

National Association of Securities Dealers, Inc.

“If we want to continue
to be a **leader** in
market innovation and
in self-regulation, *we*
must aggressively seek
out **challenges** and
turn them into
opportunities.”

National Association of Securities Dealers, Inc.

“For Nasdaq, a fair and
orderly **market** is not
a static market.

Every **improvement**
is merely a step
toward the next
improvement.”

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NASD
Mission

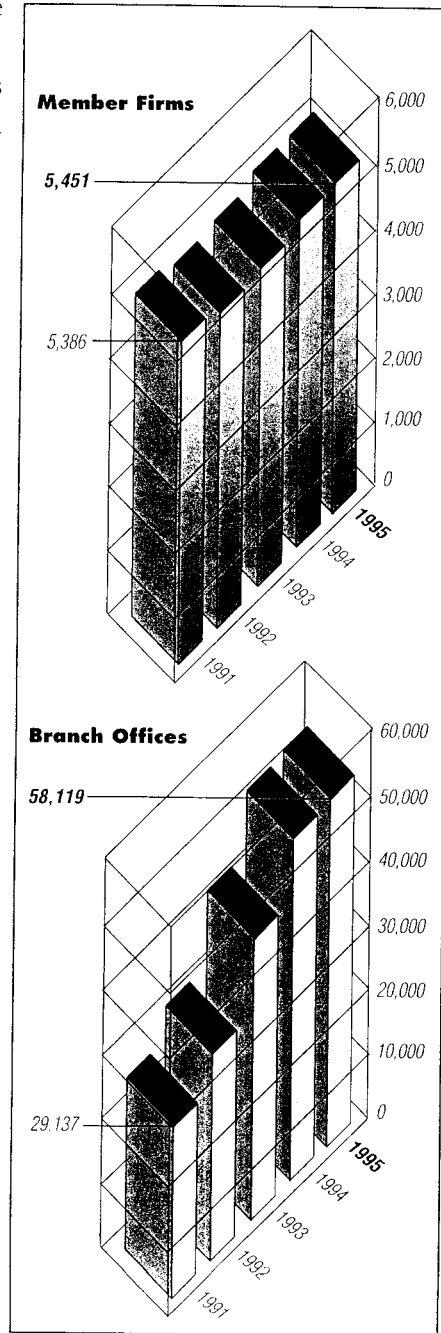
Our mission is to facilitate capital formation in the public and private sectors by developing, operating, and regulating the most liquid, efficient, and fair securities markets for the ultimate benefit and protection of the investor.

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 traded in it. The NASD, which operates subject to Securities and Exchange Commission (SEC) oversight, is the largest self-regulatory organization (SRO) 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 educa-

tion; 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 Rule-making Board, and NASD rules and regulations; continuous automated surveillance of the markets

operated by its subsidiary; review of members' advertising and sales literature; 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 and mediation, to enable investors and members to resolve disputes, and a telephone number inquiry service (800-289-9999) to provide investors with background information on members and their registered representatives.



1995 Statistical Highlights

Membership

5,451 Member firms
 58,119 Branch offices
 505,647 Registered representatives

Compliance

2,384 Main and branch office examinations conducted
 4,580 Customer complaints resolved

Disciplinary Actions

1,075 Formal actions filed
 313 Disciplinary decisions rendered
 201 Offers of Settlement accepted
 440 Acceptance, Waiver, and Consent proceedings resolved
 8 Firms expelled from membership
 412 Individuals barred from the industry
 9 Firms suspended from membership
 196 Individuals suspended

Automated Market Surveillance

7,859 Price and volume alerts
 221 Formal investigations conducted
 113 Cases referred to the SEC

Arbitration

6,055 Cases filed
 5,680 Cases closed
 3,834 Disputes resolved between parties without arbitration
 323 Industry cases arbitrated
 1,523 Customer cases arbitrated
 788 Cases decided in favor of customers

Qualifications

241,051 Registered representative and principal tests administered

Continuing Education

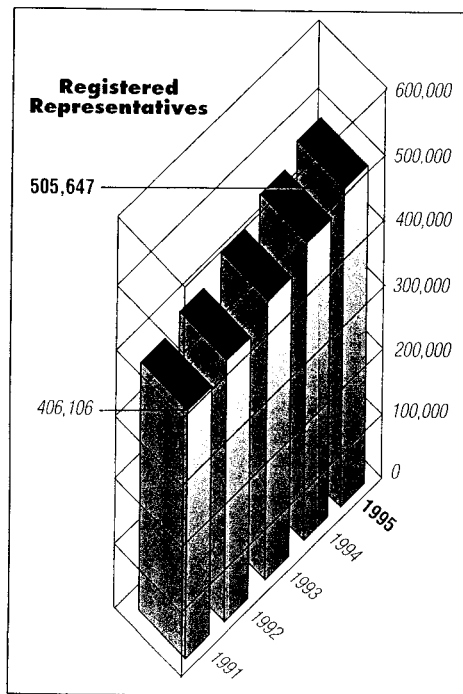
27,968 Training sessions delivered (beginning July 2, 1995)

Advertising

47,665 Items reviewed from filings, spot checks, and investigations

Corporate Financing

2,285 Underwriting arrangements reviewed
 \$277.7 Billion of public offerings reviewed



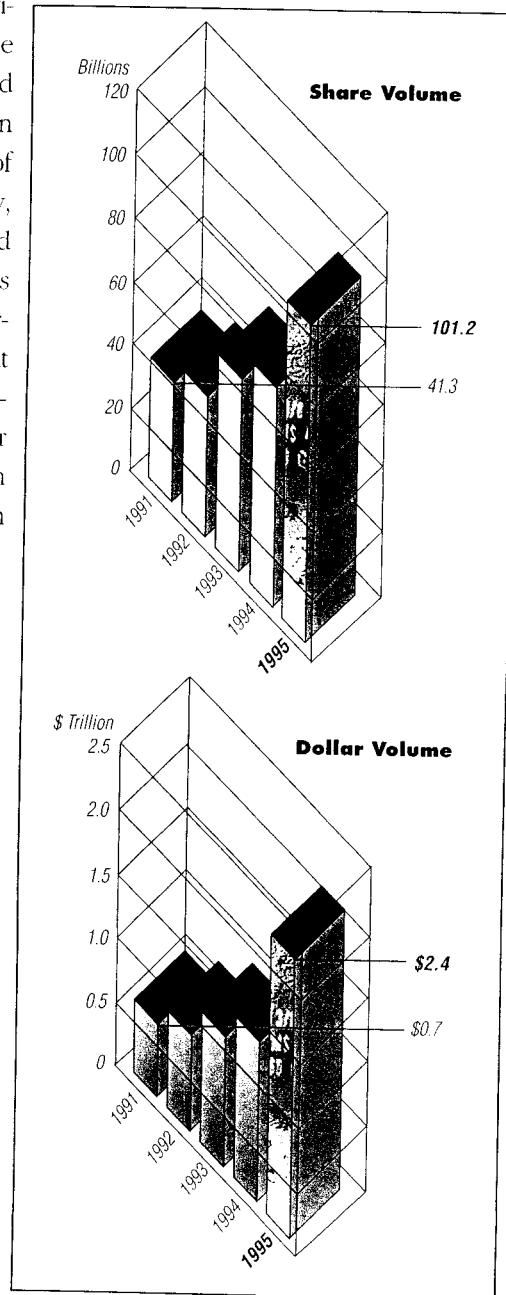
Information reflects data as of December 31, 1995.

The Nasdaq Stock Market, Inc.

The Nasdaq-Stock MarketSM, 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 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 traditional 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 3,700 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, Nasdaq

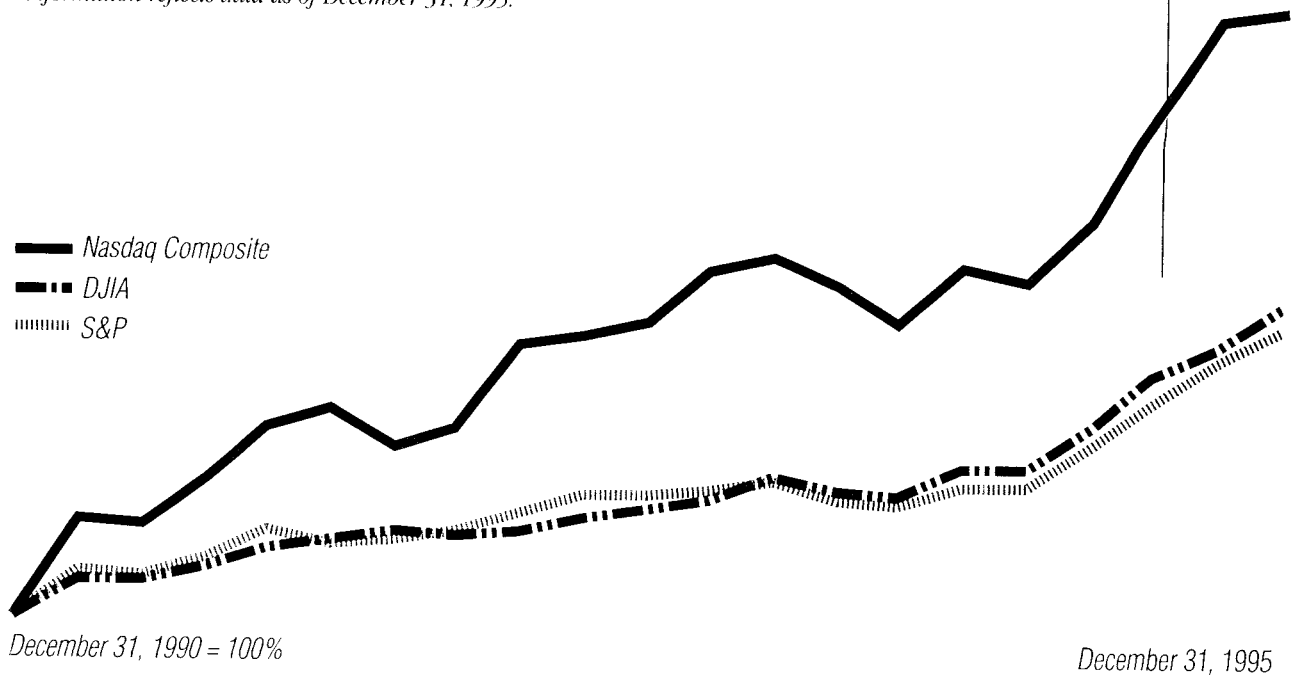
today accounts for more than one-half of all equity shares traded in our nation each day and is the second largest stock market in dollar value of trading in the world. More companies—domestic and foreign—list their securities on Nasdaq than on all other U.S. stock markets combined. Nasdaq continues to be the fastest growing securities market in the country.



1995 Statistical Highlights

<i>Annual share volume</i>	<i>101.2 billion</i>
<i>Annual dollar volume</i>	<i>\$2.4 trillion</i>
<i>Average daily share volume</i>	<i>401.4 million</i>
<i>Average daily dollar volume</i>	<i>\$9.5 billion</i>
<i>Market capitalization</i>	<i>\$1.16 trillion</i>
<i>Companies listed</i>	<i>5,122</i>
<i>Issues listed</i>	<i>5,955</i>
<i>Market makers</i>	<i>512</i>
<i>Foreign securities and American Depositary Receipts (ADRs)</i>	<i>395</i>
<i>International share volume (foreigns and ADRs)</i>	<i>6.6 billion</i>
<i>International dollar volume (foreigns and ADRs)</i>	<i>\$100.4 billion</i>
<i>Number of initial public offerings</i>	<i>476</i>
<i>Value of initial public offerings</i>	<i>\$16.7 billion</i>
<i>Number of secondary public offerings</i>	<i>375</i>
<i>Value of secondary public offerings</i>	<i>\$25.0 billion</i>

Information reflects data as of December 31, 1995.



1995 Statistical Highlights

Chairman's & President's Letter

For the NASD, 1995 was a year in which sweeping structural changes were set in motion.

Since its very beginning, the NASD has embraced change, finding innovative ways to address marketplace trends and emerging industry issues. But the change initiated in 1995 is unprecedented for our organization. It offers a new model for a self-regulatory organization. It sets new standards for public representation in regulatory and market policy. And it will provide significant new price improvement opportunities for investors buying and selling securities on The Nasdaq Stock Market.

Policy decisions made by the NASD Board of Governors in 1995 will have a profound impact on the conduct of self-regulation of the securities industry, the structure of The Nasdaq Stock Market, and the extent of public representation in policy decisions affecting both.

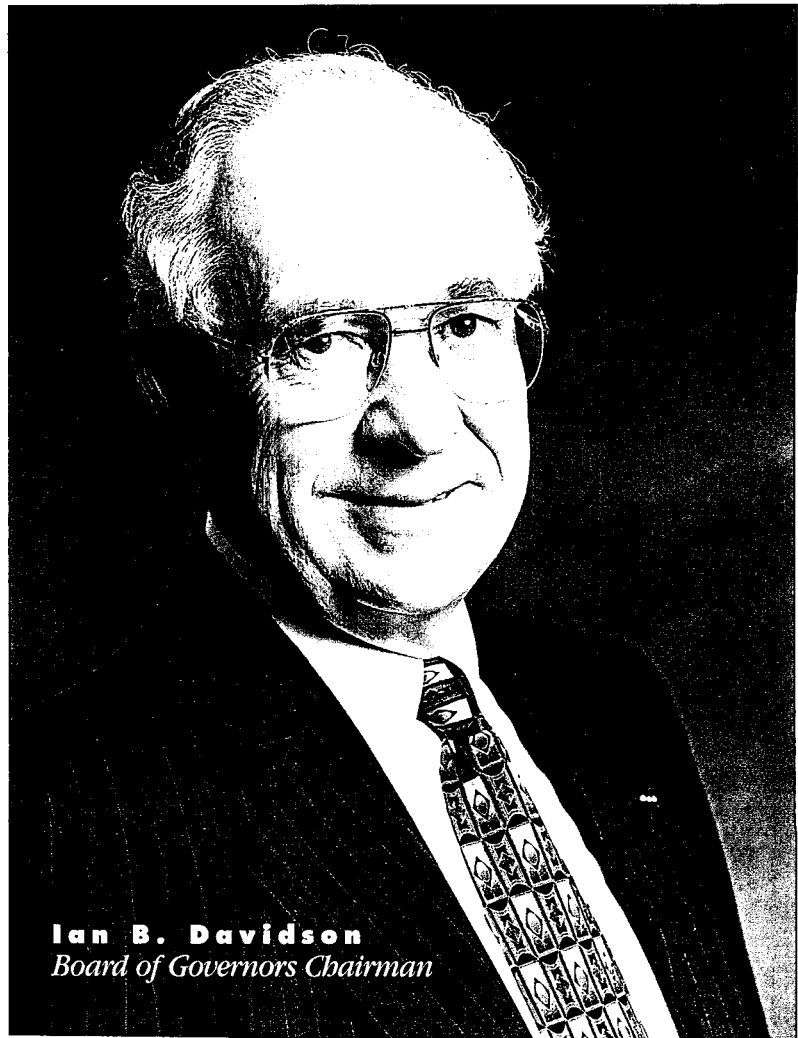
We believe these changes, as they move from approved concepts to realities, will benefit all the constituencies we serve: the millions of investors worldwide who are active in The Nasdaq Stock Market and other markets regulated by the NASD; the more than 5,100 Nasdaq companies and the hundreds of companies who join Nasdaq in record numbers every year; and the more than 5,400 securities firms regulated by the NASD.

From an economic perspective, 1995 was also exceptional. It was a year in which The Nasdaq Stock Market set new records for trading volume, price performance, and growth.

- Nasdaq share volume exceeded 100

billion, a record for any U.S. stock market; this was three times the volume of shares traded on Nasdaq in as recent a year as 1990.

- The Nasdaq CompositeSM Index crossed 1,000, closing at a record 1052.13; its gain of 39.9 percent was greater than that of any other broad market index.
- Nasdaq market capitalization exceeded \$1 trillion, closing at \$1.16 trillion, a one-year gain of 47.5 percent; the aggregate market value of



Ian B. Davidson
Board of Governors Chairman

Nasdaq companies was more than three and one-half times that at year-end 1990.

In many respects, 1995 reflects a culmination of more than two decades of growing investor recognition of this country's dynamic new economy represented by the companies on Nasdaq.

That recognition has been well rewarded. From the start of the Nasdaq market in February 1971 to year-end 1995, the Nasdaq CompositeSM Index has grown at an average annual compound rate of 9.9 percent versus 7.9 percent and 7.5 percent for the S&P 500 and Dow Jones Industrial Average, respectively, for that same period.

In the last five years alone, \$1,000 invested in the Nasdaq Composite at the end of 1990 would have

been worth over \$2,800 at the end of 1995. That same \$1,000 would have grown to only \$1,943 if invested in the Dow, and \$1,865 if invested in the S&P 500.

By operating at the leading edge of economic change, Nasdaq companies have created whole new industries; brought about breathtaking innovation in technology, healthcare, retailing, financial services, and other fields; and redefined the word competition. In the process, these companies have created millions of new jobs—an estimated one of every six in the U.S. economy in the first four and one-half years of the 1990s.

Following the 1995 recommendations of a Select Committee headed by former Senator Warren Rudman, the NASD will separate responsibility for the operation of the Nasdaq market and the regulation of the nation's broker/dealers into two distinct and independent—but related—companies, each with significant public representation in their governing structures.

A new entity, NASD Regulation, Inc., will assume a substantial portion of the NASD's role in carrying out the responsibilities of the securities industry's primary self-regulator. Its governing board will have at least 50 percent representation from outside the securities industry. NASD Regulation will oversee the activities of more than 5,400 securities firms, more than 58,000 branch offices, and in excess of 505,000 registered securities professionals. It will also regulate the markets operated by its sister subsidiary, The Nasdaq Stock Market, Inc.

To deal with the growing complexity of disciplinary matters, NASD Regulation will integrate professional hearing



Joseph R. Hardiman
President and Chief Executive Officer



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TO SHARPLY INCREASE PUBLIC REPRESENTATION
Adopting Principles of Rudman Committee Report
Nasdaq Stock Market, NASD Regulation of Brokers, Firms
Under Separate, Independent Units
Washington, D. C.—The Board of Governors for the National Association
of Securities Dealers, Inc. (NASD), acting on the Report of the Select Committee
on Exchange and Governance headed by former U.S. Senator Warren B. Rudman,
has adopted the Principles of Effective Governance recommended
by the committee, including a recommendation that the NASD Board be
composed of a cross-section of public representatives for public representation among the
board of a major securities market in the U.S.
The board also would separate oversight and
regulatory functions of the board into two separate
boards of directors.

**NASD ADOPTS
PRINCIPLES OF
RUDMAN REPORT—**

*Joseph R. Hardiman, NASD
President and CEO (left) and
former U.S. Senator Warren B.
Rudman discuss the Select
Committee's Report and the
NASD's response with reporters
at a September 19, 1995 press
briefing in Washington, D.C.*

officers into its process. These individuals will play a key role in managing cases and handling the many legal and procedural issues that increasingly arise in disciplinary proceedings. While industry volunteers will continue

to constitute the majority on disciplinary panels, hearing officers will chair, and be voting members of, all hearing panels.

Overall, the NASD's regulatory resources will be strengthened. In 1995, the NASD Board of Governors approved a budget that includes an 18 percent increase in the NASD's 1996 outlays for regulation and related technology support.

In December, Mary L. Schapiro, former chair of the Commodity Futures Trading Commission and a former commissioner of the Securities and Exchange Commission, was named President of NASD Regulation. She assumed her responsibilities in February 1996. Her experience, knowledge, and skills will serve the industry well as she leads our efforts in regulating the broker/dealer profession.

The Nasdaq Stock Market will also operate under a new president in a separate subsidiary encompassing the vast technology complex at the heart of the market, an on-line StockWatch unit responsible for trading halts, and the extensive services provided to Nasdaq companies and Nasdaq market participants. Like the Board of NASD Regulation, the Nasdaq Board will have at least 50 percent representation from outside the securities industry.

The NASD, the parent organization, will help establish and coordinate the policy agendas of its two subsidiaries, provide essential corporate services, and oversee the effectiveness of each

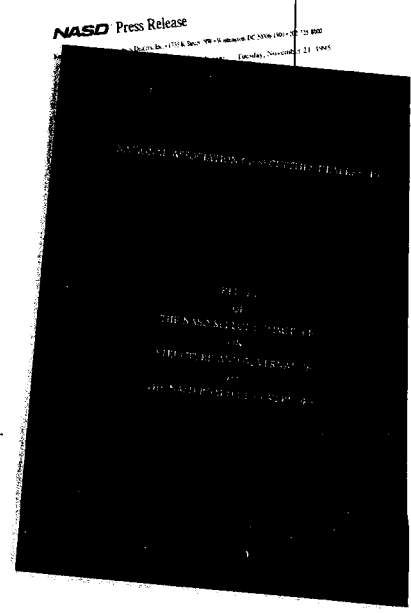
organization as it carries out its respective responsibilities.

The NASD parent will house two key oversight and liaison operations: a much-strengthened Office of Internal Review to conduct regular internal audits and reviews of NASD Regulation and act as "ombudsman" for regulatory or market concerns and complaints; and a new Office of Investor Services to act as liaison with, and to monitor and advance the views and interests of, individual investors.

The NASD parent will have a governing board with a majority of outside governors—a first in the securities industry. All three boards and a new nominating committee will be structured to provide balanced representation of investor, Nasdaq company, member firm, and other constituent interests.

This restructuring, approved in early 1996 by a vote of the NASD membership, follows in every major respect the landmark recommendations of the seven-member Select Committee in its 400-page report.

The NASD and Nasdaq Boards also acted decisively to expand investor opportunities for price improvement in buying and selling securities on Nasdaq. In September, the NASD and Nasdaq filed with the SEC a proposal called NAQcessSM. NAQcess will feature a unique limit-order file in which customer orders on opposite sides of the market will be automatically executed whenever they are at prices better than the best market-maker bid or offer on Nasdaq.



Not all major initiatives in 1995 involved structural change. Several deserve special mention.

At year-end, Nasdaq's capacity was expanded to handle one billion shares a day as part of an ongoing, \$180 million systems migration that represents the largest and most complex single technology project undertaken by any major U.S. stock market.

Elements include the conversion of the vast Nasdaq telecommunications network from an analog to a digital base, upgrade of the industry's first fully redundant system in case of primary system failure, a complete hardware changeover, and the upgrade and integration of software driving Nasdaq's unique trading systems. The new systems will also enhance the NASD's advanced market surveillance capability and other regulatory programs.

The NASD in 1995 took regulatory leadership in proposing new rules governing customer-complaint and significant-event reporting, customer cold calls, mutual fund sales practices, and brokerage activities conducted by NASD members in banks; in changing non-cash compensation practices to reduce the potential for conflict of interest between brokers and their customers; in strengthening compliance with trade-reporting and firm-quote rules; and in continuing education for securities industry professionals, among other areas.

In closing this summary of a remarkable year, we

**NEW NASD REGULATION
SUBSIDIARY CREATED—**

The first chairman of NASD Regulation, Inc. is Mary Alice Brophy (left) of Dain Bosworth Incorporated and the company's first President is Mary Schapiro, former Chair of the Commodity Futures Trading Commission.

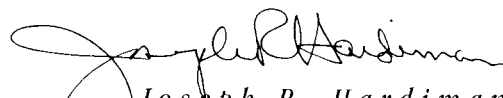
want to pay special tribute to the members of the NASD Select Committee on Structure and Governance: the Honorable Warren B. Rudman, Chair; Jean W. Gleason; Stephen L. Hammerman; Peter S. Lynch;

Robert H. Mundheim; Irving R. Pollack; and A.A. Sommer, Jr. Ably assisting the Committee in its work was its counsel, Mark Belnick. The work of this Committee is truly shaping the future of the NASD and The Nasdaq Stock Market.

In looking to the future, we would like to offer a perspective from the past. In 1971, the first year of Nasdaq's operation, the personal computer did not exist. Biotechnology was more of an idea than an industry. Telecommunications and computer software were in their infancy. Revolutionary changes that would reshape healthcare, retailing, and financial services were yet to come.

For the past two and a half decades, Nasdaq companies, with their innovative spirit, have led in the creation or reengineering of these industries so pivotal to our nation's new economy. Contributing to their success has been the capital formation expertise of member firms and the foresight of investors who recognized their potential. As Nasdaq marks its 25th year of operation in 1996, Nasdaq companies, investors, and member firms should feel a special pride in the role that they all have played in this economic revolution. Like them, we believe our best days are ahead.


 Ian B. Davidson
 1995 Chairman


 Joseph R. Hardiman
 President and CEO



National Association of Securities Dealers, Inc.
1995-The Year In Review

For the NASD, 1995 was a year of substantial change. It was also a year in which the NASD vigorously carried out its responsibilities of regulating the broker/dealer profession and the securities markets it operates.

Significant Enforcement Actions Taken in 1995

The mix of major cases brought by the NASD in 1995 spanned the full spectrum of sales-practice abuse and involved a wide range of securities products, including derivatives, mutual funds, and new offerings of equity securities. A total of 954 cases were decided, resulting in the expulsion from membership of eight firms and the suspension of another nine. Moreover, 412 registered persons were barred from the securities industry and another 196 were suspended. The monetary sanctions imposed totaled \$46.9 million, of which \$17.1 million was in the form of restitution directed to investors.

NASD Participates in Cooperative Enforcement Initiatives

During 1995, the NASD participated in several cooperative enforcement programs with the SEC, other government agencies, other SROs, and state regulators. These included a Joint Regulatory Sales Practice Sweep with the SEC, the New York Stock Exchange (NYSE), and the North American Securities Administrators Association (NASAA). The purpose of this effort was to identify problem brokers, review their sales practices, and assess whether adequate hiring, retention, and supervisory practices existed at the firms employing them. Some 347 brokers from 101 securities firms were selected for review.

More broadly, in 1995 the NASD continued to work side by side with state and federal law enforcement agencies, including the Federal Bureau of Investigation, the Internal Revenue Service, and various U.S. Attorneys around the country. These cooperative efforts have led to a number of criminal prosecutions, convictions, and imprisonment for serious sales-practice and other abuses.

In late 1995, the NASD joined the SEC, the NYSE, the American Stock Exchange (Amex), the Chicago Board Options Exchange, and NASAA in signing a Memorandum of Understanding to promote cooperation and coordination among the SROs and state securities commissions that have authority to examine the financial condition and business practices of securities firms.

NASD Introduces Innovative Enforcement Programs

During 1995, the NASD completed work on a new examiner training and performance support system. Designed to assist the regulatory staff in keeping abreast of trends, the program relies on computer-based training, self-paced training, performance support technology, and on-site mentors.

The program, designated CornerStone, represents a radical departure from traditional training methods by providing examiners with on-line access to databases on various securities-related products and provides "just-in-time" training capabilities that are available to users on demand.

National Association of Securities Dealers, Inc.

The NASD also introduced a National Regulatory Plan to provide for timely identification of high-risk firms, individuals, practices, and new products and to prescribe an appropriate regulatory response that cuts across individual District and Department boundaries.

Market Surveillance Capabilities Strengthened

The NASD's automated market surveillance system was significantly improved in 1995 with the implementation of RADARSM, the Research and Data Analysis RepositorySM. This totally new system was made possible by the new Nasdaq technology and its open architecture design. RADAR consists of a market surveillance "superstation" that combines a powerful workstation interacting with a local database utilizing local applications.

RADAR provides immediate access to market data and other related information, dramatically increasing the speed and flexibility with which large quantities of data are analyzed. Whenever Nasdaq's Stock-Watch Automated TrackingSM (SWATSM) system detects unusual price or volume movements in a stock's trading, RADAR assists market surveillance analysts by rapidly pinpointing the identity of the securities firms responsible for the trading, the precise time at which trades took place, how much was bought or sold and for whose account. RADAR is a major enhancement

to the NASD's surveillance capabilities and its investor protection programs.

Mediation Program Launched

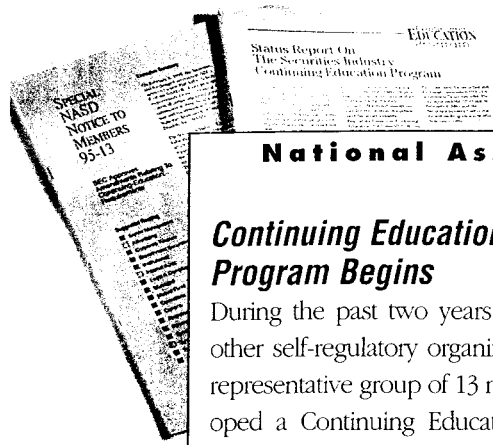
To complement its dispute resolution services and provide an alternative to litigation, the NASD in 1995 developed and launched a mediation program. The NASD currently operates the most active arbitration forum in the securities industry for dispute resolution, now processing some 86 percent of all cases filed. During the first six months of the mediation program, over 80 percent of the cases submitted resulted in settlements. Further, cases are being resolved within an average of 30 days from the parties' agreement to mediate.

Mediation has the potential to become as popular as arbitration because it is as fair, but more simple, and more cost-effective than arbitration. It provides the parties, typically investors and members, with a way to resolve disputes more quickly and less expensively. By design, it is less formal than arbitration or litigation, does not impose a decision,

and creates a non-adversarial environment that is controlled by the disputing parties. The mediator facilitates negotiations between the parties within a flexible format determined by them, hopefully helping them find a mutually acceptable resolution of their dispute.







National Association of Securities Dealers, Inc.

Continuing Education Program Begins

During the past two years, the NASD and five other self-regulatory organizations, along with a representative group of 13 member firms, developed a Continuing Education Program that is uniform across the entire industry. Designed to build investor trust and confidence, the program has two parts: a Regulatory Element and a Firm Element.

Launched in July 1995, the Regulatory Element takes the form of computer-based training administered by the NASD. It is required for all persons on the second, fifth, and tenth

MANDATORY TRAINING FOR BROKERS BEGINS—

The Continuing Education Program has been designed to help securities professionals earn the trust and confidence of investors by maintaining high minimum standards of competence and professionalism.

anniversaries of their initial securities registration. The training focuses on their knowledge of applicable requirements relating to registration and reporting; ethics and sales practices; business conduct; trade and settlement practices; and securities distributions.

The Firm Element, effective January 1, 1996, supplements the Regulatory Element. Each firm is required to prepare and

implement an annual training plan to provide training to all registered persons having direct contact with customers, and the immediate supervisors of those registered persons. The training must meet minimum standards and focus on the particular investment products and services that each firm offers its customers.

Member Suitability Obligations To Institutions Clarified

To provide guidance to members making recommendations to institutional investors, the NASD filed for SEC approval a new interpretation to its rule that requires firms to have reasonable grounds for believing their investment recommendations are suitable for customers. The two most important considerations under the interpretation are the customer's capability to evaluate investment risk independently and the extent to which the customer is exercising independent judgment in evaluating a member's recommendation.

Relevant considerations in determining an institutional investor's capability to evaluate risk could include the use of consultants, investment advisers, or bank trust departments; the general level of experience in financial markets and specific experience with the type of instrument being recommended; the ability to understand the economic features of the security; the ability to independently evaluate how market developments would affect the security; and the complexity of the security itself.

Considerations for determining whether an investor is making independent investment decisions include the understanding between the member and the customer regarding their relationship and the services to be provided; whether the customer has accepted the member's recommendations in the past; the customer's use of investment advice obtained from other member firms or professionals; and the extent of the information the customer has provided the member firm for discussing recommended transactions.

1995 - The Year In Review

National Association of Securities Dealers, Inc.

New Restrictions on Broker/Dealer Incentives Planned

In 1995, the NASD took steps to restrict the cash and non-cash compensation received by broker/dealers and their associated persons who sell investment company and variable contract securities. This action was in response to the increasing use of non-cash compensation as an incentive to encourage the sale of these products.

For the most part, the proposed rule would prohibit associated persons from receiving any compensation, cash or non-cash, from anyone other than the NASD member with which the person is associated. The rule would require that members maintain records of compensation received by the firm and/or its associated persons from offerors. It would prohibit members from receiving cash compensation for the sale of investment companies, unless the arrangement is described in the current prospectus. With certain exceptions, the rule would prohibit members and associated persons from accepting any non-cash compensation that they are offered.

Exceptions would permit, under specific restrictions, in-house sales incentive programs for a member's associated persons, and sales incentive programs of a non-member for the associated persons of its broker/dealer subsidiary. Additional exceptions to the prohibition would permit payment or reimbursement for training and educational meetings held for associated persons of broker/dealers, gifts of up to \$100 per person annually, and an occasional meal, ticket to a sporting event or theater, or comparable entertainment for associated persons and their guests.

New Rules for Broker/Dealers Operating on Premises of Financial Institutions Proposed

The NASD filed a proposed new rule with the SEC in 1995 to eliminate the confusion that may arise when both insured deposit instruments and securities products, such as mutual funds, are offered to retail customers from a single location on the premises of a bank or other financial institution.

A major feature of the rule is the requirement that a member firm located at a financial institution (e.g., bank, savings and loan, or credit union) conduct its securities business in a location distinct from the area where deposits are taken, whenever possible, and in all situations clearly distinguish the member's broker/dealer services from the financial institution's deposit-taking activities. Further, the member must provide customers orally and in writing an explanation of the differences in insurance coverage and risks between securities and non-securities products.

The rule requires that registered broker/dealers ensure that written agreements governing brokerage arrangements with financial institutions stipulate that the SEC and NASD be given access to the financial institution in order to inspect the books and records maintained by the member.

Finally, members would be prohibited from using the confidential financial information of the institution's customers unless the customer grants prior written approval. All communications with customers must clearly indicate that the brokerage services are provided by the NASD member, not the financial institution.

NASD
NOTICES

SPECIAL
NASD
NOTICE TO
MEMBERS
95-81

SEC Approves Rules
For Reporting Customer
Complaint Information

Proposed Rule

- Branch Management
- Accounting
- Compliance
- Investment Services
- Insurance
- Corporate Governance
- Marketing
- Operations
- Regulatory
- Risk Management
- Technology
- Training
- Other

Background
The SEC staff proposed a rule to require broker-dealers to report to the SEC all customer complaints received by the firm or its associated persons. The rule would require the reporting of all complaints, regardless of whether the complaint is resolved or not. The rule would also require the reporting of all complaints received by the firm or its associated persons, regardless of whether the complaint is received by the firm or its associated persons. The rule would also require the reporting of all complaints received by the firm or its associated persons, regardless of whether the complaint is received by the firm or its associated persons.

Summary Of The Proposed Rule
The rule would require broker-dealers to report to the SEC all customer complaints received by the firm or its associated persons. The rule would require the reporting of all complaints, regardless of whether the complaint is resolved or not. The rule would also require the reporting of all complaints received by the firm or its associated persons, regardless of whether the complaint is received by the firm or its associated persons.

The Nasdaq Stock Market, Inc.

The Nasdaq Stock Market Sets Performance Records

In 1995, investor participation in The Nasdaq Stock Market surged to record levels as total share volume passed the 100 billion mark, making Nasdaq the first U.S. market to reach this milestone. For the year, share volume reached 101.2 billion, up from the previous record of 74.4 billion set in 1994.

The Nasdaq-100® Index, an index of the 100 largest non-financial companies on Nasdaq, performed impressively, ending up 42.5 percent at 576.23. The market's best-performing sector indexes were the Nasdaq Biotechnology Index, up 88.5 percent, and the Nasdaq Computer Index, up 56.5 percent.

The depth and breadth of investor participation in the Nasdaq market was similarly evident in average daily share volume, which reached 401.4 million shares in 1995, surpassing by 36 percent the prior record of 295.1 million shares, also set in 1994. There was yet another record: total dollar volume skyrocketed in 1995, reaching \$2.4 trillion, an increase of 65 percent over 1994.

Last year established a new record for foreign listings on Nasdaq. More foreign-based companies listed on Nasdaq than on all other U.S. stock markets combined. The listing on Nasdaq of 14 American Depositary Receipts and 55 ordinary share securities during 1995 brought the totals to 115 and 280, respectively, both new records.

Other new Nasdaq records were set as well.

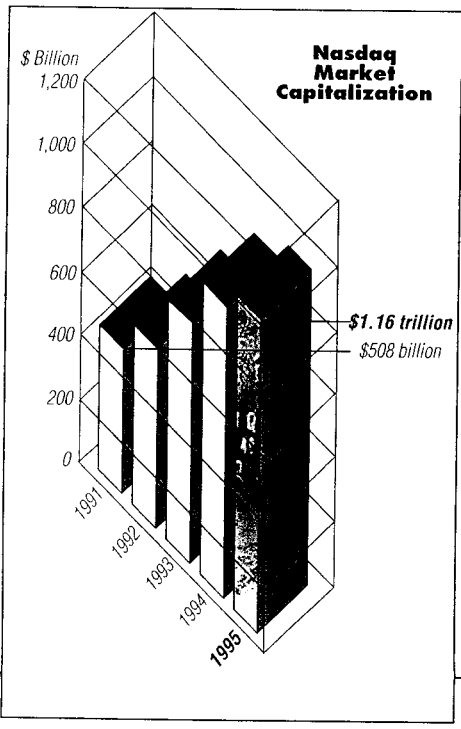
Nasdaq Companies Raise Record Amounts of Capital, Create Jobs

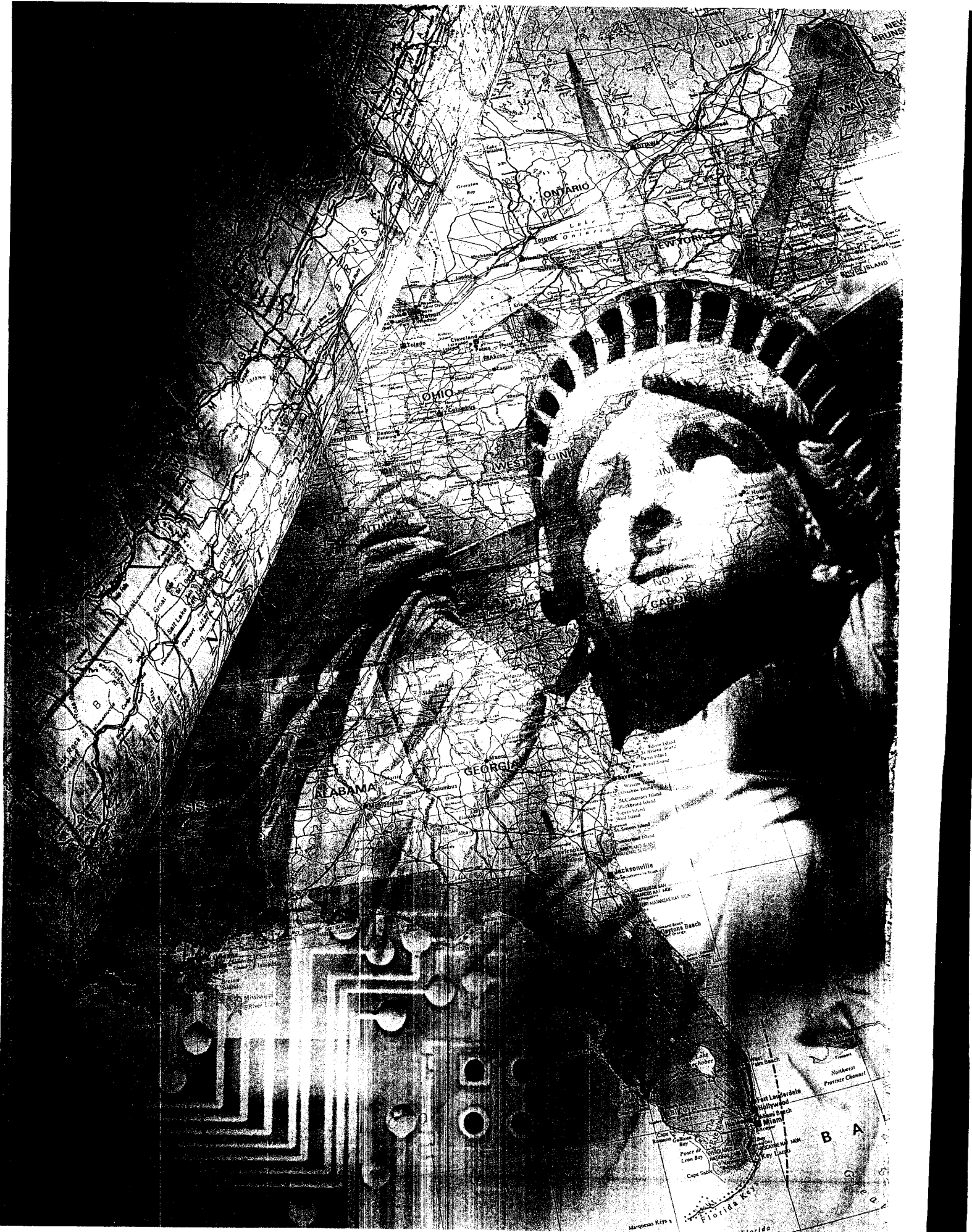
The market capitalization of the record 5,122 companies listed on Nasdaq crossed the \$1 trillion mark for the first time in 1995, closing the year with an aggregate market value of \$1.16 trillion.

This past year was an excellent year for companies raising capital. A total of 476 first-time-to-market companies raised \$16.74 billion, the highest single-year total for companies new to Nasdaq. Another 375 Nasdaq companies raised nearly \$25 billion through secondary offerings, also a record.

In terms of price performance, the Nasdaq Composite crossed the 1,000 mark for the first time on July 17 and set its all-time high of 1069.79 on December 4. It closed 1995 at 1052.13, up 39.9 percent, the best performance of this index in a single year since it recorded a 57 percent gain in 1991.

According to a study conducted by Cognetics, Inc., Nasdaq companies are "powerhouses in creating new jobs, far out of proportion to their number and size." In its study, "The Role of Nasdaq Companies in the U.S. Economy,"





The Nasdaq Stock Market, Inc.

NASDAQ COMPANIES ARE RESPONSIBLE FOR 1 IN 6 NEW JOBS IN THE U.S.—
The prolific job creation of Nasdaq companies is attributable in large part to their relatively rapid growth.

Cognetics found that from January 1990 to June 1994, Nasdaq companies created 500,000 new jobs, or more than one in every six new jobs created in the American economy during that period. This is a remarkable accomplishment, given that the 4,000 Nasdaq companies studied represented less than one percent of all U.S. businesses.

The prolific job creation of Nasdaq companies is attributable in large part to their relatively rapid growth. According to Cognetics, 51 percent of all Nasdaq companies are growing at rates it defines as "explosive," based on such factors as growth in sales and employment, compared to a national average of only 3 percent. Moreover, the study found that Nasdaq companies tend to grow over their entire lives relative to other companies that were started at the same time.

orders that are at prices better than the best market-maker bids and offers on Nasdaq.

NAqcess will also permit customer limit orders that are at prices equal to or better than the best market-maker bid and offer prices to become part of the best bid/best offer quotation distributed throughout the entire Nasdaq system.

The new service will enable investors to get the best available prices for their orders. They will be able to specify the prices at which they are willing to buy and sell Nasdaq securities and they will have greater control over the prices they pay.

NAqcess has been filed with the SEC and awaits Commission action. The concepts embodied in NAqcess appear to be compatible with those contained in a concept release on the subject of handling and execution of customer limit orders which was issued by the SEC in September 1995.

Greater Price Improvement Opportunities for Nasdaq Investors Proposed

In 1995, the NASD and Nasdaq Boards developed a proposal for a new stock trading system that will give Nasdaq investors greater access to more competitive prices and faster execution of their orders. The features of NAqcess are unique among major U.S. stock markets in that they will provide for the automated execution of investors' matching limit orders and the interaction of market orders with limit

Bulletin

Nasdaq's NAqcess Gives Your Shareholders Better Prices When Buying and Selling Stock

SEC Asks Public for Comment on NAqcess Trading System Plan

The Nasdaq Stock Market's NAqcess proposal, before the Securities and Exchange Commission since September, will create a new stock trading system that gives your shareholders more competitive prices and faster execution for their trades.

"We are going to make it possible for investors, particularly small investors, to better control their transaction costs by having their orders interact directly with other investor orders," said Nasdaq Chairman, Chief Executive Officer Joseph R. Lindman.

NAqcess will let investors place orders inside the bid-ask spread to match other individual investor's orders in the system.

In response to the September filing, the SEC is publishing the proposal in the Federal Register and seeking public comments through January 16, 1996.

Also in September, the SEC securities industry rule U.S. markets of Nasdaq.

Market Place

Nasdaq Offers Its Own Plan To Cut Costs For Investors

Individual NAqcess Compete C

When a limit order bid to buy or offer to sell at an exact price — is a

By FLOYD NORRIS

The Nasdaq stock market formally proposed a plan yesterday that would make it easier for individual investors to trade at better prices than they get now. The proposal, called NAqcess, would make it possible for the first time for investors to reduce the spread between the bid and ask prices that is shown on the Nasdaq screen.

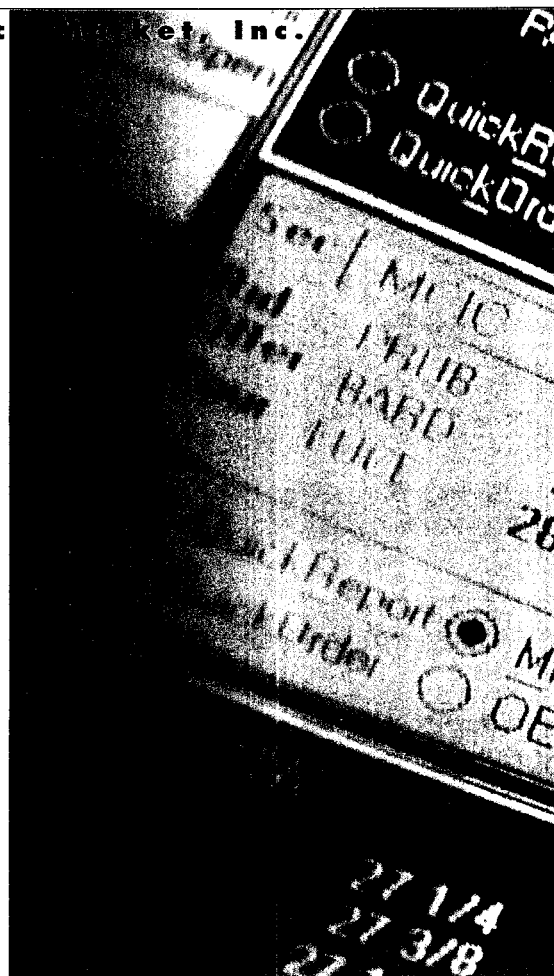
The Nasdaq Stock***Limit-Order Protection Extended***

A new rule proposed by the NASD and approved by the SEC in 1995 further increases the protections afforded limit orders placed by individual investors in Nasdaq securities. Through prior rulemaking, the NASD acted to prohibit member firms from trading for their own accounts at the same or at better prices than limit orders they carry for their own customers. In 1995, the application of this rule was extended to limit orders sent to a market maker from another member firm (so-called "member-to-member" orders). The new rule provides flexibility in executing limit orders placed by institutions or institutional-size orders (those greater than 10,000 shares or \$100,000 in value).

Technology Migration Accelerated

While share volume has tripled since 1990, the number of transactions processed by Nasdaq during 1995 has increased nearly fivefold to more than 55 million. This unprecedented growth in the Nasdaq market led to a mid-year decision in 1995 to accelerate Nasdaq's \$180 million technology migration. By year end, more than 5,300 trading workstations were upgraded and running on a new telecommunications network with new central mainframe computers, half a year ahead of schedule. Nasdaq is the first major stock market to replace all of its technology and to do so while continuing to operate a dynamic trading system doing unprecedented volume. The new technology can now handle more than 500 transactions per second and trading volume of one billion shares daily while maintaining the response times required by the marketplace.

The centerpiece of the new technology is



Nasdaq Workstation IISM, a windows-based trade-execution, transaction-reporting, and market-information software designed to run on Pentium-grade workstations. The system utilizes a UNIX-based server interfacing with the central system. This provides securities firms with flexibility to use a variety of workstation hardware and software and to customize trader-screen displays.

Nasdaq's new central data complex employs powerful, highly reliable Unisys 2200 and Tandem enterprise-wide servers. These computers handle many complex transactions simultaneously, including the updating of quotes, the handling of inquiries, the entering of orders, the execution

The Nasdaq Stock Market, Inc.

of orders, the generation of trade reports, the sending of information to the clearing corporation, and the updating of market indexes.

The new system's open, client-server architecture gives it the flexibility to accommodate a variety of different technologies, enabling Nasdaq to respond promptly to the rapidly growing needs of investors and securities firms for new trading and market information services.

A digital telecommunications network leased from MCI Communications Corporation links the central data complexes at Trumbull and Rockville to Nasdaq Workstations in the United States and Canada. The digital system transmits more information at greater speeds than the analog network it replaced. The speed of the new network is 56,000 bits per second, compared to the old network's 9,600 bits per second, which results in a five-fold increase in communications capacity.

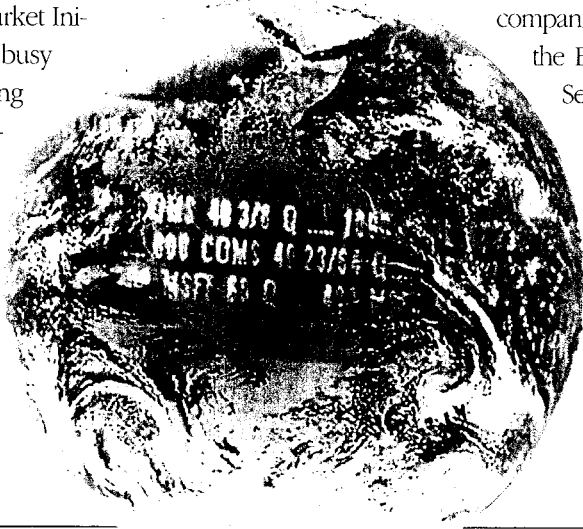
International Consulting Activities Expanded

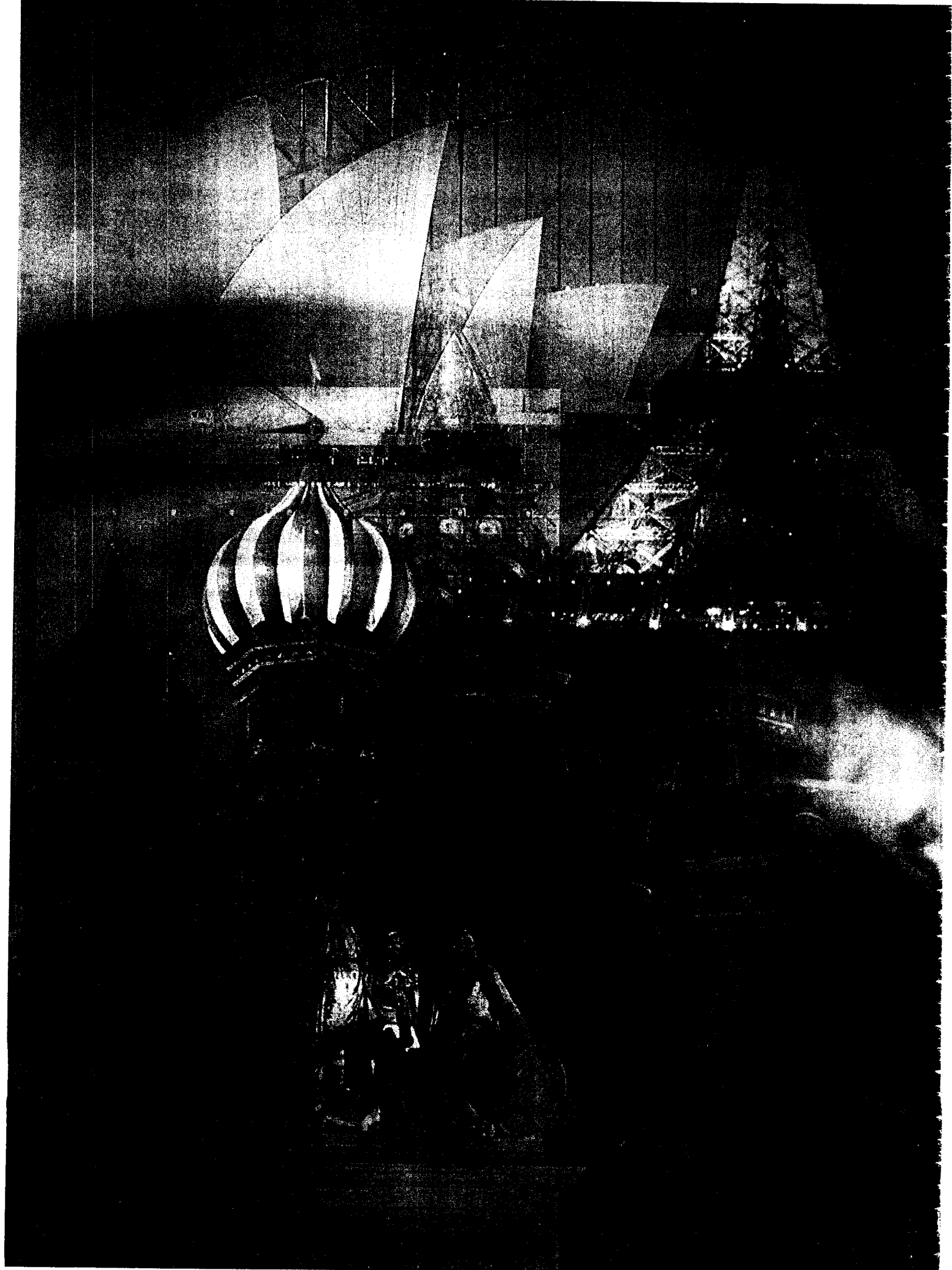
During its first full year of operation, Nasdaq International Market Initiatives (NIMI) was both busy and productive. Utilizing the knowledge, experience, and expertise of the professional staff of the NASD and Nasdaq, NIMI offers a variety of consulting services to assist emerging and estab-

lished securities markets around the world with both technology applications and regulation.

During 1995, NIMI assisted in the creation of an Australian small-cap market—the Australian Dealers Automated Quotes, Ltd. (AUSDAQ)—featuring competing dealers, electronic trading and simultaneous settlement, and delivery of securities not listed on The Australian Stock Exchange. Through NIMI, Nasdaq licensed its Automated Confirmation Transaction ServiceSM (ACTSM) software to the Societe des Bourses Francaises (SBF). NIMI also worked with the securities practitioners of the Russian Federation to create its first national self-regulatory organization, PAUFOR, located in Moscow and modeled on the NASD.

During 1995, The Nasdaq Stock Market worked with European venture capitalists, issuers, and dealers in support of the development of a pan-European, Nasdaq-like, dealer-driven, electronic stock market for growth companies. The European Commission and an increasing group of European investors and market professionals recognize that the presence of a Nasdaq-like market will significantly enhance the capital formation process in Europe for growth companies. The formation of the European Association of Securities Dealers Automated Quotation system (Easdaq) and its related trade association, the European Association of Securities Dealers (EASD), is a direct response to this need.





Nasdaq International Ltd.

Serving Companies Worldwide

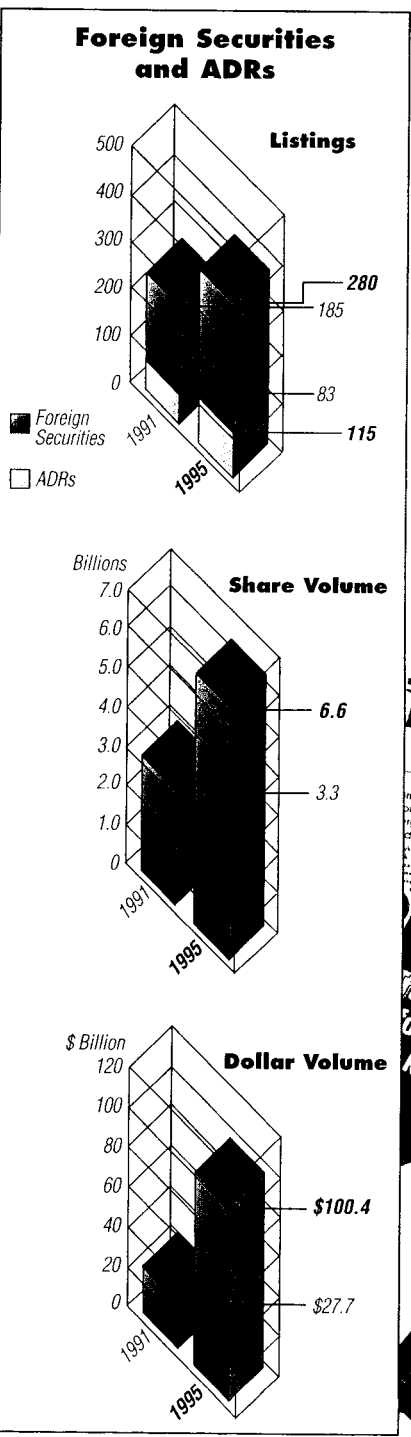
The Nasdaq Stock Market is an international marketplace with hundreds of company listings from around the world. It is also a market that has attracted active participation by thousands of overseas-based institutional investors.

Headquartered in London, Nasdaq International provides an array of services to both domestic and foreign companies. With representatives based throughout the world, this office assists foreign companies in accessing the U.S. capital markets and in gaining a listing on The Nasdaq Stock Market. On behalf of U.S. issuers, Nasdaq International arranges overseas investor seminars to help companies

in their efforts to expand their international base of shareholders. In 1995, senior officers from a number of companies headquartered in the United States met with over 200 institutional investors across Europe in meetings organized by Nasdaq International.

To help The Nasdaq Stock Market stay in touch with emerging global trends, an NASD International Markets Advisory Board (IMAB) meets twice a year to provide the Nasdaq Board with insights and judgments on developments in the major international markets of the world. In 1995, the IMAB met in Buenos Aires, Argentina and in New York.

NASDAQ IS AN INTERNATIONAL MARKETPLACE—
Nasdaq lists hundreds of companies from around the world and attracts thousands of overseas investors.



The Nasdaq Stock Market Educational Foundation, Inc.

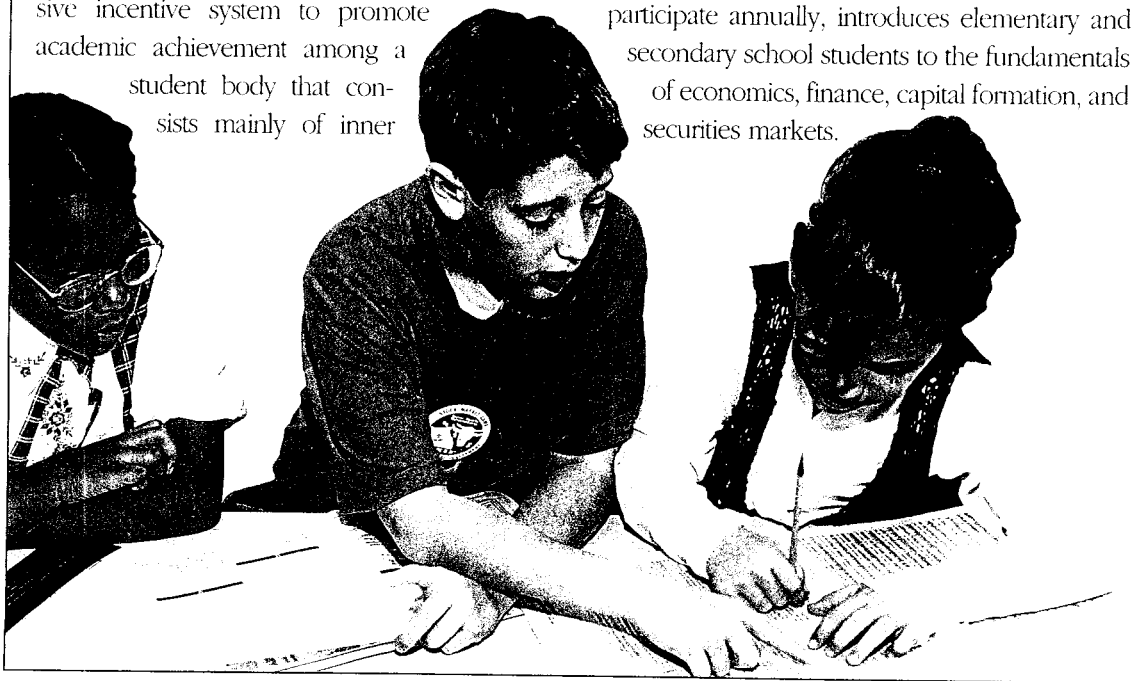
Foundation Grants Advance Economic Literacy

Established in 1993 as an independent entity, The Nasdaq Stock Market Educational Foundation provides financial support to programs and projects that foster economic literacy, promote understanding of the capital formation process, and provide an education on how securities markets operate and function.

In 1995, its second year of operation, the Foundation awarded a number of general support grants to various financial research centers of major universities and the National Council on Economic Education. In addition, the Foundation issued grants to fund an assortment of specific projects. Georgetown University's School of Business received a grant for the development of curricula for two courses: an MBA course designated "Emerging Companies" and an executive program course entitled "The Functioning and Regulation of Capital Markets." The High School of Economics and Finance in New York City was awarded a grant to establish a comprehensive incentive system to promote academic achievement among a student body that consists mainly of inner

city children from low-income families. To Memphis State University's Institute for the Study of Securities Markets, the Foundation awarded a grant to fund the development of software to enable academics to conduct research on personal computers with data from all of the stock, futures, options, and commodities markets in the United States.

The Foundation also awarded a grant to the National Academy Foundation to enhance the programs of the Academy of Finance (AOF) at its high school sites in Baltimore, Maryland; Broward County, Florida; and San Francisco, California. These locations will serve as demonstration sites for the directors at other AOF high schools to observe and replicate. Finally, the Foundation awarded a grant to the Securities Industry Foundation for Economic Education to develop a site on the Internet World Wide Web for The Stock Market GameSM. This simulation exercise, in which more than one-half million participate annually, introduces elementary and secondary school students to the fundamentals of economics, finance, capital formation, and securities markets.



“**Self-regulation**

works because the
industry recognizes it is
a **privilege**,
not a right.”

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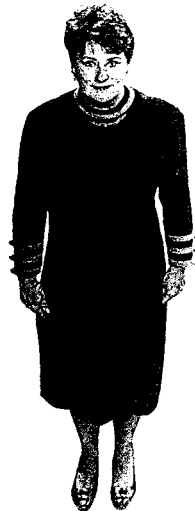
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Northern California (the counties of Monterey, San Benito, Fresno, and Inyo, and the remainder of the state north or west of such counties), northern Nevada (the counties of Esmeralda and Nye, and the remainder of the state north or west of such counties), and Hawaii; 275 members, 4,329 branches

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Nicholas C. Cochran
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Southern California (that part of the state south or east of the counties of Monterey, San Benito, Fresno, and Inyo), southern Nevada (that part of the state south or east of the counties of Esmeralda and Nye), and the former U.S. Trust Territories; 434 members, 5,158 branches

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1995 NASD Disciplinary Committees**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); 745 members, 10,629 branches

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Anthony J. Hyatt, *Vice Chairman*

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R. Gerald Baker
Kathy J. Birk
Ronald D. Brooks
Lewis H. Echlin, III
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Ruth C. Hannenberg
Thomas A. Harenburg
Wayne F. Holly
Earl Clifford Oberlin, III
Ronald R. Rzonca
James J. Titak
Christopher J. Whybrow

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); 404 members, 5,138 branches

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Frederick J. Arnold
Michael D. Botte
Michael P. Bova
John J. Gray
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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); 1,444 members, 3,875 branches

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Howard M. Brenner
Roger J. Cohen
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James F. Doolin
Michael F. Dura
Michael Gironta
Joyce L. Kramer
Michael S. Martin
Frank Masi
Blair D. Mitchell
Edwin F. Payne
Benita Pierce
Stephen F. Schwartz
Robert B. Sculthorpe
Guy G. Woelk

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); 518 members, 4,157 branches

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National Association of Securities Dealers, Inc.

1995 CONSOLIDATED FINANCIAL STATEMENTS

Management Report on Financial Operations

The National Association of Securities Dealers, Inc. (NASD) and its wholly owned subsidiaries achieved record revenues of \$438 million in 1995, an 18 percent increase over 1994's level of \$372 million. The \$66 million revenue gain was primarily attributed to the record share and dollar volume activity of The Nasdaq Stock Market (Nasdaq) in 1995. Beneficial revenues included market data fees, listing fees, charges for execution and comparison system usage and regulatory fees.

Over one-half or \$36 million of the revenue growth arose from market information and transaction service fees. Specifically, revenues from execution and comparison systems rose \$17 million as Nasdaq registered record trading volume of 101.2 billion shares, a 36 percent increase over 1994. Revenue growth was also fueled by an 11 percent increase to a record 295,800 in professional retail, dealer and institutional Nasdaq market information users, as well as by the introduction of value-added services and capacity through the Nasdaq Workstation II service. Revenues from Nasdaq issuers rose \$13.5 million as a record number of companies and issues traded on Nasdaq in 1995, and raised a record dollar volume of \$41.7 billion from initial and secondary public offerings. On the regulatory side, member assessments were \$5.7 million higher from increased net assessment rates in 1995. Regulatory service fees grew by approximately \$5 million, mostly attributed to the volume surge in Nasdaq trading.

Expenses in 1995 increased by 20 percent to \$411 million or nearly \$70 million over 1994, driven by cost growth associated with the technology upgrade of the Nasdaq market systems, professional fees related to various external studies and reviews, and development of a number of enhanced regulatory and market applications. Specifically, during 1995 Nasdaq completed a significant component of its systems technology upgrade by installing new and fully redundant mainframe systems, completed installation of a new high speed digital communications network, and introduced a state-of-the-art trader workstation for access to Nasdaq's quotation and trading systems. These developments were accelerated to significantly increase Nasdaq system capacity in rapid response to the rising volumes experienced throughout the year. Substantial resources were also devoted in 1995 to designing and developing landmark systems. These included the unique NAccess limit-order trading system, which will provide greater price improvement opportunities and enhanced liquidity for investors, as well as a number of new market surveillance systems, in particular, the Research and Data Analysis Repository (RADAR), which allows for markedly increased speed and flexibility to analyze large quantities of trading data through a powerful workstation platform. 1995 also saw the inauguration of a watershed Continuing Education training program intended to enhance investor trust and confidence in industry representatives, and an extensive data integrity

effort and conversion of disciplinary and related information on industry professionals as reflected in the Central Registration Depository system in preparation for roll-out of the new system in 1996.

These efforts required increased spending on technology-based resources, including a nearly 14 percent increase in technology staff, outsourcing of certain development and related activities to consultants and contractors, higher communications and training costs, and greater depreciation from record levels of capital spending in 1994 and 1995. Outside of technology, staff growth rose 6 percent. The Regulation and Member Services business lines accounted for 60 percent of these additions, with particular increases in market surveillance staffing, to bolster case analysis activities, and in the arbitration service, as case close-outs rose 25 percent in a concentrated effort to address rising caseloads. Headcount levels for Nasdaq services to traders and other market participants and Nasdaq companies also rose to meet the growth in market volumes, subscriber terminals and companies.

Considerable progress was also made in 1995 in other aspects of the NASD's technology migration program, aimed at upgrading the hardware and software components and systems development methodologies for our market and corporate/regulatory systems to improve responsiveness and flexibility for users. Spending on the program reached \$30.7 million in 1995, compared to \$29.1 million in 1994. Cumulative program expenditures since inception have totalled approximately \$142 million, including capital outlays of \$53 million. The principal development efforts during the year focused on the Integrated Quotation Management Service (IQMS), the eventual successor to Nasdaq's current quotation system, for which substantial development was completed and is now in quality assurance; and the Integrated Registration and Testing Service (IRTS), which will provide centralized qualification, registration and renewal services to the industry as a replacement for CRD, now planned for roll-out in 1996.

Consolidated income for NASD and its wholly-owned subsidiaries of \$27 million in 1995, before provision for income taxes, declined \$4 million or 13 percent from 1994. Net income of \$17.1 million was likewise lower by \$4 million.

Working capital, including the non-current portion of investments, of \$181.2 million fell \$13.1 million from the end of 1994, as capital spending of \$59 million followed last year's record level of \$63 million. Approximately 70 percent of the capital investments over the last two years relate to mainframe computer, communications and desktop devices to expand systems capacity and improve throughput for system users and enhance the productivity of the staff. Working capital levels will continue to be prudently managed to ensure that capital needs to fulfill NASD's mission can be readily met.

National Association of Securities Dealers, Inc.**Management Report on Financial Reporting Responsibility**

Management is responsible for the preparation, integrity, and objectivity of the consolidated financial statements of the National Association of Securities Dealers, Inc. (NASD) 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, that 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 an internal audit program developed and carried out by NASD's Internal

Review Department. It is management's opinion that the system of internal control as of December 31, 1995, 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 Committee (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 judgement as a committee member.

The NASD's independent auditors, Ernst & Young LLP, have conducted an audit in accordance with generally accepted auditing standards of the consolidated financial statements of NASD for the years ended December 31, 1995 and 1994. Representatives of Ernst & Young LLP 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.

National Association of Securities Dealers, Inc.

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, 1995 and 1994, 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, 1995 and 1994, and the consolidated results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

Ernst & Young LLP
February 23, 1996

National Association of Securities Dealers, Inc.
Audited Consolidated Financial Statements

Consolidated Balance Sheets

	December 31	
	1995	1994
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 19,476	\$ 14,177
Investments — current	67,059	43,158
Receivables and other current assets	51,555	44,829
Total current assets	<u>138,090</u>	102,164
Investments — non-current	171,563	202,914
Property and equipment:		
Land, buildings and improvements	47,652	46,695
Data processing equipment and software	153,888	124,947
Furniture, equipment and leasehold improvements	77,226	63,068
	<u>278,766</u>	234,710
Less accumulated depreciation and amortization	(134,067)	(121,064)
	<u>144,699</u>	113,646
Other assets	4,237	4,051
	<u>\$458,589</u>	<u>\$422,775</u>
Liabilities and Members' Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 81,732	\$ 59,263
Deposits, refunds due and deferred revenue	46,700	51,407
Total current liabilities	<u>128,432</u>	110,670
Accrued pension costs	15,690	14,768
Other liabilities	7,581	7,595
Total liabilities	<u>151,703</u>	133,033
Members' equity	306,886	289,742
	<u>\$458,589</u>	<u>\$422,775</u>

See accompanying notes to consolidated financial statements.

National Association of Securities Dealers, Inc.

Consolidated Statements of Income and Members' Equity

	Year ended December 31	
	1995	1994
	<i>(In Thousands)</i>	
Revenue		
Market information and transaction service fees	\$ 171,220	\$ 135,082
Nasdaq issuer fees	92,700	79,219
Member assessments	49,831	44,152
Registration and examination fees	45,076	45,761
Interest and other	28,636	25,988
Regulatory service fees and fines	23,557	18,406
Corporate finance fees	16,891	15,787
Arbitration fees	9,660	7,592
Total Revenue	<u>437,571</u>	<u>371,987</u>
 Expenses		
Compensation	150,127	132,444
Professional and outside services	96,374	67,142
Computer operations and data communications	44,052	31,355
Depreciation and amortization	28,345	20,380
Occupancy	21,005	19,840
Travel, meetings and training	16,306	16,121
Publications, supplies and postage	13,884	10,996
Other	9,817	13,598
	<u>379,910</u>	<u>311,876</u>
Systems Technology Migration expenses	30,658	29,053
Total Expenses	<u>410,568</u>	<u>340,929</u>
 Income before provision for income taxes	27,003	31,058
Provision for income taxes	9,859	9,927
	<u>17,144</u>	<u>21,131</u>
Net income	17,144	21,131
Members' equity at beginning of year	289,742	268,611
	<u>289,742</u>	<u>268,611</u>
 Members' equity at end of year	<u>\$ 306,886</u>	<u>\$ 289,742</u>

See accompanying notes to consolidated financial statements.

National Association of Securities Dealers, Inc.

Consolidated Statements of Cash Flows

	Year ended December 31	
	1995	1994
	<i>(In Thousands)</i>	
Net income	\$ 17,144	\$ 21,131
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	29,687	22,681
Increase in receivables	(6,726)	(19,097)
(Increase) decrease in other assets	(186)	2,067
Increase in accounts payable and accrued expenses	22,469	14,926
(Decrease) increase in deposits and deferred revenue	(4,707)	9,792
Increase (decrease) in accrued pension and other liabilities	908	(1,937)
Net cash provided by operating activities	58,589	49,563
Investing activities		
Proceeds from redemptions of investments	50,749	68,571
Purchases of investments	(43,299)	(64,239)
Purchases of property and equipment, net	(60,740)	(59,909)
Net cash used in investing activities	(53,290)	(55,577)
Increase (decrease) in cash and cash equivalents	5,299	(6,014)
Cash and cash equivalents at beginning of year	14,177	20,191
Cash and cash equivalents at end of year	\$ 19,476	\$ 14,177

See accompanying notes to consolidated financial statements.

National Association of Securities Dealers, Inc.

Notes to Consolidated Financial Statements December 31, 1995 and 1994

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 (collectively "the Company"), including The Nasdaq Stock Market, Inc. (Nasdaq), Nasdaq International, Ltd. (Nasdaq International), Securities Dealers Insurance Company Ltd. (SDIC), and the Securities Dealers Risk Purchasing Group, Inc. (SDRP) after elimination of all significant intercompany transactions.

NASD is a membership association established to regulate the Nasdaq and over-the-counter securities markets. Nasdaq owns and operates the domestic and international electronic Nasdaq quote and trade information system and provides national market facilities to benefit NASD members and investors in their pursuit of efficient execution of securities transactions and to help issuers reduce their cost of capital. Nasdaq International promotes the Nasdaq market worldwide. SDIC is a captive insurance company established to reinsure risks associated with the member fidelity bond program. SDRP is a risk purchasing group formed to make available professional liability insurance for NASD members.

As an association established to regulate the Nasdaq and the over-the-counter securities markets and provide information and trading services to market participants, the Company's receivables are concentrated with firms in the broker/dealer industry.

A wholly owned subsidiary, NASD Regulation, Inc. (NASDR) was incorporated on January 25, 1996. NASDR was created to assist the NASD in fulfilling its self-regulatory responsibilities as set forth in Section 15A of the Securities Exchange Act of 1934.

Use of Estimates

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

Cash and Cash Equivalents

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

Investments

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each balance sheet date. Debt securities are classified as held-to-maturity in accordance with the investment policy of the Company to hold securities to maturity. Held-to-maturity securities are stated at amortized cost, adjusted for amortization of premium and accretion of discounts to maturity.

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 and Advertising 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. The Company expenses advertising costs in the periods in which the costs are incurred.

Income Taxes

NASD is a tax-exempt organization under the Internal Revenue Code (IRC) Section 501(c)(6). NASDR is currently in the process of applying for tax exempt status under IRC Section 501(c)(6). All other subsidiaries of NASD 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.

2. Investments

Investments are made in U.S. Treasury securities and obligations of U.S. Government sponsored enterprises and are classified as held-to-maturity in accordance with the investment policy of the Company. Throughout the year, up to 5 percent of the investments may be classified as available for sale to satisfy cash management needs.

The amortized cost and estimated fair value of debt securities at December 31, by contractual maturity, are shown below (in thousands):

	1995		1994	
	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Due in one year or less	\$ 67,059	\$ 67,599	\$ 43,158	\$ 43,121
Due after one year through five years	171,563	173,946	202,914	194,263
	<u>\$238,622</u>	<u>\$241,545</u>	<u>\$246,072</u>	<u>\$237,384</u>

The gross unrealized gains and (losses) of the investments at December 31, 1995 were \$3,056,000 and (\$133,000), respectively. The gross unrealized gains and (losses) at December 31, 1994 were \$113,000 and (\$8,801,000), respectively.

3. Leases

Furniture, equipment and leasehold improvements include the following amounts relating to leases which have been capitalized. The initial terms of the capitalized leases are 60 months.

	December 31	
	1995	1994
	<i>(In Thousands)</i>	
Furniture, equipment and leasehold improvements	\$3,371	\$1,606
Less accumulated depreciation	1,271	881
	<u>\$2,100</u>	<u>\$ 725</u>

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 \$10,185,000 in 1995 and \$10,646,000 in 1994. 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, 1995:

National Association of Securities Dealers, Inc.

	Capital Leases	Operating Leases
	(In Thousands)	
Year ending December 31:		
1996	\$ 787	\$10,369
1997	410	9,222
1998	410	7,965
1999	410	7,182
2000	373	7,072
Remaining years	—	15,446
Total minimum lease payments	<u>2,390</u>	<u>\$57,256</u>
Less: Amount representing interest	279	
Present value of net minimum lease payments	<u>2,111</u>	
Less: Amounts due in one year	685	
	<u>\$ 1,426</u>	

4. Income Taxes

The income tax provision includes the following amounts for the year ended December 31:

	1995	1994
	(In Thousands)	
Current liability:		
Federal income taxes	\$ 3,328	\$ 8,505
State income taxes	768	2,981
Total current liability	<u>4,096</u>	11,486
Deferred expense (benefit):		
Federal income taxes	4,802	(1,420)
State income taxes	961	(139)
Total deferred expense (benefit)	<u>5,763</u>	(1,559)
Total provision	<u>\$ 9,859</u>	<u>\$ 9,927</u>
Income taxes paid during the year	<u>\$ 6,891</u>	<u>\$ 15,901</u>

The effective tax rates for the taxable entities were 37% percent and 36% percent for 1995 and 1994, respectively.

Components of the net deferred asset (liability) consisted of the following as of December 31:

	1995	1994
	(In Thousands)	
Deferred tax assets:		
Network installation	\$ —	\$ 3,669
Deferred entry fees	1,275	820
Compensation and benefits	1,683	1,652
Other	826	745
Total deferred tax assets	<u>3,784</u>	6,886
Deferred tax liability:		
Depreciation	4,360	1,699
Net deferred tax asset (liability)	<u>\$ (576)</u>	<u>\$ 5,187</u>

5. 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 \$5,625,000 and \$4,333,000 were required for 1995 and 1994, respectively. The entire 1995 contribution is due by September 13, 1996.

The following table sets forth the plans' net pension cost for the years ended December 31:

	1995	1994
	(In Thousands)	
Service cost	\$ 5,029	\$ 5,297
Interest cost	5,004	4,341
Actual return on plan assets	(11,224)	1,223
Deferred net asset gain (loss)	8,177	(3,939)
Net pension cost	<u>\$ 6,986</u>	<u>\$ 6,922</u>

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

	1995	1994
	(In Thousands)	
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of \$37,452 in 1995 and \$26,833 in 1994	<u>\$ 43,934</u>	<u>\$ 31,829</u>
Projected benefit obligation	<u>\$ 73,993</u>	<u>\$ 57,558</u>
Less plan assets at fair value, principally common stocks, U.S. Government and agency bonds	<u>45,921</u>	37,130
	<u>28,072</u>	20,428
Unrecognized net asset	2,483	2,606
Unrecognized net (loss)	(5,278)	(3,717)
Prior service cost	(3,524)	(3,841)
Accrued pension cost	<u>\$ 21,753</u>	15,476
Less current portion	6,063	708
Long-term accrued pension cost	<u>\$ 15,690</u>	<u>\$ 14,768</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 7.25 percent and 5.5 percent, respectively, at December 31, 1995, and 8.75 percent and 6 percent, respectively, at December 31, 1994. The expected long-term rate of return on plan assets was 9 percent for 1995 and 1994. 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 voluntary savings plan for employees. Employees are immediately eligible to make contributions to the plan and after one year of service are also eligible for an employer contribution match at an amount equal to 50 percent of the first 6 percent of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from NASD. Savings plan expense for the years 1995 and 1994 was \$3,998,000 and \$3,522,000, respectively.

The expense included a discretionary match authorized by the Board of Governors totaling \$1,542,000 for 1995 and \$1,387,000 for 1994.

The 1995 discretionary match was paid in full on January 31, 1996.

6. Systems Technology Migration

NASD and Nasdaq are in the midst of 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, regulatory and corporate systems for the ultimate benefit of users. In 1995, Nasdaq completed the rollout of the new enterprise-wide network in conjunction with the introduction of the new Nasdaq workstation service, NWIPSM. In 1995, NASD and Nasdaq incurred and expensed \$30,658,000 for this program compared to \$29,053,000 in 1994. The primary expenses incurred under the program relate to compensation, professional and outside services, and depreciation and amortization. Capital purchases for this program totaled \$10,870,000 for 1995 compared to \$31,400,000 in 1994.

7. Commitments and Contingencies

There are certain legal proceedings, and investigations, pending against NASD and its subsidiaries. Management believes, based upon the opinion of counsel, that any liabilities or settlements arising from these proceedings will not have a material effect on the financial position or results of 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 to be incurred by July 1997. As of December 31, 1995 \$19,741,000 has been incurred against this commitment.

The Company had purchase commitments at December 31, 1995 of approximately \$5,866,000 for computer equipment purchases and software licensing charges.

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The quotations appearing on the envelope and front cover are taken from the remarks of Joseph R. Hardiman, NASD President and Chief Executive Officer, to the Securities Industry Association at its Annual Meeting in Boca Raton on November 11, 1995. The quotation on the inside cover is taken from Mr. Hardiman's remarks to the Commonwealth Club of California at its meeting in San Francisco on August 24, 1995. The quotation on page 25 is taken from Mr. Hardiman's comments during the panel discussion, "Enforcement and Disciplinary Activities by the Securities Markets," at the Annual Meeting of the Federation of International Bourses Valeurs (FIBV) in Santiago, Chile, on October 16, 1995.

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