

National Association of Securities Dealers, Inc. 1998

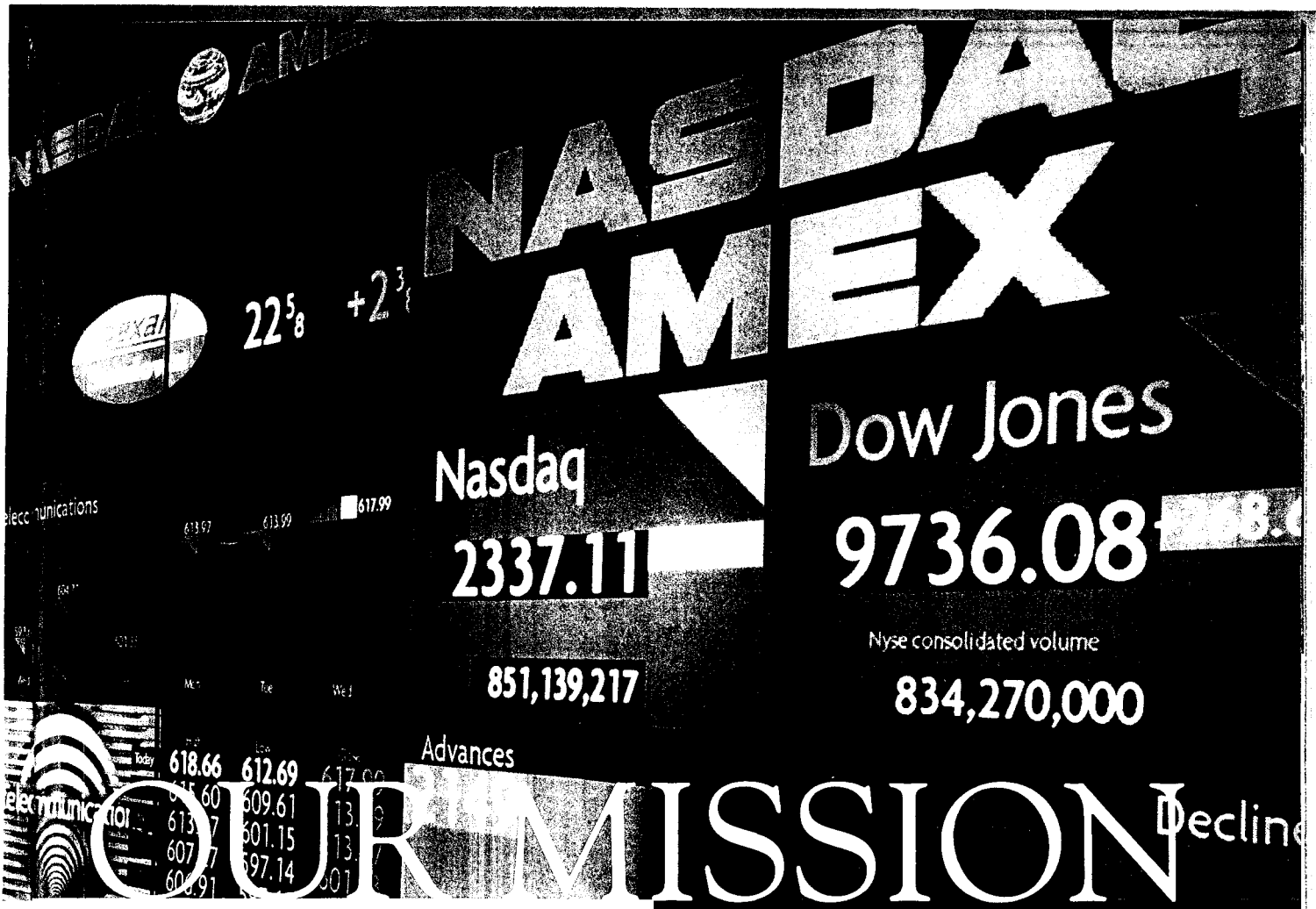
1998 NASD ANNUAL REPORT

THE MARKET
OF
MARKETSSM



NASD[®]

Parent of The Nasdaq-Amex Market Group



is to facilitate capital formation by creating the markets of choice — operated and regulated to achieve the most liquid, cost-efficient, technologically advanced, and fair securities markets in the world — for the benefit and protection of investors.

C O N T E N T S

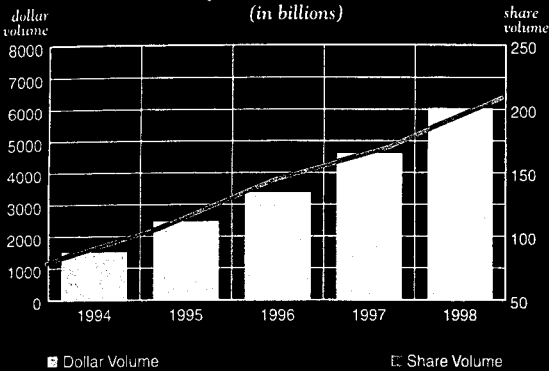
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NASDAQ-AMEX: LEADERSHIP IN CAPITAL FORMATION

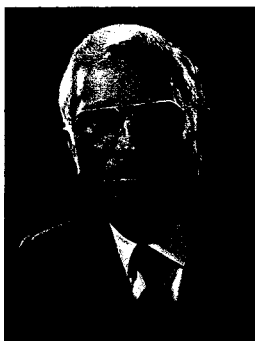
In a historic combination, NASD united with the American Stock Exchange on October 30, 1998. The Nasdaq-Amex Market Group is the first step in the Market of Markets vision to create the world's most technologically advanced trading network, delivering better products at lower cost.

Nasdaq-Amex Volume Growth
(in billions)



Nasdaq-Amex: Leadership in Capital Formation

<p>IN DAILY SHARES TRADED</p>	<p>Based on Nasdaq and NYSE statistics, Nasdaq began to surpass the NYSE in daily share volume in early 1994 and currently trades more shares on a daily basis on an average 9 out of 10 days.</p>	<p>IN DAILY DOLLAR VOLUME</p>	<p>Based on Nasdaq and NYSE statistics, Nasdaq surpassed the NYSE in dollar volume for the first time on a monthly basis in January 1999, and continued to do so in February and March.</p>
<p>IN NUMBER OF COMPANIES LISTED</p>	<p>Based on published exchange records for year-end 1998, total companies listed were as follows: Nasdaq-5,068; Deutsche Börse-3,525; NYSE-2,669; London Stock Exchange-2,520.</p>	<p>IN INITIAL PUBLIC OFFERINGS</p>	<p>Based on published exchange records, 1998 total IPOs were as follows: Nasdaq-273; NYSE-68; Amex-21.</p>
<p>IN NUMBER OF NON-U.S. LISTINGS</p>	<p>Based on published exchange records for year-end 1998, the total number of non-U.S. listings were as follows: Nasdaq-484; NYSE-461; Amex-67.</p>	<p>IN GROWTH COMPANIES</p>	<p>Of the Business Week 100 Hot Growth Companies (June 1, 1998), 95 were listed on Nasdaq-Amex. Of the FORTUNE 100 Fastest Growing Companies in America (September 28, 1998), 60 were listed on Nasdaq-Amex.</p>
<p>IN PRICE PERFORMANCE</p>	<p>Based on published records, the Nasdaq Composite® Index has risen 475% over the past 10 years, compared with a 343% gain for the Standard & Poor's 500 Index and a 323% gain for the Dow Jones Industrial Average. The Nasdaq-100 Index® has risen by 935%.</p>	<p>IN OPTIONS TRADING</p>	<p>Based on published exchange records, the Amex accounted for 24.03% of total U.S. options trading in 1998, compared with 50.89% for the Chicago Board Options Exchange, and 14.1% for the Pacific Stock Exchange, the number 1 and number 3 options traders, respectively.</p>
<p>IN INDEX SHARES</p>	<p>The American Stock Exchange, the pioneer in index share products, traded 2.237 billion index shares in 1998.</p>	<p>SELF-REGULATORY ORGANIZATION IN THE WORLD</p>	<p>The NASD is the largest self-regulatory organization in the world, having 5,592 member firms with 70,752 domestic branch offices and 589,120 registered representatives at year-end 1998.</p>



Frank G. Zarb
NASD Chairman and
Chief Executive Officer

Sweeping changes are happening in the world of investing. The NASD is, and will continue to be, an instrument of those changes.

The changes are being spurred by several factors. An explosion of Internet and computer-based trading is revolutionizing investing and shattering geographic boundaries. Contemporary investors, from the smallest individual shareholder to the largest institutions, are demanding, and increasingly getting, instant access to information and immediate execution of trades. The economy now is truly global and interconnected, and the markets are evolving to meet capital formation needs worldwide. Changing demographics — from people living longer and investing more for retirement to the growth of new investors in Europe and Asia — will continue to shape the market.

The stock markets have to change to respond to these needs. Listed companies and investors are demanding improvements in the process of exchanging stock. A next generation of stock markets is needed, not only to fulfill the capital formation function, but to provide worldwide, instant price discovery and trade execution in a fair, orderly, low-cost, and well-regulated environment, without time zone limitations.

We at the NASD plan to lead this effort.

As the premier electronic stock market in the world, we are poised for the challenge. We have already started on several fronts. With international alliances, domestic mergers, and the continued advancement of our high-speed communications and trading and regulatory networks, we are on the way to becoming a global network connecting with investors worldwide.

Here is what we have done recently and what we plan to do:

Nasdaq-Amex Combination. The NASD acquired the American Stock Exchange last autumn as the first step toward our vision to create a worldwide high-tech trading network delivering more and better products at lower cost. This combination creates the world's first major financial market that brings together a central auction Specialist system (Amex) and a multiple Market Maker system (Nasdaq) — in short, a "Market of Markets." By integrating such strengths as Nasdaq's technology expertise and premier issuer base with Amex's historic leadership in options and exchange-traded fund products, The Nasdaq-Amex Market Group increases choices and opportunities for market participants like never before. Offering two distinct market structures, Nasdaq-Amex can now provide the system that is best for any given company, and can deliver objective advice and consultation to companies in determining which system will benefit them most.

A significant investment in technology, including automating Amex trading, will lead to more efficient pricing, faster trade execution, and reduced transaction costs. Cost efficiencies for members will be realized as a result of the increased economies of scale and reduced order-handling charges.

Globally Linked Markets. We are continuing to explore acquisitions and alliances with other stock markets, both domestically and internationally. Internationally, we are collaborating, or holding discussions, with various stock exchanges and others to develop alliances that will expose investors outside the United States to our listed companies, and expose U.S. investors to listed companies from abroad.

Our plan is to create Nasdaq-type markets, using the Internet, to connect pools of liquidity and to provide real-time trading information and execution internationally. Over time, this will lead to dual listings of companies on Nasdaq-Amex and overseas markets, and eventually to a transparent, seamless, electronic, well-regulated, global marketplace in which investors can buy and sell global securities anytime, anywhere in the world.

Last year we embarked on a venture with the Stock Exchange of Hong Kong (SEHK) to create a cross-listing program and joint Web site that enables U.S.

investors to trade in non-U.S. securities, and vice versa. In a pilot project, Nasdaq companies will trade on SEHK and Hong Kong companies will trade on Nasdaq. The new joint Web service allows investors to review financial data and maintain their portfolios for stocks on both SEHK and Nasdaq-Amex in the currency of their choice.

We see major potential in Asia. We are exploring similar cross-border opportunities with the Shanghai Stock Exchange and other Asian markets as well. China has tremendous potential as a securities market. During 1999, we will open an office in Shanghai. We also see major potential in Europe, where we are exploring joint programs with several markets.

We are launching a Web-based stock screening investment service in the United Kingdom to help empower individual investors by giving them the same type of sophisticated research tools used by institutions. Nasdaq-Amex already has a U.K. Web site. We are exploring other ventures in the U.K. where sophisticated investors are increasingly interested in our growth companies.

Regulation Keeping Pace with Changing Markets. NASD Regulation will keep pace with these dramatic market changes, the extraordinary growth in retail investor participation, advances in technology, and globalization. Regulation of trading in the new global market will be enhanced by new Internet technology, including advanced electronic surveillance systems, to ensure continued investor confidence, which is the cornerstone of a successful market.

More Trading Hours and NASD Restructuring. As part of such dramatic changes to the existing market system, we are studying extending trading hours into the evening, earlier in the morning, or both. This change would benefit investors who want to be able to trade stocks when they get home after work, and could deepen liquidity, benefiting investors, issuers, and our members.

Another change to the market being considered is restructuring The Nasdaq-Amex Market Group, making it a for-profit company. The equity could be owned by the Market Makers and corporate issuers, or even some of it, eventually, by the public through a stock offering. Done properly, a change in status could provide needed capital to build our marketplace, lower costs to our members,

and better serve investors. This type of restructuring already has been done by some overseas markets.

As you can see, we at the NASD don't intend to stand by as the world changes.

Record Nasdaq Growth. We experienced record growth in 1998 in trading volume and market value. Significantly outperforming virtually every other market index, the Nasdaq-100 Index emerged as a new "blue chip" indicator, demonstrating the importance of these and other Nasdaq-Amex companies to both the nation's and the world's economic vitality. Nasdaq has become the fastest growing equities market in the U.S., in addition to being home to America's fastest growing companies.

The NASD itself produced solid financial results in 1998, with consolidated revenues reaching an all-time high and net income increasing by 30 percent over the previous year. Our financial strength, in turn, enabled us to reduce trading costs to our members by \$130 million, and gave us additional resources to invest in people and technology for the future.

Individual investor participation is mushrooming, especially on the Internet, which now accounts for a third of all trading by individual investors. Nasdaq-amex.com, our investor Web site, now averages more than 24 million hits per day. This year, we will open our new \$37 million MarketSite, including a public interactive exhibit and a Nasdaq-Amex broadcast facility. It will be in Manhattan's busy and revitalized "new" Times Square and will give our listed companies increased visibility.

Rapid changes and improvements will continue in 1999 and beyond, leading toward our vision of being a prime creator of the next-generation stock market that will revolutionize trading. We will lead, not follow.



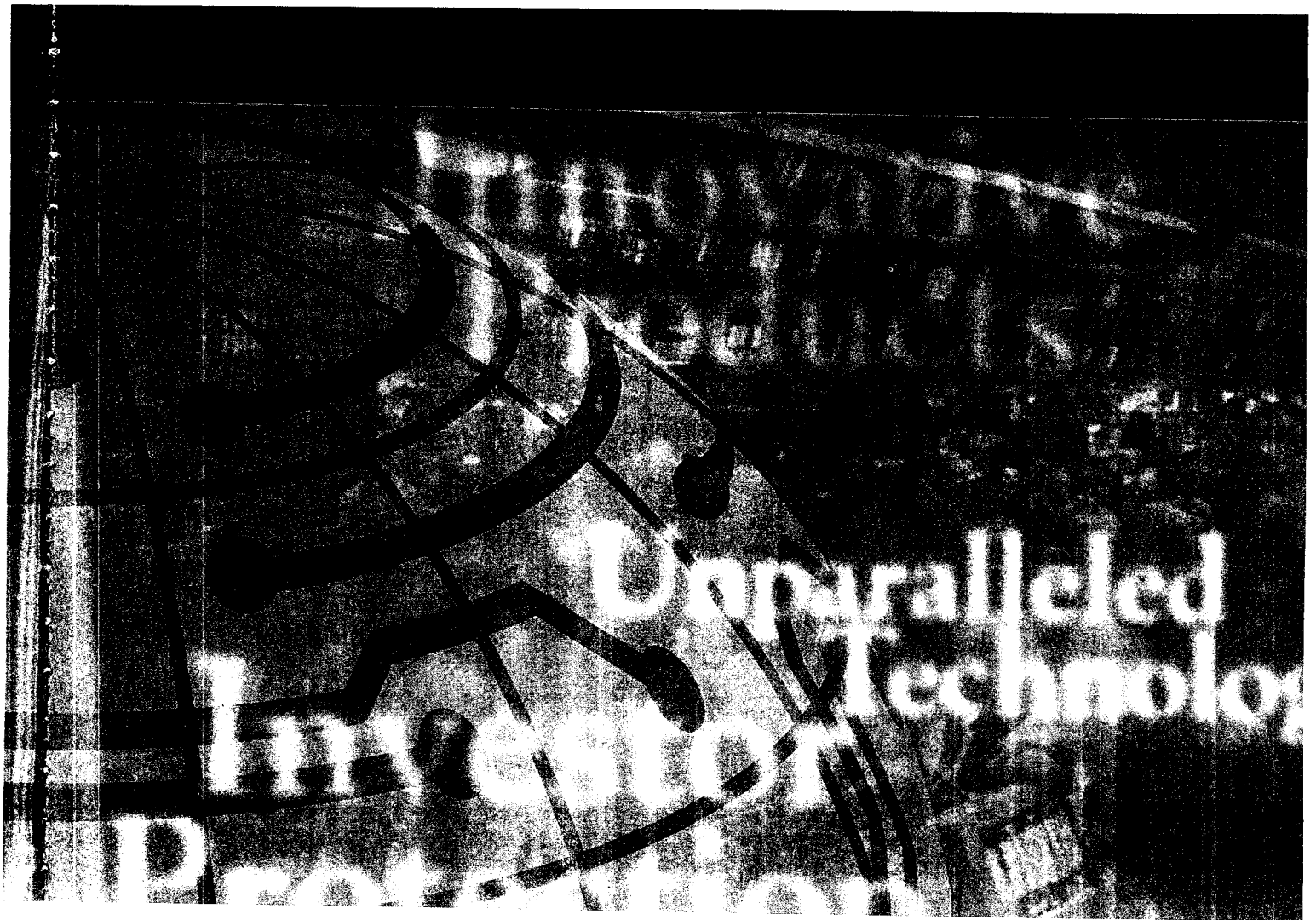
Frank G. Zarb
NASD Chairman and Chief Executive Officer
May 17, 1999



THE MARKET OF MARKETS

The Vision





The Market of Markets is NASD's vision for the changing face of global financial markets. With neither borders nor boundaries, it is poised to deliver value and opportunity in the fastest, most efficient manner to the ever-expanding universe of investors.

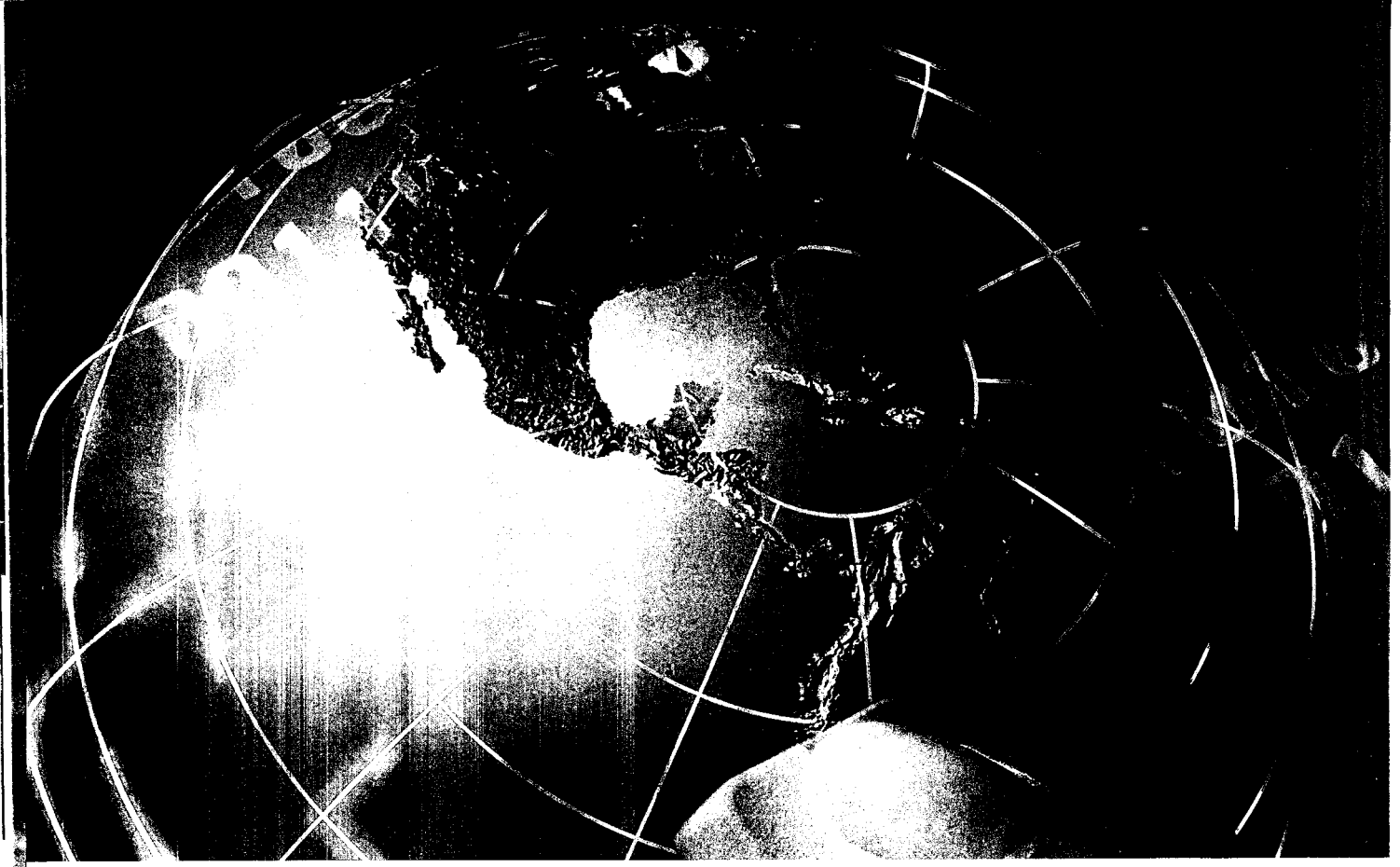
The Market of Markets transcends national and technological boundaries to connect investors and issuers worldwide. Free of limitations, it provides fair and inclusive access, bringing the world's financial markets to the screen of each and every investor. It provides a clear avenue to the world's top growth companies and a host of innovative investment products.

Through the most technologically advanced trading networks and comprehensive financial Web sites, it offers superior efficiency and visibility, and provides the highest quality market information to both companies and their shareholders.

Fulfillment of the Market of Markets vision will create a 24-hour, seamless, transparent, and well-regulated global market, providing high-quality investment products at lower cost to Wall Streets, Main Streets, and High Streets worldwide.

The Market of Markets builds the foundation for connecting market participants in the new millennium of investing.

GLOBAL REACH



Linking global markets for worldwide trading

Global
Reach

THE MARKET
OF
MARKETS

Total Non-U.S. Nasdaq-Amex Companies: 507

(as of year-end 1998)

Canada	189	Belgium	3
Israel	77	Switzerland	3
United Kingdom	50	Argentina	2
Bermuda	23	Denmark	2
Netherlands	19	Italy	2
Australia	17	New Zealand	2
Japan	16	Singapore	2
Hong Kong	15	Taiwan	2
Sweden	13	Virgin Islands	2
South Africa	12	Bahamas	1
Ireland	11	Belize	1
France	9	Brazil	1
Cayman Islands	6	Chile	1
Mexico	6	Finland	1
Germany	4	Indonesia	1
Greece	4	New Guinea	1
Liberia	4	Norway	1
Luxembourg	4		



NASD's strategic plan for a globally linked market is straightforward: Connect pools of liquidity and provide real-time information through international market partnerships to assemble a transparent and well-regulated 24-hour global market.

Our alliance with the Stock Exchange of Hong Kong (SEHK), initiated in 1998, demonstrates a cross-listing and information-sharing model of full market globalization with unlimited access. This will enable U.S. investors to trade in non-U.S. securities, and vice versa, with lower cost, fewer restrictions, and timely information.

In an innovative pilot program, 10 Nasdaq companies will trade as ordinary shares in Hong Kong and 10 Hong Kong companies will trade as ordinary shares on Nasdaq.

A new joint Web service — porttracker.nasdaq-sehk.com — is already in service. Investors can review financial data for stocks listed on SEHK and Nasdaq-Amex in either U.S. or Hong Kong dollars.

NASD is also exploring similar cross-border opportunities with many of the world's exchanges, including Deutsche Börse, the Shanghai Stock Exchange, and the Singapore Stock Exchange.

In all these initiatives, investor protection remains NASD's and NASD Regulation's (NASDRSM) highest priority. We are committed to fair and balanced regulation among the world's capital markets, while respecting regional culture and practices. NASDR puts the investor first through a regulatory agenda dedicated to investor protection and complete market integrity.



NASDAQ-100®



adaptec

ADC Telecommunications



ATERA

amazon.com

APC
AMERICAN POWER CONVERSION

MSFT

INTC

CSO

NCOM

DELL

HAS

FITB

NWAC

MLHR

SBUX

FHCC

QWST

YHOO

YHOO

Where do you find the
world's most exciting
companies?

Premier
Companies

THE MARKET
OF
MARKETS



Nasdaq-Amex is home to a diverse array of the world's most dynamic companies. They represent leaders in technology, manufacturing, biotechnology, transportation, communications, and finance. Why do high-performing companies choose Nasdaq-Amex?

By electing to list on a Nasdaq-Amex market, companies have access to:

- unmatched market quality and a growing global network
- international visibility and an expanded pool of investors
- innovative investment products, such as the Nasdaq-100 Index Tracking StockSM, designed to create wider demand for a company's equities
- the world's most advanced and comprehensive market technology and information services
- vigorous regulatory oversight and protection for their shareholders

Business Week's
100 Hot Growth Companies
 6/1/98

Nasdaq-Amex
 has
 95

Home
Feedback
Help & Reference
Investor Resources
Market of Markets
Site Map & Tour

InfoQuotes
News
Market Activity
Portfolio Tracking
Screening
Equity & Index Options
Index-Based Investments

Market Activity
May 12, 1999 Market Closed

Nasdaq Volume 1,032,502,400

Nasdaq Composite 2,606.54 ▲ 39.86

DJIA 11,000.37 ▼ 25.78

Quotes for Nasdaq, AMEX & NYSE

Enter up to 10 symbols for Stocks, Mutual Funds, or Options

MSFT	INTC	CSCO	WCOM	DELL
HAS	MLHR	AMZN	YHOO	SBUX

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Nasdaq Earnings Surprises

- ▲ 30 Exceeded Expectations
- 4 Met Expectations
- ▼ 30 Failed to Meet Expectations

[View Earnings](#)

Site News

- [The World of Investing in Transition: Day Trading. Know what you're getting into.](#)
- [The Mutual Educational Foundation Wins! Trading Awards.](#)
- [View Information about the NASD's Year 2000 Program.](#)
- [The Nasdaq-Amex Market Group and The Stock Exchange of Hong Kong Create a Joint Web Service for Investors.](#)

Refresh this page to update charts

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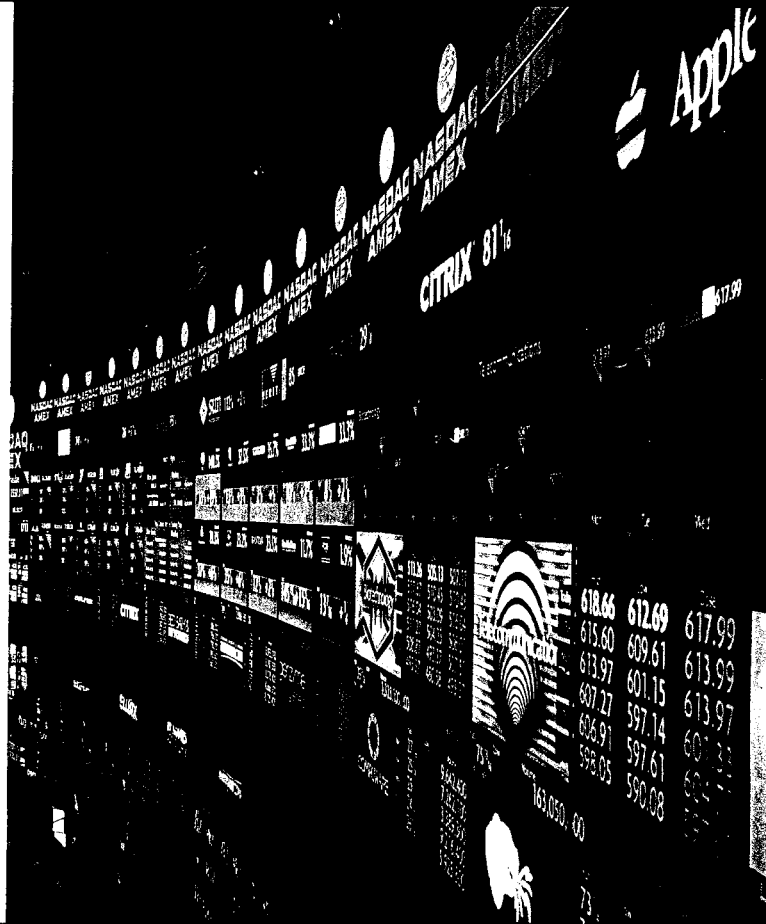
COMPUWARE



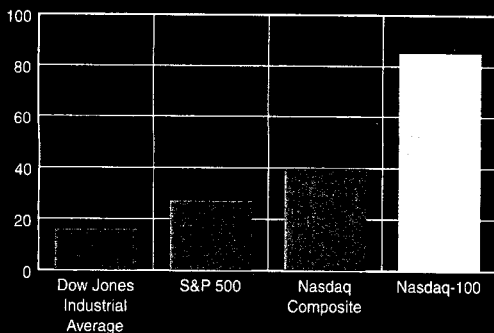
The Nasdaq-100 Index — the best performing major index in the world — includes Nasdaq's top 100 U.S. and international non-financial listed stocks. They are household names, some of the world's most exciting companies that have achieved success — and continue to surpass expectations — in their existing and newly created industries.

These companies are part of what makes The Nasdaq-Amex Market Group the most dynamic market. They are the new blue chips in today's competitive global economy.

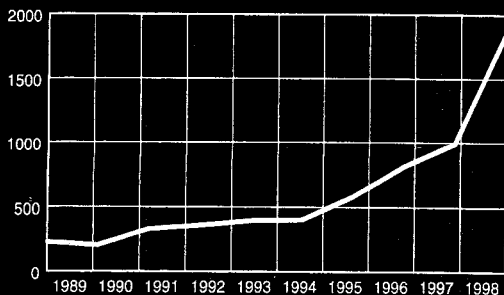
The Index reflects Nasdaq's largest growth companies across major industry groups, including computer hardware and software, telecommunications, airlines, department stores, retail/wholesale, and biotechnology. All index components currently have a market capitalization of at least \$500 million, and a minimum average daily trading volume of 100,000 shares.



1998 Industry Growth Comparison



Nasdaq-100 Index Value



Nasdaq-100 Index
1998 close: 1,836.01

85%
growth

58 percentage points
better than the S&P 500
68 percentage points
better than the DJIA

CONCORD EFS

Corporate EXPRESS

COSTCO WHOLESALE

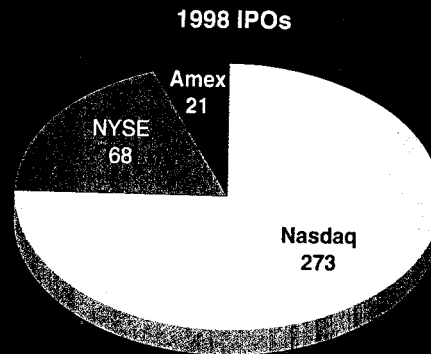
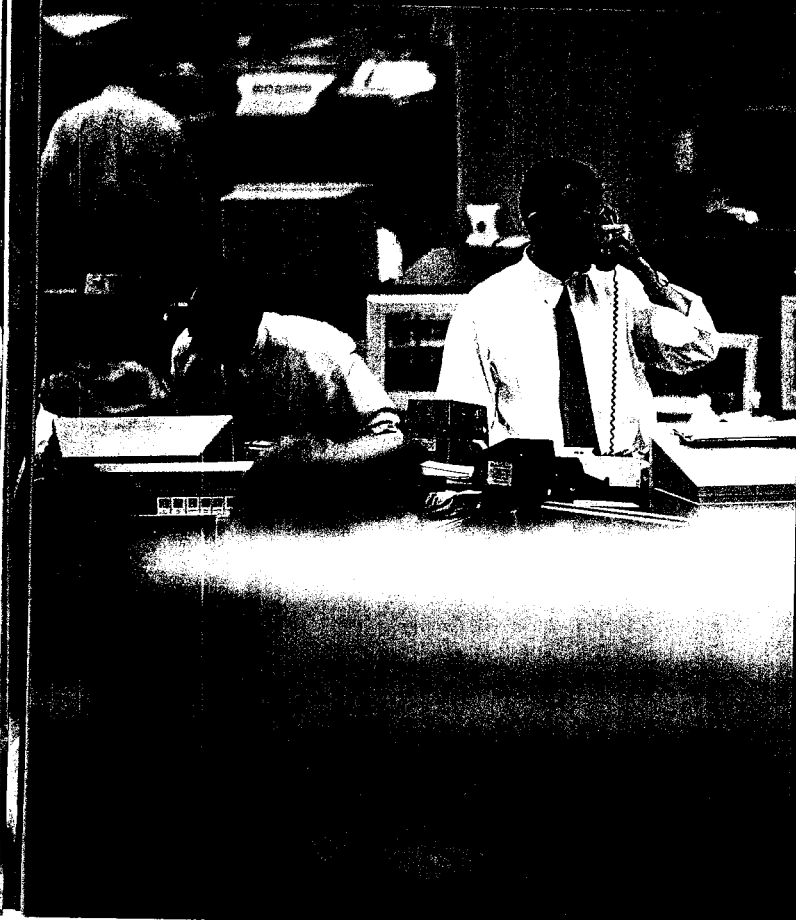
DELL

Dollar TREE

ELECTRONIC ARTS

Efi

FASTENAL FIRST IN FASTENERS



Participating Market Makers and Specialists helped Nasdaq-Amex offerings raise more than

\$35 billion

in 1998

More companies go public on Nasdaq-Amex



With more than 80 percent of U.S. initial public offerings, Nasdaq-Amex creates opportunities for new companies by providing them access to the capital markets. Newly listed companies invest this capital to grow their companies, and to deliver value to consumers and shareholders.

Nasdaq-Amex provides investors with opportunities to invest in emerging industry leaders. By bringing issuers and investors together efficiently, The Nasdaq-Amex Market Group creates exciting opportunities to participate in leading-edge developments in business, science, and technology — developments that fuel economic growth worldwide.



Innovative Investments at lower cost.

THE MARKET OF MARKETS

The Amex is a true pioneer in investment products. Its creation of Index Share products allows investors to invest in diverse pools of equities — trading groups of equity shares as if they were single stocks — at the lowest possible cost with the highest convenience. Index Share products currently include SPDRs® and MidCap SPDRs™, based on the S&P 500 and MidCap 400 indexes, respectively; Select Sector SPDRs, based on S&P 500 companies; DIAMONDS™, based on the Dow Jones Industrial Average; and WEBS™, based on a selection of Morgan Stanley Capital International (MSCI) indexes.

In a perfect example of the synergies in The Nasdaq-Amex Market Group, in early 1999 we launched the Nasdaq-100 Index Tracking Stock, a new product based on the Nasdaq-100 Index. A unit investment trust, it is designed to track closely the price and yield performance of the Nasdaq-100 Index. This proved to be the most successful product launch in Amex history, trading 2.6 million shares in its first day.

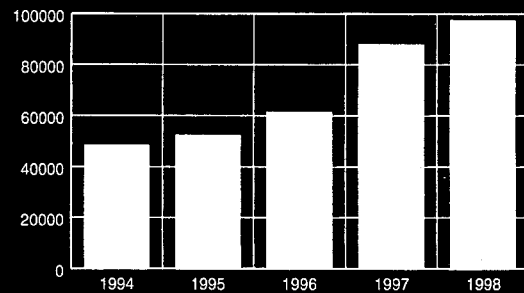
Amex also introduced its long history of expertise in options trading to The Nasdaq-Amex Market Group alliance. Amex trades options on 26 indexes that represent entire groups of stocks embracing specified domestic or global industries or markets. In this way, index options provide diversity for investors because one option consists of many individual stocks.

Trading in options opens a wide range of investment strategies to investors, offering greater flexibility and control of stock holdings as well as broader opportunities to enhance investment returns.

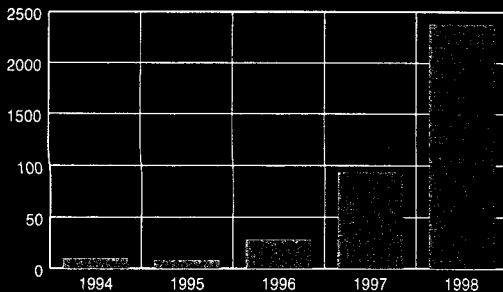
Amex Continues to Offer Investment Choice

	Started In
SPDRs	1993
MidCap SPDRs	1995
WEBS	1996
DIAMONDS	1998
Select Sector SPDRs	1998
Nasdaq-100 Index Tracking Stock	1999

Options Trading Volume



Total Index Shares Volume (in millions)



Nasdaq-100 Index Tracking Stock

2.6 million

shares in its first day of trading

As one of the premier exchanges in options trading, the Amex trades put and call options on more than 1,100 common stocks and 26 broad-market, sector, and international indexes. Nasdaq-Amex now offers quotes on the Internet for equity and index options (nasdaq-amex.com).

Our options market has advanced technology and lowered costs significantly. Recent changes applying to both equity and index options represent a savings to member firms of more than 50 percent on transaction charges. Amex has also upgraded its technology to increase trading efficiency.

The Amex share of options trading volume rose from 18 percent in 1994 to 24 percent in 1998, demonstrating growth that will only continue as efficiency improves.

NEXTEL NORDSTROM  NORTHWEST AIRLINES Novell  ORACLE PACCAR Inc 



Technology unlike any other stock market

THE MARKET
OF
MARKETS

Unparalleled
Technology

Market Technology

As the founder of the electronic financial marketplace, Nasdaq-Amex leads the way in providing a level playing field for all investors. Striving for the highest levels of efficiency, Nasdaq-Amex has the technology platform in place to reduce costs and ultimately provide greater convenience for investors, members, and issuers.

Nasdaq/OptiMark Alliance

Nasdaq is working with OptiMark Technologies to implement its computerized trading system, which matches buyers' and sellers' anonymous orders, reflecting the willingness to trade at multiple prices and sizes.

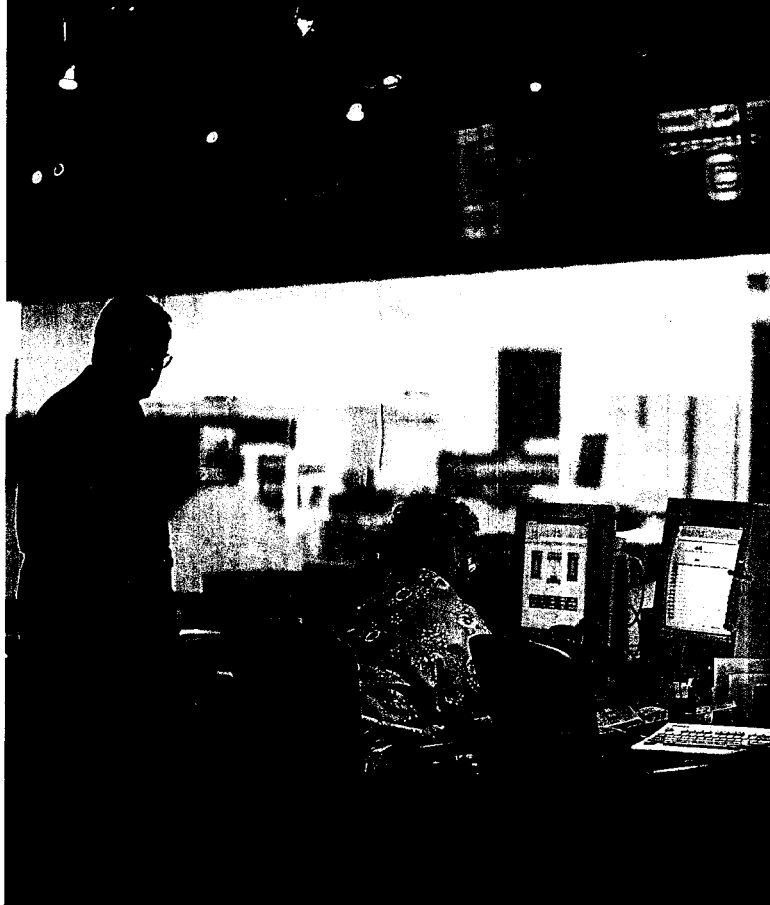


The new technology is expected to increase opportunities for price improvement and reduce Nasdaq trading costs by increasing the likelihood that investor orders will find matches at the desired price and size.

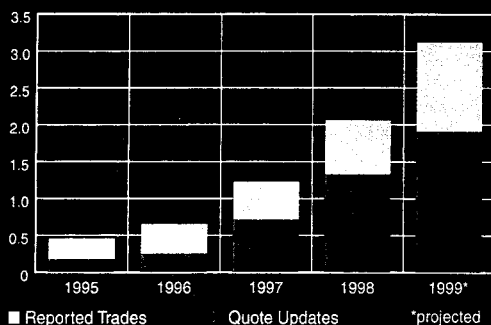
OptiMark will also enable institutional investors to trade large orders with reduced impact on price, and individual investors to access the same facility as large customers and market professionals.

Enhanced Nasdaq SelectNet Access

In 1998, we encouraged NASD members to offer their institutional customers a service to route orders electronically and directly into the Nasdaq SelectNetSM system. SelectNet facilitates trading and negotiation with the possibility of price improvement, elimination of verbal contact between trading desks, and automatically reported, compared, and cleared trades, as well as before- and after-hours trading. Traditionally, SelectNet has been used by NASD members to access the quotations of other Market Makers and Electronic Communications Networks (ECNs).



Average Daily Nasdaq Trades & Quotes
(in millions)



Amex Electronic Limit Order Book

NASD is working with Amex to provide unprecedented access to the Amex trading floor with a new Electronic Limit Order Book. This state-of-the-art system will allow electronic orders from on and off the trading floor and provide automatic execution capabilities at lower costs. It will also provide greater transparency by enabling investors to view orders in the Book beyond those at the inside bid and ask.

Unlike anything the central auction Specialist markets have seen, the Amex Book will provide all investors — without exception — the ability to interact with the market instantaneously. With the implementation of this innovation, Amex will be the most technologically advanced auction market in the world.

Information Delivery

We are constantly looking for ways to provide investors with a broader context in which to make investment decisions. The award-winning Nasdaq-Amex Web site, nasdaq-amex.com, has emerged as one of the top sources of financial information on the Internet,



NASDAQ TRADER

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PSFT | **Trading Data** | **Proprietary Trading Data** | March 1999

10,740,371	MASH	6,486,787	MLCO	6,139,642	MSCO	4,777,982	SBSH	4,475,567	OSCO
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[Merrill Lynch](#) | [Merrill Lynch](#) | [Merrill Lynch](#)

Nasdaq News

Friday April 30, 1999

- Technical Update/Change - New Version of Nasdaq Workstation II Software Will Be Implemented in May
- Technical Update/Change - Delay of PIP Modifiers and P Participation's Expiry
- Word of Mouth Alerts/PSFT - PSFT Fee Adjustment Extended until March 31, 2000
- General News - Issuance List of SPKAS in The Nasdaq Stock Market
- Market 100 Update - Changes Effective May 2 and May 6, 1999
- Technical Update/Change - Suspension of Special Services Network
- Vendor Alert #1999-3 - Media Launches First Free-to-View Non-Professional Market Data Feed
- Industry Update/Change - 201 CCI Spoke News Modified in Support of OptiWay
- Market Operations News - Market Participant Membership Change for CIBC Securities Corporation (CPOC)
- Market Operations News - Market Participant Membership Change for Clearing G.P. Bellard Inc. (CGBL)
- General News - The Nasdaq Index On-Respectively Trading Data Provided for Comment in the Federal Register
- General News - New Earnings Reports Introduced by WBC, July 20, 1999

Circuit Breakers

EWN II

Head Trader Alerts

Market Ops News

Technical Updates

Trader Manual

UPC Notices

Upcoming Events

NASD REGULATION

An NASD Company

Investors and the Securities Industry

REGULATING THE SECURITIES INDUSTRY FOR THE BENEFIT AND PROTECTION OF INVESTORS

Tell Us About Problematic Day Trading Practices

averaging 24 million hits a day. The site offers a "window on the market" by making institutional-quality information available to the individual investor.

NASDR has taken the lead in educating investors through nasdr.com. This site assists individual investors in choosing a broker by providing the ability to review the background on securities firms and their associated personnel. It provides NASD member firms and securities professionals with information about the rules and regulations that govern the securities industry.

NASD's Web-based products provide the best information to all market participants, including:

- Nasdaq-Amex Online: An exclusive service for issuers providing real-time market intelligence on all publicly traded companies from a single, integrated source.
- www.nasdaqtrader.com: Provides information specific to the professional trading of Nasdaq securities.
- www.nimi.com: For those involved in the development and implementation of markets around the world who seek information and technical assistance.
- www.nasdaq-uk.com: A site for international investors and part of an initiative to provide institutional-quality information on The Nasdaq Stock Market and its listed companies to investors in major European markets.
- www.investor.nasd.com: Provides individual investors with online training, information on working with brokers, and an investing education curriculum.
- www.nasdaq-amexnews.com: Provides a wide variety of information to the news media about the Nasdaq and Amex markets.

THE MARKET OF MARKETS

Unparalleled Technology

- www.porttracker.nasdaq-sehk.com: Provides international investors a single source for tracking stocks from the Stock Exchange of Hong Kong, Nasdaq, Amex, and other U.S. equities, mutual funds, and options, in either U.S. or Hong Kong dollars.

Regulatory Technology

Ongoing integration of new and existing technologies enables NASDR to be at the leading edge of regulatory efficiency, with lower costs and enhanced ability to provide an orderly market for investors.

Advanced Detection System (ADS)

ADS, a break detection system that identifies potential violations, was upgraded. The ADS system was nominated for three national technology awards in 1998.

Central Registration Depository (CRD) Modernization

The CRD, first implemented in 1981, is the single repository for all licensing, qualified work history, and disciplinary history of 600,000 registered representatives and 6,000 firms. CRD system modernization will be complete in the third quarter of 1999 and available to member firms and regulators via the Internet.

Integrated Regulatory Information System (IRIS)

IRIS is an NASDR intranet application that integrates data from various regulatory systems and provides a consolidated, detailed perspective of member firms and associated persons. IRIS Risk Profile serves as an automated tool to assess the regulatory risk characteristics of member firms.

Neutral List Selection System (NLSS)

NLSS provides parties involved in a dispute with a significantly greater role in selecting arbitrators. Procedures implemented in 1998 incorporate newly developed software that rotates and lists arbitrators in different hearing locations. After parties rank the listed arbitrators, NLSS consolidates the rankings and selects arbitrators accordingly.

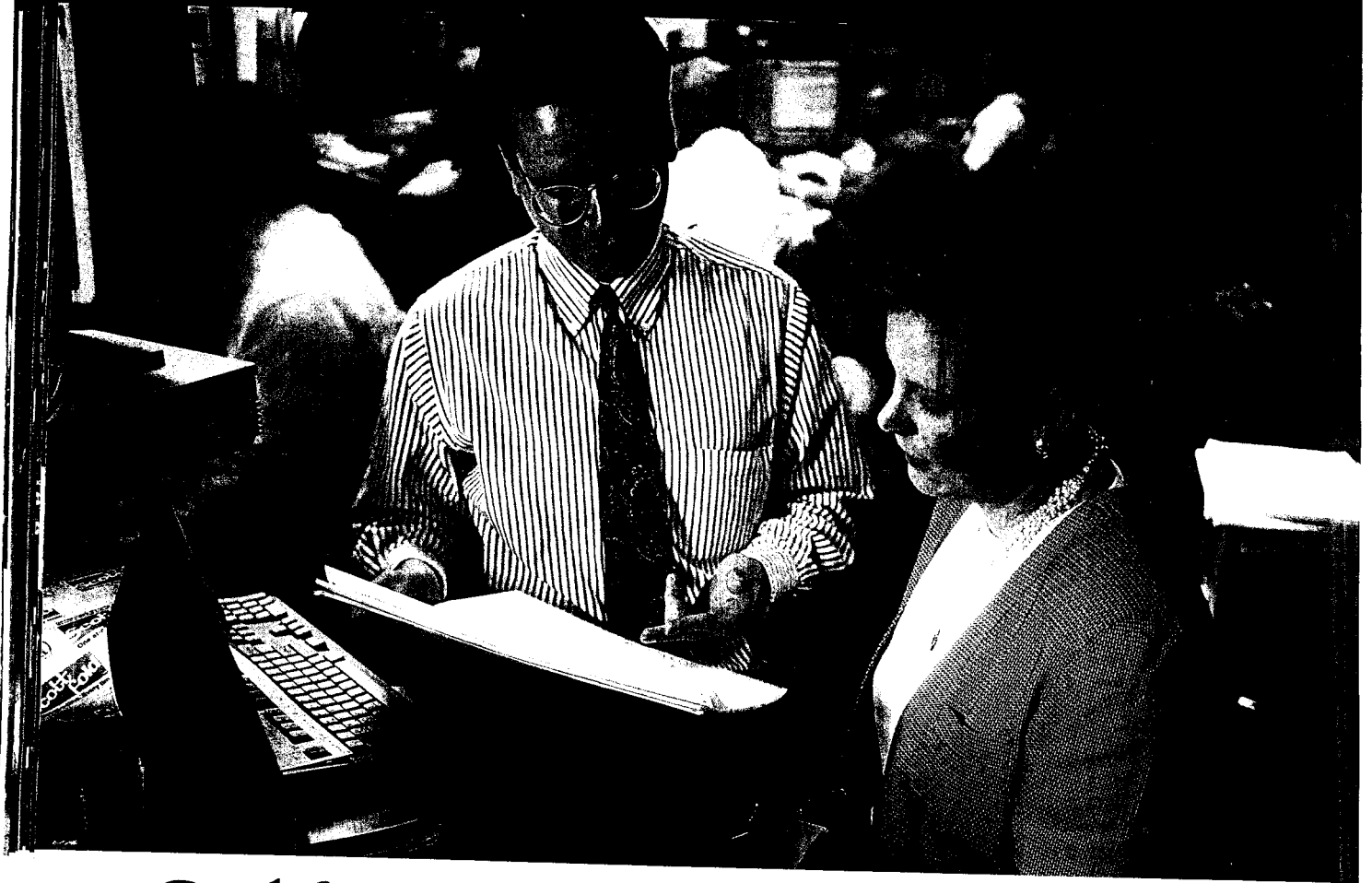
Order Audit Trail System (OATS)

OATS provides a system that monitors the processing of customer securities orders from the moment the broker is contacted to the moment the transaction is executed and reported. The ability to allow clearing firms access to OATS data on behalf of their correspondent firms was added in March 1999.

YEAR 2000

The financial community has joined together in cooperative and coordinated preparations for Y2K. The NASD Year 2000 Program Office is on target and continues to meet and exceed set objectives.

NASD, Nasdaq-Amex, and NASDR are ready for 2000.



Self-regulation: The front line of investor protection

Market confidence is built on trust that material information is disclosed, prices are fair, fiduciary obligations are honored, and abusers of public trust are punished.

In the U.S. securities markets — the deepest, most liquid, and transparent in the world — self-regulation ensures these important standards are enforced.

NASD Regulation puts investors first. This self-regulatory entity thrives on its close collaboration with the securities industry and its wealth of talent, as well as the cutting-edge technological expertise that exists within the NASD.



NASDR is on the front line of investor protection. Despite the changing landscape of investing, the fundamental ethics remain the same. NASD members must deal fairly with customers when making recommendations, executing orders, and charging commissions.

NASDR monitors compliance and enforces securities laws through examinations and special investigations of its members. NASDR vigorously enforces the compliance of securities firms and professionals with NASD rules by imposing fines, suspensions, limitations on business, bars, and expulsions of firms and individuals from the industry.

Securities Industry Personnel

In order to promote the high quality of securities industry personnel, NASDR ensures that the brokers who serve investors are qualified to do so. Securities professionals must pass competency examinations administered by NASDR that ensure understanding of federal securities laws, NASD rules and regulations, the operation of financial markets, and the uses, features, and tax treatment of securities products. These individuals continue to receive important training and education throughout their careers.

Communication and Underwriting Reviews

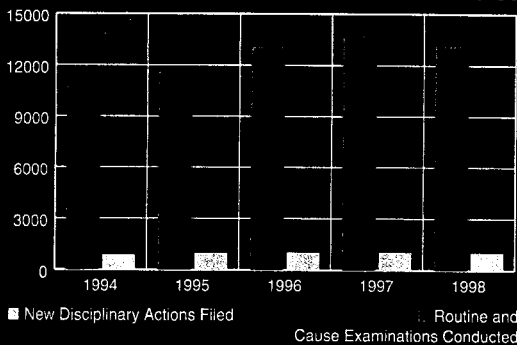
To protect investors from false and misleading information, NASDR regularly reviews member firms' advertising, print and electronic sales literature, research reports, and e-mail.

NASDR reviews member firms' underwriting terms and arrangements in connection with all public offerings to ensure that underwriting compensation paid to the member is fair, and that the terms and arrangements are equitable.

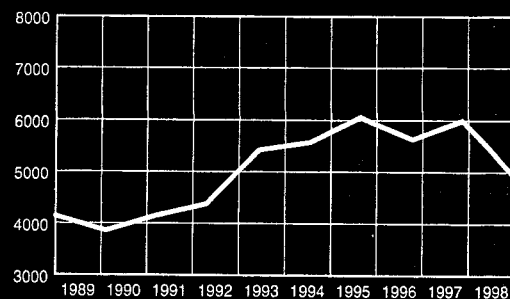
Dispute Resolution

To assist in the resolution of monetary and business disputes between investors and securities firms, and in the resolution of employment disputes between persons and their firms, NASDR operates the largest dispute resolution forum in the securities industry, including both arbitration and mediation programs. Mediation and arbitration benefit investors by providing prompt, inexpensive alternatives to litigation in the courts. NASD arbitrators and mediators are selected from a broad cross section of people, diverse in culture, profession, and background.

**NASDR New Disciplinary Actions Filed/
Routine and Cause Examinations Conducted**



NASD Regulation Arbitration Cases Filed





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NASD's Board of Governors, innovative and visionary individuals, understands the inherent challenges of the securities industry. They are people who have led industries, major corporations, and even our country through periods of change. Half of the membership comes from outside the securities industry.

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1998 STATISTICAL HIGHLIGHTS

NASD	
Member firms	5,592
Member firm branch offices	70,752
Registered representatives	589,120

THE NASDAQ STOCK MARKET

Annual share volume	202,040,229,000
Annual dollar volume	\$5,758,558,039,000
Average daily share volume	801,747,000
Average daily dollar volume	\$22,851,420,790
Market capitalization	\$2,558,776,649,000
Companies listed	5,068
Issues listed	5,583
Market makers	535
Non-U.S. securities and American Depository Receipts (ADRs)	484
International share volume (non-U.S. and ADRs)	11,362,443,000
International dollar volume (non-U.S. and ADRs)	\$215,948,147,000
Initial public offerings	273
Value of initial public offerings	\$13,757,270,000
Secondary public offerings	215
Value of secondary public offerings	\$19,651,720,000

AMERICAN STOCK EXCHANGE

Members	
Regular	661
Registered options principals	203
Annual share volume	7,310,268,000
Annual dollar volume	\$283,057,963,000
Average daily share volume	29,009,000
Average daily dollar volume	\$1,123,245,880
Market capitalization	\$152,269,761,000
Companies listed	770
Issues listed	900
Specialist units	23
Non-U.S. securities and ADRs	67
International share volume (non-U.S. and ADRs)	942,077,825
International dollar volume (non-U.S. and ADRs)	\$6,218,875,454
Initial public offerings	21
Value of initial public offerings	\$386,950,000
Secondary public offerings	23
Value of secondary public offerings	\$1,332,650,000
Equity options volume	94,332,281
Index options volume	3,329,392
Total options volume	97,661,673

Index Shares	
SPDRs volume	1,747,807,100
MidCap SPDRs volume	94,746,900
DIAMONDS	138,095,500*
WEBS	254,228,000
Select Sector SPDRs	2,912,500**
Total index share volume	2,237,790,000

NASD REGULATION

Compliance	
Routine examinations conducted	2,606
Terminations for cause received	3,347
Terminations for cause completed	3,535
Other cause examinations received	1,262
Other cause examinations completed	1,311
Customer complaints received	5,957
Customer complaints completed	5,671
Disciplinary Actions	
New disciplinary actions filed	1,051
Formal actions resolved	1,153
Firms expelled	8
Individual registrations revoked	102
Individuals barred from the industry	384
Firms suspended from membership	2
Individuals suspended	273
Advertising	
Total items reviewed from filings, spot checks, and investigations	65,980
Corporate Financing	
Underwriting arrangements reviewed	1,754
Public offerings reviewed (\$ billion)	\$417
Arbitration	
Cases filed	4,938
Cases closed	5,484
Disputes resolved between parties without arbitration	3,566
Industry cases arbitrated	345
Customer cases arbitrated	1,573
Cases decided in favor of customers	937
Mediation	
Cases brought	863
Cases closed	1,158
Cases settled	932
Qualifications	
Registered representative and principal examinations administered	318,583
Continuing Education	
Training sessions delivered (under the auspices of the Securities Industry/Regulatory Council on Continuing Education)	125,000

*DIAMONDS began trading on 1/20/98

**Select Sector SPDRs began trading on 12/22/98

1998

CONSOLIDATED FINANCIAL STATEMENTS

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Management Report on Financial Operations



Salvatore F. Sodano

*NASD Chief Operating Officer
and Chief Financial Officer, and
American Stock Exchange Acting
President*

The National Association of Securities Dealers, Inc. (NASD), produced solid financial results in 1998. Consolidated revenues reached an all-time high of \$740 million, approximately \$106 million, or 17 percent, ahead of last year's total of \$634 million. Net income increased by approximately 30 percent to \$47 million, one of the best outcomes achieved in the organization's history. The continued financial success of the NASD reflects the strong, although volatile, performance and activity of the securities markets overall in 1998, including the sharp growth in trading volume of The Nasdaq Stock Market (Nasdaq), which jumped over 23 percent to an average of 802 million shares per day. Transaction growth was even higher at 44 percent, illustrating the greater presence in the market of the small investor. Also contributing to the higher revenue levels were the results from the acquisition of the American Stock Exchange (Amex LLC). Overall, nearly 38 percent, or \$40 million of the higher revenues in 1998 reflect the results of operations of Amex LLC for the last two months of the year.

Demand for market information as measured by professional, retail, institutional, and non-professional users rose 19 percent as the population boosted to over 529,000 with revenues expanding by over \$27 million. Conversely, Nasdaq transaction service fees fell \$15 million despite materially higher share and trade volumes, principally as a result of enactment of substantial fee reductions for member firms totaling over 70 percent from those in effect in the prior year. This action saved the industry and investors over \$130 million in 1998.

Nasdaq issuer fees climbed over \$24 million, or 22 percent, as a result of targeted fee increases to fund the costs of incremental value-added visibility and information services provided to this segment of our listed companies.

On the regulatory side, assessments based on members' business volumes grew by \$11 million, or approximately 13 percent, providing funding for continued diligence on regulatory initiatives aimed at responding to the SEC's 21(a) report requirements and other emerging regulatory issues. Registration and qualification fee revenues also gained by \$10 million or 15 percent from comparable gains in the volume of registrations and exam enrollments as the population of registered representatives continued to escalate by 5.5 percent to accommodate growth in industry activity. Regulatory transaction fees increased by over \$7 million, or 32 percent, as a direct result of the increase in average daily share and trading volume. Additionally, price increases applicable to our dispute resolution service, the largest such forum in the nation, were established in 1998, causing a net revenue gain of \$6 million despite an 18 percent decline in new case volume.

Although operating expenses, excluding Amex LLC, trended up by \$80 million, or 14 percent, spending was targeted to strategic resources and initiatives aimed at the NASD's "Market of Markets" vision. Specifically, over \$30 million of cost savings from the "Reinvesting for Our Future" program were implemented and redeployed to higher priority initiatives. Comparative results demonstrate the organization's success in minimizing absolute cost growth in administrative expense areas, such as occupancy, travel, and printing and postage, while directing resources to regulatory and technology staffing, contract personnel and computer operations, data communications, and technology capital. In particular, a key focus of our efforts

in 1998 was devoted to major system development projects, including the Year 2000 program; the modernized Central Registration Depository; the Order Audit Trail System, a unique regulatory system designed to promote the integrity of retail order processing; and the initial stage of a \$110 million commitment to upgrade the technology of Amex LLC. Regulatory resources were supplemented to continue to implement regulatory improvements in response to the undertakings emanating from the SEC's 21(a) report issued in the latter half of 1996, as well as to respond to emerging regulatory issues, in particular those related to the microcap market and Internet activities. At the end of 1998, the NASD had fulfilled \$86.9 million of its \$100 million commitment to the SEC to devote incremental resources over the period 1996 through 2001 to enhance the NASD's market surveillance systems and to increase staffing for member examinations, surveillance, enforcement, and internal audit. This commitment is expected to be fully met in 1999.

The acquisition of Amex LLC in late 1998 provides the NASD with unique opportunities and challenges going forward. The NASD has committed to spend \$110 million over the next five years to upgrade the technology and facilities supporting Amex LLC's market trading and administrative systems, as well as \$30 million over two years to promote The Nasdaq-Amex Market Group (Nasdaq-Amex) brand identity through a public relations and advertising program. These efforts are intended to create a more efficient, lower cost trading environment for Amex LLC, as well as to enhance the attractiveness of a listing within The Nasdaq-Amex Market Group. The financial success of this alliance is also expected to be achieved through realization of annual cost savings of \$70 million by the end of 2001 as a result of reduction or elimination of redundant administrative processes and marketing services as well as through technology improvements. These savings are expected to be passed on to the industry.

During 1998, the NASD also began the deployment of a new communications infrastructure to link Nasdaq's computerized market facilities to the market participants. This state-of-the-art network is being developed and managed by MCI WorldCom, whereby the NASD has agreed to provide a minimum guarantee of \$300 million through the year 2003, whose costs will be covered directly from market participants. This custom intranet will be able to handle a four billion share day level soon after the full rollout is accomplished, and is scalable up to eight billion shares. In order to lessen the financial impact, particularly on our smaller members, of transitioning to the new network, the NASD absorbed the \$6.2 million cost of installing the higher capacity lines at each firm.

The NASD continues to examine ways to lower its costs and rationalize the nature and sources of its revenues to fund its operations. In 1998, we launched the Enterprise Review initiative, which is focused on identifying cost reductions through consolidation of shared services and leveraging opportunities with vendors, as well as pursuing revenue enhancement opportunities linked to value-added services. The NASD has a target of identifying and implementing \$50 million in margin impact from this program. As part of this effort, the NASD announced in late 1998 an agreement-in-principle with EDS Corporation to establish

an alliance, NasTech, through which EDS will provide state-of-the-art technology services to the NASD's regulatory and administrative operations. This alliance is expected to bring to the NASD strategic technology capabilities as well as significant cost efficiencies.

Capital spending on property and equipment totaled \$68 million in 1998, about one-half the peak of \$122 million in 1997. Spending on technology and related facilities accounted for the largest portion, totaling \$53 million as the NASD continued to respond to the rapid growth in Nasdaq market volumes and associated surveillance and regulatory systems. During 1998, the NASD Board acted on two major capital commitments. We have budgeted to expend \$70 million to complete the construction of a 250,000 square foot office facility in suburban Rockville, Maryland, by the end of the year 2000, in order to consolidate our Washington, D.C. area operations. It is anticipated that this consolidation will save \$19 million in occupancy costs over a period of 10 years. Additionally, the Board approved funding of approximately \$37 million for the construction of a new "Global Investor Center" and broadcast facility located in the New Times Square in New York City. The new Nasdaq-Amex MarketSite is expected to further enhance the competitive value of listings on our markets by improving the visibility and stature of The Nasdaq-Amex Market Group in order to achieve the "Market of Markets" vision and will be completed by the end of 1999.

The NASD entered 1999 with working capital of \$262 million and members' equity of \$450 million. These levels remain sound and place the NASD in a firm position to meet the financial commitments and challenges ahead.

Year 2000

The Year 2000 issue is the result of computer programs using two digits rather than four to define a given year. Computer programs that process dates having two-digit years may recognize "00" as 1900 rather than the year 2000. Also, an algorithm sometimes used to calculate leap years may not work when the year is represented as "00." These shortcomings in date processing may cause miscalculations or even system failures affecting various activities and operations of the NASD.

Based on an initial assessment in 1996, the NASD determined that the Year 2000 issue would have a material impact on business operations unless steps were taken to modify ("remediate") or replace certain software and hardware systems. Accordingly, the NASD implemented a comprehensive program to identify, analyze, and remediate or replace these systems. As of December 31, 1998, 100 percent of the NASD's mission critical systems had been remediated or replaced, and over 98 percent of all other remaining systems had been completed. Remediation or replacement of all remaining systems is expected to be completed by mid-1999.

The NASD also has in place formal programs to ensure that its facilities and third-party vendors are Year 2000 compliant. As of December 31, 1998, 100 percent of the Company's mission critical facilities, which include power and telecommunications, and 96.8 percent of other facilities, were determined to be Year 2000 compliant. In terms of vendor-supplied

hardware and application software, 54.5 percent of vendor-supplied hardware and 90.4 percent of application software were compliant. The compliance of all pending facilities and third-party vendors is expected to be completed by mid-1999.

The total cost of the Year 2000 program is estimated at approximately \$55 million and is being funded through operating cash flows. To date, the Company has incurred approximately \$41 million (\$33.9 million expensed and \$7.1 million capitalized for new systems and equipment) for activities related to all phases of the Year 2000 program. These costs have not and are not expected to have a material adverse impact on the Company's financial position, results of operations, or cash flows.

The costs of the project and the date at which the Company plans to complete the Year 2000 modifications are based on management's best estimates. These estimates were based upon numerous assumptions as to future events, including continued availability of certain resources and other factors. However, there can be no guarantee that these estimates will be achieved, and actual results could differ from those anticipated.

The NASD will continue to monitor the compliance of internal systems through 1999 and into the next century. The NASD is participating in the Securities Industry Association (SIA) sponsored industry-wide test in addition to direct testing with external vendors and members. In order to ensure "business as usual," Business Continuity Plans are also being updated to provide further protection for our computing systems, physical facilities, and communications systems in case of unexpected events. The NASD intends to complete and test these plans by July 31, 1999. Each plan will be exercised for effectiveness and completeness. As the transition to the new millennium occurs, the NASD will be staffed and ready to execute the business continuity plans as defined.

The NASD management believes that the comprehensive Year 2000 program described above will ensure the success of internal systems and the business processes they support. Management has confidence in its program to manage the compliance of third-party products, services and facilities-related systems. Extensive testing with other critical elements of the securities industry has shown a high level of readiness for the millennium change. However, failures external to the industry which bear directly upon its critical elements could have material adverse effects upon the NASD. Similarly, Year 2000 difficulties in another segment of the U.S. economy could have an adverse effect upon the NASD through reduced economic efficiency and activity.

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). 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 the 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 the NASD. Important elements of the internal control system include capital and operating budgets, which are subjected to continuous review and reporting 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 the NASD's Internal Review Department. The Internal Review Department is directly responsible to the Audit Committee of the Board of Governors of the NASD. It is management's opinion that the system of internal control as of December 31, 1998, is effective in providing reasonable assurance that the consolidated financial statements are free of material misstatement.

The Board of Governors of the NASD establishes charters for its Audit and Finance Committees, as applicable. The Audit Committee reviews the following: the adequacy and effectiveness of the NASD's internal controls; significant financial reporting issues and practices, including new or changed accounting principles and disclosures; the scope and results of the annual audit of the NASD's financial statements by the independent auditors; and monitors the independence and performance of the independent auditors. The Audit Committee consists exclusively of non-employee governors, a majority of whom are non-industry governors, including at least two public governors.

The Finance Committee oversees the financial operations and condition of the NASD through review and discussion of current financial results; reviews annual operating and capital budgets and material modifications thereto; and reviews all other financial matters related to the operation and financial position of the NASD. The Finance Committee, with the exception of the Chairman and CEO of the NASD, consists of non-employee governors, a majority of whom are non-industry members.

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, 1998, and 1997. 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.

Consolidated Balance Sheets

		Year Ended December 31 (In Thousands)	
		1998	1997
Assets	Current assets:		
	Cash and cash equivalents	\$ 143,325	\$ 43,551
	Investments:		
	Available-for-sale, at fair value	377,108	-
	Held-to-maturity, at amortized cost	11,582	108,713
	Receivables, net and other current assets	112,234	76,160
	Total current assets	<u>644,249</u>	<u>228,424</u>
	Investments:		
	Held-to-maturity, at amortized cost	16,588	221,637
	Property and equipment:		
	Land, buildings, and improvements	97,856	89,440
	Data processing equipment and software	253,229	232,783
	Furniture, equipment, and leasehold improvements	150,213	125,237
	Total property and equipment	<u>501,298</u>	<u>447,460</u>
	Less accumulated depreciation and amortization	(254,167)	(203,834)
Total property and equipment, net	<u>247,131</u>	<u>243,626</u>	
Other assets	13,252	3,884	
Total assets	<u>\$ 921,220</u>	<u>\$ 697,571</u>	
Liabilities and Members' Equity	Current liabilities:		
	Accounts payable and accrued expenses	\$ 238,133	\$ 146,447
	CRD deposits and deferred revenue	70,520	49,358
	Net SEC fees	62,304	47,726
	Total current liabilities	<u>370,957</u>	<u>243,531</u>
	Long-term debt	25,000	25,000
	Accrued pension costs	20,066	14,740
	Accrued other postretirement benefit costs	20,303	-
	Other liabilities and deferred credits	34,424	16,493
	Total long-term liabilities	<u>99,793</u>	<u>56,233</u>
	Total liabilities	<u>470,750</u>	<u>299,764</u>
	Members' equity	444,780	397,807
	Unrealized gains on available-for-sale investments, net of tax	5,690	-
	Total members' equity	<u>450,470</u>	<u>397,807</u>
	Total liabilities and members' equity	<u>\$ 921,220</u>	<u>\$ 697,571</u>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income and Members' Equity

		Year Ended December 31 (In Thousands)	
		1998	1997
Revenue	Market information and transaction service fees	\$ 307,418	\$ 267,811
	Issuer fees	139,699	113,019
	Member assessments	92,128	81,206
	Registration and qualification fees	80,051	69,861
	Regulatory fees and fines	49,195	39,453
	Interest and other	33,401	27,841
	Arbitration fees	21,488	15,604
	Corporate finance fees	16,143	19,585
	Total revenue	739,523	634,380
Expenses	Compensation	281,701	246,286
	Professional and contract services	166,848	129,463
	Computer operations and data communications	65,101	44,037
	Depreciation and amortization	60,600	51,989
	Occupancy	25,757	25,825
	Publications, supplies, and postage	24,020	22,285
	Travel, meetings, and training	23,749	21,374
	Other	23,937	23,407
	Total expenses	671,713	564,666
		Income before provision for income taxes	67,810
	Provision for income taxes	20,837	33,640
	Net income	46,973	36,074
	Members' equity at beginning of year	397,807	361,733
	Unrealized gains on available-for-sale investments, net of tax	5,690	—
	Members' equity at end of year	\$ 450,470	\$ 397,807

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

		Year Ended December 31 (In Thousands)	
		1998	1997
Net income		\$ 46,973	\$ 36,074
	Adjustments to reconcile net income to net cash provided by operating activities:		
	Depreciation and amortization	60,600	51,989
	(Benefit from) Provision for deferred income taxes	(3,466)	3,751
	Changes in operating assets and liabilities net of effects from business acquisition:		
	Increase in receivables and other current assets	(7,429)	(12,461)
	Increase in other assets	(9,368)	(434)
	(Decrease) increase in accounts payable and accrued expenses	(7)	36,851
	Increase (decrease) in CRD deposits and deferred revenue	30,399	(4,649)
	Increase in accrued pension costs and other liabilities and deferred credits	841	4,602
Net cash provided by operating activities		118,543	115,723
Investing activities	Net cash from business acquisition	71,372	-
	Proceeds from redemptions of available-for-sale investments	239,173	-
	Purchases of available-for-sale investments	(284,712)	-
	Proceeds from maturities of held-to-maturity investments	56,124	170,215
	Purchases of held-to-maturity investments	(50,127)	(233,727)
	Purchases of property and equipment, net	(64,105)	(118,579)
Net cash used in investing activities		(32,275)	(182,091)
Financing activities	Increase in net SEC fees	13,506	47,726
	Proceeds from acquisition of long-term debt	-	25,000
Net cash provided by financing activities		13,506	72,726
	Increase in cash and cash equivalents	99,774	6,358
	Cash and cash equivalents at beginning of year	43,551	37,193
	Cash and cash equivalents at end of year	\$ 143,325	\$ 43,551

See accompanying notes to consolidated financial statements.

1. Organization and Nature of Operations

The National Association of Securities Dealers, Inc. (NASD) is the parent company of The Nasdaq-Amex Market Group (Nasdaq-Amex); NASD Regulation, Inc. (NASDR); Nasdaq International Market Initiatives, Inc. (NIMI); Nasdaq International, Ltd. (Nasdaq International); Securities Dealers Insurance Company, Ltd. (SDIC); and the Securities Dealers Risk Purchasing Group, Inc. (SDRP); collectively referred to as the Company. The Nasdaq Stock Market, Inc. (Nasdaq) and the American Stock Exchange LLC (Amex LLC) operate under Nasdaq-Amex, a holding company.

NASD oversees the activities of the U.S. broker/dealer profession and regulates Nasdaq, Amex LLC and the over-the-counter securities markets. Through Nasdaq-Amex, the NASD operates Nasdaq and Amex LLC in a unique dual market structure that brings together the central auction Specialist and multiple Market Maker systems. NASDR carries out the NASD's regulatory functions, including on-site examinations of member firms, continuous automated surveillance of markets operated by Nasdaq-Amex, and disciplinary actions against broker/dealers and their professionals. NIMI offers a variety of consulting services to assist emerging and established securities markets around the world with both technology applications and regulation. Nasdaq International promotes the Nasdaq and Amex markets 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.

2. Significant Transactions

American Stock Exchange, Inc.

On April 8, 1998, the NASD and the American Stock Exchange, Inc. and its wholly-owned subsidiaries (Amex, Inc.) entered into a Transaction Agreement in order to create a new, more electronic, centralized floor-based Specialist auction market for equities and a more technologically competitive and efficient centralized market for standardized options. On October 30, 1998 (acquisition date), after obtaining necessary membership and regulatory approvals, the acquisition was consummated.

This acquisition has been accounted for using the purchase method of accounting, and accordingly, assets acquired and liabilities assumed have been recorded at their estimated fair values at the date of acquisition. Amex, Inc. transferred all of its assets and liabilities to Amex LLC. In return, Amex, Inc. received a limited liability company interest in Amex LLC. The controlling limited liability company interest is owned by Nasdaq-Amex. The results of operations of Amex LLC are included in the consolidated statements of income and members' equity from the acquisition date. Periods prior to the acquisition date are not included in the consolidated statements of income and members' equity.

Approximately \$12,063,000, the excess of the fair value of net assets acquired over consideration incurred, is being recognized as income on a straight-line basis over 25 years. This deferred credit is included in other liabilities and deferred credits in the consolidated balance sheets.

As a result of the acquisition and in connection with the integration of operations of Amex LLC into the Company, the Company has accrued liabilities of approximately \$18,920,000 associated with the consolidation of facilities and employee costs resulting from the business combination.

Notes to Consolidated Financial Statements (cont.)

The following unaudited pro forma information presents the results of operations of the Company as if the acquisition had occurred at the beginning of the respective periods.

(In Thousands)	Year ended December 31,	
	1998	1997
Revenues	\$ 925,645	\$ 848,282
Net income	75,955	75,885

These unaudited pro forma results have been prepared for comparative purposes only and include the effects of the allocation of the excess of the fair value of net assets acquired over consideration to noncurrent assets which results in no depreciation expense for property and equipment acquired. These unaudited pro forma results are not necessarily indicative of the results of operations which would have actually resulted had the acquisition been consummated in the past nor are they indicative of future results.

Philadelphia Stock Exchange, Inc.

On June 9, 1998, the Company, Amex, Inc., and the Philadelphia Stock Exchange, Inc. (PHLX), agreed in principle to add PHLX to the NASD. The transaction is subject to completion of a definitive agreement and to governing body, membership, and regulatory approvals. Costs deferred by the Company relating to this proposed transaction amounted to \$1,436,000 and have been included in other assets in the consolidated balance sheets.

3. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the NASD and its wholly owned or controlled subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

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 non-restricted investments purchased with a remaining maturity of three months or less at the time of purchase.

Investments

Under Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," management determines the appropriate classification of investments at the time of purchase and reevaluates such designation as of each balance sheet date. Investments for which the Company does not have the intent or ability to hold to maturity are carried at fair market value, with the unrealized gains and losses, net of tax, reported as a separate component of members' equity. Investments for which the Company has the intent and ability to hold to maturity are carried at amortized cost. The amortized cost of debt securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts. Transfers of debt securities into the available-for-sale category from the held-to-maturity category are made at fair value at the date of transfer. Realized gains and losses on sales of securities are included in earnings using the specific identification method.

A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings, and a new cost basis for the security is established.

Receivables, Net

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

Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation and amortization. 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 or an accelerated method over the estimated useful lives of the assets. Estimated useful lives generally range from 10 years to 40 years for buildings and improvements, 2 years to 5 years for data processing equipment and software, and 5 years to 10 years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the lesser of the useful life of the improvement or the term of the applicable lease.

Investments in Affiliates

The Company carries its various investments in affiliates at cost and under the equity method of accounting depending upon its ability to influence the operation of the affiliate.

CRD Deposits and Deferred Revenue

CRD deposits represent deposits made by NASD member firms into the Company's Central Registration Depository (CRD) system. These deposits are used by the member firms to pay for CRD transactions, including registration fees charged by states and other self regulatory organizations. CRD deposits totaled approximately \$30,339,000 and \$25,056,000 at December 31, 1998 and 1997, respectively.

Deferred revenues represent cash received and billed receivables for which services have not yet been provided. Total deferred revenues at December 31, 1998 and 1997 were approximately \$40,181,000 and \$24,302,000, respectively.

Net SEC Fees

Pursuant to the National Securities Markets Improvement Act of 1996, the Securities and Exchange Commission (SEC) is permitted to collect a fee based on a percentage of the total dollar value of securities sold in the Nasdaq-Amex market. These fees are designed to cover costs incurred by the government in the supervision and regulation of securities markets and securities professionals. The Company charges these fees monthly to its members and remits them to the United States Treasury semiannually in March and September. Net SEC fees represent amounts charged to members less amounts billed and not yet collected.

Pensions and Other Postretirement Benefits

The Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," in 1998, as required. The provisions of this Statement revise employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of expense for these plans. It standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable.

Income Taxes

NASD and NASDR are tax-exempt organizations under the Internal Revenue Code (IRC) Section 501(c)(6). All other subsidiaries of NASD are taxable entities. Deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse.

Comprehensive Income

The Company adopted SFAS No. 130, "Reporting Comprehensive Income" in 1998, as required. SFAS 130 establishes new rules for the reporting and display of comprehensive income and its components; however, the adoption of this Statement had no impact on the Company's net income or members' equity. SFAS 130 requires unrealized gains and losses on the Company's investments available-for-sale to be included as other comprehensive income in the consolidated balance sheets.

Advertising Costs

The Company expenses advertising costs in the periods in which the costs are incurred. Advertising expenses totaled \$37,556,000 and \$49,120,000 for 1998 and 1997, respectively. These expenses are included in professional and contract services in the consolidated statements of income.

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.

In March 1998, the AICPA issued Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed for or Obtained for Internal Use." The Company adopted the SOP on January 1, 1999. The SOP requires the capitalization of certain costs incurred after the date of adoption in connection with developing or obtaining software for internal use. Prior to January 1, 1999, the Company expensed such costs as incurred. Management expects that the adoption of this SOP will have a significant impact on the Company's net income.

Fair Value of Financial Instruments

Generally, the majority of the Company's financial assets and liabilities, as defined under SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," are either valued at market or estimated fair value or, because of their short-term nature, approximate fair value.

Classifications

Certain amounts for the prior year have been reclassified to conform with the 1998 presentation.

4. Investments

Investments consist of U.S. Treasury securities and obligations of U.S. Government sponsored enterprises. Upon completion of management's reevaluation of the classification of the investment portfolio at December 31, 1998, a majority of the held-to-maturity investment portfolio was reclassified to available-for-sale in order to align the investment portfolio with management's current intentions. The amortized cost and fair value of the investments transferred amounted to \$346,236,000 and \$352,797,000, respectively.

Following is a summary of investments classified as available-for-sale which are carried at fair value as of December 31, 1998:

(In Thousands)	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
Due in one year or less	\$135,942	\$ 751	(\$1)	\$136,692
Due after one year through five years	234,222	6,198	(4)	240,416
	\$370,164	\$6,949	(\$5)	\$377,108

Following is a summary of investments classified as held-to-maturity which are carried at amortized cost as of December 31, 1998:

(In Thousands)	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
Due in one year or less	\$ 11,582	\$ 31	-	\$ 11,613
Due after one year through five years	16,588	310	-	16,898
	\$ 28,170	\$ 341	-	\$ 28,511

Following is a summary of investments classified as held-to-maturity which are carried at amortized cost as of December 31, 1997:

(In Thousands)	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
Due in one year or less	\$108,713	\$ 46	(\$ 75)	\$108,684
Due after one year through five years	221,637	2,685	(27)	224,295
	\$330,350	\$2,731	(\$102)	\$332,979

At December 31, 1998 and 1997, investments with a carrying amount of approximately \$28,000,000 were pledged as collateral.

5. Comprehensive Income

The transfer of investments from the held-to-maturity to available-for-sale classification resulted in recognition of comprehensive income as of December 31, 1998 as follows:

(In Thousands)	Year ended December 31, 1998
Net income	\$46,973
Other comprehensive income, net of income taxes	
Unrealized gains on available-for-sale investments, net of tax of \$1,020	5,398
Comprehensive income	\$52,371

6. Long-Term Debt

In May 1997, the Company entered into a \$25,000,000 note payable with a financial institution (the Lender). The note requires monthly interest payments at a rate of 7.41 percent through May 2007. In May 2007, NASD will incur interest equal to the Lender's cost of funds rate, as defined in the agreement, plus .5 percent. Principal payments are scheduled to begin in 2007 and continue in equal monthly installments until maturity in 2012. Interest payments under the agreement totaled approximately \$1,878,000 and \$1,009,000 for 1998 and 1997, respectively. Of these amounts, \$381,000 was capitalized in connection with the expansion of NASD facilities in 1997.

Notes to Consolidated Financial Statements (cont.)

7. Income Taxes

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

(In Thousands)	1998	1997
Current income taxes:		
Federal	\$19,684	\$23,890
State	4,619	5,999
Total current income taxes	24,303	29,889
Deferred income taxes:		
Federal	(2,815)	3,005
State	(651)	746
Total deferred income taxes	(3,466)	3,751
Total provision for income taxes	\$20,837	\$33,640
Income taxes paid during the year	\$24,132	\$29,074

The effective federal and state tax rates for the taxable entities were 36 percent and 45 percent for 1998 and 1997, respectively.

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

(In Thousands)	1998	1997
Deferred tax assets:		
Deferred entry fees	\$1,627	\$ 518
Compensation and benefits	964	399
Other	2,757	1,116
Total deferred tax assets	5,348	2,033
Deferred tax liability:		
Depreciation	(7,247)	(7,398)
Net deferred tax liability	(\$1,899)	(\$5,365)

The net deferred tax asset resulting from the acquisition of Amex, Inc., consists of temporary differences existing at the date of acquisition, and is offset in its entirety by the excess of the fair value of net assets acquired over consideration.

8. Pension and Other Postretirement Benefits

The Company provides defined benefit pension and postretirement benefit plans to certain employees. The NASD maintains a noncontributory, defined-benefit pension plan, along with other arrangements, for the benefit of eligible employees of subsidiaries other than Amex LLC. The benefits are primarily based on years of service and the employees' average salary during the highest 60 consecutive months of employment. Amex LLC maintains a contributory, defined-benefit pension plan for the benefit of eligible Amex LLC employees. The benefits are primarily based on years of service and compensation levels. Amex LLC also maintains postretirement benefit plans that provide medical and life insurance benefits for Amex LLC retirees and eligible dependents. Amex LLC employees become eligible for these benefits if they meet minimum age and service requirements and are eligible for retirement benefits.

(In Thousands)	1998	Pension Benefits 1997	Other Postretirement Benefits 1998
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 90,468	\$79,958	\$ -
Service cost	9,162	6,743	120
Interest cost	7,094	5,860	219
Plan participants' contributions	200	-	-
Actuarial losses/(gains)	5,390	8,885	(49)
Acquisition	58,197	-	20,119
Benefits paid	(8,479)	(10,978)	(106)
Benefit obligation at end of year	\$162,032	\$90,468	\$20,303
Change in plan assets			
Fair value of plan assets at beginning of year	\$ 68,467	\$56,054	-
Actual return on plan assets	12,929	10,322	-
Acquisition	84,159	-	-
Company contributions	7,850	13,069	\$106
Plan participants' contributions	246	-	-
Benefits paid	(8,479)	(10,978)	(106)
Fair value of plan assets at end of year	\$165,172	\$68,467	-
Funded status of the plan (underfunded)	\$3,140	(\$22,001)	(\$20,303)
Unrecognized net actuarial gain (loss)	1,838	(1,182)	-
Unrecognized prior service cost	3,465	3,355	-
Unrecognized transition obligation/(asset)	(1,949)	(2,119)	-
Prepaid (accrued) benefit cost	\$6,494	(\$21,947)	(\$20,303)

For all plans with an accumulated benefit obligation in excess of plan assets as of December 31, 1998, the aggregate projected benefit obligation totaled \$108,273,000 and the aggregate fair value of plan assets totaled \$77,749,000.

The accrued pension liability as of December 31, 1998 is \$27,171,000, of which \$7,105,000 is included in accounts payable and accrued expenses in the consolidated balance sheets.

	1998	Pension Benefits 1997	Other Postretirement Benefits 1998
Weighted-average assumptions as of December 31			
Discount rate	7.00%	7.25%	7.00%
Expected return on plan assets	8.21	9.00	-
Rate of increase (compensation or health care cost)	5.07	5.41	4.50

The assumptions for the annual increase in the cost of covered health care benefits for 1999 are as follows:

Under age 65	7.80%
Age 65 and over	7.00

The rate was assumed to decrease gradually to an estimated annual increase of 4.5 percent in the year 2003 and thereafter.

Notes to Consolidated Financial Statements (cont.)

(In Thousands)	1998	Pension Benefits 1997	Other Postretirement Benefits 1998
Components of net periodic benefit cost			
Service cost	\$9,162	\$6,743	\$120
Interest cost	7,094	5,860	219
Expected return on plan assets	(7,108)	(5,060)	-
Amortization of prior service cost	357	1,824	-
Amortization of unrecognized transition obligation/(asset)	(213)	(215)	-
Recognized net actuarial loss	92	249	-
Benefit cost	\$9,384	\$9,401	\$339

The assumed health care cost trend rate has a significant effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

(In Thousands)	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total of service and interest cost components in 1998	\$ 67	(\$ 53)
Effect on postretirement benefit obligation as of December 31, 1998	2,689	(2,185)

The NASD also maintains a voluntary savings plan for certain employees of subsidiaries other than Amex LLC. 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 the Company. Savings plan expense for the years 1998 and 1997 was \$7,072,000 and \$5,818,000, respectively. The expense included a discretionary match authorized by the Board of Governors totaling \$3,300,000 for 1998 and \$2,812,000 for 1997.

Amex LLC also maintains a voluntary savings plan for Amex LLC employees. Employees are eligible to make contributions to the plan after one month, and after six months of service are also eligible for an employer contribution match at an amount equal to 25 percent of the first 6 percent of eligible employee contributions. Eligible plan participants may also receive a discretionary match from the Company equal to an additional 75 percent of the employee's contributions (up to the first 6 percent of the employee's compensation). Savings plan expense for the period subsequent to the acquisition date was \$134,000.

9. Leases

The Company 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 \$16,081,000 in 1998 and \$17,072,000 in 1997. Future minimum lease payments under noncancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 1998:

Year ending December 31	Operating Leases (In Thousands)
1999	\$ 20,300
2000	23,100
2001	19,700
2002	17,900
2003	13,300
Remaining years	76,500
Total minimum lease payments	\$170,800

10. Commitments and Contingencies

There are certain legal proceedings pending against the Company. 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 the Company.

In November 1997, the Company entered into an agreement with a major telecommunications company to replace the existing data network that connects the Nasdaq market facilities to market participants. The contract contains a minimum guarantee of \$300,000,000 to be incurred through November 2003. Data communication costs incurred under network agreements are directly charged to market participants and, therefore, are netted against these revenues. Billings under the contract had not commenced as of December 31, 1998.

In November 1998, Nasdaq entered into a \$36,800,000 agreement to manage the construction of a complex to be located in Times Square, New York. The new complex, the Nasdaq-Amex MarketSite, will include office, conference, and retail space, in addition to a public interactive exhibit and a Nasdaq-Amex broadcast site.

The Transaction Agreement entered into by the Company related to the acquisition of Amex, Inc., included a Member Equity Program (Program) to support the value of current Amex LLC Members' seats. On October 30, 1998, the closing date, the NASD committed \$30,000,000 to support seat prices with an additional \$10,000,000 commitment effective on January 1, 1999. This fund can grow without a cap through buying, selling, and leasing seats as well as a 5 percent return on the account. Under the Program, an elected Seat Committee will monitor the effectiveness of the Program at 18 months, 36 months, and 60 months from the acquisition date. At the time of the reviews, the Seat Committee will disburse portions of the initial commitment amount in one of the following ways: to owners of membership interests in Amex LLC; as a reduction of Amex LLC Exchange fees; and/or for investments in technology. Additionally, the Seat Committee may elect a roll-over option under which it would not disburse funds until the next review date. After five years, the undistributed amount will be eligible for distribution to the Amex LLC members, reduction of Amex LLC fees, or investments in technology as determined by a membership vote. Every two years after that, the remainder will be eligible for distribution in the same manner until the commitment has been fully paid. The commitment will be funded from operations of the Company.

Also as a condition of the acquisition, a Member Supplemental Fund was established under which annual distributions may be made by Nasdaq-Amex based upon 15 percent of the amount, if any, that the net income of Amex LLC exceeds established thresholds for the years 1999 through 2008. Funding will be either paid directly to, or used to fund, pension or retirement benefits to owners of membership interests in Amex LLC, or paid for investments in technology as determined by a Member Supplemental Fund Committee.

Any contingency payments to members made under the Member Equity Program or the Member Supplemental Fund will be accounted for as contingent consideration through an adjustment of the original purchase price allocation and will be amortized over the remaining life of any remaining goodwill.

On October 30, 1998, the NASD and Amex LLC entered into a Technology Transfer and Development Agreement (the Technology Agreement) whereby \$110 million will be disbursed over the next five years for the purpose of operating and upgrading Amex LLC's trading market and administrative systems. To the extent that Amex LLC's revenues are not sufficient to fund this \$110 million program as scheduled, the NASD will spend or make available the difference through capital contributions, loans, or guarantees of loans. For the year ended December 31, 1998, approximately \$11,673,000 was incurred related to the Technology Agreement.

During the two-year period following the acquisition date of Amex LLC, the NASD committed to spending \$30,000,000 on a public relations and advertising program designed to promote the Nasdaq-Amex market. For the year ended December 31, 1998, approximately \$6,200,000 was expensed towards this advertising program.

Securities Industry Automation Corporation (SIAC), an affiliated company, has a lease agreement for a data processing site. SIAC's performance under the terms of the lease, which has a remaining obligation of approximately \$91,134,000 over the next seven years, has been guaranteed by the NYSE as majority owner of SIAC. The Amex LLC has agreed to indemnify the NYSE for a portion of losses, if any, sustained by the NYSE in the event of a default by SIAC. The Amex LLC's share of potential losses (\$15,493,000, or 17 percent, at December 31, 1998) is based upon its utilization of SIAC services for the proceeding three years, and is adjusted annually.

11. Business Segment Information

The Company adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," in 1997, which changes the way the Company discloses information about its operating segments.

The NASD manages two primary business segments: NASDR and Nasdaq-Amex. NASDR and Nasdaq-Amex provide substantially all of the Company's revenues. As described in the summary of significant accounting policies, these segments also represent separate identifiable organizations. Services provided by all other potential segments represent less than 10 percent of consolidated gross revenues. Accordingly, activities related to these entities, including those of the NASD parent, are included in the category "All Other." Revenues generated by entities in "All Other" consist mainly of interest income and assessments on registered representatives charged to cover regulatory and market policy functions.

NASDR - Carries out the regulatory functions of the Company, including on-site examinations of member firms, continuous automated surveillance of markets operated by Nasdaq-Amex, and disciplinary actions against broker/dealers and their professionals. Fees are assessed to cover particular services, both regulatory and non-regulatory, and member assessments are levied to cover examinations and related regulatory functions.

Nasdaq-Amex - Operates a unique dual market structure that brings together the central auction Specialist and multiple Market Maker systems and services, and develops and for-

mulates market policies and listing criteria. Fees are charged for the sale or distribution of market data and related information and for transactions using Nasdaq-Amex's market facilities. Fees are also charged to listed companies to cover the cost of Nasdaq-Amex's value added services, as well as listing qualification functions. Additionally, through Amex LLC, fees are derived from trading options on broad-based and sector indexes and from listing unit investment trusts, warrants on selected indexes and foreign currencies, hybrid instruments, and other structured investment products.

Segment Income or Loss

The NASD's accounting policies for segments are the same as those described in the summary of significant accounting policies. Management evaluates segment performance based on operating income or loss before income taxes. Transfers between segments are accounted for at cost.

1998 (In Thousands)	NASDR	Nasdaq-Amex	All Other	Consolidated
Revenues, principally from				
external customers	\$257,395	\$466,215	\$ 15,913	\$739,523
Direct expenses	236,621	409,130	25,962	671,713
Operating income				
before income taxes	20,774	57,085	(10,049)	67,810
Income taxes	-	20,834	3	20,837
Total assets	174,779	548,403	198,038	921,220
Working capital	68,558	178,635	14,517	261,710
Capital expenditures	3,682	34,514	29,876	68,072

1997 (In Thousands)	NASDR	Nasdaq	All Other	Consolidated
Revenues, principally from				
external customers	\$226,813	\$390,891	\$ 16,676	\$634,380
Direct expenses	226,025	316,549	22,092	564,666
Operating income				
before income taxes	788	74,342	(5,416)	69,714
Income taxes	-	33,640	-	33,640
Total assets	139,168	343,012	215,391	697,571
Working capital, including				
non-current, unrestricted				
investments	42,542	92,589	43,288	178,419
Capital expenditures	9,702	79,887	31,985	121,574

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. as of December 31, 1998 and 1997, 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. at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Ernst + Young LLP

Washington, D.C.
February 18, 1999

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Washington, DC

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Microsoft Corporation
Redmond, WA

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The Heritage Foundation
Washington, DC

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The Duberstein Group, Inc.
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