

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF MEMBER REGULATION,

Complainant,

v.

Respondent.

Expedited Proceeding
No. FPI060008

Hearing Officer—Andrew H. Perkins

HEARING PANEL DECISION

September 15, 2006

Expedited Proceeding charging the Respondent with failure to file annual audit reports as required by Exchange Act Rule 17a-5 is dismissed.

Appearances

J. Barron Knight, Esq., Washington, DC for Complainant.

_____, President, for the Respondent.

DECISION

I. PROCEDURAL HISTORY

The Department of Member Regulation (the “Department”) sent a letter to Respondent on April 26, 2006, notifying the Respondent that, pursuant to NASD Rule 9552, its NASD membership would be suspended for failure to timely file its annual audit reports for its 2004 and 2005 fiscal years, as required by the Securities and Exchange Commission’s Exchange Act Rule 17a-5.¹ On May 17, 2006, the Respondent filed a request for a hearing, pursuant to Rule 9552(e). The hearing was held by telephone

¹ Exchange Act Rule 17a-5 requires every registered broker-dealer to “file annually ... a report which shall be audited by an independent public accountant.” Failure to file a report timely as required by Rule 17a-5 is a violation of NASD Rule 2110. *E. Magnus Oppenheim & Co.*, Exchange Act Release No. 51,479, 2005 SEC LEXIS 764 at *7 (Apr. 6, 2005).

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conference call on August 25, 2006, before an NASD Hearing Panel that included an NASD Hearing Officer, a former member of the District 6 Committee, and a former member of the District 3 Committee.²

II. FINDINGS OF FACTS AND CONCLUSIONS OF LAW

The facts are undisputed. The Respondent, an NASD member since 1969, filed an unaudited annual report for 2004 and 2005.³ On each report, the Respondent claimed an exemption from filing audited financial statements under Exchange Act Rule 17a5(e)(1)(i)(B), which provides in relevant part:

[T]he financial statements ... need not be audited if, since the date of the previous financial statements of the report filed pursuant to Sec. 240.15b1-2 or this section:

* * *

(B) Its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance or security for any securities customer.

Exchange Act Rule 17a5(e)(1)(i)(B) provides that when a firm files an annual report that is not covered by an accountant's opinion the firm "shall include in the oath or affirmation required by [Exchange Act Rule 17a5(e)(2)] ... a statement of the facts and circumstances the firm relied upon as a basis for exemption from the requirement that financial statements and schedules filed pursuant to [Exchange Act Rule 17a-5(d)] be covered by the opinion of an accountant."⁴ The Respondent complied with this

² CX-13. In this decision, "CX" refers to Complainant's exhibits; "RX" to Respondent's exhibits; and "Tr." refers to the transcript of the hearing.

³ The Respondent filed its 2004 report on March 10, 2005, and its 2005 report on March 13, 2006.

⁴ The facing page of the Annual Audited Report Form X-17A-5, Part III includes the following footnote:

Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as a basis for the exemption. *See* Section 240.17a-5(e)(2).

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requirement when it filed each annual report. Specifically, the Respondent stated that the firm's business was limited to buying and selling evidences of indebtedness secured by mortgage, deed of trust, or other lien upon real estate or leasehold interests, and the firm has not carried any margin account, credit balance or security for any securities customer.⁵

Although NASD member firms are required to file their annual reports with NASD, the applicable SEC Exchange Act Rules do not delegate to NASD the authority to approve or reject firms' claims for exemption. Nonetheless, the Department argued that the Respondent should have done more than what is required by Exchange Act Rule 17a5(e)(1)(i)(B). At the hearing, the Department argued that the annual reports the Respondent filed were inconsistent with the description of its business on file with NASD. Accordingly, the Department contended that the Respondent was required to get its change of business approved before it filed the annual reports without an accountant's opinion. Because the Respondent had not filed a request for approval of a change in business operations under NASD Membership and Registration Rule 1017, the Department concluded that the Respondent had not filed an annual report for 2004 and 2005.⁶

At a hearing for the Department to show cause why this case should not be dismissed because the Department failed to comply with the Order Setting Pre-Hearing and Hearing schedule dated May 19, 2006, the Hearing Officer directed the Department

⁵ See RX-1, at 2; RX-6, at 2.

⁶ Rule 1017(a)(4) requires members to file an application for approval of any "material change in business operations as defined in Rule 1011(i)." The Department presented no evidence to support its conclusion that the change in business operations described on the annual reports met the definition of a "material change" under Rule 1011(i).

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to submit any authority it had that supported its contention that the Respondent had not complied with Exchange Act Rule 17a-5(d). None of the material the Department filed supports its argument. Indeed, the thrust of the Department's argument is that the Respondent failed to file an application for approval of the change in its business operations. However, the Respondent's alleged failure to notify NASD of its change in business operations is not the subject of this expedited proceeding. Pursuant to the notice of suspension the Department issued on April 26, 2006, the only issue presented in this proceeding is whether the Respondent filed its annual reports for 2004 and 2005 in compliance with Exchange Act Rule 17a-5, which it did.

III. CONCLUSIONS

The Hearing Panel finds that the Respondent filed annual reports for 2004 and 2005 that comply with Exchange Act Rule 17a-5. The Respondent properly claimed an exemption from filing audited financial statements under Exchange Act Rule 17a5(e)(1)(i)(B). The Respondent included a statement of facts and circumstances that it relied on as the basis for the exemption, as required by Exchange Act Rule 17a-5(e)(1)(ii). Specifically, the Respondent stated that the firm's business was limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests, and the firm has not carried any margin account, credit balance or security for any securities customer.⁷ Contrary to the Department's arguments, Exchange Act Rule 17a5(e)(1)(i)(B) does not require firms claiming such exemption to take any further action.

⁷ See RX-1, at 2; RX-6, at 2.

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IV. ORDER

For the foregoing reasons, this Expedited Proceeding is dismissed.

HEARING PANEL

By: Andrew H. Perkins
Hearing Officer