BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. FCS Securities New York, NY, and Dale Kleinser New York, NY, Respondents.	DECISION Complaint No. 2007010306901 Dated: July 30, 2010

Respondents failed to file audited annual reports. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Jeffrey T. Kern, Esq., Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Pro Se

Decision

Pursuant to NASD Rule 9311(a), FCS Securities ("FCS" or "the Firm") and Dale Kleinser ("Kleinser") appeal a May 13, 2009 Hearing Panel decision.[1] The Hearing Panel found

[1] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

that FCS, by and through Kleinser, failed to file audited annual reports for fiscal years 2006 and 2007, in violation of Section 17(e) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 17a-5, and NASD Rule 2110. The Hearing Panel fined respondents $5,000 and suspended FCS for four months. The Hearing Panel further ordered that the four-month suspension would convert to an expulsion if FCS did not file audited annual reports for 2006 and 2007 prior to the end of the four-month suspension.

The single issue before us is whether FCS demonstrated that it was exempt from the requirement that every broker-dealer file audited annual reports because its securities 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" pursuant to Exchange Act Rule 17a-5(e)(1)(i). We find that FCS failed to show that it was exempt from having to file audited annual reports and failed to file audited annual reports for fiscal years 2006 and 2007. We affirm the Hearing Panel's findings and sanctions.

I. Factual and Procedural History

A. Respondents' Background and Background of FCS Ventures, Inc.

Kleinser entered the securities industry in 1986, and formed FCS as a sole proprietorship in 1997. During all relevant time periods, Kleinser served as FCS's sole owner, and was registered as a financial and operations principal, general securities representative, and general securities principal.

FCS became registered with FINRA in 1997. Kleinser testified that he intended FCS to engage in proprietary principal trading. Nevertheless, Kleinser entered into a membership agreement with FINRA that limited FCS's operations to investment advisory services. Kleinser never intended that FCS provide investment advisory services; rather, Kleinser agreed to this limitation because he lacked the necessary capital to trade on a proprietary basis, but wanted to secure FINRA membership for the Firm. Prior to 2006, FCS conducted little, if any, securities business.[2]

During all relevant time periods, Kleinser also controlled FCS Ventures, Inc. ("Ventures"), a non-FINRA member. Kleinser serves as Ventures's sole officer, director and

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[2] Although FINRA staff questioned the Firm's eligibility to remain a member due to its apparent lack of any securities business, the Firm's membership was not canceled prior to 2006. *See* FINRA By-Laws, Article III, Section 1(a) ("Any registered broker, dealer . . . whose regular course of business consists in actually transacting, any branch of the investment banking or securities business in the United States . . . shall be eligible for membership in the Corporation[.]").

common shareholder. Ventures has approximately 12 preferred shareholders, including Kleinser's sister ("CA").[3] Kleinser operates both Ventures and FCS from his private residence.

B. FCS's History of Failing to File Audited Reports

For fiscal years 2000 through and including 2003, FCS filed unaudited annual reports.[4] Kleinser testified that the Firm filed an unaudited annual report for fiscal year 2000 because the Firm's accountant failed to perform an audit despite having agreed to do so. For FCS's 2001 fiscal year, Kleinser filed unaudited annual reports in reliance upon the exemption set forth in Exchange Act Rule 17a-5(e)(1)(i). Kleinser testified that he "stumbled upon" the exemption, and filed unaudited annual reports for FCS's fiscal years 2001, 2002, and 2003 in reliance upon the exemption.

After a routine examination of the Firm in 2004, FINRA staff determined that FCS did not qualify under the exemption and needed to file audited annual reports. FINRA issued FCS a Letter of Caution, dated January 11, 2005, for the Firm's failure to file audited annual reports for the years 2001, 2002, and 2003.

Despite the Letter of Caution, Kleinser claimed that FCS was exempt—pursuant to Exchange Act Rule 17a-5(e)(1)(i)—from filing an audited annual report for fiscal year 2005.[5] In February 2006, FINRA staff arranged a conference call with Kleinser and a representative from the Commission to discuss whether FCS could file unaudited annual reports in reliance upon the exemption. FINRA and Commission staff opined that the Firm did not qualify for the exemption. Although Kleinser disagreed, he filed an audited annual report on behalf of the Firm for 2005.

C. 2006 and 2007 Activities at Issue

Kleinser testified that after filing FCS's audited annual report for fiscal year 2005, he sought to engage in some business activity on behalf of the Firm that would allow it to claim an exemption from filing an audited annual report. The genesis of the Firm's purported activity in 2006 and 2007 is a loan from Ventures to CA and AA (Kleinser's sister and brother-in-law), made originally in either 2000 or 2001. The loan is evidenced by a promissory note in the amount of $185,398, and dated April 16, 2001 (the "2001 Note"). CA and AA borrowed funds from Ventures to purchase a home in Toledo, Ohio. The loan is purportedly secured by the

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[3] Kleinser testified that the number of Ventures preferred shareholders changed "depending upon how you want to count separate compliance." Much of Kleinser's testimony and supporting documentation lacked specificity.

[4] The record is unclear whether FCS filed audited reports prior to 2000.

[5] The record does not show whether FCS filed an audited annual report for 2004. The record, however, does show that Kleinser had numerous communications with FINRA staff over several years concerning whether FCS could rely on the exemption.

home, as evidenced by a financing statement filed with Ohio's secretary of state. The 2001 Note required CA and AA to send their monthly payments to an account at Fidelity Investments in the name of Ventures, CA, and AA.

1. 2006 Activity

Kleinser testified that by 2006, CA and AA had defaulted under the 2001 Note. Rather than force CA and AA to sell their home to satisfy their debt to Ventures, Kleinser believed that if he "restructured" the loan to transfer the "risk" of default from Ventures to another party, he could, in his capacity as sole owner and principal of FCS, satisfy the exemption of Exchange Act Rule 17a-5(e)(1)(i) and CA and AA could keep their home.[6]

As explained by Kleinser and evidenced by the record, Kleinser orchestrated the restructuring of the 2001 Note. Kleinser alleges to have done so in his capacity as owner of FCS. Kleinser explained that he needed to "step aside" from his positions as a Ventures officer and director to avoid any conflict of interest if he acted as a controlling person for both Ventures and FCS. He therefore had his parents act on behalf of Ventures, which left Kleinser free to purportedly broker "the sale of the risk" associated with the 2001 Note.

As part of the alleged restructuring of the 2001 Note, Ventures purportedly purchased the interests in the 2001 Note held by each of the individual preferred shareholders of Ventures.[7] Kleinser and a family friend ("KK") then purportedly purchased Ventures's interest in the 2001 Note. Ventures, however, never endorsed the 2001 Note to the alleged new holders (Kleinser and KK), nor did Ventures or any Ventures shareholder receive any consideration for the alleged sales. Moreover, there is no evidence that CA and AA made any payments to Kleinser and KK, the alleged new holders of the 2001 Note. Kleinser documented this transaction on or about December 27, 2006. This transaction was the only business that FCS allegedly conducted in 2006.

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[6] Kleinser continued to have discussions with FINRA staff concerning the exemption throughout 2006. Indeed, prior to restructuring the 2001 Note, Kleinser informed staff generally that he intended to rely upon the restructuring activity to qualify FCS for the exemption for fiscal year 2006. In a letter dated December 12, 2006, FINRA staff informed Kleinser that such activity would not enable FCS to qualify for the exemption under Exchange Act Rule 17a-5(e)(1)(i), and that a failure to file an audited annual report for 2006 may result in disciplinary action against the Firm.

[7] Kleinser assumed that the preferred shareholders held transferrable interests or "participations" in the 2001 Note. Kleinser also assumed that his parents had the authority to act not only on behalf of Ventures, but also on behalf of Ventures's preferred shareholders. Nothing in the record supports these assumptions.

2. 2007 Activity

Kleinser conducted a "round robin" transaction in late 2007, which he alleges permitted FCS to file unaudited annual reports for fiscal year 2007 pursuant to Exchange Act Rule 17a-5(e)(1)(i). Kleinser testified that after completing the 2006 restructuring of the 2001 Note, Ventures's preferred shareholders decided that they "wanted to attempt to do the right thing and take some of the burden and so they decided that they wanted to try and buy back this thing that was restructured to get [CA and AA] the best chance of getting out of this in one piece." The 2007 activity thus consisted of attempting to undo the 2006 transaction.

To undo the 2006 transaction, Kleinser first had CA and AA execute a new promissory note, dated December 29, 2007, in favor of Ventures (the "2007 Note"). The 2007 Note was in the same principal amount ($185,398) as the 2001 Note and was purportedly secured by CA's and AA's residence. Second, Kleinser prepared a document dated December 30, 2007, pursuant to which Ventures sold, and Kleinser's parents purchased (presumably on behalf of Ventures's preferred shareholders), all of Ventures's interests in the 2007 Note; and Kleinser and KK sold the same interest in the 2007 Note to Ventures.[8] Kleinser alleged that he brokered the sales of the interests in the 2007 Note in his capacity as sole owner and principal of FCS. The record contains no evidence that the buyers of interests in the 2007 Note paid any consideration for the purchases.

FCS's unaudited annual report for 2007 showed that it received revenue of $2,000 for "investment advisory fees." Kleinser testified that he wrote and signed two checks drawn on Ventures's account, payable to FCS, totaling $2,000. Kleinser further testified that FCS received this revenue from Ventures for the services provided in connection with the restructuring activity. This activity was the only business that FCS allegedly conducted in 2007.

D. Procedural History

FINRA's Department of Enforcement filed a one-cause complaint against respondents on July 25, 2008. The complaint alleged that FCS violated Section 17(e) of the Exchange Act, Exchange Act Rule 17a-5(d)(1)(i), and NASD Rule 2110, and that Kleinser violated NASD Rule 2110, by respondents' failure to file audited annual reports for 2006 and 2007. The Hearing Panel conducted a hearing on January 27, 2009. On May 13, 2009, the Hearing Panel issued its decision. The Hearing Panel found that respondents had committed the violation alleged in the complaint, and fined respondents $5,000 (jointly and severally) for this misconduct. The Hearing Panel further suspended FCS for four months, and ordered that the suspension would convert to an expulsion if respondents did not file audited annual reports for 2006 and 2007 prior to the end of FCS's suspension. Respondents' appeal followed.

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[8] It is unclear what interest (if any) in the 2007 Note Kleinser and KK had to sell.

II. Discussion

The Hearing Panel characterized the 2006 and 2007 transactions as private transactions "principally involving family and family friends"; found that these activities "bore no economic reality" and did not cause FCS to qualify for the exemption; and concluded that respondents failed to show that FCS conducted any securities business in 2006 and 2007. We agree.

Exchange Act Rule 17a-5(d) requires that "[e]very broker or dealer registered pursuant to Section 15 of the Act shall file annually, on a calendar or fiscal year basis, a report which shall be audited by an independent public account." Exchange Act Rule 17a-5(e)(1)(i), however, provides several limited exemptions to this requirement. Rule 17a-5(e)(1)(i) provides, in pertinent part, that:

> An audit shall be conducted by a public accountant who shall be in fact independent . . . . Provided, however, [t]hat the financial statements filed pursuant to paragraph (d) need not be audited if, since the date of the previous financial statements of report . . . 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 interest, and said broker or dealer has not carried any margin account, credit balance, or security for any securities customer.[9]

A. Respondents Bore the Burden to Demonstrate that FCS Qualified for the Exemption

It is undisputed that FCS filed unaudited annual reports for 2006 and 2007. It is also undisputed that respondents rely upon Exchange Act Rule 17a-5(e)(1)(i) to claim that FCS was exempt from filing audited annual reports. Respondents bear the burden of demonstrating that the exemption permitted them to file unaudited annual reports in 2006 and 2007. *See generally FTC v. Morton Salt Co.*, 334 U.S. 37, 44-45 (1948) (holding that "the general rule of statutory construction [is] that the burden of proving justification or exemption under a special exception to the prohibitions of a statute generally rests on one who claims its benefits"); *cf. SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953) (holding that the burden of proof lies with an issuer when it claims an exemption from registration under the Securities Act of 1933); *James M. Bowen*, 51 S.E.C. 1152, 1154 n.9 (1994) (stating applicant bears the burden of producing evidence to support his purported defense). As explained in detail below, we find that respondents have not met their burden.

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[9] Section 17(e)(1)(C) of the Exchange Act provides that the Commission may exempt any registered broker or dealer, or class of such brokers or dealers, from the requirement that they file audited annual reports if the Commission "determines that such exemption is consistent with the public interest and the protection of investors." The exemption contained in Exchange Act Rule 17a-5(e)(1)(i) is self operating (i.e., a broker dealer need not obtain prior approval to invoke the exemption).

B. There Is No Evidence of a Purchase or Sale in 2006 and 2007

Respondents have not demonstrated that FCS's securities business was "limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate[.]" First, respondents have failed to show that anything was purchased or sold, as is expressly required by Exchange Act Rule 17a-5(e)(1)(i). With respect to the alleged 2006 restructuring of the 2001 Note, Ventures never endorsed the 2001 Note to the alleged purchasers of the note, and the record does not show that any party paid or received any consideration related to the alleged sale. Further, there is no evidence that Kleinser and KK, as the alleged new holders of the 2001 Note, received any payments from CA and AA. Similarly, with respect to the alleged 2007 restructuring, nothing in the record shows that Ventures, Ventures's preferred shareholders, or Kleinser and KK received any consideration related to the execution of the 2007 Note, cancellation of the 2001 Note, or the alleged transfer of interests related to the restructuring. Indeed, the terms of the 2001 Note and the 2007 Note are substantially the same. We agree with the Hearing Panel's finding that "the real economic interests of the obligors and the holder of the promissory notes never changed[,]" and find that no purchase or sale of any interest occurred as a result of the restructuring transactions.[10]

C. FCS Played No Evident Role in the Restructuring Transactions

Second, even assuming that respondents had demonstrated that the 2006 and 2007 transactions involved a purchase or sale of the interests described in Exchange Act Rule 17a-5(e)(1)(i) (they have not), it is unclear what role, if any, FCS played in such activity. Rather, the activity in 2006 and 2007 involved Kleinser personally assisting—by and through a non-FINRA member entity he controlled—family members experiencing financial distress. Respondents have provided no reasonable rationale for FCS's alleged involvement in the restructuring transactions as a securities broker. FCS's receipt of payment from Ventures in 2007, allegedly in connection with the investment advisory services FCS provided to the parties regarding the restructurings, does not alter our conclusion that respondents failed to demonstrate that FCS was somehow involved with the buying and selling of the notes.[11]

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[10] The Hearing Panel characterized Kleinser's descriptions of the restructuring activity as "convoluted, vague, contradictory, and nonsensical." We agree.

[11] It is undisputed that FCS did not itself purchase or sell any interests in connection with the 2006 and 2007 restructurings. Rather, Kleinser testified that FCS assisted with purchases and sales by providing investment advisory services to the parties in connection with such transactions. Such services, however, would appear to preclude FCS from qualifying under the exemption, as FCS's business must be "limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interest . . . ." *See* Exchange Act Rule 17a-5(e)(1)(i).

D. FCS's Securities Business Did Not Consist of Buying and Selling Evidences of Indebtedness Pursuant to Exchange Act Rule 17a-5(e)(1)(i)

Third, respondents presented no evidence that FCS's "securities business" consisted of buying and selling evidences of indebtedness as set forth in Exchange Act Rule 17a-5(e)(1)(i). We find that neither the 2001 Note nor the 2007 Note is a security.[12] Moreover, other than FCS's alleged involvement with the restructuring activity in 2006 and 2007 (which itself was quite limited), the record does not show that FCS conducted *any* business in those years. *Cf., e.g.*, Louis Loss & Joel Seligman, *Securities Regulation* 3009 (3d ed. 2002) (suggesting that the phrase "engaged in the business" which is common to the definition of broker and dealer "connotes a certain regularity of participation in purchasing and selling activities rather than a few isolated transactions") (citing cases).

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Respondents argue that they attempted to obtain advice from FINRA staff concerning how FCS could qualify for the exemption and that staff evaded respondents. We reject respondents' attempt to shift responsibility to FINRA. *See Dep't of Enforcement v. Am. First Assoc. Corp.*, Complaint No. E1020040926-01, 2008 FINRA Discip. LEXIS 27, at *17 (FINRA NAC Aug. 15, 2008) (holding that respondent could not shift responsibility to FINRA even if he sought FINRA's advice and did not receive a response). We also reject respondents' reliance upon several no-action letters issued by the Commission to argue that FCS was not required to file audited annual reports. The Commission issued the no-action letters to a party unrelated to FCS or Kleinser, and based its determinations upon the business of the unrelated third party, not the business of FCS or the facts of this case. *See also Gwozdzinsky v. Zell/Chilmark Fund, L.P.*, 979 F. Supp. 263, 267 (S.D.N.Y. 1997) (holding that although a no-action letter may be persuasive, it is not entitled to judicial deference), *aff'd*, 156 F.3d 305 (2d Cir. 1998). Based upon the record before us, respondents have not demonstrated that FCS qualified for the exemption.

Finally, Exchange Act Rule 17a-5(e)(1)(i) does not exempt a firm that fails to otherwise satisfy the requirements of the rule simply because it has minimal revenue or operations. *Cf.*

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[12] *See Reves v. Ernst & Young*, 494 U.S. 56, 65-66 (1990) (holding that although the definition of "security" includes "any note," a note secured by a mortgage on a home is not properly viewed as a security). We also reject respondents' argument that the 2001 Note and 2007 Note are securities under the "family resemblance" test articulated in *Reves*. First, there is no evidence that the notes' purpose was to raise money for the general use of a business; rather the notes were "exchanged to facilitate the purchase and sale" of CA and AA's home. *See id.* at 66. Second, the notes are not instruments "in which there is common trading for speculation or investment," and there is no plan of distribution in connection with the notes. *Id.* (internal quotations omitted). Third, the record does not show that the investing public reasonably expected that the notes were securities. *Id.* Fourth, application of the Exchange Act to the notes—private loans primarily involving Kleinser and his family—is unnecessary and unwarranted. *Id.* at 67.

North Woodward Fin. Corp., Exchange Act Rel. No. 60505, 2009 SEC LEXIS 2796, at *10, 20 (Aug. 14, 2009) (rejecting argument that firm's small size and lack of activity excused it from complying with recordkeeping requirements); *E. Magnus Oppenheim & Co.*, Exchange Act Rel. No. 51479, 2005 SEC LEXIS 764, *17-18 (Apr. 6, 2005) (rejecting respondent's "negative opinion" of requirement that non-clearing broker-dealers file FOCUS reports and emphasizing critical role of accurate reports "in effecting timely oversight of the financial health of broker-dealers and in protecting public investors"). Further, respondents' allegation that no customer funds were at risk, even if true, is insufficient by itself to satisfy the exemption set forth in Exchange Act Rule 17a-5(e)(1)(i). Consequently, we find that respondents were required, and failed, to file audited annual reports in 2006 and 2007, in violation of Section 17(e) of the Exchange Act, Exchange Act Rule 17a-5, and NASD Rule 2110.[13]

E. Procedural Arguments

The Subcommittee empanelled to hear this matter denied a motion filed by respondents to adduce additional evidence pursuant to NASD Rule 9346(b). Respondents argue generally that the proposed additional evidence was wrongfully excluded. We find that the Subcommittee properly denied respondents' request. NASD Rule 9346(b), which governs motions to adduce additional evidence on appeal, requires that a respondent demonstrate that the proposed additional evidence is material and there was good cause for failing to introduce the evidence below. Admitting evidence pursuant to NASD Rule 9346(b) is reserved for "extraordinary circumstances." *See* NASD Rule 9346(a).

The Subcommittee afforded respondents several opportunities to explain the materiality of the proposed additional evidence to the narrow issue central to this case, but they failed to do so. *See Timothy H. Emerson, Jr.*, Exchange Act Rel. No. 60328, 2009 SEC LEXIS 2417, *32 (July 17, 2009) (stating that an adjudicator "cannot manufacture arguments for an appellant"). Moreover, we have reviewed the proposed additional evidence and find that it is not material to this case. Respondents also failed to demonstrate good cause for failing to introduce the evidence below. We therefore find that the Subcommittee properly rejected respondents' request to adduce additional evidence on appeal.

In addition, the Subcommittee denied, with one limited exception, respondents' request to admit documents they presented at the hearing but were excluded from the record by the Hearing Officer. Respondents challenge this ruling. We find that the Subcommittee properly denied respondents' request because the Hearing Officer did not abuse his discretion in excluding the exhibits. *See Dep't of Enforcement v. Strong,* Complaint No. E8A2003091501, 2008 FINRA

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[13] A violation of another FINRA rule is also a violation of NASD Rule 2110's requirement that all FINRA members, in conducting their business, "observe high standards of commercial honor and just and equitable principles of trade." *See Joseph Abbondante*, Exchange Act Rel. No. 53066, 2006 SEC LEXIS 23, at *36 (Jan. 6, 2006) (holding that a violation of a FINRA rule also violates NASD Rule 2110). NASD Rule 0115 provides that FINRA rules apply to all members and persons associated with a member and that such persons have the same duties and obligations as a member under the rules.

Discip. LEXIS 19, at *17-18 (FINRA NAC Aug. 13, 2008) (holding that the NAC reviews a hearing officer's exclusion of evidence for an abuse of discretion and that the moving party "assumes a heavy burden"). Certain of the excluded exhibits were already part of a previously admitted exhibit, or were withdrawn by respondents at the hearing. As to the remaining exhibits, respondents have not demonstrated that they are relevant to the narrow issue before us. The exhibits were thus properly excluded. *See* NASD Rule 9263(a) ("The Hearing Officer shall receive relevant evidence, and may exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial."); NASD Rule 9235(a)(2) (stating that the Hearing Officer is charged with regulating the course of the proceeding).

Finally, respondents attached to their opening brief portions of transcripts from state court proceedings involving Kleinser. These transcripts were not part of the record below, nor were they the subject of respondents' motion to adduce additional evidence denied by the Subcommittee. Respondents failed to timely request that the transcripts be admitted as part of the record pursuant to NASD Rule 9346(b). Moreover, we have reviewed the transcripts and they are not relevant to whether FCS was exempt from the requirement that all broker-dealers file audited annual reports. For these reasons, we have not considered these transcripts in rendering this decision.

III. Sanctions

The Hearing Panel fined respondents $5,000 (jointly and severally) and suspended FCS for four months. The Hearing Panel further ordered that the four-month suspension would convert to an expulsion if FCS did not file audited annual reports for 2006 and 2007 prior to the end of the four-month suspension. We affirm the Hearing Panel's sanctions.

FINRA's Sanction Guidelines ("Guidelines") contain no specific guideline applicable to respondents' failure to file audited annual reports. Nevertheless, the Guidelines provide principal considerations to guide the formulation of all sanctions.[14] In addition, the Guidelines recommend that, when a violation is not addressed specifically, we look to the Guidelines for analogous violations in formulating sanctions.[15] The Guidelines for late filing of FOCUS reports are instructive, and recommend a fine between $10,000 and $50,000 and a suspension of the firm for 30 business days, or until the firm files the report, and a suspension of the responsible principal for up to two years.[16] The Guidelines also recommend that we consider the number of days late the reports were filed, and whether the respondent delayed filing the report to prevent disclosure of a recordkeeping, operational, or financial deficiency.[17]

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14 *See FINRA Sanction Guidelines* 6-7 (2007), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*].

15 *See id.* at 1.

16 *Id.* at 72.

17 *Id.*

The sanctions imposed by the Hearing Panel are appropriately remedial. Although respondents filed timely annual reports for 2006 and 2007, they were not audited as required. Prompt receipt of audited annual reports is critical, and "provides the NASD and the Commission with an important means of timely oversight of the financial health of broker-dealers and of protecting public investors." *See Clinger & Co.*, 51 S.E.C. 924, 926 (1993). The record contains no evidence that respondents filed unaudited reports to prevent disclosure of any deficiency; rather, respondents filed unaudited reports to avoid the expense of an auditor. The fact that compliance with the securities laws and regulations may require member firms to expend funds does not excuse or mitigate respondents' misconduct. *See* FINRA By-Laws, Article IV, Section 1(a)(1) (stating that pursuant to a member firm's application for FINRA membership it agrees to comply with the federal securities laws and rules). We also find that in December 2006 FINRA staff notified respondents that the restructuring activity could not form the basis for FCS's use of the exemption. Despite this warning, respondents filed unaudited reports for 2006 and 2007.[18]

Respondents contend that because FCS held no customer funds, no customer or member of the public was harmed or at risk because respondents failed to file audited annual reports. We do not consider this factor, even if true, mitigating. *See Kevin M. Glodek*, Exchange Act Rel. No. 60937, 2009 SEC LEXIS 3936 (Nov. 4, 2009) ("The fact that many of the customers did not lose money and did not complain about the violations does not further mitigate Glodek's misconduct."), *appeal pending*, 09-5325-AG (2d Cir. filed Dec. 28, 2008); *Dep't of Enforcement v. Mizenko*, Complaint No. C8B030012, 2004 NASD Discip. LEXIS 20, at *20 (NASD NAC Dec. 21, 2004) ("[T]here is no authority for the proposition that the absence of harm to customers is mitigating."), *aff'd*, Exchange Act Rel. No. 52600, 2005 SEC LEXIS 2655 (Oct. 13, 2005).

For all of these reasons, we find that a $5,000 fine imposed upon Kleinser and FCS (jointly and severally) is appropriately remedial. We have imposed a fine below the lowest recommended fine for the late filing of FOCUS reports because of FCS's small size and limited revenue.[19] We further find that suspending FCS in all capacities for four months, with such suspension to convert to an expulsion if the Firm fails to file audited annual reports for 2006 and 2007, is appropriate and will ensure that the Firm files audited annual reports for the years at issue and going forward.

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[18] The Hearing Panel found that respondents had a "long history of refusing to file compliant annual reports." While we agree that respondents did not file audited annual reports for several years prior to 2006 and 2007, respondents argue that the exemption at issue in this case applies because of the restructuring activities in 2006 and 2007 (which were not the basis for respondents' exemption claims in prior years). We thus find that respondents' attempts to satisfy the exemption in 2006 and 2007, while misguided, appear to be factually unrelated to the Firm having filed unaudited reports in prior years.

[19] *See Guidelines*, at 2 (General Principles Applicable to All Sanction Determinations, No. 1).

IV. Conclusion

We affirm the Hearing Panel's finding that Kleinser caused FCS to violate Section 17(e) of the Exchange Act, Exchange Act Rule 17a-5, and NASD Rule 2110, and that Kleinser violated NASD Rule 2110, by failing to file audited annual reports for 2006 and 2007. Accordingly, we fine respondents, jointly and severally, $5,000. We also suspend FCS for four months, and order that if respondents have not filed audited annual reports for 2006 and 2007 by the end of the four-month suspension, FCS shall be expelled from FINRA membership. Finally, we order that respondents pay, jointly and severally, $2,017.15 in costs.[20]

On behalf of the National Adjudicatory Council,

Marcia E. Asquith,
Senior Vice President and Corporate Secretary

[20] Pursuant to FINRA Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.

We also have considered and reject without discussion all other arguments of the parties.