEO Conference, which brought together NASDAQ CEOs, analysts, and institutional investors.

to trade over a two-week span during October in 1984. In addition, these sessions were attended by 100 NASDAQ company officials. A summary of the proceedings of the Conference was published and distributed to NASDAQ companies, members and other interested parties.

NASD Participates In Overseas Forums

To further the NASD's goal of achieving greater international recognition and awareness of the NASDAQ market, the NASD participated in the Actual European Institutional Investor Conference held in London in November 1984. Over 400 of the leading institutional investors throughout Europe attended the Conference. The NASD's presentation at the Conference was aimed at educating Conference participants on the state of development of the NASDAQ market, its emergence as a world class market, the advantages of participating in it, and the depth and breadth of NASDAQ markets. Through its participation in conducting seminars, the NASD has

In November, the SEC approved, without change, the NASD's suggested amendments to the voluntary-inclusion criteria for the NASDAQ National Market System, the effect of which was to make all NASDAQ National Newspaper List securities eligible to enter NASDAQ/NMS. Another landmark development occurred when the FRB adopted a rule which grants automatic margin status to all securities admitted to trading in the NASDAQ National Market System.

Throughout the year, the NASD also participated in several international conferences, meetings and seminars sponsored by other operators of world markets.

London Stock Exchange to Build NASDAQ-Like System

After many months of studying various securities markets, the London Stock Exchange Council announced its decision in July 1984 to pattern its new equities trading system after the NASDAQ market with its competing market makers and computerized quotation system. The London system is scheduled to debut in 1986.

Among the reasons cited by the Exchange's Council in adopting a NASDAQ-like system were: the efficiencies that computer technology can bring to a dealing environment; the advantage of placing all members on an equal basis irrespective of geographical location; its lack of reliance on the quality and state of mind of one individual for the continuity of the market in any given share; and its ability to lend itself readily to the concept of a 24-hour international market.

Comprehensive NASDAQ Rate Study Gets Underway

During the last several years, the information services offered by the Association's subsidiary corporations have experienced substantial growth and diversification. The pricing of these services has become increasingly complex by virtue of the integrated nature of the systems utilized to provide these services and the difficulty of allocating

the cost of the shared technical resources utilized. The SEC's decision in Instinet, described elsewhere in this report, has accelerated the need for more precise measurement and allocation of shared services.

In an effort to comply with the Commission's directives in the Instinet decision and to continue to assure the fair and equitable allocation of costs among all service sectors, an independent consultant, Coopers & Lybrand, was retained to perform a comprehensive study of all related costs and current services offered by NASDAQ, Inc. and NASD Market Services, Inc. The study is expected to be completed early in 1985.

Institutional Investor Committee to Be Formed

Recognizing the increasing institutional participation in the NASDAQ market, the NASD Board of Governors in 1984 approved the creation of a new NASD committee to be composed of institutional investors and professional portfolio managers. This committee, which will become operational in 1985, will be responsible for advising the NASD Board on policy matters relating to NASDAQ market operations and regulation. It will also assist the NASD in broadening the investment community's awareness and understanding of the NASD and the NASDAQ market.

REGULATORY DEVELOPMENTS

SEC Approves Expansion of NASDAQ/NMS

In November, the Securities and Exchange Commission approved, without change, the NASD's suggested amendments to the vol-

untary-inclusion criteria for the NASDAQ National Market System, the effect of which was to make all NASDAQ National Newspaper List securities eligible to enter NASDAQ/NMS. This brings the number of securities eligible for participation in NASDAQ/NMS to nearly 2,600.

The amendments allow two new alternative sets of criteria for voluntary inclusion in the system. The basis for being included in NASDAQ/NMS has been changed from market activity standards where share volume was the primary qualification filter to qualitative criteria which have a focus on earnings and net worth.

The SEC action concluded a 10-month rule-making process. During that time, more than 350 NASDAQ companies and Association members endorsed the criteria in letters to the Commission; the stock exchanges generally opposed it.

Beginning in January 1985, the NASD will implement the SEC decision by adding additional securities at a rate of up to 200 a month until all eligible securities that have applied for NASDAQ/NMS designation are included.

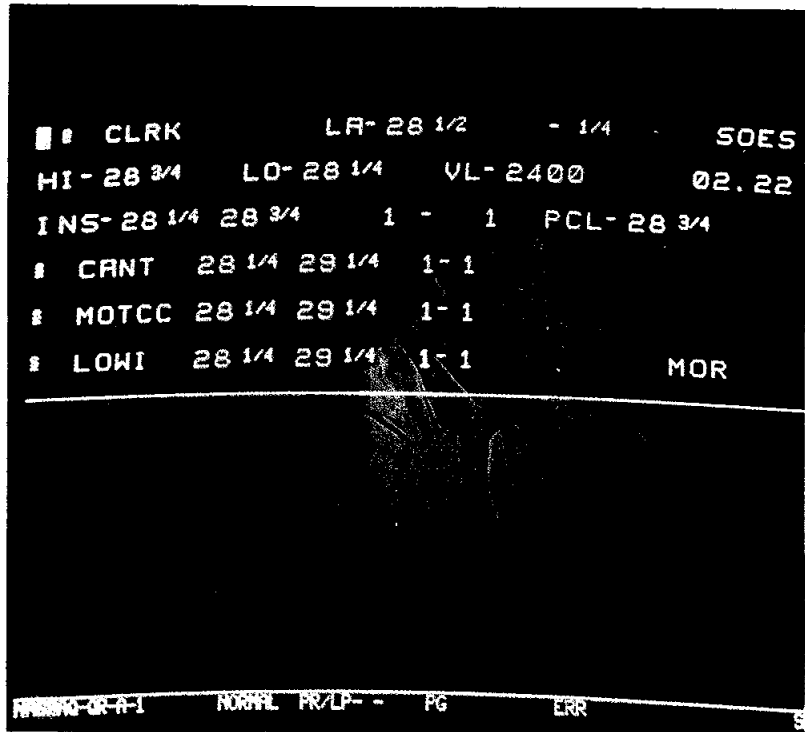
Automatic Margin for NASDAQ/NMS Issues

Another landmark development for the NASDAQ market occurred in September when the FRB adopted a rule which grants automatic margin status to all securities admitted to trading in the NASDAQ National Market System.

The Board's action was in response to an earlier request by the NASD that all stocks included in the NASDAQ National Newspaper

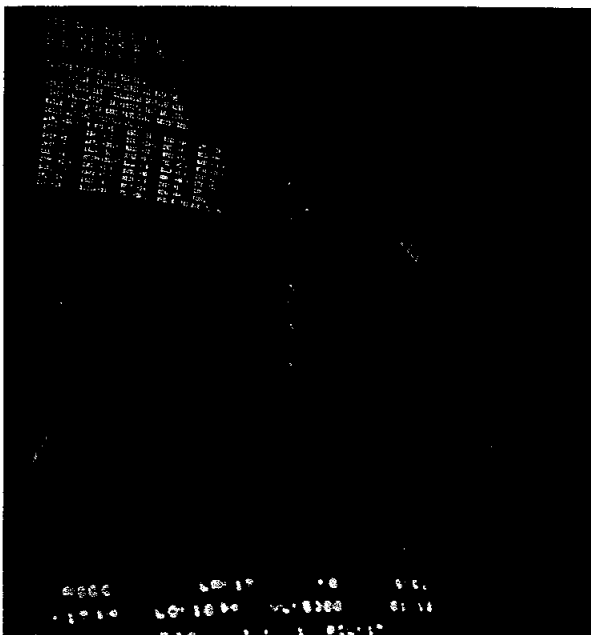


Trading room — Merrill Lynch, Pierce, Fenner & Smith Incorporated, New York City.

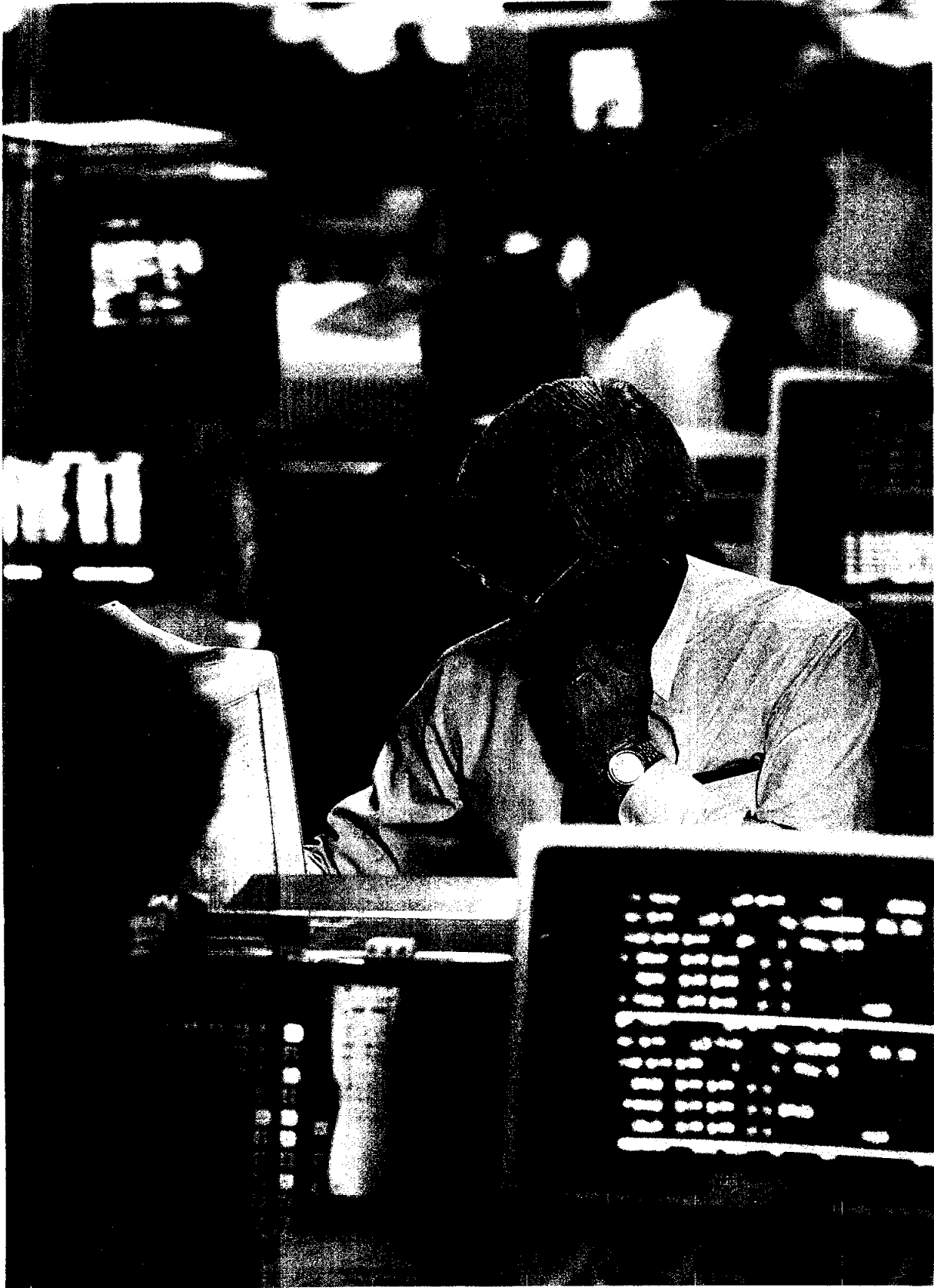


Patrick F. Davern, Cantor, Fitzgerald & Co., Inc., Beverly Hills, California.

Patrick C. Ryan, Johnston, Lemon & Co. Incorporated, Washington, D.C.



The multiple market-maker system is a unique feature of the NASDAQ market and the source of its superior liquidity. In 1984, more than 450 firms — large national firms, wholesale market makers, regional firms and local firms — made markets across the country in over 4,700 NASDAQ securities. The typical NASDAQ stock has more than eight market makers.



Jeremiah "Jerry" A. Mullins, Dean Witter Reynolds Inc., New York City.

sources into a single terminal. In August 1984, the NASDAQ Board approved such interface arrangements subject to certain technical conditions being satisfied. The first of these arrangements is expected to become operational in mid-1985.

Computer-to-Computer Interfaces

In 1983, NASDAQ subscribers were offered a computer-to-computer arrangement as a vehicle for reducing the time required and cost involved in reporting trades to NASDAQ in NASDAQ/NMS securities. By virtue of this link, a firm is now able to simultaneously report its trades to its in-house computer system for record keeping purposes and to NASDAQ for trade reporting purposes by a single set of entries to its own terminal. At year-end 1984, a total of 18 firms were participating or preparing to participate in this interface arrangement. Early in 1985, the capability to report volume in non-NASDAQ/NMS issues through computer interface is scheduled to become available.

Automated Mutual Fund Quotation Collection

In late 1984, the Association began an automated system for the collection of mutual fund prices and money market fund yields. These quotations are collected daily by the Association for almost 1,000 funds. The quotes are then transmitted to quotation vendors and newswires, which, in turn, make them available for computer terminal display and retrieval and for publication in newspapers.

At year-end, over 45 percent of these quotations were being

supplied through the quote terminals of 32 NASDAQ subscribers. The NASD is currently taking steps to make this the primary method of submitting fund quotes.

NASD MARKET SERVICES

On December 14, NASD Market Services, Inc. initiated the Small Order Execution System, a pioneering system for rapid automatic execution of customer trades up to 500 shares in NASDAQ stocks. SOES enables a customer to place a buy or sell order with a stockbroker for up to 500 shares of a NASDAQ stock and to have that order executed and confirmed automatically by computer—in seconds—at the "inside" or best available price in NASDAQ at the time the order entered the system. At the end of December, more than 200 firms were participating in SOES, with more being added each day.

Because a computer executes the trade for the investor, the Small Order Execution System eliminates the problems of a large number of orders on the trading floor and of the customer's loss of control over the trade. The risk of another firm, and by a broker in the stock, the system automatically reports the date to NASDAQ, fund trade transactions direct to the clearing corporation for confirmation and immediate trading securities being considerable time and paperwork.

Fades of 500 shares or fewer represent over 30 percent of all transactions in NASDAQ securities by a broker with another securities firm acting as market maker, and an estimated 25 percent of all NASDAQ trades.

At year-end, 30 NASDAQ/NMS stocks were eligible for purchase or sale on SOES. The balance of NASDAQ/NMS stocks are to be phased into SOES by the end of the first quarter of 1985, with eventual coverage to include all NASDAQ rates.

NASDAQ Options Program

For some time, the NASD has had a proposal pending before the SEC which would permit the trading of standardized put and call options on certain actively traded NASDAQ/NMS securities and certain NASDAQ indices.

In 1984, the NASD worked closely with the SEC to prepare for the start-up of this long-awaited program. As proposed by the NASD, the program would feature several new and innovative second-generation concepts in the trading of options. They include a small order execution system (similar to SOES for equities now in operation) and the introduction of facilities for obtaining blockable markets for the purpose of trade execution, confirmation and clearance.

Because of the issues and the amount of capital involved in the proposal, one of the primary exchanges as well as the NYSE has requested SEC approval to trade options on NASDAQ stocks. The NASD proposal was still pending before the SEC at year-end. In the meantime, the NASD took steps to the trade confirm statements of its proposed plan to develop the equity under full on-facility surveillance over the trading of both NASDAQ options and their underlying securities.



Alex Hammond-Chambers, at left, is Joint Deputy Chairman of Ivory & Sime, an investment trust firm in Edinburgh, Scotland. He is also the first overseas Governor of the NASD. His firm manages investments in excess of \$2 billion of which approximately one-half is invested in the U.S. More than \$500 million of that amount is invested in NASDAQ securities. Ivory & Sime's investment practices illustrate the worldwide participation by institutional investors in the NASDAQ market. Institutions now account for more than 40 percent of NASDAQ/NMS volume.

At right, a retail investor discusses his investments with his registered representative. Interest in the NASDAQ market by retail investors has grown significantly in recent years. According to a recent survey, between 1981 and 1983, NASDAQ had the largest gain among U.S. markets in the percentage increase in shareowners. Individual shareowners in NASDAQ securities now number in excess of 10,000,000.





In November 1984, the senior Governors of the NASD met with President Reagan at The White House. From left to right: Edmund J. Cashman, Jr., Legg Mason Wood Walker, Incorporated, Baltimore, Maryland; Russell H. Baumgardner, Apogee Enterprises, Inc., Minneapolis, Minnesota; L. H. Bayley, David A. Noyes & Company, Indianapolis, Indiana; Carl P. Sherr, 1984 NASD Chairman, Carl P. Sherr and Company, Worcester, Massachusetts; President Reagan; Gordon S. Macklin, NASD President; Bill T. Wall, Stern Brothers & Co., Kansas City, Missouri; David M. Underwood, Underwood, Newhaus & Co., Incorporated, Houston, Texas; Peter K. Loeb, Paine Webber Incorporated, New York, New York; and Donald W. Crowell, Crowell, Weedon & Co., Los Angeles, California.

The NASD expects the SEC to act favorably on its options proposal in 1985, thereby paving the way for the start-up of a pilot operation in approximately 50 NASDAQ/NMS stock options and certain NASDAQ index options.

New TARS Features

At the end of 1984, the Trade Acceptance and Reconciliation Service (TARS) had 64 subscriber firms. These firms account for nearly 75 percent of all over-the-counter cleared transactions. TARS was designed to assist broker-dealers in resolving uncomparated OTC trades processed through participating clearing corporations.

Through a communications link with National Securities Clearing Corporation, TARS provides a subscriber with a terminal display of the details of his compared and noncompared trades. This information is developed from the trade data supplied to the clearing corporation by the subscriber on the preceding day. TARS covers the transactions of a subscriber in all clearing-eligible securities — NASDAQ as well as exchange listed. By means of a series of queries to its TARS terminals, a subscriber is able to make on-line adjustments to resolve any problem trade.

During 1984, TARS was expanded to allow a subscriber to enter original OTC trade data directly through his TARS terminal. TARS automatically transmits this data to the clearing corporation, thus extending the cut-off time for furnishing trade detail to the clearing corporation. Also, all orders now executed through the Small Order Execution System and

the Computer Assisted Execution System are also automatically reported via TARS to the National Securities Clearing Corporation.

\$1,400,000 Rebate

In 1984, NASD Market Services, Inc. approved a refund of service fees related to the distribution of last-sale information for NASDAQ National Market System securities. The rapid growth of the NASDAQ National Market System and the related economies of scale produced by that growth made this cost savings to subscribers possible.

The distribution, which covered the fiscal year ending September 30, 1984, totaled approximately \$1,400,000. On an individual basis, it amounted to \$14 per subscriber terminal — a refund of almost two months' worth of charges.

LITIGATION/PROCEEDINGS

FDIC vs. NASD

The Federal Deposit Insurance Corporation sued the NASD claiming that the NASD was negligent in admitting Lewellyn Company, a broker-dealer, into membership. The FDIC was negligent in connection with its review and analysis of the reports filed by the broker-dealer and finally, was negligent in its conduct of a financial and operational examination of the broker-dealer. Gary Lewellyn, the president and principal of the broker-dealer, converted almost \$15 million of a bank's funds and securities to his own use and benefit. As a result, the bank was declared insolvent and the FDIC

was appointed its receiver. The NASD filed a Motion to Dismiss which was granted by the District Court which held that the FDIC had no common law cause of action against the NASD for its alleged negligence in failing to adequately screen and monitor the activities of the broker-dealer. In a *per curiam* opinion filed November 13, 1984, the United States Court of Appeals for the 8th Circuit affirmed the judgment of the District Court and dismissed the FDIC's complaint.

Service Fee Dispute

On April 17, 1984, the SEC issued an Order disapproving a proposed fee for a new NASDAQ service. This fee had been challenged by Institutional Network Corporation (Instinet). This new service would permit subscribers to receive individual market maker quotations in NASDAQ/NMS securities on terminals supplied by commercial securities information vendors. The Commission held that the proposed fee, upon resubmission, must be cost-based and include only those costs related to the quotation collection function. In so holding, the Commission precluded consideration of certain costs relating to the NASDAQ System's query function which the NASD believes are an integral part of the collection function. Two separate Requests for Reconsideration of the Order were filed with the Commission, the latter of which remains pending. Also, the NASD has filed a Petition for Review of the Commission's Order with the U.S. Court of Appeals for the District of Columbia Circuit.



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David A. Noyes & Company
Indianapolis, Indiana

RUTH S. BLOCK* *(seated)*
The EQUITABLE Life Assurance
Society of the United States
New York, New York

BILL T. WALL
Stern Brothers & Co.
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Graduate School of Business
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Louisville, Kentucky
Vice Chairman, 1985

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The Pioneer Group, Inc.
Boston, Massachusetts

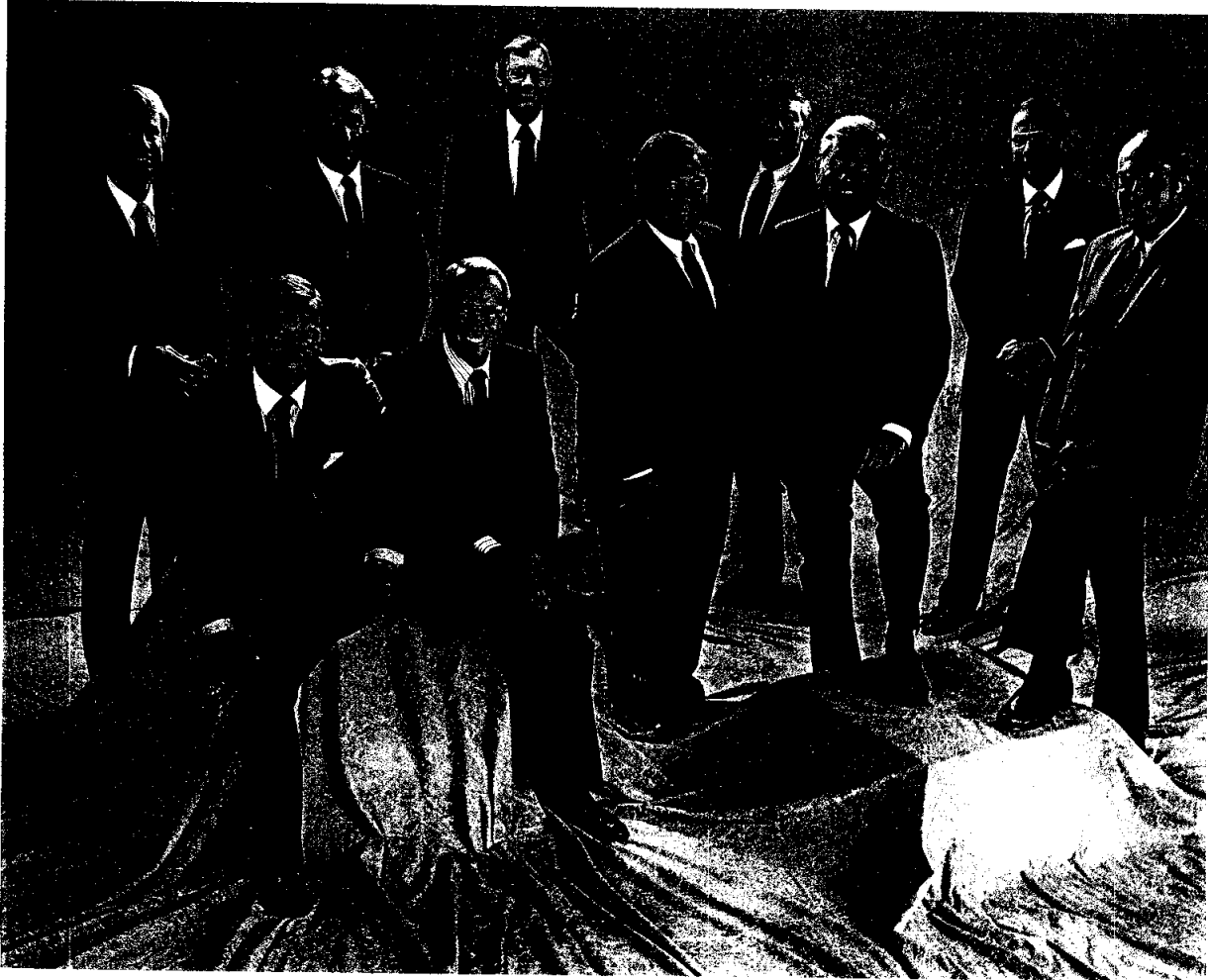
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 *Bernard L. Madoff
 *Leonard Mayer
 Jeremiah A. Mullins
 Hugh J. Quigley
 Rupert M. Richards
 William R. Rothe
 Owen L. Saddler, Jr.
 Kenneth J. Wessels
 Basil G. Witt
 Victor Wright

UNIFORM PRACTICE

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 *John B. Levert, Jr.
 *Leonard Mayer
 Charles M. Viviano
 Joe C. Weller

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 John M. Smith
 *Roland M. Trafton
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*Member, NASD Board of Governors

Members of the District Committees, who are elected by NASD member firms in their respective areas, supervise NASD programs in the Districts and serve on Business Conduct Committees. In this capacity, they review reports of NASD examiners, investigate complaints against members, conduct disciplinary proceedings and impose penalties for violations of federal and state laws and the NASD's Rules of Fair Practice. The Chairmen of the District Committees make up the Advisory Council to the Board of Governors.

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 Montana
 Oregon
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 Peterson & Company, Inc.
 Spokane, Washington
Dorina Price
 KMS Financial Services, Inc.
 Seattle, Washington
Alan T. Robertson
 Piper, Jaffray & Hopwood Incorporated
 Seattle, Washington

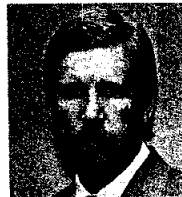
Bradford M. Patterson, Director
 One Union Square, Suite 1911
 Seattle, Washington 98101
 (206) 624-0790

DISTRICT 2 ■

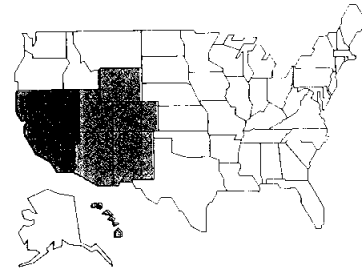
California 832 Members
 Nevada 2,865 Branches
 Hawaii



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 Judy & Robinson Securities, Inc.
 Menlo Park, California



Jeffrey P. Shackett, Co-Chairman (right)
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 Los Angeles, California
Douglas A. Campbell
 D.A. Campbell Company, Inc.
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Melvin L. Peterson
 Emmett A. Larkin Company, Inc.
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 San Francisco, California
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F. Van Kasper
 Van Kasper & Company
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John B. Weingart
 Smith Barney, Harris Upham & Co.
 Incorporated
 San Francisco, California



Theodore F. Schmidt, Director
 425 California Street, Room 1400
 San Francisco, California 94101
 (415) 781-3434

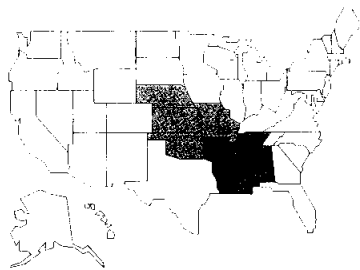
Kye Hellmers, Director
 727 W. Seventh Street
 Los Angeles, California 90017
 (213) 627-2122

DISTRICT 3 ■

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 New Mexico
 Utah
 Wyoming



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 Wall Street West, Inc.
 Denver, Colorado
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 Merrill Lynch, Pierce, Fenner & Smith
 Incorporated
 Tucson, Arizona
Frank J. Birgfeld, Director
 1401 17th Street, Suite 700
 Denver, Colorado 80202
 (303) 298-7234



DISTRICT 4 ■

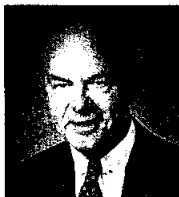
Kansas 209 Members
 Missouri 661 Branches
 Nebraska
 Oklahoma



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 Scherck, Stein & Franc, Inc.
 St. Louis, Missouri
 Gerald A. Geiger, *Vice Chairman*
 Woosley & Company, Incorporated
 Oklahoma City, Oklahoma
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 Kidder, Peabody & Co. Incorporated
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 Kansas City, Missouri
 Ernest C. Dippel
 E. F. Hutton & Company Inc.
 Kansas City, Missouri
 J. Jerry Dolan
 R. Rowland & Co., Incorporated
 St. Louis, Missouri
 Gordan Evans
 Security Distributors, Inc.
 Topeka, Kansas
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 Krentz, Meyer & McClellan
 Investment Corporation
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 Robert L. Smart
 Smart, Moreland, Neuner & Soden,
 Incorporated
 Kansas City, Missouri
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 First Securities Company of Kansas,
 Incorporated
 Wichita, Kansas
 James T. Warren
 Paine Webber Incorporated
 Omaha, Nebraska
 Jack Rosenfield, *Director*
 911 Main Street, Suite 2230
 Kansas City, Missouri 64105
 (816) 421-5700

DISTRICT 5 ■

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 Arkansas 579 Branches



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 Birmingham, Alabama
 Philip Montelepre
 Montelepre Securities, Ltd.
 New Orleans, Louisiana
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 Berney Perry & Company
 Birmingham, Alabama
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 Powell & Satterfield, Inc.
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 1004 Richards Building
 New Orleans, Louisiana 70112
 (504) 522-6527

DISTRICT 6 ■

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 931 Branches



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 Rausher Pierce Refsnes, Inc.
 San Antonio, Texas
 Don A. Buchholz
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 Dallas, Texas

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 E. F. Hutton & Company Inc.
 Houston, Texas
 William E. Read
 William E. Read & Co., Inc.
 Dallas, Texas
 M. David Standridge
 Shearson Lehman/American Express Inc.
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 Houston, Texas
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 Eppler, Guerin & Turner, Inc.
 Dallas, Texas
 Peter M. Walker, *Director*
 1999 Bryan Street, 14th Floor
 Dallas, Texas 75201
 (214) 969-7050

DISTRICT 7 ■

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 Georgia 1,507 Branches
 South Carolina
 Eastern Tennessee
 Puerto Rico
 Canal Zone
 Virgin Islands



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 Cumberland Securities Company Inc.
 Knoxville, Tennessee
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 Johnson, Lane, Space, Smith & Co., Inc.
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 Edgar M. Norris & Co., Inc.
 Greenville, South Carolina
 Bennett Whipple, *Director*
 250 Piedmont Avenue, N.E.
 Atlanta, Georgia 30308
 (404) 658-9191

DISTRICT 8 ■

Illinois 665 Members
 Indiana 2,058 Branches
 Iowa
 Michigan
 Minnesota
 North Dakota
 South Dakota
 Wisconsin



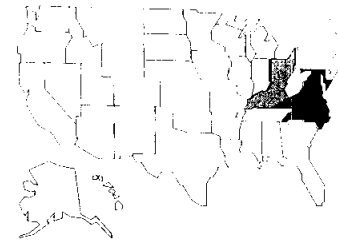
Victor Elting, III, Chairman
 The Chicago Corporation
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James A. Richter, Vice Chairman
 Roney & Co.
 Detroit, Michigan
Eugene P. Albers, Jr.
 Smith, Hague & Co., Incorporated
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 Summers & Company, Inc.
 Fort Wayne, Indiana
E. Craig Dearborn, Director
 Three First National Plaza, Suite 1680
 Chicago, Illinois 60602
 (312) 236-7222

DISTRICT 9 ■

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 Ohio 552 Branches



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Robert A. Greenberg, Vice Chairman
 Robert W. Baird & Co. Incorporated
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A. Edgar Aub
 A. E. Aub & Co.
 Cincinnati, Ohio
Richard A. Evans
 Vercoe & Company, Inc.
 Columbus, Ohio
G. James McCloy
 Cowen & Co.
 Cincinnati, Ohio
Jack A. Moss
 Prescott, Ball & Turben, Inc.
 Louisville, Kentucky
James C. Redinger
 McDonald & Company Securities, Inc.
 Cleveland, Ohio
Alexander S. Taylor
 Kidder Peabody & Co. Incorporated
 Cleveland, Ohio
W. Everett Thomas
 The Ohio Company
 Toledo, Ohio
George W. Mann, Jr., Director
 1940 East Sixth Street, 5th Floor
 Cleveland, Ohio 44114
 (216) 694-4545



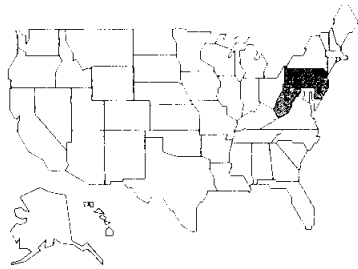
DISTRICT 10 ■

District of Columbia 247 Members
 Maryland 769 Branches
 North Carolina
 Virginia



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 Alex. Brown & Sons, Inc.
 Baltimore, Maryland
Wendie L. Wachtel, Vice Chairman
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J. Murrey Atkins, Jr.
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 Charlotte, North Carolina
John C. Engler
 Merrill Lynch, Pierce, Fenner & Smith
 Incorporated
 Charlotte, North Carolina
Anthony J. Frank
 Branch, Cabell & Company
 Richmond, Virginia
Donald C. McMillion
 McMillion/Eubanks Securities, Inc.
 Greensboro, North Carolina
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 Riviere Securities Corporation
 Washington, D.C.
Robert T. Reeves
 Ferris & Company, Incorporated
 Annapolis, Maryland
John P. Rodler
 Folger Nolan Fleming Douglas, Incorporated
 Washington, D.C.
Coleman Wortham, III
 Davenport and Co. of Virginia, Inc.
 Richmond, Virginia
Thomas P. Forde, Director
 1125 15th Street, N.W., 5th Floor
 Washington, D.C. 20005
 (202) 728-8400

1984 DISTRICT COMMITTEES



34

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 West Virginia
 New Jersey (except counties adjacent to New York City)



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 Philadelphia, Pennsylvania
 James I. Anfang
 Cunningham, Schmertz & Co., Inc.
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 Hopper Soliday & Co., Inc.
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 Dean Witter Reynolds Inc.
 Wilmington, Delaware
 Francis C. Doyle
 Butcher & Singer Inc.
 Philadelphia, Pennsylvania
 Arthur Judson, III
 Collings Legg Mason, Inc.
 Philadelphia, Pennsylvania
 Nicholas D. Meyer
 N. D. Meyer & Co., Inc.
 Philadelphia, Pennsylvania
 Frank J. Murray, Jr.
 Prudential-Bache Securities Inc.
 Philadelphia, Pennsylvania
 William R. Radetzky
 Janney Montgomery Scott Inc.
 Philadelphia, Pennsylvania
 George G. Sofis
 Arthurs, Lestrangle & Short
 McKeesport, Pennsylvania
 Clarence Z. Wurts
 Edward C. Rorer & Co., Inc.
 Philadelphia, Pennsylvania
 John P. Nocella, *Director*
 1818 Market Street, 12th Floor
 Philadelphia, Pennsylvania 19103
 (215) 665-1180

DISTRICT 12 ■

New York City 1,217 Members
 (including 1,020 Branches
 adjacent New York
 and New Jersey counties)



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 The First Boston Corporation
 New York, New York
 Timothy E. Barnes, *Vice Chairman*
 Tucker, Anthony & R. L. Day, Inc.
 New York, New York
 Gene Apruzzi
 Cyrus J. Lawrence Incorporated
 New York, New York
 James J. Bauman
 L. F. Rothschild, Unterberg, Towbin
 New York, New York
 Howard L. Blum, Jr.
 Ladenburg, Thalmann & Co., Inc.
 New York, New York
 Edward T. Braniff
 Oppenheimer & Co., Inc.
 New York, New York
 Peter A. Fried
 Rothschild Inc.
 New York, New York
 Donald V. Hanson
 Hornblower, Fischer & Co.
 New York, New York
 George E. Hartz, Jr.
 Pruco Securities Corporation
 Newark, New Jersey
 J. Kevin Kenny
 J. J. Kenny Co., Inc.
 New York, New York
 James H. Lynch
 Spear, Leeds & Kellogg Corporation
 New York, New York
 Robert L. Mattis
 Richardson Greenshields Securities, Inc.
 New York, New York
 Wilfred J. Meckel, II
 Seligman Securities, Inc.
 New York, New York
 Norman H. Pessin
 Newberger & Berman
 New York, New York
 Charles T. Peterson
 Paine Webber Incorporated
 New York, New York
 Samuel A. Ramirez
 Samuel A. Ramirez & Co., Inc.
 New York, New York
 Judith G. Shepard
 Goldman, Sachs & Co.
 New York, New York
 Richard B. Wigton
 Kidder, Peabody & Co. Incorporated
 New York, New York

George J. Bergen, *Vice President, Director*
 Two World Trade Center
 South Tower, 98th Floor
 New York, New York 10048
 (212) 839-6200

DISTRICT 13 ■

Connecticut 447 Members
 Maine 875 Branches
 Massachusetts
 New Hampshire
 Rhode Island
 Vermont
 New York (except New York City and adjacent counties)



John G. Higgins, Chairman
 Kidder Peabody & Co. Incorporated
 Boston, Massachusetts
 Sheldon M. Fechter, *Vice Chairman*
 Fechter, Detwiler & Co., Inc.
 Boston, Massachusetts
 Ernest E. Dunbar
 Colonial Investment Services, Inc.
 Boston, Massachusetts
 Alan P. Goldberg
 Hawthorne Securities Corporation
 Boston, Massachusetts
 Richard Hilliker
 S. C. Parker & Co., Inc.
 Buffalo, New York
 Vincent J. McCauley
 Conning & Company
 Hartford, Connecticut
 Daniel L. Murphy
 Burgess & Leith Incorporated
 Boston, Massachusetts
 Daniel R. Overcash, Jr.
 Bodell Overcash Anderson & Company, Inc.
 Jamestown, New York
 Gregory P. Plunkett
 First New England Securities Corporation
 Boston, Massachusetts
 Frank D. Romano
 Equity Services, Inc.
 Montpelier, Vermont
 Thomas J. Tagliamonte
 NEL Equity Services Corporation
 Boston, Massachusetts
 Robert N. Unsworth
 Brown, Lisle & Marshall Incorporated
 Providence, Rhode Island
 Allen Weintraub
 Advest, Inc.
 Hartford, Connecticut
 William S. Clendenin, *Director*
 50 Milk Street
 Boston, Massachusetts 02109
 (617) 482-0466

CONSOLIDATED BALANCE SHEETS

National Association of Securities Dealers, Inc.

September 30 (in thousands)	1984	1983
ASSETS		
Current assets		
Cash	\$ 853	\$ 964
Marketable debt securities, principally U.S. Government, at cost (approximate market value for 1984: \$57,083; for 1983: \$35,756)	57,329	35,668
Receivables and other current assets	5,281	3,438
Total current assets	63,463	40,070
Fixed assets		
Land, buildings and improvements	9,544	8,941
Data processing, subscriber equipment and software	33,776	27,914
Furniture, equipment and leasehold improvements	5,124	3,758
	48,444	40,613
Less accumulated depreciation and amortization	20,323	12,016
	28,121	28,597
Other assets	1,779	1,580
	\$93,363	\$70,247
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable and accrued expenses	\$ 9,637	\$ 6,482
Deferred fee income and deposits	6,020	4,559
Current portion of obligations under capital leases	1,109	1,055
Total current liabilities	16,766	12,096
Obligations under capital leases	1,977	3,086
Other liabilities	1,145	1,172
Total liabilities	19,888	16,354
Equity	73,475	53,893
Commitments and contingencies		
	\$93,363	\$70,247

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS AND EQUITY

National Association of Securities Dealers, Inc.

<i>Year Ended September 30 (in thousands)</i>	<i>1984</i>	<i>1983</i>
INCOME		
NASDAQ and MSI service fees	\$31,254	\$21,410
Member assessments	20,257	18,998
Registration and examination fees	17,975	14,756
NASDAQ issuers fees	8,867	7,351
Interest and other	7,554	4,671
Corporate finance fees	3,968	6,110
Regulatory fees	1,603	1,805
	91,478	75,101
EXPENSES		
Salaries and employee benefits	35,475	30,170
Data processing and transmission	8,909	6,939
Depreciation and amortization	8,410	5,866
Professional and other services	5,683	4,613
Office expense	5,161	4,385
Publications, supplies and postage	3,905	3,360
Travel, meetings and investigations	3,521	3,227
Interest and other	832	411
	71,896	58,971
Income before provision for income taxes and extraordinary item	19,582	16,130
Provision for income taxes	1,496	
Income before extraordinary item	18,086	16,130
Extraordinary item – utilization of tax loss carryforward	1,496	
Net income	19,582	16,130
Equity at beginning of year	53,893	37,763
Equity at end of year	\$73,475	\$53,893

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

National Association of Securities Dealers, Inc.

Year Ended September 30 (in thousands) 1984 1983

FINANCIAL RESOURCES WERE PROVIDED BY:

Income before extraordinary item	\$18,086	\$16,130
Add items not affecting working capital		
Depreciation and amortization	8,410	5,866
Loss on disposal of equipment	4	151
Working capital provided by operations	26,500	22,147
Extraordinary item – utilization of tax loss carryforward	1,496	
Proceeds from sale of fixed assets	64	29
Increase in obligations under capital leases		886
	28,060	23,062

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FINANCIAL RESOURCES WERE USED FOR:

Additions to fixed assets	8,002	7,710
Decrease in long-term obligations under capital leases	1,109	891
Increase in other assets	199	357
Decrease in other liabilities	27	27
	9,337	8,985

INCREASE IN WORKING CAPITAL \$18,723 \$14,077

ANALYSIS OF CHANGES IN WORKING CAPITAL

Increase (decrease) in current assets		
Cash	\$ (111)	\$ 561
Marketable debt securities	21,661	14,380
Receivables and other current assets	1,843	467
	23,393	15,408
Decrease (increase) in current liabilities		
Accounts payable and accrued expenses	(3,155)	(286)
Deferred fee income and deposits	(1,461)	(852)
Current portion of obligations under capital leases	(54)	(193)
	(4,670)	(1,331)
INCREASE IN WORKING CAPITAL	\$18,723	\$14,077

The accompanying notes are an integral part of these financial statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Business Segments

The consolidated financial statements include the accounts of the National Association of Securities Dealers, Inc. (NASD) and its wholly owned subsidiaries, including NASDAQ, Inc. and NASD Market Services, Inc. (MSI), after elimination of all significant intercompany transactions.

NASD is a membership association established to regulate the over-the-counter securities market.

NASDAQ, Inc. owns and operates the nationwide, electronic NASDAQ quote information system.

MSI provides national market facilities to assist the NASD in carrying out its regulatory responsibilities and for the benefit of NASD members in their pursuit of efficient execution of securities transactions.

Depreciation and Amortization

Fixed assets are depreciated on a straight-line basis over useful lives as follows:

Buildings	30 to 38 years
Building improvements	10 years
Data processing, subscriber equipment and software	4 to 6 years
Furniture and equipment	4 to 10 years
Leasehold improvements	Term of lease

Equipment acquired under capital leases is amortized on a straight-line basis over the terms of the leases.

Software Costs

Purchased software, developed by others, is capitalized if it has a continuing value and is considered an integral part of purchased hardware. All other software development costs are charged to expense as incurred.

Income Taxes

NASD and NASDAQ, Inc. are tax-exempt, not-for-profit organizations. MSI is a taxable entity and recognizes certain expenses, principally start-up expenditures and depreciation, in different periods for income tax purposes than for financial reporting purposes. Investment tax credits, to the extent available, are accounted for under the flow-through method.

NOTE 2: BUSINESS SEGMENTS

(in thousands)	NASD	NASDAQ	MSI	Consolidated
1984				
Income	\$59,282	\$25,788	\$ 8,682	\$91,478
Expenses	44,394	24,346	5,430	71,896
Net income	\$14,888	\$ 1,442	\$ 3,252	\$19,582
Total assets	\$68,796	\$24,069	\$ 3,285	\$93,363
Equity (deficit)	\$57,243	\$18,532	\$(1,149)	\$73,475
1983				
Income	\$53,556	\$20,408	\$ 3,211	\$75,101
Expenses	37,355	19,658	4,032	58,971
Net income (loss)	\$16,201	\$ 750	\$ (821)	\$16,130
Total assets	\$50,610	\$24,029	\$ 1,955	\$70,247
Equity (deficit)	\$42,355	\$17,090	\$(4,401)	\$53,893

Intercompany billings, payables and receivables have been eliminated from the consolidated financial data.

In 1984, NASDAQ, Inc. reduced the estimated useful life for subscriber equipment from 5 to 4 years in recognition of advancing technological developments in the field of telecommunications equipment. The effect of this change was to reduce 1984 net income by approximately \$1,600,000.

NOTE 3: CAPITALIZED LEASES

Data processing, subscriber equipment and software at September 30, 1984 and 1983 includes the capitalization of computer leases of \$6,233,000. Amortization expense was \$1,075,000 and \$910,000 in 1984 and 1983, respectively, and related accumulated amortization at September 30, 1984 is \$3,268,000. The initial terms of the leases are 60-76 months. Minimum lease payments are \$1,283,000 per year in 1985 and 1986, \$628,000 in 1987 and \$249,000 in 1988. The present value of future minimum lease payments is \$3,086,000, resulting in imputed interest of \$357,000.

NOTE 4: RETIREMENT BENEFITS

NASD maintains a savings plan and a defined benefit pension plan for the benefit of all eligible employees. Current service costs are funded as they accrue. Unfunded prior service costs are being funded over a period of 30 years.

Savings plan expense for the years 1984 and 1983 was \$458,000 and \$401,000, respectively.

Pension expense for the years 1984 and 1983 aggregated \$1,963,000 and \$1,316,000, respectively. The increase in the pension expense in 1984 results principally from certain plan changes since the previous plan valuation, primarily related to an increase in the various benefit formulas. A comparison of accumulated pension plan benefits and net pension plan assets as of the most recent valuation dates is presented below:

January 1	1984	1983
Actuarial present value of accumulated plan benefits:		
Vested	\$4,426,000	\$3,182,000
Nonvested	1,572,000	882,000
	\$5,998,000	\$4,064,000
Net assets available for plan benefits	\$9,404,000	\$7,492,000

The average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 7% for 1984 and 6% for 1983.

NOTE 5: INCOME TAXES

The extraordinary item in 1984 reflects the elimination of the 1984 federal income tax provision of MSI through the utilization of tax loss carryforwards.

MSI has tax-basis net operating loss and investment tax credit carryforwards available for future utilization as follows:

Year Expires	Net Operating Loss	Investment Tax Credit
1995		\$ 25,000
1996		20,000
1997		2,000
1998	\$682,000	83,000
1999		128,000
	\$682,000	\$258,000

MSI's net operating loss and investment tax credit carryforwards for financial statement purposes are \$2,299,000 and \$258,000, respectively.

NOTE 6: COMMITMENTS AND CONTINGENCIES

In connection with its operations, NASD incurred office and equipment rental expense of \$3,291,000 and \$2,977,000 during the years ended September 30, 1984 and 1983, respectively. Minimum lease payments for the succeeding fiscal years are as follows: \$3,363,000 in 1985, \$3,190,000 in 1986, \$1,834,000 in 1987, \$1,352,000 in 1988, \$1,290,000 in 1989 and \$4,669,000, in aggregate, from 1990 through 1995. No lease extends beyond 1995. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs.

During the current year the NASD entered into contractual agreements for the purchase of computer hardware and software. At September 30, 1984, the amount outstanding on these agreements was approximately \$477,000.

There are legal proceedings pending against the NASD separately or with others. Management believes, based upon the opinion of counsel, that liabilities arising from these proceedings, if any, will not have a material effect on the NASD.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Governors of
National Association of Securities Dealers, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and equity and of changes in financial position present fairly the financial position of the National Association of Securities Dealers, Inc. and its subsidiaries at September 30, 1984 and 1983, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse

Washington, D.C.
January 4, 1985

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