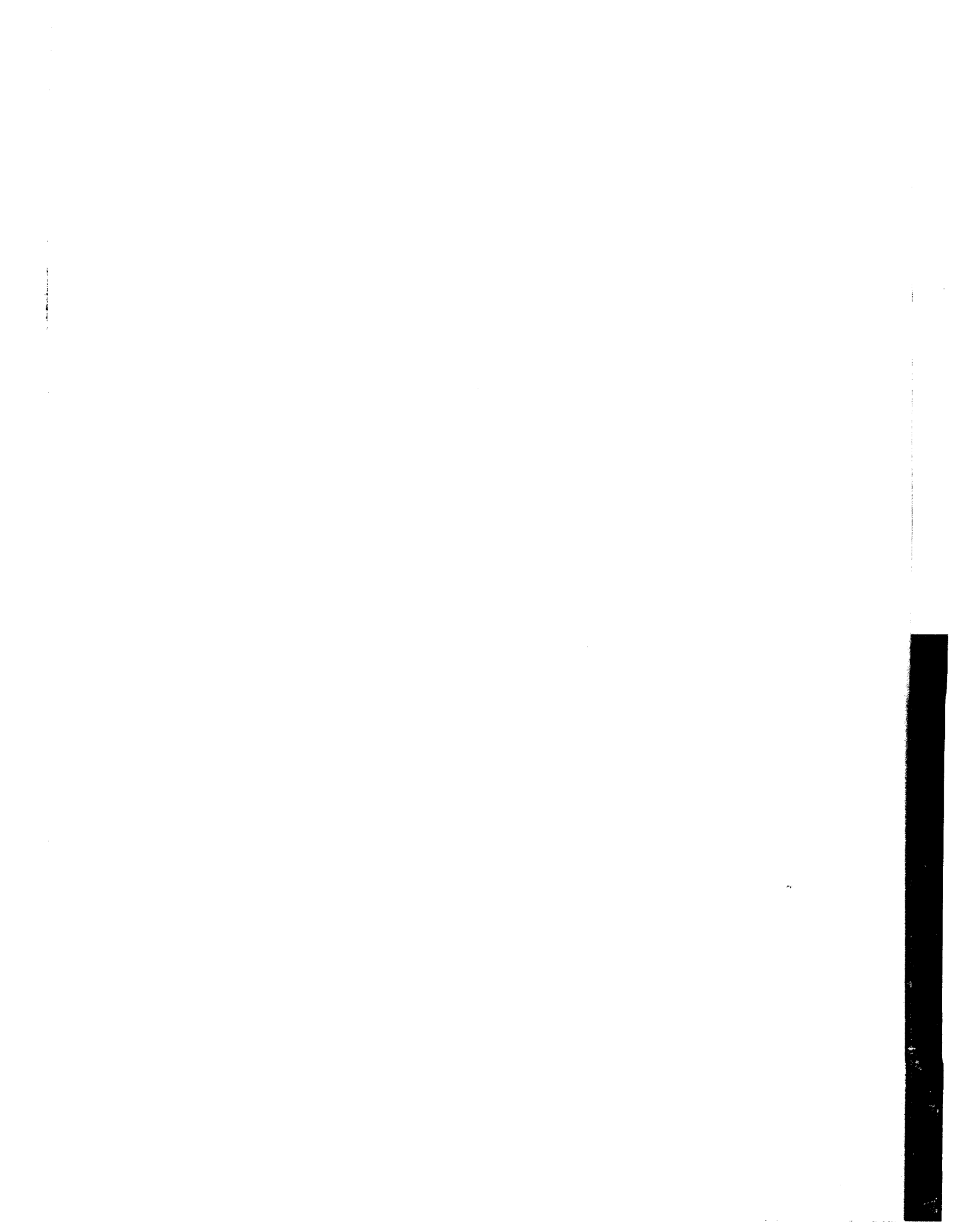


National Association of Securities Dealers, Inc.
1993 Annual Report



*Earning
Investor Trust
Through
Effective &
Responsible
Regulation*







NASD Mission

Our mission is to facilitate capital formation in the public and private sectors by developing, operating, and regulating the most liquid, efficient, and fair securities markets for the ultimate benefit and protection of the investor.



Contents

2	1993 NASD Statistical Highlights
3	1993 Nasdaq Statistical Highlights
4	From the Chairman and the President
6	Securities Regulation and Investor Protection
12	NASD Regulatory Responsibilities at a Glance
20	NASD 10-Year Review
21	Nasdaq 10-Year Review
22	1993 Review of Operations
28	1993 NASD Board of Governors
30	1993 Nasdaq Board of Directors
30	Corporate Committees
31	Advisory Boards
31	Standing Committees
32	District Committees
34	Corporate Officers
35	1993 Consolidated Financial Statements



The National Association of Securities Dealers, Inc.

Established under authority granted by the 1938 Maloney Act Amendments to the Securities Exchange Act of 1934, the NASD is the self-regulatory organization of the securities industry responsible for the regulation of The Nasdaq Stock MarketSM as well as the vast over-the-counter securities market and the many products that are traded in it. The NASD, which operates subject to Securities and Exchange Commission oversight, is the largest self-regulatory organization in the United States, with a membership that includes virtually every broker/dealer in the nation that does a securities business with the public. Utilizing a nationwide system of local and standing committees composed of securities professionals, the NASD conducts regulatory reviews of members' business activities, develops rules and regulations, and designs and operates marketplace services and facilities. The NASD carries out its regulatory responsibilities through member education; the registration and testing of securities professionals; on-site examinations of member firms to determine their compliance with federal securities laws, the rules of the Municipal Securities Rulemaking Board, and NASD rules and regulations; continuous automated surveillance of the markets it operates; the review of members' advertising and sales literature; the review of underwriting arrangements proposed by members in connection with new securities offerings; and cooperative programs with governmental agencies and industry organizations to solve problems affecting investors, public companies, and member firms. The NASD also offers a variety of services, including arbitration, to enable investors and members to resolve disputes, and an 800 telephone number inquiry service that provides investors with disciplinary information regarding members and their registered representatives.

1993 NASD Statistical Highlights

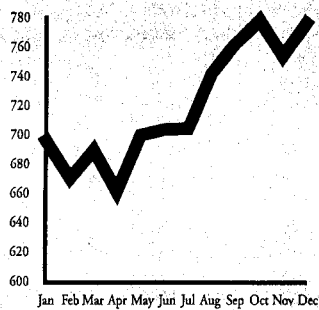
Membership					
5,296 member firms	220	settlement offers accepted	122	formal investigations conducted	Qualifications
46,423 branch offices	327	acceptance, waiver and consent proceedings resolved	71	cases referred to the SEC	242,005 registered representative and principal tests administered
463,836 registered representatives					
Compliance				Arbitration	Advertising
3,495 main and branch office examinations conducted	41	firms expelled from membership	5,419	cases filed	36,961 filings reviewed
4,015 customer complaints resolved	404	individuals barred from the industry	4,327	cases closed	569 items reviewed during spot checks
	18	firms suspended from membership	2,723	disputes resolved between parties without arbitration	853 items reviewed during investigations
	228	individuals suspended	275	industry cases arbitrated	
Disciplinary Actions				1,329 customer cases arbitrated	Corporate Financing
914 formal actions filed		Automated Market Surveillance		730 cases decided in favor of customers	3,001 underwriting arrangements reviewed
323 disciplinary decisions rendered	7,829	price and volume alerts			\$330.9 billion of public offerings reviewed

THE NASDAQ STOCK MARKETSM

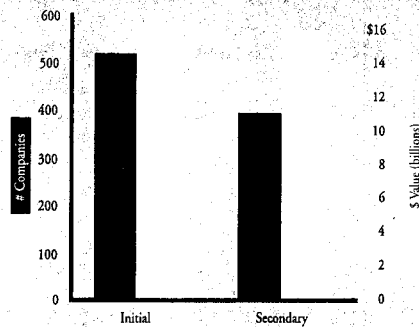


The Nasdaq Stock Market, the premier securities market operated and regulated by the NASD, is the largest electronic, screen-based equity market in the world. Using advanced computer and telecommunication technologies to unite its participants, Nasdaq enables securities firms everywhere to execute transactions for investors and for themselves within an environment of real-time trade reporting and automated market surveillance. In addition to its use of sophisticated technology, Nasdaq is distinguished from exchanges by its use of multiple market makers— independent dealers who openly compete with one another for investor orders in each Nasdaq security. Known for its innovative, forward-looking growth companies, Nasdaq has two tiers: the Nasdaq National Market[®], with more than 3,300 of Nasdaq's larger companies whose securities are typically more actively traded; and The Nasdaq SmallCap MarketSM, with over 1,300 smaller, emerging growth companies. Founded in 1971, today Nasdaq accounts for nearly one half of all equity shares traded in our nation each day and is the second largest stock market in dollar value of trading in the world. More companies—domestic and foreign—list their securities on Nasdaq than on all other U.S. stock markets combined. Nasdaq continues to be the fastest growing securities market in the country.

Nasdaq Composite Index



Nasdaq Public Offerings



1993 Nasdaq Statistical Highlights

Annual Share Volume	66.5 billion	Foreign Securities and American Depositary Receipts	322
Annual Dollar Volume	\$1,350.1 billion	International Share Volume	4.4 billion
Average Daily Share Volume	263.0 million	International Dollar Volume	\$72.6 billion
Average Daily Dollar Volume	\$5.3 billion	Number of Initial Public Offerings	520
Market Capitalization	\$791.2 billion	Value of Initial Public Offerings	\$16.4 billion
Companies Listed	4,611	Number of Secondary Public Offerings	398
Issues Listed	5,393	Value of Secondary Public Offerings	\$16.0 billion
Market Makers	492		

From the Chairman And the President



*1993 Chairman Fredric M. Roberts (seated)
and President and CEO Joseph R. Hardiman*

Nowhere in the world do the citizens of a country participate as fully in its securities markets as in the United States. Whether through direct purchase of securities as individual investors or through mutual funds and retirement funds, more Americans invest, and they invest more.

These vigorous markets give the United States an unparalleled ability to raise capital to support business enterprise and government projects and to generate a prosperity in which all can share through sound investment.

Undoubtedly, participation in our stock markets results from the fact that equities have proven to be a good investment, generation after generation. Yet, it is also attributable to the confidence of investors that the markets are fair and equitable, the kind of confidence that can only be earned through effective regulation.

In its capacity as a self-regulatory organization registered with the SEC, the NASD plays a central role in regulating the nation's securities industry. Whether through on-site examination of sales practices or automated surveillance of securities trading, the NASD uses advanced technology to protect the investor. By improving the quality of our nation's securities markets and refining the industry's business practices, regulation benefits not only investors but other participants as well.

The scope and comprehensiveness of the NASD's regulatory efforts are readily apparent when we realize that, in 1993, the NASD administered over 242,000 qualifying examinations to prospective securities professionals, conducted almost 3,500 on-site examinations of member firms' main and branch offices, resolved some 4,000 customer complaints, and closed more than 4,300 arbitration cases.

While the disciplinary actions taken in 1993 document a vigorous enforcement program, they also illustrate clearly that the overwhelming majority of securities professionals are honest and ethical. In fact, during 1993, just three-tenths of one percent of the NASD's member firms were expelled from membership by disciplinary decision and only one-tenth of one percent of all registered representatives were barred from the industry. The 4,000 total customer complaints that the NASD received during the year can be put in perspective when compared to the almost 65 million individual transactions that occurred in the equity and mutual fund markets alone.

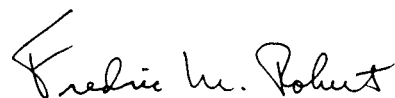
The record-setting year that The Nasdaq Stock Market had in 1993 is attributable, to be sure, to the quality performance of our growth companies. It is unlikely, however, that it would have performed as well if member firms and the market had not served investors fairly. By building investor trust and confidence, self-regulation has provided the framework for Nasdaq's record-breaking year.

To stay abreast of these dynamic and complex markets, the NASD is continuing to improve its regulatory programs as well as the knowledge and skills of its examiners to ensure that the industry is surveilled fairly and effectively. Over the next several years, the NASD will employ more sophisticated methods of examining members by utilizing auditing techniques that test the integrity of a securities firm's internal regulatory systems in addition to the results of those systems.

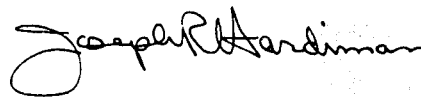
We will continue to apply advanced technology to the regulatory process, downloading information from members' data systems to facilitate more comprehensive reviews and analysis. The result will be improved testing of members' compliance with applicable rules and regulations.

As a complement to its strong enforcement programs, the NASD is committed to assisting its members in their compliance efforts as well. Among the preventive measures that the NASD administers on both a national and district level are various educational and informational programs that focus on members' regulatory obligations.

As we continue to strengthen our regulatory capabilities, we will remain a unified, fully integrated self-regulatory organization, operating and regulating securities markets, both screen-based and over-the-counter, and deterring and detecting rule violations. Knowing how securities markets operate shapes their regulation as much as regulation shapes their design and operation. That both kinds of expertise and information are embodied and shared throughout our organization is fundamental to our success. As one organization, one group of individuals dedicated to operating and regulating securities markets, we pledge to the investing public and all participants in our markets to continue our commitment to fair markets and service quality.



Fredric M. Roberts
1993 Chairman



Joseph R. Hardiman
President and Chief Executive Officer

Securities Regulation and Investor Protection

The Motivation to Regulate

A free market is economic democracy at work. Democracy signifies freedom—and competition is freedom in the marketplace: the freedom to create a better product or provide a better service; to deliver a product or service more efficiently; and to choose to purchase what is most advantageous. Competition serves the marketplace by creating value—the highest quality at the lowest possible price—because competition is the freedom to innovate, to meet an economic challenge, to respond to market opportunities. In essence, competition is the process that reveals the best that the world has to offer.

If markets tend to function best when they operate freely, why regulate them? Markets are regulated to ensure that the competition among participants is fair and equitable. If the market favored one group of participants over another, or if an individual participant were taking advantage of others, then the freedom that gives rise to quality would be impaired. The best would not prevail, and all participants would suffer.

Above all, securities regulation functions to protect the investor. Rules and regulations are designed to ensure that the investor has accurate and sufficient information to make reasonable investment decisions and to prevent, insofar as possible, acts and practices that are inconsistent with the public interest.

In addition, securities markets are regulated to ensure that issuing companies, governments, and agencies can raise capital to create or expand business enterprises that generate jobs or fund projects that benefit the public at large. At the same time, securities regulation maintains an environment in which investment banking and other financial services firms can do business effectively and be compensated appropriately for the services they provide.

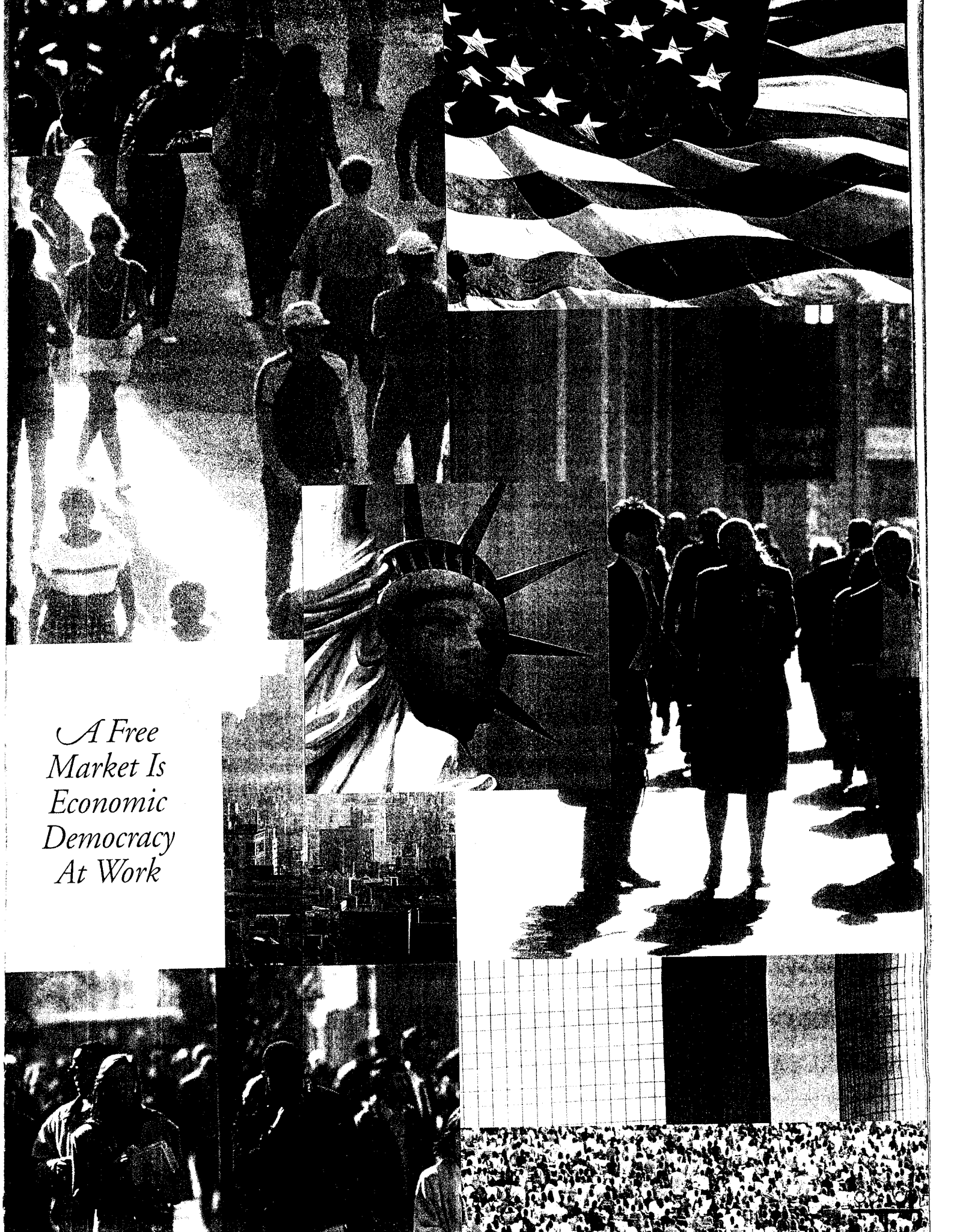
Securities markets provide a unique service to our country. They enable people to contribute to and participate in the American economy and the global economic system of which it is a part by managing the capital resources of a company, providing ways to finance a company, or investing in a company's future performance through stock ownership.

Given the uncertainties characteristic of market economies, such participation is not without risk. Securities regulation seeks to ensure that this risk is understood and that marketplace professionals deal fairly with those they serve. This is accomplished by structuring and operating markets according to rules that prohibit manipulation and insider trading as well as ensure participants full information on investment and capital raising opportunities, timely reporting of market activity, and prompt access to the marketplace. It is also accomplished by swiftly detecting and disciplining participants who violate those rules.

The Benefits of Self-Regulation

Securities markets in the United States are regulated according to an interlocking network of federal and state laws. Congress authorized the Securities and Exchange Commission (SEC) to oversee the securities industry both by establishing rules and regulations that elaborate the laws and by enforcing these laws and regulations. Concurrently, state securities commissions enforce their respective laws.

The securities industry has evolved into one of the most dynamic, innovative, and competitive industries in the United States and the world. One explanation for this is that the securities business is an information business. As such, it participates in the technological revolution that has given rise to the information age. Another reason is that the essence of the securities business is movement: the moving of capital. Movement means change. Whether it is the trading of securities or structuring the securities and the



*A Free
Market Is
Economic
Democracy
At Work*

offerings from which they result, each transaction is an opportunity to add value through innovation—in essence, by doing what has never been done before.

To meet the challenge of regulating such a market, securities laws permit the establishment of self-regulatory organizations, which operate under the oversight of the SEC. These self-regulatory organizations are supported by their members—securities firms—rather than by government funding. Industry professionals participate in formulating rules of fair business practice and market operation and in promoting compliance with those rules as well as securities laws through education, examination, and disciplinary action.

In an industry that innovates so quickly, whose products and services can be so technically complex and abstract, the participation of securities professionals in the regulatory process is invaluable. Because of their day-to-day involvement in the ongoing activity of the securities business, industry practitioners are in a unique position to provide reliable information and expert insight. Industry participants are often the first to know what new products or services require special regulation or what current business practices call for new rules or regulatory approaches. Indeed, they know from experience which regulatory approaches will be effective and which will not.

How can securities professionals help to regulate their own industry? Would it rather be in their economic self-interest not to concern themselves with regulation? In point of fact, it *is* in the economic self-interest of securities professionals to ensure that their industry treats participants fairly. The very future of their industry depends on customer satisfaction and repeat business. Otherwise, investors, companies, and governments would resort to other capital-raising alternatives that would readily welcome their business.

That the securities industry leads the capital-formation process in this country is a tribute to the value that it provides its customers and the degree to which they find it to be fair. That the industry *is* fair can be attributed, in large part, to self-regulation. By enabling industry practitioners to participate in the regulatory process, the regulatory system gains their help, their confidence, and their support.

The NASD is the largest securities-industry self-regulatory organization in the United States and the only securities-industry association to have registered with the SEC. The NASD's nationwide system of committees of securities industry professionals representing all regions of the country and all facets of the securities industry epitomizes the principle of self-regulation.

The Business of Regulation

The NASD helps companies, municipalities, and government agencies raise capital by regulating the screen-based markets that it develops and operates as well as the over-the-counter securities markets. Regulation is crucial in the capital-raising process because it ensures, for all who participate, a market environment that is not only efficient but also fair. To accomplish this task, the NASD mobilizes member firms to participate directly in the regulatory effort themselves.

Consensus. Self-regulation begins with the formulation of rules and regulations that govern the conduct of member firms in originating, selling, and trading securities. If those rules are to regulate the market fairly and address its mechanisms effectively, there must be agreement regarding what they should be. Typically, the NASD's standing committees—composed of members, issuers, and investors—address regulatory issues and propose rules to the Board of Governors for its consideration. The Board may also initiate rules on its own.

Cooperation. Next, self-regulation involves a partnership between the industry and the government that Senator Francis T. Maloney—the architect of the legislation authorizing the NASD—said created a “two-way street in which members of the industry, subject to federal supervision, exercise as large a measure of authority as their natural genius permits.” In effect, self-regulation is an essential and officially sanctioned part of the securities regulatory system in the United States.

Regulatory cooperation has many dimensions, particularly in the enforcement of laws and rules, ranging from referrals to task forces. The NASD coordinates with such federal agencies as the SEC, the Federal

Bureau of Investigation, and the Internal Revenue Service as well as the Attorney General and the U.S. Attorneys office. In addition, the NASD cooperates with the various state securities commissions and the other self-regulatory organizations on enforcement responsibilities and special initiatives. The NASD also maintains working relationships with various congressional committees to supply analysis and opinion. This cooperation makes securities regulation in the United States not only efficient but also comprehensive.

Commitment. Self-regulation can only succeed through the participation of the NASD's member firms and their registered representatives in the self-regulatory process. This participation begins, of course, with a recognition of their obligation and responsibility to abide by securities laws and rules, and the vast majority of securities professionals do. They know that good compliance is simply good business.

Self-regulation also involves industry members volunteering their time to serve on the NASD's various standing committees to craft regulatory policy and decide enforcement cases. Specifically, the locally elected members of District Business Conduct Committees (DBCCs) review reports of apparent violations of rules, regulations, and business practices revealed by on-site examinations or customer complaints, conduct disciplinary proceedings, and render decisions and impose sanctions as necessary. The Market Surveillance Committee, which has similar authority, acts as the central reviewing body for disciplinary cases involving possible market-related violations developed by the Market Surveillance and Enforcement staffs.

Supervision. Self-regulation involves both education and regulation. It begins with qualifying securities professionals through examinations administered by the NASD and with qualifying securities firms that do a business with the public for membership in the NASD. Qualification is reinforced through NASD member education and preventive compliance programs.

Beyond the qualifications standards, the NASD, through its on-site examination programs, regularly reviews member firms' sales practices to ensure that customers are being treated fairly, that the investments they are making are suitable, and that the prices being paid are fair and reasonable. In addition, the NASD's field examinations review the financial soundness of members and their compliance with federal securities laws and regulations as well as the rules of the NASD and the Municipal Securities Rulemaking Board (MSRB). NASD personnel employ information technology to assist in their on-site inspections and advanced automated systems to conduct real-time surveillance of trading in the markets the NASD regulates.

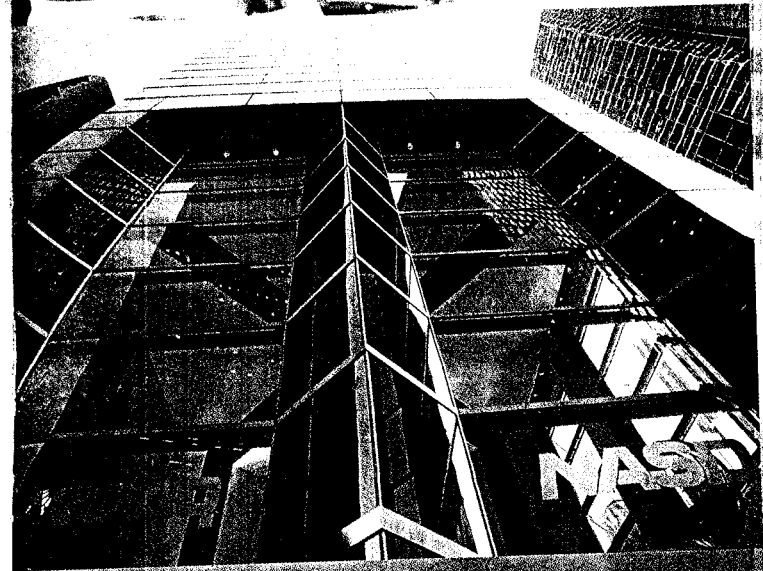
Judgment. To ensure the integrity of self-regulation, the NASD handles violations detected through examinations, investigations, and cause inspections resulting from customer complaints, among other sources, according to procedures based on fundamental legal standards of fairness. In effect, business people are empowered to judge the business practices of their peers in accordance with the NASD's ethical code of conduct and federal securities laws. Minor infractions are handled through informal actions, for example, a letter of caution or a compliance conference. More serious violations will result in the institution of formal actions that may involve hearings with possible penalties that include one or more of the following sanctions: censure, fine, restitution, suspension, expulsion, revocation, or bar. All DBCC and Market Surveillance Committee decisions may be appealed to or called for review by the National Business Conduct Committee (NBCC). NBCC decisions can be appealed to the SEC, and SEC decisions can, in turn, be appealed to a U.S. Court of Appeals.

Regulation and Trust

Regulation is, in the end, about protecting investors and earning the confidence of participants in the securities markets. That trust is earned every day during hundreds of thousands of interactions between brokers and their clients, traders and their customers, companies and their investment bankers, issuers and their markets. That this trust can be earned over and over again, transaction by transaction, one transaction at a time, is a tribute to the effectiveness of securities regulation in the United States and the dedication of securities professionals to serving their customers fairly.



*The NASD Is
Nationwide,
Representing All
Regions Of The
Country And All Facets
Of The Securities
Business*



NASD Regulatory Responsibilities At a Glance

Self-Regulatory Foundation

Securities and Exchange Act of 1934 as Amended

- Permits associations of brokers and dealers to be formed to make and enforce rules and regulations governing standards and practices
- NASD became a key part of federally supervised self-regulation of the securities industry when the SEC approved its application for registration as a national securities association on August 7, 1939
- Gives the NASD regulatory and/or enforcement authority over members' market-making activities and trading practices; their municipal and federal government securities activities; their underwriting arrangements in connection with the public distribution of securities; their new-issue distribution practices; and a wide range of products, including Nasdaq securities, over-the-counter securities, exchange-listed securities traded in dealer markets, direct participation programs, mutual funds, and variable contracts

NASD By-Laws and Related Schedules

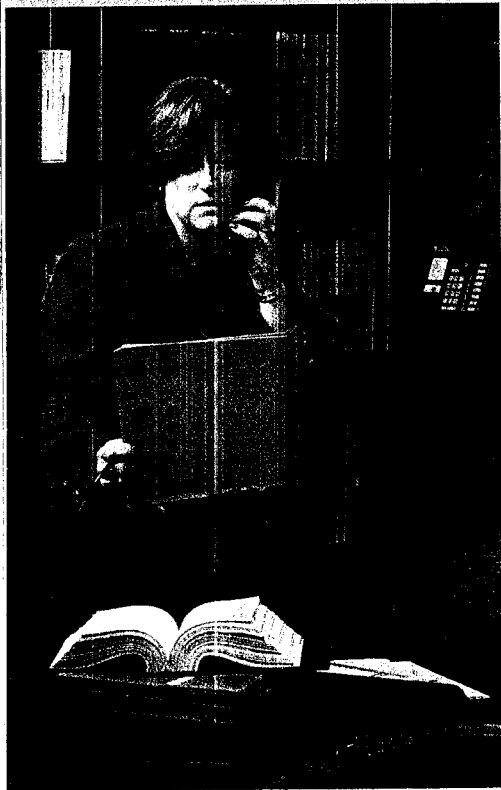
- Establish the NASD's system of governance
- Prescribe the powers and authority of the Board of Governors
- Prescribe standards for membership and professional registration
- Set forth the rules and regulations governing the operation and regulation of NASD markets

NASD Rules of Fair Practice

- Protect investors from unfair business practices—these are the core rules of the NASD
- Require members to observe high standards of commercial honor and follow just and equitable principles of trade
- Provide for the imposition of sanctions for failure to comply with applicable rules and regulations

NASD Code of Procedure

- Sets forth procedural rules governing the NASD's disciplinary process



Rulemaking

Board of Governors

Composition of the Board

- The NASD Board is composed of 29 members, inclusive of the President of the NASD
- The majority of Governors come from the securities industry and are elected by member firms from 11 districts throughout the United States
- Additional Governors in at-large positions are elected by the Board to represent investors, Nasdaq-listed companies, insurance company members, investment company underwriters, and the securities industry at large
- All Governors are volunteers—they serve without compensation

Rulemaking Process of the Board

- Refers matters that come before it to the appropriate corporate or standing committee for action
- Considers and acts on committee recommendations
- Solicits comment on significant issues
- Submits significant rule proposals to the membership for vote
- Files proposals with the SEC for approval

Corporate and Standing Committees

Role of Committees in Rulemaking

- Respond to Board requests for action
- Identify issues requiring rulemaking
- Develop proposed rules
- Submit recommendations to the Board



Securities and Exchange Commission

Procedures for Approving Proposed NASD Rules

- Publishes NASD proposals in *Federal Register* to solicit comment
- Provides direction and comment on proposed rules
- Has final approval authority over all NASD proposals



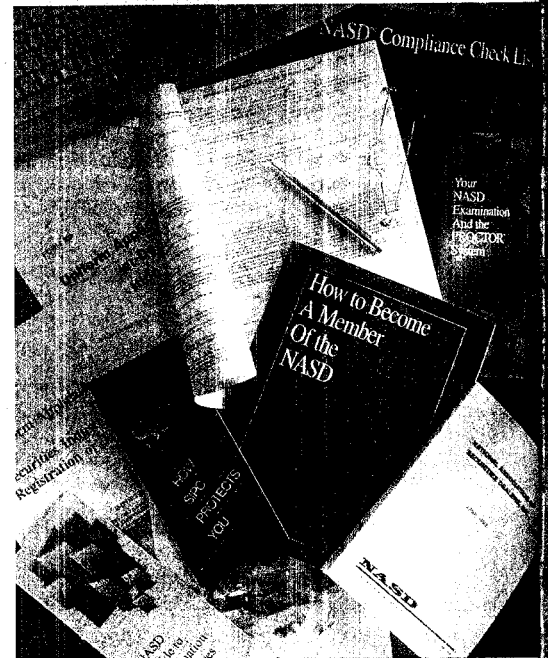
Securities Firms

NASD Membership

Required for All Firms Doing Business with the Public

Prerequisites to NASD Membership

- Registration as a broker/dealer with the SEC
- Registration with all states in which business will be conducted
- Qualification of appropriate personnel
- Adequate resources, including capital, personnel, and recordkeeping systems
- A supervisory system that facilitates compliance with applicable rules and regulations
- Fidelity bonding coverage
- Acceptance of any restrictions imposed by NASD as a condition to membership



Registration and Qualification of Securities Professionals

Registered Representatives

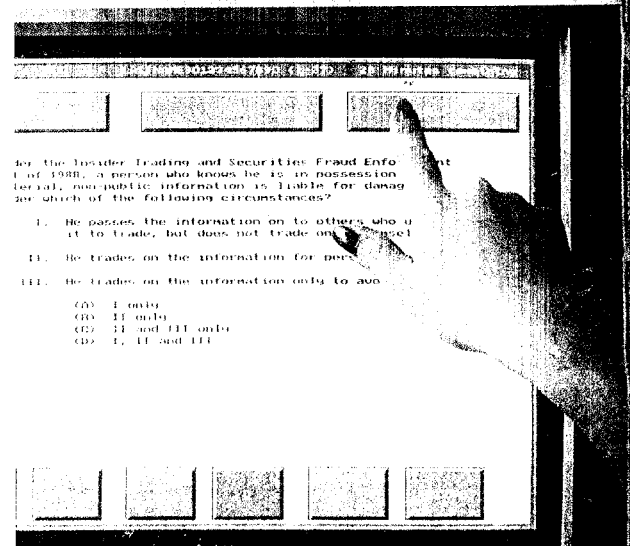
- Generally sales personnel
- Tested by the NASD to determine an applicant's knowledge of securities products, financial analysis, applicable securities laws and regulations, and the rules of the NASD

Principals

- Generally officers of the firm and other supervisory personnel involved in the day-to-day management of a member's business
- Tested by the NASD to determine an applicant's knowledge of rules and regulations governing the conduct of the member's business, the supervision of brokers, and the member's key business activities and operations

Previous Violations

- Members employing persons with prior disciplinary histories are required to exercise close supervision over such individuals
- The NASD has the authority to bar from working in the securities industry any person who has been statutorily disqualified for previous violations of securities laws, SEC regulations, or conviction of a felony

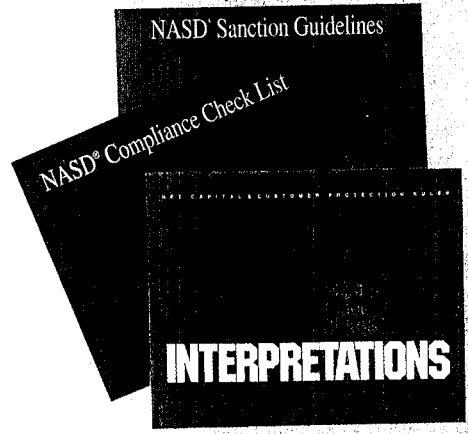




Surveillance and Investigative Procedures

NASD Business Conduct Committees

- District Business Conduct Committees—Composed of members elected locally in the NASD's 11 geographical districts, these committees review district staff examination reports and determine disciplinary actions
- Market Surveillance Committee—This committee acts on investigations emanating from the Market Surveillance and Enforcement staffs that focus on market-related practices
- National Business Conduct Committee—Composed of NASD Board members, this committee ensures that District Business Conduct Committee and Market Surveillance Committee disciplinary decisions are uniform and consistent in both findings and sanctions on a nationwide basis



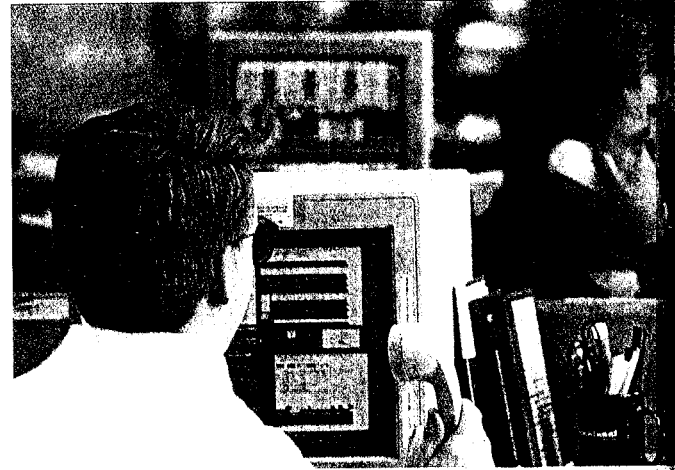
On-Site Compliance Examinations of Members

- Routine Examinations—Regular on-site reviews by district staff conducted to determine members' compliance with applicable rules, including those dealing with sales practices, supervision, trading practices, and financial responsibility
- Special Examinations and Investigations—Specific reviews for possible fraud, manipulation, or other questionable conduct; also encompass, on an as-needed basis, the review of customer complaints, terminations of brokers for cause, and referrals from other organizations/agencies
- Joint Examination Program—Examinations conducted by the NASD and the New York Stock Exchange of members of both organizations
- Coordination of Examinations—Investigations conducted by the NASD in cooperation with the SEC and state securities organizations, as well as federal and local law enforcement agencies
- Referrals—Cases involving evidence of criminal activity are referred to the appropriate law enforcement agencies



Market Surveillance

- The Nasdaq Stock Market and other NASD screen-based markets are monitored through centralized automated surveillance using sophisticated computerized systems to detect a wide variety of potential violations, including possible manipulation and illegal insider trading
- The industry regulatory organizations share surveillance information to detect cross-market aberrations
- Trading halts are imposed to give market participants the opportunity to learn of material news disseminated by public companies



Reports of Financial and Operational Condition

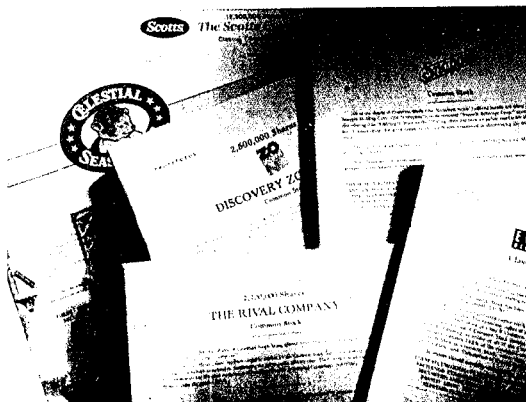
- Key indicator data are required to be filed monthly by electronic means; comprehensive financials are filed quarterly
- A formal audit is required to be conducted annually by an independent public accountant
- Each report is subject to computerized analysis as well as manual review

Sales Literature and Advertising

- Sales literature and advertising are reviewed for fairness, accuracy, and completeness
- The review process includes mandatory filings and spot checks

Underwriting Arrangements—Terms and Conditions

- Securities offerings managed by member firms are reviewed to determine whether the underwriting terms are fair and within NASD requirements, thereby assuring companies going public of their fair share of the underwriting proceeds
- Offerings with arrangements that are in excess of NASD requirements are not cleared by the SEC until adjustments are made that are satisfactory to the NASD





Disciplinary Process

Purposes

- To protect the investing public
- To promote membership compliance with all relevant rules and regulations

Process/Procedures

- All disciplinary proceedings are conducted pursuant to the Code of Procedure to assure fundamental legal standards of fairness
- District Business Conduct Committees and the Market Surveillance Committee review examinations and investigations that disclose potential violations of rules
- Minor infractions of rules are handled through cautionary letters or compliance conferences
- Disciplinary complaints are filed against firms and individuals for serious infractions of rules
- Hearings are held to determine whether a member or individual has violated applicable laws and regulations or NASD or Municipal Securities Rulemaking Board rules as alleged in the complaint action
- Written decisions are rendered and, as appropriate, sanctions designed to be remedial in nature may be imposed, including censure, expulsion, revocation, bar, monetary fine, restitution, and any other fitting penalty
- Final disciplinary actions are a matter of public record and major cases are publicized

Appeals

NASD Appellate Process

- All District Business Conduct Committee and Market Surveillance Committee decisions may be appealed to the National Business Conduct Committee
- The National Business Conduct Committee may call a District Business Conduct Committee or Market Surveillance Committee decision for review on its own motion
- The National Business Conduct Committee is empowered to affirm, dismiss, reverse, or modify any committee finding
- All National Business Conduct Committee cases are reported to the NASD Board and unless called for review by one or more Board members become final NASD actions

External Appeals

- The SEC reviews final NASD disciplinary decisions
- Final NASD decisions may be appealed to SEC
- The SEC is empowered to affirm, dismiss, reverse, or remand NASD findings reviewed
- SEC decisions may be appealed to a United States Court of Appeals

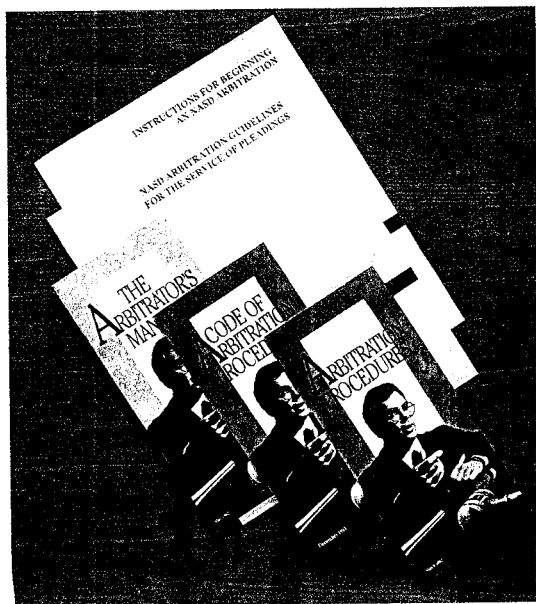




Arbitration

The NASD Operates the Largest Arbitration Forum in the Country

- Arbitration is designed as a prompt, inexpensive alternative to litigation to resolve disputes between investors and members and between members
- It is not an extension of the NASD's disciplinary process—it does not result in imposition of sanctions, but can lead to regulatory referrals for misconduct uncovered during the arbitration process
- Investor disputes are usually heard by panels composed of two public and one industry arbitrators



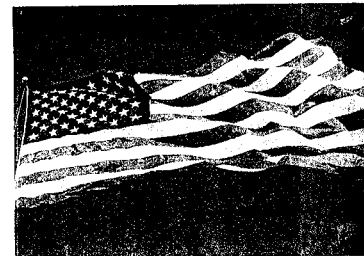
Public Disclosure Program

Telephone Hot-Line

- Provides investors with background information to help in the selection of a brokerage firm and/or sales representative
- Makes disciplinary and criminal history of registered representatives and member firms available to the public
- Available to investors free of charge

Investor Booklet

- *Invest Wisely: Advice From Your Securities Industry Regulators* is a joint project of the SEC, the NASD, and other self-regulatory organizations
- Provides advice on selecting a broker, managing an investment account, making investment decisions, protecting yourself from unlawful practices, and dealing with a problem in a securities account
- Available to investors free of charge



Nasdaq Companies

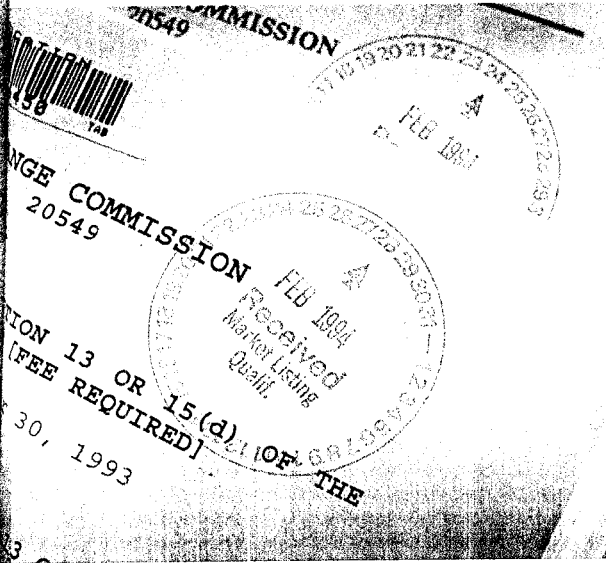
Issuer Entry and Maintenance Standards

Companies Seeking to List on Nasdaq Are Required to Meet Certain Standards

- Initial listing standards, mainly quantitative in nature, set forth the minimum requirements for gaining a listing on Nasdaq
- Maintenance standards, which are quantitative in nature, must be met on an ongoing basis to retain a listing

Listing Standards Include

- Registration with the SEC under the Securities and Exchange Act of 1934
- Quantitative standards, such as minimum bid price, number of market makers, market value of public float, assets, and capital and surplus
- Higher quantitative standards as well as corporate governance standards (dealing with requirements to have independent directors, audit committees, and shareholder voting rights) are required of companies seeking to list on the Nasdaq National Market



Corporate Disclosure Requirements

Most Disclosure Requirements Are Mandated by Federal Laws

- Public companies are required to provide ongoing disclosure about their finances and operations to investors via statements and reports
- Other event-driven reports are required to be filed whenever there are changes in control of the company, changes in management, and mergers and acquisitions, among others
- The SEC proxy solicitation rules require companies to inform shareholders of impending meetings and votes

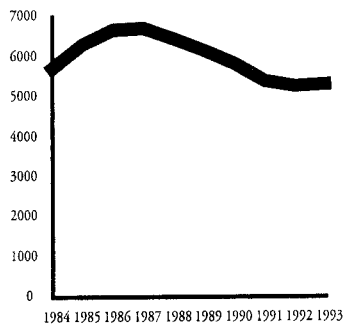


Nasdaq Requirements

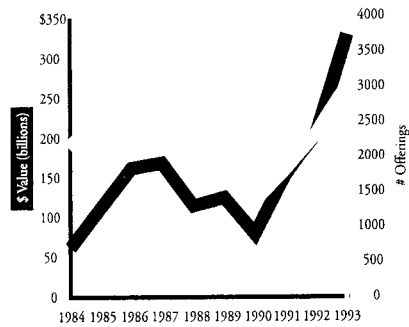
- Companies are required to promptly disclose, through the media, material developments that may affect investors' judgments about their holdings
- Companies must report to Nasdaq significant increases/decreases in shares outstanding and any intentions to pay dividends or authorize a stock split, among other required disclosures

NASD: Ten-Year Review

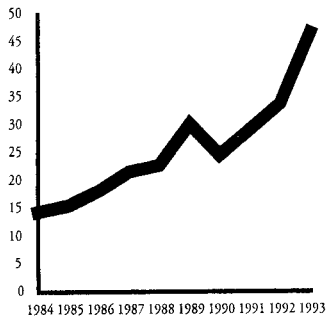
Member Firms



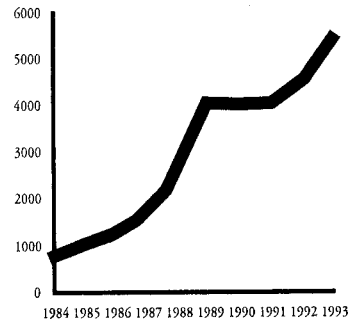
Corporate Financing Underwriting Arrangements Reviewed



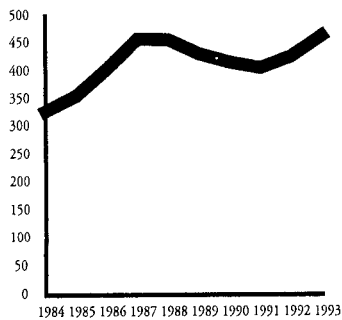
Branch Offices Thousands



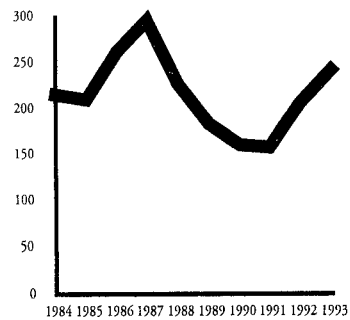
Arbitration Cases Filed



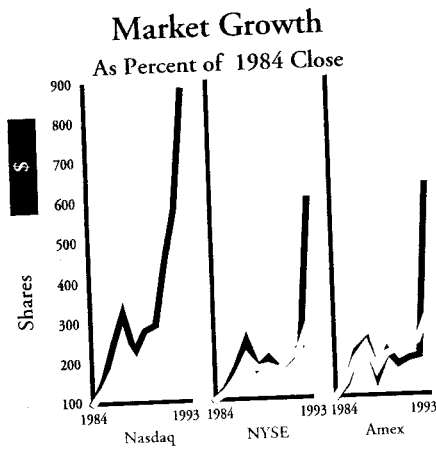
Registered Representatives Thousands



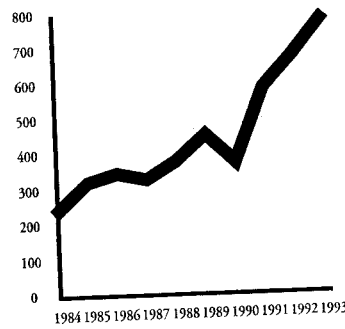
Qualification Examinations Thousands Administered



Nasdaq: Ten-Year Review

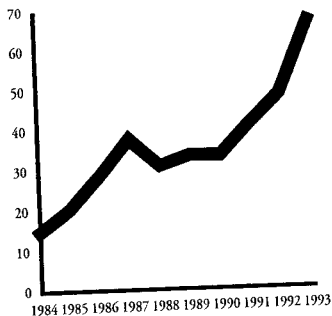


Nasdaq Composite Index



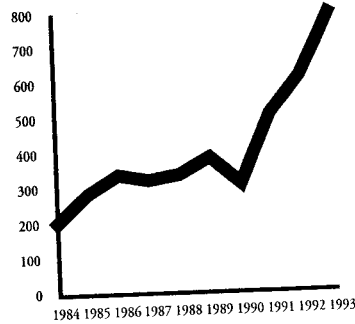
Share Volume

Billions



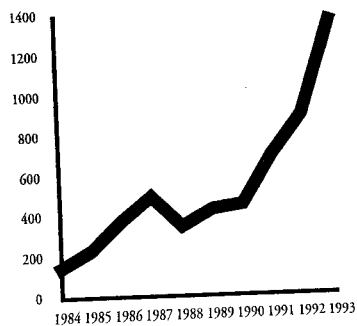
Market Capitalization

\$ Billion

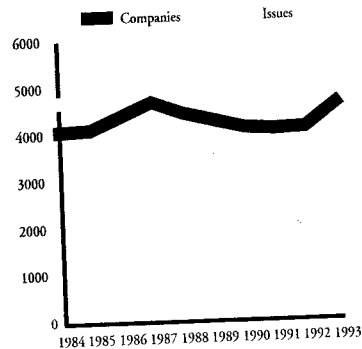


Dollar Volume

\$ Billions



Issues



1993 Review of Operations



SEC Chairman Arthur Levitt, Jr., third from left, addresses the November meeting of the Board of Governors in Washington.

MARKET PERFORMANCE

Nasdaq Sets Share and Dollar Volume Records

America's fastest growing market, The Nasdaq Stock Market closed 1993 with a record-setting annual share volume of 66.5 billion, 37 percent above last year's total, the previous record. On October 13, Nasdaq hit an all-time high in daily share volume of 415.4 million. On more than half of the trading days (136 out of 253), Nasdaq share volume outpaced that of every other U.S. market.

Dollar volume broke the \$1 trillion mark in early October and reached \$1.35 trillion by year end, 51.6 percent above last year's total, the previous

high. Average daily dollar volume reached another all-time high in 1993: \$5.3 billion daily.

Nasdaq Composite Reaches New High as Communications Sectors Lead

The Nasdaq Composite Index ended 1993 at 776.80, up 14.75 percent from the previous year, compared to the 13.7 percent gain of the Dow Jones Industrial Average and a 7.1 percent increase for the Standard & Poor's 500. The Nasdaq Composite reached an all-time closing high of 787.42 on October 15.

Nasdaq's strongest performing industry groups in 1993 were Communications Equipment, up 67.7 percent;

Gold and Silver, up 58.1 percent; Telecommunications, up 53.5 percent; Travel & Entertainment, up 53.0 percent; Machinery, up 40.8 percent; and Savings & Loans, up 40.6 percent.

Foreign Trading, Listings Highlight Nasdaq's Growing International Role

Dollar volume in foreign shares and American Depositary Receipts (ADRs) in 1993 climbed to \$72.6 billion, 129.7 percent ahead of the previous year's pace. Trading volume in these securities rose dramatically to 4.4 billion, 71.9 percent ahead of last year.

A record 56 foreign companies listed on Nasdaq in 1993, a 24 percent increase over the previous year's additions. More foreign-based companies—303—trade on Nasdaq than on all other U.S. stock markets combined.

Nasdaq-100 Index Split; New Indexes Launched

The value of the Nasdaq-100 Index[®] was halved on January 4, 1994, because of the soaring growth of The Nasdaq Stock Market. Launched in 1985 with a value set at 250, the Nasdaq-100 closed 1993 at 796.56, a gain of 219 percent. A widely watched barometer of large-capitalization growth stocks listed on Nasdaq, the Nasdaq-100 was adjusted in 1993 to reflect more accurately the changing mix of Nasdaq's 100 largest non-financial companies.

On November 1, 1993, Nasdaq created three new indexes, each set at 200, to provide investors with the statistical means to track three key growth-industry sectors. The Computer Index includes 461 companies with a total market capitalization value of \$160 billion, while the Biotechnology Index tracks 83 companies with a total market value of \$26 billion. The Telecommunications Index, created out of the former Utilities Index, contains 124 issues with a total market capitalization of \$82.8 billion. The renamed index more accurately describes its true composition, since telecommunications issues had been driving the Utilities Index to its new highs. The utilities issues have been moved to the Industrial Index.

MARKET QUALITY AND SERVICES

Passive Market Making Approved for Underwriters Of Secondary Distributions

Responding to an NASD petition, the SEC approved rules that permit market makers that are also syndicate members in a secondary offering of Nasdaq securities meeting specific share-price and public-float criteria to engage in passive market making during the two-day "cooling off" period preceding the offering. Passive market makers, which otherwise would be required to withdraw their quotes from the market, are permitted to enter bids and effect purchases at prices equal to the highest bid displayed by independent market makers.

Passive market making serves to enhance liquidity and reduce volatility prior to a secondary offering, thus ensuring that share price levels are determined by market forces unaffected

by the required withdrawal of syndicate members from the market. Passive market making also helps alleviate the negative impact of rule-imposed market-maker withdrawal on the cost of capital for companies involved in secondary distributions. At the same time, the revisions preserve one of the basic intents of the rule, which is to prevent market manipulation.

Proposed Rule Mandates Priority for Customer Limit Orders

The NASD Board has proposed a rule, now pending SEC approval, that will give priority to customer limit orders. The proposed rule will protect customer limit orders and give them priority over the market-making activities of members. In the main, this rule simply serves to codify the existing policies and practices of most large integrated firms for handling customer orders.

New Nasdaq Enterprise Network Set for 1994; Nasdaq Workstation II Software Modified

In late 1994, The Nasdaq Stock Market will begin transferring Nasdaq subscribers to the Nasdaq Enterprise Network leased from MCI Communications Corporation. This new 56 kilobit telecommunications network will not only make possible quicker transmission of current information, but it will also allow Nasdaq to enhance significantly the information and services it provides to subscribers. In addition to increased capacity, the new network will permit increased flexibility in such areas as backup mechanisms, type of service, and network interfaces. The transfer will be phased in by region of the country and continue through early 1996.

During 1993, Nasdaq staff met with traders and subscribers at demonstration meetings held across the country to gather suggestions to improve Nasdaq Workstation IISM software. The NASD used these experiences to make a number of refinements in the software that make it an even more flexible and efficient market tool, particularly in the areas of accessing windows, executing functions, and customizing features.

The Nasdaq Stock Market selected Unisys Corporation to enhance Nasdaq's information system centered on Unisys mainframe-class enterprise services. The system processes, records, and communicates the data for all aspects of Nasdaq's securities trading, including share price quotations and the reporting of purchase and sale transactions. The new trading environment will ultimately be able to support an 800-million-share trading day.

Real-Time Reporting, Size Requirements Prescribed for OTC Bulletin Board

Member firms that conduct business in over-the-counter (OTC) equity securities are now required to report individual transactions within 90 seconds of execution. This requirement applies to transactions effected in all OTC equity markets, including those in securities quoted on the OTC Bulletin Board[®]. The first phase implemented in 1993 involves the collection and processing of transaction reports on OTC equity securities exclusively for regulatory purposes. The availability of real-time trade data has greatly enhanced the NASD's automated surveillance techniques for this market segment. During the first half of 1994, the NASD will disseminate these transaction reports on a real-time basis over the Nasdaq network and the networks

of commercial vendors. Through this enhancement, investors and broker/dealers will be able to access more real-time data than ever before.

Also, the NASD has adopted a tiered structure of minimum-size requirements for market-maker quotations reflected in the OTC Bulletin Board. These are based on the price level of the individual bid or offer and replace the one-trading-unit minimum. Thus, each market maker that publishes a firm bid or offer in a domestic OTC equity—through the OTC Bulletin Board or another real-time system—must honor its quotation for individual orders up to the new minimum size applicable to that price.

New Screen-Based Market For High-Yield Bonds Set for Launch

The Fixed Income Pricing System (FIPS) will extend the benefits of screen-based trading technology to the

high-yield bond market when it begins operations in 1994. The NASD developed FIPS to enhance surveillance of all high-yield, fixed-income securities and to increase the transparency of the most liquid segment of this market.

FIPS collects audit trail information relating to all transactions in high-yield, fixed-income securities. Members are required to submit trade reports by the end of the day for regulatory purposes. Initially, FIPS will also operate as an electronic screen-based quotation system for up to 50 of the most active high-yield bonds. Time of operation will be the same as that for equity markets, and bonds must meet specific criteria. Quotations must be firm on at least one side, and brokers and dealers must report trades in FIPS-quoted bonds within five minutes after execution. High and low execution prices and accumulated daily volume will be disseminated publicly every hour by FIPS.

Increased Disclosure Proposed for Inducements Paid for Order Flow

In 1990, the NASD filed a proposal with the SEC that would require confirmation disclosure of remuneration received by a broker/dealer for directing orders to a particular market center. In 1993, the NASD Board augmented the disclosure required for members participating in inducement-for-order-flow arrangements. Under an Interpretation to the Rules of Fair Practice, member firms would have to provide each new customer, when the new account is opened, and all customers on an annual basis, a written statement disclosing the factors and inducements relating to the firm's decisions on order routing. Though the inducements need not be quantified, they would have to be identified in an informative, descriptive, and understandable manner. Both proposals are currently pending at the SEC.

Testifying before a U.S. House of Representatives subcommittee during a hearing in April 1993 concerning the national market system, NASD President Joseph R. Hardiman said that "investors should be made aware of the numerous transactional relationships that their brokers are involved in as well as the market centers in which their orders are executed so that they will be able to make informed decisions when placing orders."

The NASD believes, as Hardiman further testified, that analysis of payment for order flow should focus on "how the variety of inducements for order flow which exist in all of the markets have affected quotation competition or development of innovative pricing systems, and how inducements for order flow have affected the total transaction costs customers pay brokers for



John E. Pinto, Executive Vice President, NASD Regulation, testified before a September 9 hearing of the Telecommunications and Finance Subcommittee of the Energy and Commerce Committee of the U.S. House of Representatives concerning the municipal securities market.

their services." A 1991 NASD study, *Inducements for Order Flow*, written by an ad hoc committee chaired by former SEC Chairman David S. Ruder, found that these inducements are commonplace throughout the securities industry and are an inherently competitive strategy in the current market structure. The report found that order-flow inducements actually encourage lower execution costs and enhance services to investors because they are often related to technological improvements and economic savings.

Nasdaq 100 Options Listed on the Chicago Board Options Exchange

The NASD Board approved an agreement that allows the Chicago Board Options Exchange (CBOE) to list options on the Nasdaq 100, a benchmark index for large growth stocks traded on The Nasdaq Stock Market.

These options, which began trading February 4, 1994, give investors a new tool for market timing and hedging in Nasdaq securities, allowing them more flexibility in managing their portfolios. In addition, the use of this product can have a beneficial impact on market liquidity because market makers can hedge their equity portfolios more effectively, thus giving them the capability to take on larger positions.

NASD Opposes FASB's Proposed Stock Options Rule

The NASD Board passed a resolution opposing the stock options rule proposed by the Financial Accounting Standards Board (FASB) because it would have a negative impact on America's economic growth and job creation. The NASD is opposing

FASB's proposed rule to protect the best interests of Nasdaq companies and their investors. The rule would require companies to deduct from their earnings as compensation expense the value of fixed stock option grants as determined by certain mathematical models. The resolution stated that the proposed rule would:

- Decrease corporate earnings substantially and increase the cost of capital for both private and public companies that use stock options widely.
- Substantially reduce the ability of high-growth companies to attract and retain employees.
- Decrease America's ability to foster globally competitive innovators and rapidly create competitive companies.

Concurrently, The Nasdaq Stock Market, Inc., submitted a comment letter to FASB pointing out, in addition to these damaging public policy implications, certain faulty accounting aspects:

- No valuation model has been demonstrated to quantify accurately the heightened risks of long holding periods and lack of liquidity characteristic of employee stock options, as opposed to standardized, publicly traded options, for which the models were designed.
- The proposed rule would reduce comparability of income information and may even create misleading corporate financial statements by obscuring the operating disadvantage in economic downturns that companies relying mostly on cash compensation—a semi-fixed cost—have in relation to companies compensating mostly through stock options.



Richard G. Ketchum, Executive Vice President and Chief Operating Officer of the NASD, gave a presentation at the annual meeting of the International Organization of Securities Commissions (IOSCO) on October 26 in Mexico on the proper international regulatory treatment of electronic trading systems.

BUSINESS PRACTICES

NASD Expands Public Disclosure Program

Strengthening a highly successful investor protection initiative, the NASD expanded its Public Disclosure Program to make additional regulatory information on member firms and registered individuals available to the public. Investors and other interested parties can now obtain information concerning civil judgments in securities-related matters, pending regulatory actions, and criminal indictments, as well as final arbitration decisions in securities matters involving customers. This information is in addition to that previously disclosed, which includes criminal convictions disclosed on Form U-4 and final disciplinary actions taken by self-regulatory organizations and federal and state securities agencies. The NASD Public Disclosure Program is



NASD President Joseph R. Hardiman congratulates Commerce Secretary Ronald H. Brown on his award at the Center for the Study of the Presidency dinner on June 23, as MCI CEO and NASD Board of Governors member Bert C. Roberts, Jr. (left) looks on.

conveniently available to investors through its toll-free hotline telephone number: (800) 289-9999.

A separate program allows investors to receive copies of all NASD arbitration decisions, including those involving employment, customer, and intra-industry disputes. This service can be reached by calling (301) 590-6707.

In addition, the NASD has joined the SEC and 10 self-regulatory organizations to produce a booklet to help educate the public about investing wisely and safely in the securities markets. *Invest Wisely: Advice From Your Securities Industry Regulators* provides advice on selecting a broker, managing an investment account, making investment decisions, protecting yourself from unlawful practices, and dealing with a problem in your securities account. The booklet is available to investors free from the NASD.

Proposal Would Allow Arbitrators to Make Disciplinary Referrals

To strengthen investor protection, the NASD Board has filed a proposal with the SEC reaffirming arbitrators' inherent authority to refer questionable practices discovered during the course of an arbitration for disciplinary investigation. Referrals under the proposed rule would be initiated at the conclusion of a procedure. This measure would provide the NASD's enforcement network with an additional source of information in detecting and disciplining for rule violations.

Moreover, the SEC has approved an NASD request for authority to summarily suspend or cancel the membership of any member firm or the registration of any person failing to pay an arbitration award when due—in effect, barring them from the securities business.

Procedures for Arbitrating Large, Complex Cases Proposed

The NASD Board approved a proposal to establish, on a pilot basis, procedures to streamline the processing of large and complex arbitration cases. Cases covered by the proposal include those involving claims of at least \$1 million, including punitive damages, or where all parties agree to the use of the procedures. The measure provides for an administrative conference conducted by Arbitration Department staff to reach agreement on the details of the arbitration, including alternative procedures for the appointment of arbitrators, with any unresolved issues handled by the arbitration panel at the preliminary hearing.

NASD Strengthens Regulations on CMO and Mutual Fund Advertising

The NASD is giving increased regulatory attention to products that have recently attracted strong individual investor interest. One such product, Collateralized Mortgage Obligations (CMOs), are now subject to extensive and detailed standards for advertising and other customer communications. An additional NASD CMO standard was recently added requiring members to offer customers educational material containing important information on this product. In addition, the NASD has proposed guidelines and filing requirements for advertisements and sales literature that include mutual fund rankings.

The NASD has also reminded members of their sales practice obligations to customers, particularly where the member is affiliated with a bank or participates in a bank networking arrangement, when offering mutual

fund investments as alternatives to depository products such as certificates of deposit (CDs). The NASD has informed members that their salespersons, particularly those that sell mutual funds on bank premises, must ensure that first-time securities investors understand the distinction between bank products and broker/dealer products.

Salespersons, in their written and oral communications, are to inform all customers that mutual funds, as well as CMOs and variable insurance products, are not the same as CDs; have different risk characteristics; are not deposits or obligations of a bank or guaranteed by a bank; and are not federally insured or otherwise guaranteed by the government. The NASD recommends that bank-affiliated member firms may want to obtain signed, written acknowledgments from their customers that they have received and understand these disclosures.

In addition, the NASD has reminded members that they must ensure that suitability requirements are adequately addressed; that they have comprehensive internal supervisory and compliance controls over sales practices; and that their advertising and marketing materials and programs are accurate and fair.

NASD Board Endorses Recommendations on Continuing Education

To increase the knowledge of securities industry personnel regarding regulatory requirements and new products, the NASD and five other securities industry self-regulatory organizations agreed to develop a single continuing education program for all registered representatives and principals. A key recommendation of these SROs was to form

a Securities Industry Task Force on Continuing Education. Comprised of industry professionals, the Task Force produced a report with recommendations for the structure of the program.

The NASD has endorsed the *Report and Recommendations of the Securities Industry Task Force on Continuing Education*. The Task Force recommends a two-tier program: a regulatory element administered by the self-regulatory organizations consisting of broadly applicable information relating to compliance, regulatory, ethical, and general sales-practice standards; and a firm element consisting of specific job-function and product-related material administered by each member firm.

The Task Force's report also calls for the establishment of a permanent Industry/Regulatory Council to oversee the continuing education effort, to detail the program's specifications, to work with the SROs to enact enabling rules and to assure a funding mechanism, and to develop an implementation schedule. The Council will meet throughout 1994 to accomplish these goals with implementation of the program to begin in 1995.

NASD Publishes *Sanction Guidelines to Increase Regulatory Awareness*

To increase the awareness of member firms and registered representatives of the typical securities industry rule violations and corresponding disciplinary sanctions, the NASD widely disseminated a new publication, *NASD Sanction Guidelines*. It is a comprehensive package on violations and their respective sanctions. The guidelines provide a reference point, rather than prescribing fixed sanctions, to enable

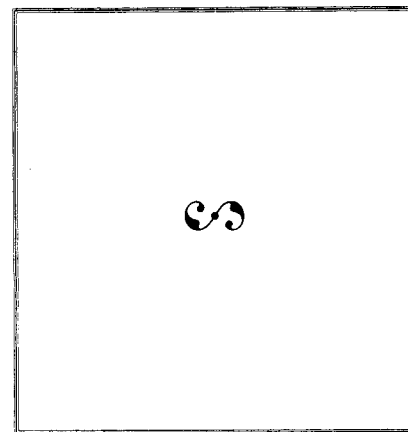
the disciplinary committees of the NASD to achieve greater consistency, uniformity, and fairness when imposing sanctions.

NASD Participates in Penny-Stock Sweep

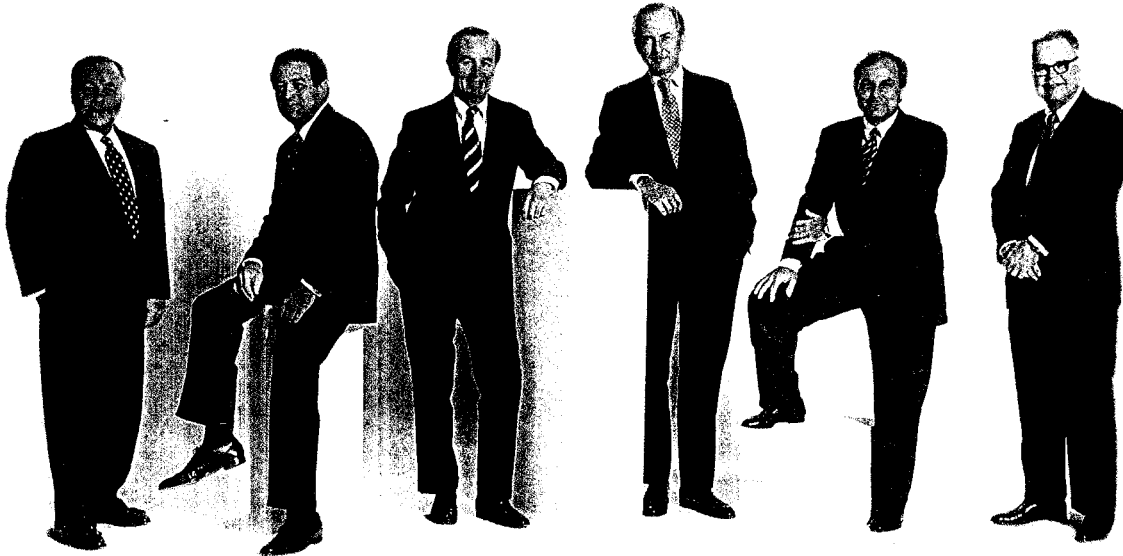
The NASD was a central participant with the SEC, the NYSE, and 40 state securities commissions working through the North American Securities Administrators Association in a nationwide examination sweep. Over 125 on-site inspections were conducted by examiners across the country during 1993 to determine broker/dealer compliance with recently adopted SEC Penny Stock Rules.

The disclosure and recordkeeping requirements of these rules provide important investor protection by, among other things, requiring that broker/dealers in penny stocks inform investors about the risks and costs of buying and selling penny stocks, characteristics of the penny-stock market, bid and ask prices for penny stocks, and amounts of compensation received by the firm and the sales representative. They must also provide a monthly statement that indicates disclosure of market value.

The successful completion of the sweep will culminate in a report by the SEC to be released in 1994.



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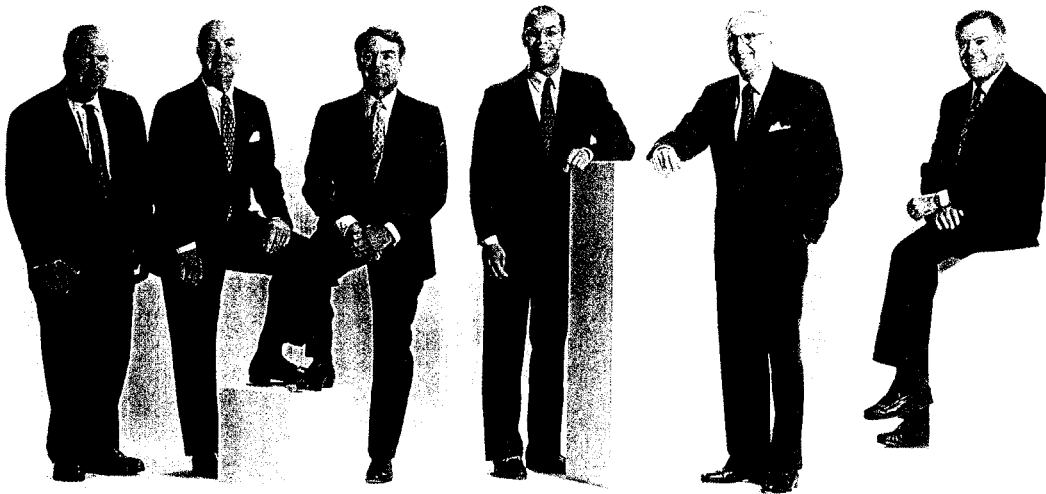
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James M. McMullan, William Blair & Company, Chicago, Illinois

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Not present for photo:

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 Stephen Sneeringer
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 Sheldon M. Fechter
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 Norman H. Pessin
 Glenn R. Oxner
 Jerry R. Roberts
 Richard C. Romano
 Patrick C. Ryan
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 L. Gene Tanner
 John B. Weingart
 Kenneth J. Wessels

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Chairman
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 Sorrell Mathes
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 H. Nicolaas Millward
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 Sabin C. Streeter
 Leopold Swergold
 Bruce Tullo

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 Philip S. Cottone
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 Bruce S. Fenton
 E. Davisson Hardman, Jr.
 Kye Hellmers
 Linda M. McKenzie
 J. Davenport Mosby
 James C. Redinger
 John S. Simmers
 Robert A. Stanger

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 Bo Flanders
 Peter Karches
 Robert E. Maina
 David Master
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 Mitch Merin
 Anthony Petrelli
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 Zack Snow

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 Jack LaPorte
 William J. Lippman
 Stephen W. O'Neil
 James B. Otness
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 John W. Rogers, Jr.*
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 Jonathan Simon
 Madelon DeVoe Talley*

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 Catherine S. Kopley
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 Leopold E. Guzman
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Rochelle Lamm Wallach

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P. Michael Brumm
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L. Kendall Palmer
Hedi Reynolds
Murray H. Sandler
Richard Sorrentino
Herman Striefler

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Kenneth B. Orenbach
Robert L. Padala
Patrick C. Ryan
Thomas Sanders
Richard A. Sorrentino
Louis B. Todd

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Charles E. Jones, Jr.
John W. Lavery
Richard F. Lynch
Jeffrey Lyons
Jerome S. Markowitz
Russell J. Page
Lynn P. Reitnouer
William B. Summers, Jr.

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Chairman
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Ian B. Davidson*
William G. Papesh
William H. Richardson*
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Thomas J. Tagliamonte
John B. Weingart
Madeline A. Weinstein

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David M. DiPietro

William B. Lynn
Vicki S. Miller
Thomas K. Reed, Jr.
Richard C. Romano
Kaye Simmons
Victor R. Wright

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Chairman
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Sheldon M. Fechter
Peter K. Loeb
Christopher J. Murphy, III
Norman H. Pessin
David J. Powell*
William R. Thomas
Jerry L. Williams

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Ian B. Davidson*
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Richard G. McDermott, Jr.*
William R. Rothe*
John E. Schmidt*
A.A. Sommer, Jr.*

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Chairman
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John Cirrito
Peter D'Angelo
Dennis Donnelly
Alfred Golden
George Hoffman
Edward H. Jones
George J. Minnig
George E. Montes

Rochelle Pullman
Vincent M. Purpura
L. Gene Tanner
Arthur Thomas
Kenneth Wagner
William Winter

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Chairman
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F. Daniel Bell, III
Richard J. DeAgazio*
F. Lee Liebolt, Jr.
Jack D. Mackey
A. Edward Moulin
William G. Papesh
Michael Unger
Martin S. Weber
Jerry L. Williams
John R. Wurth

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Chairman
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Antonio Cecin
Joseph Della Rosa
Paul L. Hennessey
George K. Jennison
Mat M. Johnson
Jerry Logan
Richard Lynch
Dennis Marino
Robert T. Mikkelsen, Jr.
Robert Morrison
Hugh J. Quigley
Murray H. Sandler
Thomas Terry

* *Member, NASD Board of
Governors*

District Committees

District 1

Northern California (the counties of Monterey, San Benito, Fresno, and Inyo, and the remainder of the state north or west of such counties), northern Nevada (the counties of Esmeralda and Nye, and the remainder of the state north or west of such counties), and Hawaii; 281 members, 3,156 branches

Steven N. Machtinger,
Chairman

Loren L. Obley,
Vice Chairman
Stephen R. Adams
Neil J. Hennessy
Rupert H. Johnson, Jr.
John F. Luikart
George A. Montes
Thomas J. O'Connell
Leonard Rossen

District 2

Southern California (that part of the state south or east of the counties of Monterey, San Benito, Fresno, and Inyo) and southern Nevada (that part of the state south or east of the counties of Esmeralda and Nye); 455 members, 3,879 branches

George H. Casey,
Chairman
Steven R. Fletcher,
Vice Chairman
Paul Arentsen
Stephen Y. Ascher
Jerry M. Gluck
Benjamin F. Hammon
Barbara A. Kelley

J. Terry Maxwell
Alfred E. Monahan
Charles A. Partain
Joan B. Seidel
Kaye A. Woltman

District 3

Alaska, Arizona, Colorado, Idaho, Montana, New Mexico, Oregon, Utah, Washington, and Wyoming; 341 members, 5,291 branches

Martin O. Nelson, Jr.,
Chairman

J. Wendell Garrett,
Vice Chairman
Vincent J. Asaro
Marilyn M. Canale
James C. Cohig
Michael Forbes
Oliver W. Hickel
Robert V. McCullough
Burton F. Mugavero
George N. Raines, Jr.
Richard A. Roysse
Daren J. Shaw

District 4

Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota; 275 members, 3,949 branches

Mary Alice Brophy,
Chairman
Anthony L. Guerrero,
Vice Chairman
John K. Boyd, III
Carol S. Bunch
Samuel M. Davidson
Thomas J. Davidson
Robert H. Gales
Eric M. Hender
Kerwin P. Ness
Edward L. Poth
Steven B. Vecchio
Donald E. Walter

District 5

Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Oklahoma, and Tennessee; 238 members, 3,139 branches

Louis B. Todd, Jr.,
Chairman

Robert W. McInnes,
Co-Vice Chairman
Douglas W. McQueen,
Co-Vice Chairman
Gerald B. Brenzel
Lester Adron Crews
Robert L. Lanford
V. Hugo Marx, III
Colin A.P. McNease
Allen B. Morgan
Miguel Uria

District 6

Texas; 322 members, 2,190 branches

Edward R. Anderson,
Chairman
Joan L. Lavell,
Vice Chairman
Henry H. Clines
William D. Felder, IV
Lewis B. Fisher, Jr.
Ira H. Green
William J. Mosley
Michael J.C. Roth
David Standridge

District 7

Florida, Georgia, North Carolina, South Carolina, Puerto Rico, the Canal Zone, and the Virgin Islands; 424 members, 5,722 branches

Grady G. Thomas, Jr.,
Chairman
Mary Allison Mullis,
Vice Chairman
W. Dennis Ferguson
Jose R. Fernandez
Howard Guggenheim
Frank D. Inman
William G. Jahnes
Robert Harris Kremer
Bert C. Madden
Roy H. Seay, Jr.
Stuart F. Vaughn
E. James Wisner

District 8

Illinois, Indiana, Michigan, Ohio, Wisconsin, and part of upstate New York (the counties of Monroe, Livingston, and Steuben; and the remainder of the state west of such counties);

728 members, 8,558 branches

William A. Rogers,
Chairman
Richard M. Wachterman,
Vice Chairman
Timothy A. Carr
Lewis H. Echlin, III
Myles M. Gordon
Timothy P. Henahan
Wayne F. Holly
Anthony J. Hyatt
Paul E. Murin
J. Will Paull
Gerald E. Pelzer
Larry E. Peters
William A. Rogers
Ronald R. Rzonca
David H. Slavik
George P. Steele

District 9

Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia, and southern New Jersey (the counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Ocean, and Salem); 406 members, 4,397 branches

James W. Brinkley,
Chairman
Samuel D. Ewing, Jr.,
Vice Chairman
Frederick J. Arnold
Michael D. Botte
John P. Hughes
Michael D. Kinsella
Allen B. Lang
Robert B. Leahy
Jay W. Lewis
Louis K. Palmer, Jr.
H. Rodney Scott
Gilbert S. Simons

District 10

The five boroughs of New York City and the adjacent counties in New York (the counties of Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester) and northern New Jersey (the state of New Jersey, except for the

counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Ocean, and Salem); 1,349 members, 3,237 branches

Dennis C. Hensley,
Chairman
Alan Maxwell,
Vice Chairman
Howard M. Brenner
Richard F. Brueckner
Vincent Buchanan
Alan L. Davidson
John C. Giesea
Richard D. Griffiths
Richard Harriton
Peter T. Kujawski
Dennis Marino
H. Nicolass Millward
Edward J. Rappa
Hans L. Reich
Howard M. Schneider
Stephen F. Schwartz
Herbert Schweitzer
Richard A. Topp

District 11

Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont, and New York (except for the counties of Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester; the counties of Monroe, Livingston, and Steuben; the remainder of the state west of such counties; and the five boroughs of New York City); 477 members, 2,905 branches

Todd A. Robinson,
Chairman
Paul G. Cuomo,
Vice Chairman
Harold J. Dixon
Dana C. Djerf
James M. Dolan
Arthur F. Grant
Kristin L. Hunnibell
Grant Kurtz
Charles E. Spooner, Jr.
James F. Twadell
Robert H. Watts

Corporate Officers

National Association of Securities Dealers, Inc.

Joseph R. Hardiman
President and Chief
Executive Officer

Richard G. Ketchum
Chief Operating Officer and
Executive Vice President
Corporate Services

C. Richard Justice
Chief Technology Officer
and Executive Vice
President
Technology Services

James P. O'Donnell
Executive Vice President
Member Services

John E. Pinto
Executive Vice President
Regulation

James M. Cangiano
Senior Vice President
Market Surveillance

Gerard F. Foley
Senior Vice President
Member Services

Douglas Henderson
Senior Vice President
Director, District 10

Wendell Jones
Senior Vice President
Technology Services

Douglas F. Parrillo
Senior Vice President
Corporate Communications

James F. Peck
Senior Vice President
Human Resources and
Service Quality

Alden S. Adkins
Vice President
Planning

James R. Allen
Vice President and
Treasurer
Finance

T. Grant Callery
Vice President and
Chief Legal Officer

Thomas R. Cassella
Vice President
Compliance

Seth Chamberlain
Vice President
Software Engineering

E. Craig Dearborn
Vice President
Director, District 8

Gene L. Finn
Vice President and Chief
Economist

Frank J. Formica
Vice President
Congressional and State
Liaison

R. Clark Hooper
Vice President
Advertising/Investment
Companies

Samuel E. Laughery
Vice President
Production Services

Deborah Masucci
Vice President
Arbitration

Frank J. McAuliffe
Vice President
Registration

John P. Nocella
Vice President
Director, District 9

Willis H. Riccio
Vice President
Director, District 11

Jack Rosenfield
Vice President
Director, District 4

J. Jack Samarias
Vice President
Information Systems

William R. Schief
Vice President
Enforcement/Regional
Attorneys

Catherine Tighe
Vice President
Administrative Services

Joan C. Conley
Corporate Secretary

The Nasdaq Stock Market, Inc.

Joseph R. Hardiman
President and Chief
Executive Officer

Richard G. Ketchum
Executive Vice President
Corporate Services

C. Richard Justice
Executive Vice President
Technology Services

John T. Wall
Executive Vice President
Market Services

S. William Broka
Senior Vice President
Trading & Market Services

Alberto C. Casanova
Senior Vice President
Planning & Analysis

John M. Hickey
Senior Vice President
Production Services

L. Brian Holland
Senior Vice President
Issuer Services

Douglas F. Parrillo
Senior Vice President
Corporate Communications

Glen R. Shipway
Senior Vice President
Trading Services

Charles Balfour
Managing Director
International Services

Andrew M. Blum
Managing Director
Member Firms and
Institutional Relations

Robert N. Riess
Managing Director
Nasdaq International
Market Initiatives

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Vice President, General
Counsel and Secretary

James R. Allen
Vice President and
Treasurer
Finance

Thomas L. Apple
Vice President
Issuer Services

Richard H. Bayha
Vice President
Migration Software
Development

Donald H. Bosis
Vice President
Issuer Services

Glenn C. Faulkner
Vice President
Issuer Services

Hilary Reilly
Vice President
Data Administration

William Wicek
Vice President
Computer Operations

Greg P. Cofoid
Assistant Treasurer

*Corporate Officers
March 21, 1994*

1993 Consolidated Financial Statements

Management Report on Financial Operations

Record revenues of \$332.1 million in 1993 increased 25.7 percent from 1992's \$264.3 million. The \$67.8 million revenue gain was attributed to a number of revenue sources benefiting from the strong performance, particularly in terms of volume, of The Nasdaq Stock Market in 1993. These included listing fees, market data fees, and charges for use of execution and settlement system facilities. The record dollar volume of initial and secondary public offerings spurred by favorable market conditions and growth in securities industry registration and qualification activities also contributed to the higher revenues. The exceptional results led to decisions by the Nasdaq Board of Directors to waive charging fees of \$3.5 million for execution system use for the last two months of 1993 and by the NASD Board of Governors to increase the gross income assessment discount from 59 percent in 1992 to 67 percent in 1993, thereby saving members \$6.4 million. In addition, the Nasdaq Board agreed to absorb the cost of installing the new enterprise-wide network on behalf of subscribers over the next two years at an estimated cost of \$5.8 million.

The largest revenue upturn occurred with Nasdaq issuer fees, which rose \$26.3 million or nearly 60 percent. This resulted from new Nasdaq listings at the second highest level in history, including achievement of an all-time high dollar volume of initial public offerings listing on Nasdaq of \$16.4 billion, which was 46 percent higher than the year earlier; the introduction of a fee for the listing of additional shares that generated \$11.8 million in new revenues; and the effects of a higher fee schedule and growth in market capitalization applicable to annual listing fees. Market information and transaction service fees increased \$17.2 million or nearly 18 percent. Nasdaq's record trading volume of 66.5 billion shares surpassed that of 1992 by over 37 percent, and share volume through Nasdaq's execution systems rose 36 percent to account for over 13 percent of total Nasdaq volume. The number of market information terminals, as represented by retail representatives and dealers/institutions, rose sharply by 13 per-

cent and 38 percent, respectively. Fees for review of underwriting arrangements jumped \$7.3 million or over 46 percent as the dollar volume of public equity and debt offerings spiraled by \$123 billion or 59 percent to a record \$330.8 billion. Regulatory service fees and fines escalated by \$8.6 million, attributable to two significant disciplinary fines totaling \$6 million and higher regulatory fees resulting from the record market volume. Registration and examination fees climbed \$5.6 million or 16 percent, reflecting an upturn in qualification examination enrollments of over 15 percent and an increase in registration and transfer activities as overall securities industry registered representative counts reached a record level of 463,836 or 9 percent higher than 1992.

Expenses in 1993 nearly matched the rate of increase in revenue, rising 23 percent or \$51.6 million over 1992. The cost growth was driven primarily by increased expenditures related to the systems technology migration, expanded media advertising and other programs designed to increase the recognition and image of The Nasdaq Stock Market and its listed companies, charges related to installation of the new enterprise-wide network and staff growth and compensation and benefit changes. 1993 was the second full year of the multi-year technology migration program, designed to establish a technical architecture and system development environment aimed at materially improving the responsiveness and flexibility of the multitude of market and corporate systems for the benefit of users.

In 1993, the NASD incurred \$19.9 million for this program compared to \$7.8 million in 1992. During 1993 key analyses and decisions were reached regarding strategic hardware, database management, and system development platforms and tools and the enterprise-wide network provider. Considerable progress was also made in business analysis and design for the new Integrated Quotation Management System (IQMS), the Integrated Registration and Testing Service (IRTS), and in the system development environment. Spending for media advertising and other marketing and analytical

programs on behalf of Nasdaq issuers was increased as part of an overall program to increase the retention and acquisition of Nasdaq-listed companies by increasing the demand for stock in these companies. Non-migration staff compensation and benefits climbed \$18 million or 17 percent as employee levels rose an average of 5 percent. Merit and promotional increases, higher targeted and discretionary incentive pay, and savings plan matching contributions accounted for the remaining increase. The majority of staff growth occurred in the technology services group, with the balance primarily represented by staff additions in the member and market services business lines. Equipment maintenance and data communications increased by \$10.4 million, of which approximately \$6 million relates to recognition of the cost of installing the new enterprise-wide network for Nasdaq subscribers. Other costs in this category escalated as a result of an increase in the installed base of hardware and software throughout the organization to accommodate growth in system applications and capacity needs, associated staff growth and greater populations of dealer and institutional subscribers to Nasdaq market data.

Consolidated income for NASD and its wholly-owned subsidiaries of \$57.1 million in 1993, before provision for income taxes, was \$16.3 million or 40 percent higher than 1992. Net income of \$48.6 million was \$13.5 million higher than the ear-

lier year. In July 1993 two wholly-owned subsidiaries, Nasdaq, Inc., formerly a tax-exempt organization, and NASD Market Services, Inc., a taxable organization, were merged into the renamed taxable entity, The Nasdaq Stock Market, Inc. In addition, the Nasdaq issuer group was transferred from NASD to this entity. This action was premised upon the increased direction of the organization toward greater integration of the two corporations' technology and services as a unified market. Also in 1993 two other wholly-owned subsidiaries were formed. Securities Dealers Insurance Company, Ltd., a Bermuda company, was formed to reinsure risks associated with the fidelity bond program sponsored by NASD on behalf of its members. The Nasdaq Stock Market Foundation, Inc., was established to advance educational purposes for the study of business, economics, and finance. The operations of these subsidiaries were immaterial in 1993.

Working capital of \$210.7 million climbed sharply from \$172.2 million at the end of 1992. This heightened liquidity will be instrumental in funding significant capital requirements associated with the technology migration as well as other resource needs to fulfill NASD's mission to facilitate capital formation by developing, operating, and regulating the most liquid, efficient, and fair securities markets for the ultimate benefit and protection of the investor.

Management Report on Financial Reporting Responsibility

Management is responsible for the preparation, integrity, and objectivity of the consolidated financial statements of the National Association of Securities Dealers, Inc. and its subsidiaries. This responsibility includes the selection of accounting procedures and practices, which are in accordance with generally accepted accounting principles. The consolidated financial statements have been prepared in conformity with these procedures and practices, applied on a consistent basis. These consolidated financial statements reflect informed judgments and estimates, which management believes to be reasonable, in the determination of certain data used in the accounting and reporting process.

The NASD maintains an effective system of

internal accounting controls that is periodically modified and improved to correspond with changes in NASD's operations. This system of internal controls is designed to provide assurance that the assets of the NASD are safeguarded against loss from unauthorized use or disposition and that the books and records, from which the consolidated financial statements were prepared, properly reflect the financial transactions of NASD. Important elements of the internal control system include capital and operating budgets, which are subjected to continuous review throughout the year; an organizational structure providing segregation of responsibilities; established policies and procedures; careful selection and training of qualified personnel; and a program of periodic internal audits developed

and carried out by NASD's independent auditors. It should be recognized that even an effective internal control system, no matter how well designed, can provide only reasonable assurance with respect to the preparation of reliable financial statements; further, because of changes in conditions, internal control system effectiveness may vary over time. It is management's opinion that the system of internal control as of December 31, 1993, is effective in providing reasonable assurance that the consolidated financial statements are free of material misstatement.

The Board of Governors establishes directives for its Audit and Finance Committees, which monitor the accounting and financial operations of NASD through the review and discussion of periodic financial plans and current operational results; proposed changes, if any, in significant accounting policies; reports prepared by the NASD's independent auditors covering the basis of their engagement and an annual review of their independence; and all other financial or accounting matters. The Audit and

the Finance Committees (with the exception of the NASD President) consist exclusively of external governors who have, in the opinion of the Board of Governors, no association or relationship that would interfere with the exercise of independent judgment as a committee member.

The NASD's independent auditors, Ernst & Young, have conducted an audit in accordance with generally accepted auditing standards of the consolidated financial statements of NASD for the years ended December 31, 1993, and 1992. Their audits included a review of internal accounting controls and appropriate tests of transactions to the extent they considered necessary to form an opinion on the fairness of the consolidated financial statements. Representatives of Ernst & Young have met with NASD management and with members of the Audit Committee of the Board of Governors with and without management present to discuss the results of their audits and other accounting, auditing, and financial matters.

Report of Independent Auditors

Board of Governors
National Association of Securities Dealers, Inc.

We have audited the accompanying consolidated balance sheets of the National Association of Securities Dealers, Inc., and subsidiaries as of December 31, 1993, and 1992, and the related consolidated statements of income and members' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the National Association of Securities Dealers, Inc., and subsidiaries at December 31, 1993, and 1992, and the consolidated results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 3 to the consolidated financial statements, effective January 1, 1993, the National Association of Securities Dealers, Inc., and subsidiaries changed their method of accounting for income taxes.

Ernst & Young

Washington, D.C.
February 25, 1994

Audited Consolidated Financial Statements

National Association of Securities Dealers, Inc.

Consolidated Balance Sheets

	December 31,	
	1993	1992
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 20,191	\$ 11,436
Investments, principally U.S. Government securities, at amortized cost (quoted market value \$258,243 and \$200,435 at December 31, 1993, and 1992, respectively)	250,404	194,165
Receivables and other current assets	26,046	20,830
Total current assets	<u>296,641</u>	<u>226,431</u>
Property and equipment:		
Land, buildings, and improvements	38,410	35,808
Data processing, subscriber equipment, and software	98,414	86,689
Furniture, equipment, and leasehold improvements	45,166	41,084
	<u>181,990</u>	<u>163,581</u>
Less accumulated depreciation and amortization	105,572	96,462
	<u>76,418</u>	<u>67,119</u>
Other assets	5,804	2,365
	<u>\$378,863</u>	<u>\$295,915</u>
Liabilities and members' equity		
Current liabilities:		
Accounts payable and accrued expenses	\$45,924	\$28,331
Deposits, refunds due, and deferred revenue	40,028	25,904
Total current liabilities	<u>85,952</u>	<u>54,235</u>
Accrued pension costs	12,255	11,504
Other liabilities	12,045	10,160
Total liabilities	<u>110,252</u>	<u>75,899</u>
Members' equity	<u>268,611</u>	<u>220,016</u>
	<u>\$378,863</u>	<u>\$295,915</u>

See accompanying notes.

National Association of Securities Dealers, Inc.

Consolidated Statements of Income and Members' Equity

	Years Ended December 31	
	1993	1992
	<i>(In Thousands)</i>	
Revenue		
Market information and transaction service fees	\$ 113,464	\$ 96,281
Nasdaq issuer fees	70,679	44,357
Registration and examination fees	40,400	34,770
Member assessments	37,453	37,202
Corporate finance fees	23,121	15,785
Interest and other	19,877	17,435
Regulatory service fees and fines	19,697	11,112
Arbitration fees	7,456	7,332
	332,147	264,274
Expenses		
Compensation	123,564	105,573
Professional and outside services	44,729	35,295
Depreciation and amortization	18,456	21,738
Office expense	18,725	18,611
Equipment maintenance and data communications	25,921	15,563
Travel and meetings	12,013	8,946
Publications, supplies, and postage	7,198	6,443
Other	4,503	3,510
	255,109	215,679
Systems Technology Migration expenses (Note 5)	19,926	7,797
	275,035	223,476
Income before provision for income taxes	57,112	40,798
Provision for income taxes	8,517	5,743
	48,595	35,055
Net income	48,595	35,055
Members' equity at beginning of year	220,016	184,961
Members' equity at end of year	\$ 268,611	\$ 220,016

See accompanying notes.

National Association of Securities Dealers, Inc.

Consolidated Statements of Cash Flows

Years Ended December 31

	1993	1992
	<i>(In Thousands)</i>	
Operating activities		
Cash received from fees and assessments	\$ 327,242	\$ 252,488
Interest received from investments	15,736	12,756
Cash paid for operating expenses	(245,974)	(200,595)
Net cash provided by operating activities	<u>97,004</u>	<u>64,649</u>
Investing activities		
Proceeds from redemptions of investments	33,400	40,750
Purchases of investments	(90,008)	(84,449)
Purchases of property and equipment	(31,641)	(20,117)
Net cash used in investing activities	<u>(88,249)</u>	<u>(63,816)</u>
Increase in cash and cash equivalents	8,755	833
Cash and cash equivalents at beginning of year	11,436	10,603
Cash and cash equivalents at end of year	<u>\$ 20,191</u>	<u>\$ 11,436</u>
Reconciliation of net income to net cash provided by operating activities		
Net income	\$ 48,595	\$ 35,055
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,211	21,924
Increase in deposits and deferred revenue	14,126	4,850
Increase in accounts payable and accrued expenses	16,748	2,326
Increase in other liabilities	5,726	2,923
Increase in receivables	(5,525)	(4,757)
Increase (decrease) in other assets	(3,440)	256
Other	1,563	2,072
Net cash provided by operating activities	<u>\$ 97,004</u>	<u>\$ 64,649</u>

See accompanying notes.

Notes to Consolidated Financial Statements

December 31, 1993 and 1992

1. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the National Association of Securities Dealers, Inc. (NASD) and its wholly owned subsidiaries, including The Nasdaq Stock Market, Inc. (Nasdaq), Nasdaq International, Ltd. (Nasdaq International), Securities Dealers Insurance Company, Ltd. (SDIC), and The Nasdaq Stock Market Educational Foundation, Inc. (Foundation) after elimination of all significant intercompany transactions.

NASD is a membership association established to regulate the Nasdaq and the over-the-counter securities markets. Nasdaq owns and operates the domestic and international electronic Nasdaq quote information system and provides national market facilities to assist NASD in carrying out its regulatory responsibilities and for the benefit of NASD members and investors in their pursuit of efficient execution of securities transactions. Nasdaq International promotes the Nasdaq market worldwide and coordinates regulatory matters within the European community. SDIC is a captive insurance company established to reinsure risks associated with the member fidelity bond program. The Foundation is a non-profit organization established and operated exclusively to support economic and financial education.

As an association established to regulate the Nasdaq and the over-the-counter securities markets, NASD's receivables are concentrated with firms in the broker/dealer industry.

Merger of Subsidiaries

Effective July 1, 1993, Nasdaq, Inc., formerly a tax-exempt organization, was merged with and into NASD Market Services, Inc., and renamed The Nasdaq Stock Market, Inc.

Cash and Cash Equivalents

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

Property and Equipment, Depreciation and Amortization

Property and equipment are recorded at cost. Equipment acquired under capital leases is recorded at the lower of fair market value or the present value of future lease payments. Depreciation and amortization are provided on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the period of the applicable lease.

Software Costs

Significant purchased application software and operational software that is an integral part of computer hardware are capitalized and amortized on the straight-line method over their estimated useful lives. All other software development costs are charged to expense as incurred.

Income Taxes

NASD is a tax-exempt organization under the Internal Revenue Code Section 501(c)(6). The subsidiaries of NASD, with the exception of the Foundation, are taxable entities. The provision for income taxes includes amounts currently payable and amounts deferred to or from other years as a result of differences in the timing of income or expenses for financial reporting and tax purposes.

Reclassifications

Certain 1992 amounts have been reclassified to conform with the 1993 presentation.

Notes to Consolidated Financial Statements

2. Leases

NASD leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was \$8,952,000 in 1993 and \$9,945,000 in 1992. Future minimum lease payments under noncancellable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 1993:

Year ending December 31:	Operating Leases <i>(In Thousands)</i>
1994	\$ 9,652
1995	8,613
1996	7,158
1997	6,189
1998	5,362
Remaining years	<u>19,253</u>
	<u>\$56,227</u>

3. Income Taxes

Effective January 1, 1993, NASD adopted Statement of Financial Accounting Standards No. 109 (SFAS 109) "Accounting for Income Taxes." The impact of adopting SFAS 109 was immaterial to the consolidated results of operations.

The income tax provision includes the following amounts:

	1993	1992
	<i>(In Thousands)</i>	
Current liability:		
Federal income taxes	\$8,920	\$4,323
State income taxes	3,202	1,893
Total current liability	<u>12,122</u>	<u>6,216</u>
Deferred benefit:		
Federal income taxes	(2,704)	(447)
State income taxes	(901)	(26)
Total deferred benefit	<u>(3,605)</u>	<u>(473)</u>
Total provision	<u>\$8,517</u>	<u>\$5,743</u>
Income taxes paid during the year	<u>\$12,802</u>	<u>\$6,200</u>

National Association of Securities Dealers, Inc.

Notes to Consolidated Financial Statements

3. Income Taxes (continued)

The effective tax rates of 15 percent and 14 percent for 1993 and 1992, respectively, are lower than the statutory federal and state rate since the NASD is a tax-exempt entity.

At December 31, 1993, a net deferred asset of \$3,628,000, included in "Other assets" on the balance sheet, consisted of the following (in thousands):

Deferred tax assets:	
Network installation	\$2,960
Deferred entry fees	411
Compensation and benefits	787
Other	110
Total deferred tax assets	<u>4,268</u>
Deferred tax liability:	
Depreciation	640
Net deferred tax asset	<u>\$3,628</u>

4. Retirement Benefits

NASD maintains a noncontributory, defined-benefit pension plan, along with other arrangements, for the benefit of eligible employees. The benefits are primarily based on years of service and the employee's average salary during the highest 60 consecutive months of employment.

NASD's funding policy is to contribute annually the minimum requirement under ERISA, subject to the full funding limitation imposed by the Internal Revenue Service. Contributions of \$4,928,000 and \$581,000 were required for 1993 and 1992, respectively. Management has indicated that the 1993 contribution will be fully funded by the end of the third quarter of 1994.

The following table sets forth the plan's net pension cost for the years ended December 31, 1993 and 1992:

	1993	1992
	<i>(In Thousands)</i>	
Service cost	\$ 4,528	\$ 3,457
Interest cost	3,816	2,970
Actual return on plan assets	(2,285)	(1,249)
Deferral of net plan asset gains and amortization	(379)	(1,670)
Net pension cost	<u>\$ 5,680</u>	<u>\$ 3,508</u>

Notes to Consolidated Financial Statements

4. Retirement Benefits (continued)

The following table sets forth the plan's funded status and amounts recognized in the financial statements at December 31, 1993 and 1992:

	1993	1992
	<i>(In Thousands)</i>	
Actuarial present value of benefit obligations		
Accumulated benefit obligation, including vested benefits of \$24,040 in 1993 and \$18,962 in 1992	\$30,143	\$23,690
Projected benefit obligation	\$56,464	\$41,504
Less plan assets at fair value, principally common stocks, U.S. government and agency bonds	31,696	30,601
	<u>24,768</u>	<u>10,903</u>
Unrecognized net asset	2,739	2,862
Unrecognized net loss	(5,889)	0
Prior service cost	(4,871)	(2,090)
Accrued pension cost	16,747	11,675
Less current portion	4,492	171
Long-term accrued pension cost	<u>\$12,255</u>	<u>\$11,504</u>

The weighted-average discount rate and rate of increase in future salary levels used in determining the actuarial present value of the projected benefit obligation were 7.75 percent and 6 percent, respectively, at December 31, 1993, and 8.25 percent and 6 percent, respectively, at December 31, 1992. The expected long-term rate of return on plan assets was 10 percent for 1993 and 1992. The unrecognized net asset is being recognized over 20 years, the average remaining service period of employees expected to receive benefits under the plan.

NASD also maintains a savings plan for employees. Eligibility for the savings plan is based upon length of service. Participation in the savings plan is voluntary. NASD makes a matching contribution of one-half of the first 6 percent of salaries contributed by covered employees. Savings plan expense for the years 1993 and 1992 was \$3,772,000 and \$1,643,000, respectively. The 1993 expense included a discretionary match authorized by the Board of Governors totaling \$1,860,000. The discretionary match was paid in full on January 28, 1994.

5. Systems Technology Migration

NASD has initiated a multi-year technology migration program to establish a technical architecture and system development environment aimed at materially improving the responsiveness, flexibility, and integration of its market and corporate systems for the ultimate benefit of users. In 1993, NASD entered into an agreement with a major telecommunications company for a new enterprise-wide network, selected new hardware platforms for the market and corporate systems, and chose a database management system and new software development tools. NASD also selected new application software for the Financial and Human Resource Information Systems. In 1993, NASD incurred and expensed approximately \$19,900,000 for this program compared to approximately \$7,800,000 in 1992, the initial year of the program. In 1993, capital purchases for this program totaled \$9,200,000. Additionally, the NASD was committed to various vendors for contracted amounts totaling \$26,100,000 at December 31, 1993.

6. Commitments and Contingencies

There are certain legal proceedings pending against NASD and its subsidiaries. Management believes, based upon the opinion of counsel, that any liabilities arising from these proceedings will not have a material effect on the operations of NASD and its subsidiaries.

In 1993, NASD entered into an agreement with a major telecommunications company to provide the Nasdaq network communication links to the broker/dealer industry. This contract has a minimum guarantee of \$30,000,000, which is expected to be incurred by December 1996.

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