

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C8B000013
v.	:	
	:	Hearing Officer - AWH
PATRICK A. BRADY	:	
(CRD #2536672),	:	Hearing Panel Decision
	:	
Toledo, OH	:	
	:	
	:	
Maumee, OH	:	
	:	
	:	
Maumee, OH	:	
	:	
	:	
Respondent.	:	May 29, 2001

Former registered representative (1) engaged in three private securities transactions for compensation without giving his employer prior written notice and without receiving prior written approval; and (2) failed to respond to requests for information from NASD staff. Respondent found liable for violations of NASD Conduct Rules 2110 and 3040, and Procedural Rule 8210. Respondent fined \$42,943.31 and suspended for one year for violations of Rule 3040, and barred from associating with any member firm for violation of Rule 8210.

Appearances

Shelly A. Goering, Esq., for the Department of Enforcement

Patrick A. Brady, *pro se*

DECISION

Introduction

The Department of Enforcement filed the Complaint in this proceeding on August 25, 2000, alleging that Patrick A. Brady (“Brady” or “Respondent”) engaged in three private securities transactions for compensation without giving his member firm prior written notice or receiving prior written approval from the member firm, in violation of NASD Conduct Rules 2110 and 3040. The Complaint also alleged that Brady failed to respond to requests for information from NASD staff, in violation of NASD Conduct Rule 2110 and Procedural Rule 8210. By letter dated September 20, 2000, Brady filed an Answer, denying the allegations in the Complaint, and a request for a hearing. A hearing was held on March 7, 2001, in Cleveland, Ohio, before a panel consisting of the Hearing Officer and two current members of the District No. 8 Committee. On April 23, 2001, the Department of Enforcement filed its Proposed Findings of Fact and Conclusions of Law. No other post-hearing submissions have been received.

Findings of Fact

Background

Respondent Brady entered the securities industry in 1994 as a General Securities Representative of a member firm. From November 26, 1997 until August 31, 1998, he was registered in that capacity with Vestax Securities Corporation (“Vestax”). Tr. 140; CX 1.¹ On August 27, 1998, Vestax terminated his employment for selling variable life insurance policies away from the firm. CX 1. While at Vestax, he worked in the Toledo, Ohio location. Tr. 26. The Complaint was filed within two years of the termination of Brady’s registration.

Upon his employment with Vestax, Brady signed a Registered Representative Selling Agreement (“Selling Agreement”). CX 2; Tr. 20, 141-42. Among other obligations, the Selling Agreement provided, and he agreed as follows:

WITHOUT THE EXPRESS PRIOR WRITTEN CONSENT OF VESTAX, Registered Representative WILL NOT MARKET ANY SECURITIES OTHER THAN THOSE APPROVED BY AND OFFERED THROUGH VESTAX . . . (Emphasis in original.) CX 2 at 1.

In the same Selling Agreement, Brady acknowledged receipt of a Private Securities Transaction Notice and an Outside Business Activity Questionnaire. CX 2 at 2. The Private Securities Transaction Notice required that Brady “always obtain written approval from Vestax prior to undertaking any action whatsoever.” CX 3 at 1. It also required that any notice of intention to participate in a private securities transaction be directed to the Compliance Department at the firm’s home office. Tr. 22-23; CX 3 at 1. Brady signed the Private Securities Transaction notice on December 7, 1997. Tr. 145; CX 3 at 1. He also signed an Outside Business Activity Report on December 7, 1997. Tr. 146; CX 4 at 1. That form required disclosure of “all outside business activities for which compensation of any nature is received.” He disclosed no outside activities. Tr. 23; CX 4 at 1.

Upon his employment, Brady also received the Vestax Registered Representative Manual. Tr. 24, 147; CX 4 at 2. That manual contained thorough and explicit procedures regarding private securities transactions, which were in effect during all time periods alleged in the Complaint. CX 5; Tr. 24. The manual specifically defined private securities transactions to include sales of variable insurance products. CX 5 at 1. It defined execution of a transaction to include placing an order or causing a third party to place an order. *Id.*

¹ References to Complainant’s Exhibits appear as CX_. Citations to the transcript of the hearing appear as Tr._.

At all times relevant to the Complaint, Stacy Bauer was Vice President of Compliance at Vestax. Tr. 17. All private securities transaction notifications were required to be sent to her. Tr. 18. Only she and the President of the firm had the authority to approve a representative's participation in a private securities transaction. Tr. 18.

Sale of Variable Life Policies

ND was one of Brady's customers at Vestax. Tr. 148. Brady sold ND and her minor daughter, JD, variable life insurance policies issued by AIG Life Insurance Company ("AIG"). Tr. 65, 67, 76. On or about March 27, 1998, ND completed those sections of the applications concerning family and medical history. Tr. 65; CX 6, 7. Brady completed the remaining sections. Tr. 67-68, 149-51. Brady signed both applications as the agent.² Tr. 72, 78, 80; CX 6, 7. ND never discussed the purchase of the policies with anyone other than Brady.³ Tr. 68, 93. *See also* CX 19, 20.

Brady also solicited MG for a variable life insurance policy. Tr. 154. On March 31, 1998, Brady introduced customer MG to Stephen Baehren, an insurance wholesaler. Tr. 75, 81, 154. During their meeting, Baehren completed an AIG Variable Life Insurance Application for MG, and Brady signed the application as agent.⁴ Tr. 82-83, 154-55; CX 8, 38. *See also* CX 18, 21.

² Brady admitted that he received compensation for the sale of the policies to ND and JD, but he denied that the signatures on their two policy applications were his. Tr. 186. The Hearing Panel does not find his denial to be credible. Both ND and Stephen Baehren, the insurance wholesaler, testified that Brady signed the applications, Brady admitted that he filled out at least two sections of each application, and no one had any motive to forge his signatures on those applications. In any event, the authenticity of his signature does not affect the finding that he "participated" in the sale of a security without prior written notice and approval.

³ Brady testified that he was not alone when he met with ND and JD. The Hearing Panel does not find that assertion to be credible. ND testified that she and JD, her daughter, dealt solely with Brady. Baehren testified that he never had any contact with ND or JD. Finally, at his on-the-record testimony that was taken by Enforcement in January 2000, Brady admitted that he was alone when he met with ND and JD, and specifically, that Baehren was not with him at that meeting. Tr. 152-53.

⁴ Brady denied that the signature on MG's application was his. Tr. 186. The Hearing Panel does not find that denial to be credible. Baehren testified that Brady signed the application; there was no motivation for anyone to forge his

Because Vestax had a selling agreement with AIG, Brady could have, but did not, submit the applications for ND, JD, and MG to Vestax for processing. Tr. 61-62,156. Baehren sent all three applications to AIG for processing, with Brady shown as the representative of record. Tr. 83-84; CX 23.

After the applications were submitted to AIG, but before the policies were issued, Brady assigned all of his commissions on the three policies to Baehren. Tr. 85-86, 115-16, 156-57; CX 9, 23. Brady told Baehren that he was in the process of leaving Vestax to go to a new broker-dealer, and he did not want Vestax to be paid. Tr. 84-85. In fact, Brady made the assignment because he refused to do business through Vestax, with whom he had a dispute over the treatment of one of his clients. Tr. 158, 177. He testified:

I lost my cool with Vestax Securities Corporation, their insurance department. As I went up the ladder, I got madder and madder, and I started using verbal slander, f-words, stuff that I am not very proud of. I totally lost control of myself....

* * *

...I was furious. Again, I blew up. I wrote a letter informing Vestax Securities Corporation that I refused to do any business whatsoever with them until they rectified the matter.

Tr. 176-77.

The assignment of his commissions to Baehren was only ostensible; Brady ultimately received them. After AIG issued the policies, it sent the commissions to Baehren who then paid Brady all commissions from the sale of the policies to ND, JD, and MG. Tr. 86, 109-110, 149-50; CX 10, 11, 12, 13. Those commissions totaled \$12,943.31. Tr. 89-92; CX 37. Brady deposited each of the commission checks in an account for his benefit. Tr. 158-161.

signature, and Brady finally admitted that the signature might in fact be his. Tr. 191-92. As noted previously, the authenticity of his signature does not affect the finding that he “participated” in the sale of a security without prior

As a result of information from another Vestax representative in Toledo, Stacy Bauer, Vestax's Compliance Officer, suspected that Brady might have been involved in the sale of variable life insurance policies away from the firm. Tr. 26. She investigated the activity, found that his dispute with Vestax over a client did not negate his violation of company rules and policies, and ultimately determined to terminate Brady's association with the firm for cause. Tr. 26-36; CX 14. Brady never had given Vestax any written notice of the variable life transactions or his role in them. Tr. 36. He never had given Ms. Bauer or anyone else verbal notice of the transactions. *Id.* He never had received permission from Vestax to engage in the transactions. *Id.* And he never had notified Vestax that he was assigning his commissions to someone else. Tr. 157.

Failure to Respond to Requests for Information

As a result of a Form U-5 filed by Vestax, Association staff opened an investigation of the circumstances surrounding the termination of Brady's employment with Vestax. Tr. 113-14. The staff sent numerous requests for information to Brady. CX 15, 16, 24, 25, 26, 28, 29, 30, 31, and 32. Two of those requests, dated January 26, 2000, and February 3, 2000, are the bases for the allegations in Cause Two of the Complaint.

During its investigation, the staff asked Brady to provide his bank statements from April through August 1998. It requested these materials to determine the extent of Brady's activities away from his firm, and whether he was receiving income from other sources. Tr. 120; CX 24. Similarly, the staff requested tax records to determine income from other sources. Tr. 121; CX 24. The staff also requested a detailed list of all payments he received from Baehren or his insurance agency. Tr. 121; CX 24. In response, Brady asserted that he had requested his bank records from the financial

written notice and approval

institution and would forward them, and that he had not filed any tax returns for 1998. Although he acknowledged that he received payments from Baehren, he did not provide the detailed list of payments as requested. Tr. 122; CX 27. In a further effort to obtain his bank records, the staff sent Brady an authorization form that would allow the staff to secure the records directly from the financial institutions. Tr. 123; CX 28, 29, 30. Brady did not sign and return that authorization.

The staff interviewed Brady on-the-record on January 26, 2000. Tr. 124. After that interview, the staff sent Brady the first request for information alleged in the Complaint. CX 31. It sent that request to the three addresses listed for Brady in the Central Registration Depository (“CRD”), by regular and certified mail. It also sent the request by overnight courier to the address Brady identified as his home address. Tr. 124-26; CX 1.

In its January 26, 2000, request, the staff asked Brady to provide his correspondence with the Internal Revenue Service (“IRS”) concerning requests for an extension to file his 1998 Federal Income Tax Return. Tr. 126-27; CX 31 at 1, CX 32 at 1, 3. It again requested documents relating to payments made to him by Baehren or his agency. Tr. 127; CX 31 at 1. In addition, the staff asked Brady to provide copies of the requests for records he allegedly sent to his banks. *Id.* Finally, the staff asked Brady to sign and return an authorization allowing the staff directly to verify the non-filing of his 1998 tax return with the IRS, and it again asked him to sign and return the authorization allowing the staff to secure his bank records directly from the banks. Tr. 127-28; CX 31 at 1.

Brady did not respond to the staff’s request of January 26, 2000. Accordingly, the staff sent a second and final request to Brady on February 3, 2000. Tr. 128-129; CX 32. The staff also served that request by regular and certified mail on all of the CRD addresses, and additionally sent the request by overnight commercial courier to his current home address. Tr. 129-130; CX 32.

Brady did not provide a substantive response to the staff's January 26, 2000, and February 3, 2000, requests. Instead, he sent a facsimile to the staff on February 18, 2000, stating: "Upon the recommendation of my legal counsel, any additional information provided by me will be done so only in response to a written, time stamped court order." Tr. 131; CX 33. He further stated that he had fully responded to the staff's requests for documents "in a forthright, honest manner during an interrogation of me on January 26, 2000", the date of his on-the-record interview. CX 33. However, Brady did not, in fact, provide the information requested by the staff. Tr. 132-33. By letter dated February 22, 2000, the staff asked Brady for the name, address, and telephone number of his attorney. Tr. 133; CX 34. Brady did not respond to this request.

Discussion and Conclusions

The Complaint in this matter was filed less than two years after Brady was last registered with a member firm. It concerns his conduct while he was registered, and his failure to respond to requests for information were within two years of termination of his last registration. Accordingly, the NASD has jurisdiction over him for purposes of this proceeding, pursuant to Article V, Section 4 of the NASD's By-Laws.

Private Securities Transactions

Conduct Rule 3040 prohibits any person associated with a member of the NASD from participating in any manner in a private securities transaction without first providing the member with written notice of the proposed transaction and the person's proposed role in the transaction. If the associated person has received, or may receive selling compensation, the associated person must obtain written approval from the member under Rule 3040(c). A violation of Rule 3040 contravenes the

standards of commercial honor and just and equitable principles of trade required by Rule 2110. *See In re Stephen J. Gluckman*, 1998 NASD Discip. LEXIS 8, *15.

By soliciting the sale of, and selling three variable life insurance policies away from Vestax, Brady participated in private securities transactions.⁵ He admitted that he received total selling compensation of \$12,943.31 from the sale of the three policies.⁶ Therefore, he was obligated to give Vestax prior notice of his participation in those transactions, and to receive written approval from Vestax to participate in the transactions, pursuant to Conduct Rules 3040 (a) and (c). He neither gave prior notice to Vestax, nor received written approval from Vestax to engage in those transactions with ND, JD, and MG.

Brady proffered two “defenses” to his conduct at the hearing. Both are legally insufficient. His first “defense” is that he had a “reciprocal contract” with Vestax. Because his Registered Representative Selling Agreement with Vestax contains an indemnification provision, he argues, essentially, that Vestax was required to indemnify him for his own violation of NASD rules. (Tr. 144, 164.) (CX 2 at 5.) This “defense” has no basis in fact or law, and is rejected. While it is true that the indemnification provision obligates Vestax to indemnify Brady for losses, claims, damages, or liability arising out of *its* intentional misconduct, it would be absurd to construe the provision to insulate a registered representative from regulatory sanction just because the member firm also happened to have engaged in intentional misconduct. Moreover, no agreement between a member firm and its

⁵ Brady does not deny that variable life policies are securities. “Because the policy owners assume investment risks, variable life insurance policies are securities within the meaning of the federal securities laws and must be registered under the Securities Act of 1933....” NASD Notices to Members, “The NASD Reminds Members of Their Responsibilities Regarding the Sale of Variable Life Insurance,” 00-44 (2000).

⁶ Brady argued that his signatures on some or all of the policies at issue were not genuine. As noted above, the Panel finds that all of the credible evidence demonstrates that he did in fact sign the three applications. In any event,

representatives would insulate either from the NASD's right to bring disciplinary actions or to impose sanctions.

The second so-called defense is that there were "mitigating circumstances" that led to his complete exclusion of Vestax from the three transactions Tr. 163. He refers to the way in which Vestax handled the account of another of his customers. However, regardless of the depth of his displeasure with the firm, it does not legitimize actions that otherwise violate his obligation to observe the high standards of commercial honor and just and equitable principles of trade required by Conduct Rule 2110 or to violate the clear proscriptions of Rule 3040. He could have terminated his association with Vestax, but he could not ignore the Rules which are designed to protect customers, as well as members.

Failure to Respond to Requests for Information

Conduct Rule 8210(a)(1) gives the staff the right to "require . . . a person subject to the Association's jurisdiction to provide information orally, in writing, or electronically." It further gives the staff the right to "inspect and copy the books, records, and accounts of such . . . person with respect to any matter involved in the investigation, complaint, examination, or proceeding." The purpose of the rule is to provide a means for the NASD to carry out its self-regulatory functions in the absence of subpoena power. Failures to comply with Rule 8210 requests are serious violations because they subvert those functions. *Joseph Patrick Hannan*, Exchange Act Release No. 40438, 1998 SEC LEXIS 1955 at *8 (Sept. 14, 1998). A violation of Rule 8210 is also a violation of NASD Conduct Rule 2110.

whether the signatures are authentic is irrelevant to a finding of violation since Brady, by his own admission, participated in each of the transactions. Conduct Rule 3040 requires nothing more.

The staff had a legitimate regulatory purpose for all of its requests for information and documents that it sent to Brady. His failure to provide that information and those documents undermined the NASD's ability fully to review and verify the scope of his activities that were under investigation. The staff properly served Brady with those requests for information, and the evidence demonstrates that he received all of them. His failure to respond to the staff's requests for information and documents constitutes a violation of NASD Conduct Rule 2110 and Procedural Rule 8210.

Sanctions

The NASD Sanction Guidelines for engaging in private securities transactions call for a monetary fine of from \$5,000 to \$50,000, and a suspension for a period of from 10 days to one year, or in egregious cases, consideration of a bar. NASD Sanction Guidelines 19 (2001). Enforcement suggests that Brady be fined \$5,000 for each of the three incidents of selling away, ordered to disgorge his ill-gotten commissions of \$12,943.31, and suspended for a period of one year. The Hearing Panel agrees that disgorgement of the commissions and the proposed suspension are appropriate. However, the violation was an intentional act of retaliation against the member firm, which Brady considers justified and therefore not to constitute selling away. In addition, ND was also a customer of the firm. Accordingly, the Hearing Panel concludes that the fine should be more than the minimum suggested by the Guidelines. Brady will be fined \$10,000 for each of the three violations, ordered to disgorge his ill-gotten commissions of \$12,943.31, and suspended for a period of one year, the fine (a total of \$42,943.31) to be due and payable upon his re-entry into the securities business.

Where an individual fails to respond in any manner to requests made pursuant to NASD Procedural Rule 8210, the Sanction Guidelines provide that a bar should be standard. NASD Sanction Guidelines 39 (2001). Brady furnished none of the documents that the staff requested. His purported

reliance on the advice of counsel to respond only to “a written, time stamped court order” is specious, as well as unavailing. When asked for the name, address, and telephone number of his attorney, Brady did not respond. At the hearing, Brady presented no evidence bearing on the existence of any attorney-client relationship that involved the 8210 requests. Finally, the purported advice is without any legal foundation. Brady was obliged to respond to the staff requests for information unconditionally. Accordingly, because there are no mitigating circumstances in this case warranting a lesser sanction, Brady will be barred from associating with any member firm in any capacity.

In summary, Brady is fined \$42,943.31 and suspended for one year for violations of Conduct Rules 3040 and 2110, and barred from associating with any member firm for violation of Procedural Rule 8210 and Conduct Rule 2110. The bar shall become effective immediately if this Decision becomes the final disciplinary action of the NASD.

SO ORDERED.

Alan W. Heifetz
Hearing Officer
For the Hearing Panel

Copies to:
Via First Class Mail & Overnight Courier
Patrick A. Brady

Via First Class Mail & Electronic Mail
Shelly A. Goering, Esq.
Rory C. Flynn, Esq.