NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. DANIEL ERIC KELSEY (CRD #3031423) 2128 Monroe Grand Rapids, MI 49505, Respondent.	Disciplinary Proceeding No. C8A020088 **Hearing Panel Decision** Hearing Officer— SW Dated: June 29, 2004

For violating NASD Conduct Rule 2110 by negligently making misleading misrepresentations to four customers, Respondent was suspended for 60 days from associating with any member firm in any capacity and ordered to re-qualify as an investment company variable contracts products representative within 60 days of the termination of his suspension.

In addition, Respondent was fined $7,000, $2,500, and $5,000 for violating NASD Conduct Rule 2110 and IM-1000-1 by (i) failing to timely update his 1998 Form U-4, (ii) filing an inaccurate 1998 Form U-4, and (iii) failing to disclose his entire ten-year employment history on his 1998 and 2000 Form U-4s.

The Hearing Panel found that Respondent's failure to disclose his entire ten-year employment history on his 2000 Form U-4 was willful within the meaning of Section 15(b)(4)(A) of the Securities Exchange Act of 1934.

Appearances

Kevin G. Kulling, Esq., Regional Attorney, and Richard S. Schultz, Esq., Regional Counsel, Chicago, Illinois, for the Department of Enforcement.

Frederick K. Hoops, Esq., and Anthony R. Paesano, Esq., Detroit, Michigan, for Respondent Daniel Eric Kelsey.

DECISION

I. Introduction

The Department of Enforcement ("Enforcement") filed an eight-count Complaint against Daniel Eric Kelsey ("Respondent"). Counts one, two, three, and four of the Complaint allege that Respondent violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110, by making fraudulent misrepresentations or omissions to four customers to induce their purchase of variable universal life insurance policies. Count five of the Complaint alleges, in the alternative, that if the above conduct was not fraudulent, it violated NASD Conduct Rule 2110.

Counts six, seven, and eight of the Complaint allege that Respondent violated NASD Conduct Rule 2110 and IM-1000-1 by: (i) failing to timely update his 1998 Form U-4; (ii) filing an inaccurate 1998 Form U-4; and (iii) failing to disclose his entire ten-year employment history on his 1998 and 2000 Form U-4s. The Complaint alleges that each of the Form U-4 violations was willful.

Respondent filed an Answer to the Complaint and requested a hearing. Respondent denied the allegations of counts one through five of the Complaint. Respondent admitted the allegations of counts six through eight of the Complaint. However, Respondent argued that the errors on the Form U-4s were not material, and were not intentional, but rather were the result of his inexperience. Accordingly, Respondent argued that the errors were not willful. A hearing on the charges was held

before a Hearing Panel composed of an NASD Hearing Officer and two members of the District 8 Committee.[1]

II. Discussion

A. Respondent

Respondent first became registered with NASD as an investment company and variable contracts products representative through Hornor, Townsend & Kent, Inc. ("HTK") on May 14, 1998. (CX-1, pp. 3-4). Respondent remained registered with HTK until November 2, 2000. (Id.). While registered with HTK, Respondent worked out of the local office of Riverfront Financial Group ("Riverfront Financial"), a general insurance agency for Penn Mutual Life Insurance Company ("Penn Mutual").[2] (Tr. p. 301). On October 18, 2000, Penn Mutual dismissed Respondent for providing false information on his 1998 Form U-4. (CX-19; Tr. p. 462).

Since December 4, 2000, Respondent has been registered with NASD as an investment company and variable contracts products representative through MML Investors Services, Inc. ("MML").[3] (CX-1, p. 3).

B. Respondent Made Misrepresentations to his Customers

Counts one, two, three, four, and five of the Complaint allege that Respondent made misrepresentations or omissions to four customers to induce their purchase of

[1] References to the testimony set forth in the transcripts of the Hearing will be designated as "Tr. p." with the appropriate page number. References to the exhibits provided by Enforcement will be designated as "CX-"; references to the exhibits provided by Respondent will be designated as "RX-".

[2] HTK is wholly owned subsidiary of Penn Mutual. (RX-24, p. 32).

[3] Since Respondent was registered when the Complaint was filed, NASD has jurisdiction over this proceeding.

variable universal life insurance ("VUL") policies issued by Penn Mutual.[4] The allegations of misleading statements may be divided into two types:

(i) misrepresentations regarding Respondent's personal history; and

(ii) misrepresentations concerning the VUL policies.

1. Misrepresentations Regarding Respondent's Personal History

In the late summer or fall of 1999, Respondent met Mr. BG, who was president of both Professional Benefit Services ("PBS") and its affiliate Professional Benefit Retirement Services ("PBRS"), and Ms. CS, who was vice president in charge of marketing for PBRS.[5]

Mr. BG and Ms. CS contacted Respondent as someone with expertise in retirement planning because they needed advice regarding the development of an investment product described as a variable employment medical account ("VEMA").[6] (Tr. pp. 61-62, 136, 197).

Mr. BG and Ms. CS stated that, in connection with their meeting with Respondent in 1999, Respondent provided them with certain information about his personal background, i.e., that: (i) he had attended Michigan State University ("Michigan State"); (ii) he was in his second or third year of law school; (iii) he had his Series 7 license; and (iv) he had managed two or three brokerage funds in Chicago. (Tr. pp. 63, 136-139, 157). Mr. BG and Ms. CS subsequently produced a marketing brochure for the VEMA product

[4] VUL polices are sold by registered representatives of HTK who are also appointed and licensed as insurance agents. (RX-24, p. 32).

[5] PBS is a third party administrator of self-funded insurance benefits claims for active employees. (Tr. p. 54). PBRS was a spin off of PBS and provided insurance administrative services for retirees. (Tr. p. 52).

[6] The VEMA product was designed to provide a method for active employees to pre-fund retiree medical expenses and thereby permit corporations to control their FASB 106 liabilities. (Tr. pp. 136, 494-495). The Hearing Panel finds it unlikely that Respondent, who had been in the insurance field for less than one year, would have had a general reputation as an expert in retirement planning.

that included the representation that Respondent had managed money for three brokerage firms in Chicago. (Tr. p. 412).

Respondent had attended Ferris State University, not Michigan State; he was not attending and had never attended law school; he did not have a Series 7 license; and he had never managed a brokerage firm. (Tr. pp. 657, 664).

Based on: (i) the demeanor of Mr. BG and Ms. CS; (ii) the admissions by Respondent that he had spoken to Mr. BG about attending Michigan State and taking the law school admissions test ("LSAT"); and (iii) the production of the marketing brochure, which included the misrepresentation that Respondent had managed brokerage firms, the Hearing Panel finds that there is a preponderance of credible evidence that Respondent misled Mr. BG and Mrs. CS about his personal history.[7]

2. <u>Misrepresentations Regarding VUL Policies</u>

After working together for several months on the VEMA product, Respondent solicited Mr. BG and Ms. CS to purchase Penn Mutual VUL policies. (Tr. pp. 201-202). Respondent also made VUL presentations to Ms. CW, vice president of marketing of PBS, and to Ms. CE, the director of operations of PBS, who also managed human resources and benefits. (Tr. pp. 27, 105). Respondent spoke to Mr. BG, Ms. CS, and Ms. CE as a group about the concept of variable life insurance, but he also made individual presentations to each customer.[8] (Tr. p. 505).

[7] Respondent does not dispute that he told Mr. BG that he had attended Michigan State. (Tr. pp. 563-564). Respondent denied that he told Mr. BG and Ms. CS that: (i) he had managed brokerage funds in Chicago; (ii) he had a Series 7 license; and (iii) he was attending law school, but he admitted he might have told Mr. BG that he had taken the LSAT and that he intended to go to law school. (Tr. p. 664).

[8] Ms. CW was not at the group presentation because she was traveling. (Tr. pp. 28-29).

a. The VUL Policies

The Penn Mutual VUL policy, in addition to a death benefit, contains an investment element, which fluctuates based on the performance of investment portfolios maintained by the insurance company in a segregated or separate account.[9] The VUL policy is a flexible premium product; the customer has a certain amount of discretion in selecting what premiums to pay, generally in amounts ranging from the "no-lapse" premium up to the "guideline" premium. (Tr. pp. 240-241).

The guideline premium for the VUL policy is the maximum premium that can be made without the policy being classified as something other than a life insurance product. (Tr. p. 241). The no-lapse premium is the minimum premium payment necessary to guarantee the existence of the policy for the first three years.[10] (Tr. pp. 241-242). The premium specified by the customer to be paid is known as the planned premium. If a customer chose to pay his premiums on a monthly basis, the customer was required to pay via "Penn Check," which involved an automatic debit of the monthly planned premium from the customer's bank account. (Tr. 246).

The prospectus for the VUL policy states that the amount of the required initial premium payment depends on a number of factors, such as age, sex, rate classification, the amount of insurance specified in the application, and any supplemental benefits. (RX-24, p. 5). The insured may make additional premium payments in any amount at any time but a premium payment must be at least $25. (Id.). The insured, however, must pay

[9] The separate account is distinct from the insurance company's general account that comprises the assets of the insurance company that issues the policy. (NASD Notice to Members 00-44 (July 2000)).

[10] There is also the "target" premium, which is most analogous to a whole life premium for an equivalent amount of traditional life insurance and is an amount greater than the no-lapse premium. (Tr. pp. 241-242). Penn Mutual paid commissions on the VUL policies based in part on the relationship between the premiums paid by the customer and the target premium of the policy. (Tr. p. 351).

enough premiums to maintain a net cash surrender value for the policy sufficient to pay policy charges.[11] (RX-24, p. 5; Tr. pp. 243-244).

b. Customer BG

Count one of the Complaint alleges that Respondent committed fraud, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110, by making misrepresentations to Mr. BG to induce him to purchase a VUL policy. Mr. BG testified that based upon Respondent's representation that his initial premium would be $4,000, and that the subsequent monthly premium would be $1,500 to $2,000 per month, he purchased a $2,000,000 VUL policy from Penn Mutual. (Tr. p. 147).

Respondent confirmed that he told Mr. BG that Penn Mutual would accept a $1,500 to $2,000 monthly premium. (Tr. p. 595). Mr. BG's VUL policy, as issued, had a monthly planned premium of $4,000. (RX-14, p. 3).

c. Customer CS

Count two of the Complaint alleges that Respondent committed fraud by making misrepresentations to Ms. CS about her ability to contribute to, and withdraw funds from, the policy in order to induce her to purchase a VUL policy. Ms. CS testified that she purchased a $200,000 VUL policy from Penn Mutual based upon Respondent's representation that she could contribute or withdraw any amount of money from the policy at any time, without penalty. (Tr. p. 67).

[11] The Penn Mutual illustration provided to customers when soliciting the purchase of an insurance policy stated, "During the first 3 policy years if the sum of all premiums paid on this policy, reduced by any partial surrenders, policy loans and unpaid interest, is greater than the no-lapse premium multiplied by the number of months the policy has been in force, the policy is guaranteed not to lapse even if the net cash surrender value is zero or less." (RX-7, p. 13). "If less than the no-lapse premium is paid during the first 3 policy years, the policy will not necessarily lapse provided the net cash surrender value is greater than zero." (Id.).

Respondent confirmed that he advised Ms. CS that she was not limited in the amount that she could contribute to the policy. The policy as issued provided that surrender charges apply to policy surrenders for the first 11 years from issue. (RX-9, p. 3). With respect to deposits into a policy, Penn Mutual's illustration provided that any deposits to the policy would be monitored for compliance with the Guideline Premium-Cash Value Corridor test, and the effect of such test could be to limit the premiums that could be paid into the policy and/or increase the amount of the death benefit. (Id.).

d. Customer CE

Count three of the Complaint alleges that Respondent committed fraud by making misrepresentations to Ms. CE regarding the amount of her monthly premium. Ms. CE testified that she purchased a $200,000 policy based on Respondent's representation that the initial premium would be approximately $259 and that the subsequent planned premiums would be $130 per month. (Tr. pp. 110, 113).

Respondent confirmed that he told Ms. CE that $130 would keep her policy in force, depending on the market. (Tr. pp. 598-599). Ms. CE's VUL policy, as issued, set forth a monthly planned premium of $259.50. (RX-16, p. 2).

e. Customer CW

Count four of the Complaint alleges that Respondent committed fraud by making misrepresentations to Ms. CW regarding the amount of her monthly premium. Ms. CW testified that she purchased a $1,000,000 VUL policy based on Respondent's representations that she could deposit as much as she wanted into the policy and that the monthly premiums would be $500 per month. (Tr. p. 34).

Respondent confirmed that he told Ms. CW the monthly premium would be about $1,000, but that $500 would be acceptable. (Tr. pp. 596, 629-630). Ms. CW's policy, as issued, set forth a monthly planned premium of $2,000. (RX-17, p. 8).

f. Customers' Complaints

In October 2000, HTK and its affiliate Penn Mutual terminated Respondent for misrepresenting on his 1998 Form U-4 that he had attended Michigan State.[12] Subsequently, Jim Yost, equity coordinator at HTK, contacted Mr. BG to direct him to stop using the VEMA product brochure. (Tr. pp. 387, 418-419).

At the meeting with Mr. BG, Mr. Yost agreed to answer questions that Mr. BG, Ms. CS, Ms. CW, and Ms. CE had about their VUL policies. (Tr. pp. 419-420). The customers complained that: (i) their policies listed higher monthly planned premiums than agreed, and (ii) Respondent had not gotten their planned premium deductions corrected.[13] (Tr. pp. 420-421).

Mr. Yost advised each of the customers that Penn Mutual would not have authorized the VUL policies for the premiums that Respondent had quoted to them. (Tr. p. 421). In addition, Mr. Yost advised Ms. CS that there was a maximum of $40,122.00 that could be deposited in her policy each year.[14] (CX-27, p. 3).

Based on Mr. Yost's representation, each of the customers wrote a complaint letter to Penn Mutual. Each of the four customers canceled their policies, and Penn

[12] Respondent's registration with HTK was terminated effective November 2, 2000. (CX-1, p. 4).

[13] Mr. BG's VUL policy, as issued, set forth a monthly planned premium of $4,000. (RX-14, p. 3). Ms. CE's VUL policy, as issued, set forth a monthly planned premium of $259.50. (RX-16, p. 2). Ms. CW's VUL policy, as issued, set forth a monthly planned premium of $2,000. (RX-17, p. 8).

[14] Ms. CS testified that she told Respondent that she intended to deposit between $50,000 to $100,000 into her policy. (Tr. p. 42).

Mutual returned to the customers all of their insurance premiums in December 2000.[15] (CX-5 at ¶18; CX-6 at ¶12; CX-7 at ¶14; CX-8 at ¶14).

g. ***Respondent's Representations Regarding Planned Premiums and Ability to Deposit or Withdraw Funds were Misrepresentations***

There is practically no dispute regarding the representations made by Respondent concerning the cost of the VUL policies or the customers' ability to deposit or withdraw funds from the policies. Respondent advised Mr. BG that he could initiate his policy for $4,000 and that a monthly planned premium of $2,000 was possible. Respondent advised Ms. CE that she could initiate her policy for $259.00 and that a monthly planned premium of $130 would be possible. Respondent advised Ms. CW that she could initiate her policy for $2,000 and pay a monthly premium of $1,000. Although Respondent did not advise Ms. CS of a specific planned premium, he did advise Ms. CS that she could deposit or withdraw funds from her account without penalty.

Based on the testimony of the customers, the Hearing Panel finds that the customers viewed the quoted premiums as a minimum fixed amount, which they had the option to modify to invest more funds, but which would be sufficient in all circumstances to keep the policies from lapsing. Ms. CS believed that she could deposit or withdraw funds from her account without penalty and without conditions. This was not true.

Mr. Yost stated, which statement the Hearing Panel finds to be credible, that Penn Mutual would not have issued policies at the premiums quoted by Respondent because of the probability that the policies would lapse.[16] (Tr. p. 421). Pursuant to the VUL prospectus, in order to avoid monetary penalties on withdrawing or depositing funds into

[15] Penn Mutual reimbursed the following amounts: $10,000 to Mr. BG; $778.50 to Ms. CE; $5,000 to Ms. CW; and $411.17 to Ms. CS. (CX-5 at ¶18; CX-6 at ¶12; CX-7 at ¶14; CX-8 at ¶14).

the policies, the customer must structure the withdrawal or deposit to meet a number of conditions.

Accordingly, the Hearing Panel finds that Respondent's representations regarding the planned premiums were misleading because he failed to disclose that, unless the investment portfolios underlying the VUL policies performed well, the customers would have to increase the planned premiums to avoid having their policies lapse. The Hearing Panel also finds that Respondent's representations that funds could be withdrawn or deposited without penalty was misleading because he did not fully discuss the requirements that the customer would have to be meet in order to avoid paying penalties.

3. Fraud Not Proven

In order to establish a violation of the fraud provisions of Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rule 2120, [17] Enforcement must prove by a preponderance of the evidence that: (1) Respondent made misrepresentations and/or omissions; (2) the misrepresentations and/or omissions were material; (3) the misrepresentations and/or omissions were made with scienter;[18] and (4)

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[16] Respondent Yost testified that the customers could not have obtained the amount of insurance that they had requested for the premiums that they said they were supposed to pay. (Tr. p. 421).

[17] Section 10(b) of the Exchange Act makes it unlawful "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention" of the SEC rules and regulations. SEC Rule 10b-5 provides in part that "[i]t shall be unlawful for any person, directly or indirectly, . . . (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Conduct Rule 2120, NASD's anti-fraud rule, provides that no member shall effect any transaction in, or induce the purchase or sale of any security, by means of any manipulative, deceptive, or fraudulent device. See Prime Investors, Inc., Exchange Act Release No. 38487, 1997 SEC LEXIS 761, at *24 (Apr. 8, 1997) (making material misstatements of fact in connection with a sale of a security is a violation of NASD Conduct Rule 2120).

[18] Scienter requires proof that a respondent intended to deceive, manipulate, or defraud or that he acted with recklessness. See Aaron v. SEC, 446 U.S. 680, 686-87, n. 5 (1980); Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).

the misrepresentations and/or omissions were made in connection with the purchase or sale of securities.[19]

a. Personal History Misrepresentations: Not in Connection with Purchase or Sale of Security

As discussed above, the Hearing Panel finds that Respondent made misrepresentations about his personal history, when he spoke with Mr. BG and Ms. CE at their first meeting in 1999. It is also clear that Respondent made the misrepresentations intentionally. Consequently, the Hearing Panel finds that the misrepresentations were made with scienter. However, the Hearing Panel does not find that Respondent made the misrepresentations in connection with the purchase or sale of a security.

The misrepresentations regarding his personal history occurred several months before either the solicitation of sale or the actual sale of the VUL policies to Mr. BG and Ms. CS. There is no suggestion that, at the time that Respondent made the personal history misrepresentations, Mr. BG, Ms. CS, or Respondent contemplated the subsequent VUL policy transactions. (Tr. p. 165). Enforcement failed to provide credible evidence of any nexus between the misrepresentations and the subsequent sale of the insurance policies.

The Hearing Panel finds that the two events were independent of each other.

[19] For Section 10(b) of the Exchange Act and SEC Rule 10b-5 thereunder, the transactions must also involve interstate commerce or the mails, or a national securities exchange. Respondent used a means and instrumentality of interstate commerce when he communicated with the customers via telephone. See SEC v. Hasho, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992), 1992 U.S. Dist. LEXIS 1322 at **148-149 (S.D.N.Y. Feb. 14, 1992).

Accordingly, the Hearing Panel finds that Enforcement failed to prove that Respondent made the misrepresentations about his personal history in connection with the purchase or sale of a security.

In light of the Hearing Panel's finding that the misrepresentations were not made in connection with the sale of the VUL policies, the Hearing Panel does not find it necessary to determine whether the misrepresentations were material, i.e., that the information would have altered the "total mix" of information available to the reasonable investor in making an investment decision.[20] The Hearing Panel notes that whether an individual graduated from a particular college or has a Series 7 license may not necessarily be material to the investment decision of a reasonable investor to purchase a life insurance policy.

b. VUL Misrepresentations: Scienter Not Shown

As discussed above, the Hearing Panel finds that misrepresentations were made with respect to the VUL policies. The Hearing Panel also finds that the misrepresentations were material, and the misrepresentations were made in the connection with the sale of a security.[21]

Scienter is the only remaining requirement needed to establish fraud. As discussed above, scienter requires proof that a respondent intended to deceive, manipulate, or defraud, or that he acted with recklessness. Recklessness has been defined as highly unreasonable conduct involving not merely simple or excusable negligence, but

[20] The test of materiality is whether a reasonable investor would consider the information significant. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988). An omitted or misstated fact is thus material if it would have been viewed by a reasonable investor as having altered the "total mix" of information available. See TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

[21] There is no dispute that the customers considered the cost of the VUL policies to be a significant factor when deciding whether to purchase the VUL policies.

an extreme departure from the standards of ordinary care that presents a danger of misleading buyers or sellers, which is either known to the defendant or is so obvious that the defendant must have been aware of it.[22]

Enforcement argued that Respondent knew at the time that he quoted the premiums to the customers that the premiums would be insufficient to initiate and maintain the insurance policies. Enforcement noted that Penn Mutual issued the insurance policies with higher monthly planned premiums than the quoted premiums. Enforcement also argued that Respondent knew that deposits and withdrawals from the policies were subject to conditions, and accordingly, he acted with scienter.

The Hearing Panel finds that Respondent's actions demonstrate that he thought the quoted premiums were sufficient. Chris Engle, HTK's sales manager, and Mr. Yost, equity coordinator at HTK, testified that it was standard procedure to collect an upfront amount that was equal to two-months of premiums to begin a policy. (Tr. pp. 247, 387). Respondent testified that he followed the practice of collecting two months of premiums with these customers. (Tr. p. 517).

Respondent quoted Mr. BG a monthly planned premium amount of $2,000 and collected $4,000 to initiate the policy. (Id.). Respondent quoted Ms. CE a monthly planned premium of $130 and collected $259 to initiate the policy. (Tr. pp. 109-110). Respondent testified that he quoted Ms. CW a monthly planned premium of $1,000 and collected $2,000 to initiate the policy. (Tr. pp. 596-597).

In response to the question why the policies as issued showed a higher monthly planned premium, Respondent testified that it was a "glitch." (Tr. p. 632). Respondent

[22] Tuchman v. DSC Communications Corp., 14 F.3d 1061, 1067 (5th Cir. 1994), 1994 U.S. App. LEXIS 3326 at **14 (1994).

testified that the $4,000 monthly premium set forth in the policy was an error and that he corrected the error, but "it was too late . . . [BG] and everyone were already filing complaints." (Tr. pp. 516-517). The Hearing Panel notes that Penn Mutual reduced Mr. BG's and Ms. CW's monthly planned premiums to $2,000 and $1,000, respectively, before it repaid the customers all of their premium payments in December 2000.[23]

The Hearing Panel finds that Respondent quoted the premiums based on his understanding that a VUL policy provides that premiums may be changed every month and the amounts due depend in part on the investment experience of the investment portfolio chosen by the customer.[24] Respondent testified that only when the cash value of the policy gets lower than the actual cost of the insurance does Penn Mutual become concerned about the policy lapsing. [25] (Tr. p. 515).

With respect to the withdrawing or depositing of funds without penalty, funds may be withdrawn if the net cash surrender value remaining in the policy exceeds $1,000, and funds may be deposited in excess of the Guideline premium if the death benefits were changed. (RX-24, pp. 15, 17). Due to the VUL's flexibility, the determination of whether a particular policy would be a modified endowment contract and subject to penalties depended on the individual circumstances of each policy. (RX-24, p. 30).

Accordingly, the Hearing Panel finds that Enforcement failed to show by a preponderance of the evidence that Respondent acted with scienter when he quoted the

[23] Penn Mutual reimbursed Mr. BG $10,000, i.e., two payments of $4,000, and one payment of $2,000, and reimbursed Ms. CW $5,000, i.e., two payments of $2,000, and one payment of $1,000. (CX-5, p. 2; CX-7, p. 2).

[24] At the time of the purchase of the VUL policies, even Mr. BG thought that the May 2000 market break was just a short-term glitch. (Tr. p. 205).

[25] Mr. BG's monthly cost of insurance was $2,229.94. (RX-14, p. 3). Ms. CS's monthly cost of insurance was $79.78. (RX-15, p. 2). Ms. CE's monthly cost of insurance was $124.71. (RX-16, p. 2). Ms. CW's monthly cost of insurance was $191.19. (RX-17, p. 2).

premiums to the customers or when he disclosed that deposits or withdrawals could be made without penalty.[26]

c. Fraud Charges Dismissed

Having found that Enforcement failed to prove that: (i) the personal history misrepresentations were made in connection with the purchase or sale of a security; and (ii) the VUL policy misrepresentations were made with scienter, the Hearing Panel dismisses the charges that Respondent's misrepresentations violated Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rule 2120 as alleged in counts, one, two, three, and four of the Complaint.

C. Misrepresentations Violated Conduct Rule 2110

Count five of the Complaint alleges that, if Respondent's actions in counts one through four of the Complaint are not deemed to be fraud, such misrepresentations or omissions violated NASD Conduct Rule 2110.

The Hearing Panel finds that although Respondent's misrepresentations concerning the required premium payments and the withdrawal or deposit of funds to the policy were not intentional or reckless, they were negligent. Respondent should have clarified for the customers that although the quoted premiums may have been sufficient to initiate the insurance policies, if the investment portfolios did not continue to perform well, it was likely that the customer would need to increase the amount of the planned premiums to maintain the policies. Respondent should have clarified for Ms. CS that there were conditions that would have to be met if she wanted to withdraw or deposit funds into her policy without a penalty. Respondent's belief that his explanation of the VUL product was sufficient, in part because of the customers' insurance background,

[26] The Hearing Panel is doubtful that Respondent completely understood the features of the VUL policy.

does not excuse the misrepresentations.[27] Respondent's negligent misrepresentations of material facts violated NASD Conduct Rule 2110.[28]

In addition, although Respondent's misrepresentations concerning his personal history were not made in connection with the sale of securities, NASD Conduct Rule 2110 "is not limited to securities-related conduct; instead, it covers all unethical business-related conduct."[29] Respondent's misrepresentations concerning his personal history were intentional and therefore manifestly unethical. Accordingly, the Hearing Panel finds that Respondent's conduct violated NASD Conduct Rule 2110 as alleged in count five of the Complaint.

D. Respondent (i) Failed to Timely Update his Form U-4, (ii) Filed a False Form U-4, and (iii) Failed to Disclose Material Information on Two Form U-4s

Counts six, seven, and eight of the Complaint allege that Respondent made material omissions and misrepresentations on two Form U-4s.

1. Respondent Failed to Timely Update his 1998 Form U-4 to Disclose his Criminal Charges, Plea, and Conviction

Count six of the Complaint alleges Respondent failed to amend his Form U-4 to disclose criminal charges, a guilty plea, and a misdemeanor conviction.

Article V, Section 2(c) of the NASD By-Laws provides that every application for registration filed with NASD shall be kept current at all times by

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[27] In 2000, Ms. CW was a licensed insurance agent in Michigan and held 17 nonresident licenses. (Tr. p. 56). Ms. CS was a licensed insurance agent in several states and a licensed insurance counselor. (Tr. p. 77). Mr. BG and Ms. CE worked for PBS, a third party administrator of self-funded insurance benefits claims for active employees. (Tr. p. 54).

[28] Dep't of Enforcement v. Reynolds, No. CAF990018, 2001 NASD Discip. LEXIS 17 (NAC June 25, 2001) (finding a Rule 2110 violation, but not fraud, where representative's investigation was inadequate, his reliance on issuer's representations was unreasonable, and his assumptions mistaken).

[29] Dep't of Enforcement v. Shvarts, No. CAF980029, 2000 NASD Discip. LEXIS 6 (NAC June 2, 2000). See also In re Leonard John Ialeggio, Exchange Act Rel. No. 37,910 (Oct. 31, 1996) (finding that although Ialeggio's misconduct did not involve securities, his actions cast doubt on his commitment to the fiduciary

supplementary amendments, via electronic process or such other process as NASD may prescribe to the original application. Such amendment to the application shall be filed with NASD not later than 30 days after learning of the facts or circumstances giving rise to the amendment. Accordingly, the Form U-4 explicitly provides that applicants are under a continuing obligation to amend and update information required by the Form U-4 as changes occur.

On March 6, 1998, Respondent signed and submitted a Form U-4 to become associated with HTK.[30] (CX-2). Shortly thereafter, on March 27, 1998, Respondent was charged with embezzlement of property over $100 in value, a felony under Michigan law. (CX-3B).[31] Subsequently, Respondent was charged with a second criminal count, attempted larceny from a building, a misdemeanor. (CX-3E). On May 27,1998, Respondent pled guilty to the charge of attempted larceny from a building, and the embezzlement charge was dismissed.[32] (CX-3F).

Respondent testified that in 1998 he disclosed the criminal charge to his sales manager, Chris Engle, and his supervisor, James Garlock. (Tr. pp. 530-531). Both Mr. Engle and Mr. Garlock testified that Respondent told them of a dispute with his former employer, but they denied that Respondent told them about the criminal charge. (Tr. pp. 255, 305-307). However, Mr. Garlock admitted that he received an April 30, 1998

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standards demanded of registered persons in the securities industry and thus properly were the subject of NASD disciplinary action).

[30] Question 22(B) of the 1998 Form U-4 asked, "Have you…ever been charged with any felony . . .?" (CX-2, p. 3).

[31] Respondent testified that the charge arose out of a dispute with a former employer when, consistent with standard practice, he gave a fax machine as a bonus to a customer who had purchased a copy machine. (Tr. pp 487-488).

[32] On August 18, 1998, pursuant to a plea agreement, Respondent was sentenced to 30 months probation and a fine, which included reimbursement of $12,500 to his former employer. (CX-3H).

Infolink Service report that disclosed Respondent's criminal charge, and that after receiving the report, he discussed the criminal charge with Respondent.[33] (Tr. p. 312).

In March 2000, Respondent advised Mr. Yost of his criminal history. (Tr. pp. 401, 458-459). Upon the advice of Mr. Yost, Respondent updated his Form U-4 on March 24, 2000, approximately two years after the event.[34] (RX-55, p. 3).

Based on the demeanor of Respondent, the admissions of Mr. Garlock, and Respondent's subsequent behavior, the Hearing Panel finds Respondent's testimony credible that he told Mr. Garlock about his criminal charge, and that he did not intentionally fail to update his 1998 Form U-4.

Nevertheless, it is undisputed that Respondent did not update his Form U-4 until two years after the required events. Having found that Respondent was required to know, understand, and comply with his obligation to file an updated Form U-4,[35] the Hearing Panel finds that Respondent violated NASD Conduct Rule 2110 and IM-1000-1 by failing to timely update his Form U-4 as alleged in count six of the Complaint.

2. Respondent Filed a 1998 Form U-4 with False Information

Count seven of the Complaint alleges that Respondent willfully and affirmatively misrepresented material information on the Form U-4 that he executed on March 9, 1998 to become registered with HTK when he wrote on the Form U-4 that he was student at Michigan State in East Lansing, Michigan, from August 1990 to May 1994. There is no

[33] Although Mr. Garlock was the supervisor of Riverfront Financial, he initially testified that the home office of Penn Mutual requested criminal reports. (Tr. pp. 309, 321). When confronted with a request for criminal reports from Riverfront Financial's office manager, however, Mr. Garlock admitted that it was standard practice for his office to request a criminal report for new hires. (Tr. p. 322).

[34] On July 14, 2000, Mr. Yost advised Respondent that the 1998 Form U-4 problem had been resolved. (RX-64).

[35] See Department of Enforcement v. Howard, No. C11970032, 2000 NASD Discip. LEXIS 16, at*31 (NAC Nov. 16, 2000), aff'd, 2002 SEC LEXIS 1909 (July 26, 2002).

dispute that, in fact, Respondent graduated from Ferris State University, and never attended Michigan State. (CX-2, p. 2; CX-4, p. 2).

In connection with completing his 1998 Form U-4, Respondent told Mr. Yost that he had attended Michigan State. (Tr. p. 393). Respondent reviewed the completed Form U-4 for accuracy and then signed the Form U-4 without correcting the misinformation concerning Michigan State.[36] (Tr. p. 397).

IM-1000-1 provides that "[t]he filing with [NASD] of information with respect to membership or registration as a Registered Representative which is incomplete or inaccurate so as to be misleading, or which could in any way tend to mislead, or the failure to correct such filing after notice thereof, may be deemed to be conduct inconsistent with just and equitable principles of trade. . ." The SEC has held that misrepresentations on an application for registration violate the standards of just and equitable principles of trade to which every person associated with any NASD member is held.[37]

Accordingly, the Hearing Panel finds that Respondent violated NASD Conduct Rule 2110 and IM-1000-1 by providing false material information on his Form U-4, as alleged in count seven of the Complaint.

3. Respondent Failed to Disclose Material Information on his 1998 and 2000 Form U-4s

Count eight of the Complaint alleges that Respondent willfully made misrepresentations and omissions on the Form U-4 he executed in March 1998 to become

[36] It was Mr. Yost's practice to complete the Form U-4s himself by reading the questions to the new applicants and writing down their answers. (Tr. p. 390).

[37] Robert E. Kauffman, Exchange Act Rel. No. 33219 (Nov. 18, 1993), aff'd, Kauffman v. SEC, 40 F.3d 1240 (3rd Cir. 1994).

registered with HTK, and the Form U-4 he submitted on October 20, 2000 to become associated with MML, in violation of NASD Conduct Rule 2110 and IM-1000-1.

Questions 19 on Respondent's 1998 Form U-4 stated, "**ACCOUNT FOR ALL TIME FOR THE PAST TEN YEARS**. Give all employment experience starting with your previous employer and working back ten years. Include full and part-time work, self-employment, military service, unemployment and full-time education." (CX-2, p. 2). Question 19 on Respondent's 2000 Form U-4 was slightly different from the 1998 Form U-4. The 2000 Form U-4 stated, "PROVIDE COMPLETE EMPLOYMENT HISTORY FOR THE PAST 10 YEARS. INCLUDE THE FIRM(S) NOTED IN ITEM 4 AND 10. INCLUDE ALL FIRM(S) FROM ITEM 9 (Account for all time including full and part-time employments, self-employment, military service, and homemaking. Also include statuses such as unemployment, full-time education, or travel that lasted for at least one month). (RX-54, p. 3).

In response to Question 19 on his 1998 and 2000 Form U-4s, Respondent failed to disclose a complete account of his time for the past ten years. Specifically, Respondent failed to disclose the following information: (i) he had been employed by Management Recruiters, Inc., in Richmond, Kentucky; (ii) he had been employed by Woodland Creek Apartments in Grand Rapids, Michigan; (iii) he had been employed by CEC in Grand Rapids, Michigan; (iv) he had been employed by Visser Computer Training, a/k/a Visser Resources, in Grand Rapids, Michigan; (v) he had been employed, during college, by: (1) Winners Creek Golf Course in Big Rapids, Michigan; (2) McDonalds in Lansing, Michigan; (3) Rogers-Mohnke Funeral Home in Big Rapids, Michigan; (4) Mecosta County Sheriff's Department in Big Rapids, Michigan; (5) Pope Chevrolet in Roswell,

Georgia; (6) Triple M (Toshiba) in Louisville, Kentucky; and (vi) he had been a student at Ferris State University. (CX-2, p. 2; RX-54, p. 3; CX-18, pp. 4-5).

The evidence is undisputed, and Respondent admitted that he failed to disclose his complete employment history and his attendance at Ferris State University on the 1998 Form U-4. (Tr. pp. 658-659).

Respondent admitted that he personally completed the employment and personal history information on the 2000 Form U-4 for MML.[38] (Tr. p. 586). Respondent also admitted that the information he provided was not his complete employment history. (Id.).

Accordingly, the Hearing Panel finds that Respondent violated NASD Conduct Rule 2110 and IM-1000-1, as alleged in count eight of the Complaint, by executing and filing two Form U-4s, in which he failed to disclose material information.

4. Respondent's Failure to Disclose Material Information on his 2000 Form U-4 was Willful

Section 15(b)(4)(A) of the Securities Exchange Act of 1934 states that a person who files an application for association with a member of a self-regulatory organization and who "willfully" fails to disclose "any material fact which is required to be stated" in that application is statutorily disqualified from participating in the securities industry. The respondent does not have to intend to violate a specific rule or law; rather, the Hearing Panel must determine "whether the respondent knew or reasonably should have known under the particular facts and circumstances that his conduct was improper." The term "willfully" requires

[38] On December 4, 2000, Respondent's registration as an investment company contracts products representative through MML became effective. (CX-1, p. 3).

proof that the respondent acted intentionally in the sense that he was aware of what he was doing.[39]

Respondent argued that he simply made honest mistakes in completing the 1998 and 2000 Form U-4s, although Respondent admitted that, when completing the 2000 Form U-4, he was aware that the form asked for his employment for the last ten years. (Tr. p. 586).

The Form U-4 clearly calls for the information that Respondent omitted. When Respondent was terminated by HTK on October 18, 2000, he was told he was terminated for failure to provide information on a Form U-4 in a timely manner. (RX-48). Accordingly, Respondent was reminded of the importance of providing accurate information on his Form U-4.

The Hearing Panel finds that Respondent's failure to provide correct employment information on his 2000 Form U-4 was willful because Respondent should have known under the particular facts and circumstances that his failure to provide all of his employment information was improper.

Given that the Hearing Panel found that Respondent willfully failed to disclose his employment information on the 2000 Form U-4, the Hearing Panel did not find it necessary to make willfulness findings concerning the 1998 Form U-4, especially since "willfulness" differs from inadvertence or negligence, and evidence was presented that could be viewed as supporting a finding of negligence.[40]

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[39] Christopher LaPorte, Exchange Act Rel. No. 39,171, 1997 SEC LEXIS 2058 at *8 (Sept. 30, 1997); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976).

[40] The 1998 Form U-4 was Respondent's first exposure to the NASD's form. In addition, Mr. Yost read the form to Respondent and thereby may have deprived Respondent of the opportunity to adequately absorb and understand all of the requirements of the form. Respondent testified that in 1998, he was not aware that he could amend a Form U-4. The Hearing Panel notes that Respondent told his supervisor of his felony charge in 1998, and that when discussing the felony charge with a relatively new hiree, Mr.

III. Sanctions

A. Misrepresentations and Omissions

For negligent misrepresentations or omissions, the NASD Sanction Guidelines recommend a fine ranging from $2,500 to $50,000, and a suspension for up to 30 business days. For reckless or intentional misrepresentations or omissions, the Guidelines recommend a fine of $10,000 to $100,000 and a suspension of 10 business days to two years, or in egregious cases a bar.[41]

The Hearing Panel finds that Respondent violated NASD Conduct Rule 2110 by misrepresenting his background in certain respects. The Hearing Panel also finds that Respondent violated Rule 2110 by making negligent misrepresentations in connection with the sale of VUL policies.

The Hearing Panel did not find either of these violations to be egregious.[42] However, because Respondent's VUL policy misrepresentations could have resulted in harm to the customers and because the personal history misrepresentations were intentional, although not made in connection with the sale of the VUL policies, the Hearing Panel finds more than a minimum sanction is warranted. In determining what sanctions would be sufficient to deter future misconduct, the Hearing Panel noted that

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Garlock failed to advise him that he needed to update his Form U-4. In addition, when Respondent advised Mr. Yost of his criminal history in 2000, Mr. Yost found it necessary to contact HTK's home office to determine whether Respondent's March 1998 Form U-4 needed to be updated. (Tr. pp. 387, 402, 459).

[41] NASD Sanction Guidelines, p. 96 (2001).

[42] With respect to the intentional misrepresentation regarding Respondent's personal information, the Hearing Panel finds that the testimony of Mr. BG and Ms. CE meets the preponderance of the evidence standard to support a finding of liability. However, the Hearing Panel does not find that the strength of the evidence, other than Respondent's admitted misrepresentation regarding his attendance at Michigan State, was sufficient to find the misrepresentations egregious. The Hearing Panel noted that: (i) the two complaining customers, Mr. BG and Ms. CE, had a prior business relationship; (ii) the complaining customers had a possible dispute with Respondent regarding the VEMA product; and (iii) the complaining customers' complaint letters, declarations, and testimony contained certain inconsistencies.

Respondent has not had a repeat of the incidents in more than two years.[43]

For violating NASD Conduct Rule 2110, the Hearing Panel suspends Respondent for 60 days from associating with any member firm in any capacity, and orders Respondent to re-qualify as an investment company variable contracts products representative within 60 days of the termination of his suspension.

B. Inaccurate Form U-4s

For filing a false, misleading, or inaccurate Form U-4, the NASD Sanction Guidelines recommend a fine ranging from $2,500 to $50,000, as well as the consideration of a 5 to 30 business-day suspension in any or all capacities. In egregious cases, the Guidelines recommend consideration of a longer suspension, of up to two years, or a bar.[44] The applicable principal considerations are: (1) the nature and significance of the information at issue; and (2) whether failure resulted in a statutorily disqualified individual becoming or remaining associated with a firm.

In determining what sanctions should be imposed for the failure to update timely the 1998 Form U-4, the Hearing Panel considered the serious nature of the omitted information, i.e., that Respondent had been initially charged with a felony. However, the

[43] In response to the allegations of the complaining customers, the State of Michigan required that Respondent's sales activities be monitored. (RX-33, p. 6). Pursuant to the State of Michigan, MML monitored all of Respondent's insurance sales and securities sales from November 17, 2000 to November 2002, and made quarterly reports to the State of Michigan. (Id.). Only the four customers associated with PBS filed, and did not withdraw, complaints about Respondent's description of the features of the VUL policies. (Tr. pp. 518-519). As of the date of the hearing, Respondent had sold 128 VUL policies. (Id.).

[44] Guidelines at 77-78.

Hearing Panel also noted that the failure to disclose did not result in a statutorily disqualified person becoming associated with a firm. In addition, the Hearing Panel finds that Respondent's conduct was not egregious based on Respondent's voluntary disclosure of the criminal charges to his supervisors in 1998 and again in 2000. On his own initiative, rather than at the prompting of the Firm, Respondent took steps to amend the Form U-4 to include the correct information regarding his criminal charges. The Hearing Panel fines Respondent $7,000 for his failure to timely update his Form U-4, as alleged in count six of the Complaint. Because Respondent did not repeat the misconduct, i.e., he disclosed the criminal charge on the 2000 Form U-4, the Hearing Panel finds that a fine is sufficient to deter any future misconduct.

With respect to Respondent's misrepresentation concerning his attendance at Michigan State on the Form U-4 in count seven of the Complaint, the Hearing Panel considered (1) the nature of the misrepresentation, i.e., that he had graduated from Michigan State rather than from Ferris State University, and (2) that the misrepresentation was intentional. Based on the nature of the information, the Hearing Panel does not find the misrepresentation egregious.[45] Respondent acknowledged his misconduct and expressed remorse. The Hearing Panel fines Respondent $2,500 for misrepresenting that he graduated from Michigan State on his Form U-4 as alleged in count seven of the Complaint. Because Respondent did not repeat the misconduct, i.e., he correctly disclosed Ferris State University on his 2000 Form U-4, the Hearing Panel finds that a fine is sufficient to deter any future misconduct.

[45] If Respondent had not graduated from an accredited university, the Hearing Panel would have viewed the misrepresentation as warranting a more serious sanction.

With respect to his failure to disclose his entire employment history on the 1998 and 2000 Form U-4s, the Hearing Panel considered the nature of the omitted information, i.e., most of the omitted employment information involved summer or college jobs. Respondent acknowledged his misconduct and expressed remorse. The Hearing Panel also determined that Respondent was not attempting to hide his prior history, he was negligent in believing he only needed to list substantive employment. Consequently, although on two separate occasions Respondent failed to disclose his complete employment history, the Hearing Panel did not find the filing of the second Form U-4 was egregious. The Hearing Panel fines Respondent $5,000 for failing to disclose his complete employment history, as alleged in count eight of the Complaint.

Finding that Respondent's conduct reflected irresponsibility rather than a deliberate intention to deceive on substantive matters, the Hearing Panel finds that Respondent's greater maturity and the above sanctions are sufficient to deter further misconduct by Respondent.

IV. Order

The Hearing Panel suspends Respondent Daniel Eric Kelsey for 60 days from association with any NASD member firm in any capacity, and orders him to re-qualify as an investment company variable contracts products representative within 60 days of the termination of his suspension for engaging in unethical conduct as alleged in count five of the Complaint.

Respondent Kelsey is fined $14,500 (due and payable when and if Respondent seeks to return to the securities industry) for violating NASD Conduct Rule 2110 and IM-1000-1 by: (i) failing to timely update his Form U4; (ii) filing a False Form U-4; and (iii) failing to disclose his complete employment history as required on two Form U-4s,

as alleged in counts six through eight of the Complaint. In addition, Respondent is ordered to pay costs in the total amount of $3,179, which includes an administrative fee of $750 and hearing transcript costs of $2,429.

If this Decision becomes the final disciplinary action of NASD, the suspension of Respondent Daniel Eric Kelsey, in his capacity as investment company variable contracts products representative, shall commence with the opening of business on Monday, August 16, 2004, and end at the close of business on October 14, 2004. The Respondent's fines and costs shall become due and payable upon his re-entry into the securities industry.[46]

HEARING PANEL

By: Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
June 29, 2004

Copies to:
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[46] The Hearing Panel has considered all of the arguments of the Parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.