

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of

Department of Enforcement,

Complainant,

vs.

Robert E. Strong  
New York, NY,

Respondent.

DECISION

Complaint No. C04050005

Dated: February 23, 2007

**Respondent failed to supervise a research analyst, who traded securities contrary to the recommendations contained in various research reports and traded during the blackout periods; failed to include or included insufficient or inaccurate required disclosures in research reports; and failed to file timely an annual attestation of supervisory procedures for research analysts. Held, findings and sanctions modified.**

**Appearances**

For the Complainant: James M. Stephens, Esq., Leo F. Orenstein, Esq., Department of Enforcement, NASD

For the Respondent: Robert Strong, Pro Se

**Decision**

Robert E. Strong (“Strong”) appeals a March 1, 2006 decision of an NASD Hearing Panel. The Hearing Panel found that Strong failed to supervise adequately a research analyst in violation of NASD Conduct Rules 3010 and 2110; failed to ensure that research reports contained requisite disclosures in violation of NASD Conduct Rules 2711(h) and 2110; failed to enforce restrictions on the content of draft research reports in violation of NASD Conduct Rules 2711(c) and 2110; and failed to file timely the annual attestation of supervisory procedures for research analysts in violation of NASD Conduct Rules 2711(i) and 2110. The Hearing Panel suspended Strong for nine months in all supervisory capacities and fined him \$15,000. After a

complete review of the record, we modify the Hearing Panel's findings of violation and the sanctions imposed.

I. Background

Strong entered the securities industry in 1989 as an examiner for NASD. An NASD member firm employed Strong as its director of compliance from 1998 to 2001. In 2002, Strong became registered with Jesup & Lamont Securities Corporation ("Jesup" or "the Firm") as a general securities principal, municipal securities principal, and general securities representative. Strong served as the Firm's chief compliance officer until December 2005 when he left the Firm. Strong's conduct relevant to this decision occurred during the time when he was associated with Jesup. He is not currently associated with an NASD member firm.

II. Procedural History

This case arose out of an NASD on-site examination of Jesup in October 2003. During this examination, NASD found several violations with respect to the Firm's research activities. On January 28, 2005, the Department of Enforcement ("Enforcement") filed a 12-cause complaint against Jesup and Strong.<sup>1</sup> While all 12 causes applied to the Firm, only causes one through five applied to Strong. With respect to Strong, the complaint alleged that: (1) Strong failed to supervise a research analyst who sold securities in the analyst's personal trading account when such sales were inconsistent with the "buy" or "strong buy" recommendations contained in the Firm's research reports and allowed the research analyst to execute four purchase transactions of covered securities during the blackout period surrounding the issuance of the research reports on the purchased securities; (2) Strong failed to include or included inaccurate or insufficient required disclosures in the Firm's research reports, (3) Strong submitted a draft research report, that contained a research summary and price target, to the subject company prior to publication; (4) Strong untimely filed the Firm's 2002 attestation for supervisory procedures for research analysts; and (5) Strong failed to maintain for the Firm copies of draft research reports sent to subject companies prior to publication.<sup>2</sup> Strong generally denied these allegations.

The Hearing Panel held a hearing on December 6, 2005, and heard closing arguments from the parties on December 13, 2005. Enforcement presented three witnesses: an NASD investigator; Jesup research analyst Gary Davis ("Davis"); and Jesup's president William

---

<sup>1</sup> Jesup settled this matter with NASD in April 2005.

<sup>2</sup> Cause five of the complaint further alleged that through this misconduct the Firm violated Securities Exchange Act Rule 17a-4(b)(4) and NASD Conduct Rule 2110 and that Strong violated Rule 2110. The Hearing Panel made no findings regarding this allegation with respect to Strong but noted that Jesup violated Securities Exchange Act Rule 17a-4(b)(4) through this misconduct. We conclude that the record is insufficient to support a finding of violation regarding this allegation against Strong and therefore dismiss cause five.

Moreno (“Moreno”). Strong testified on his own behalf. On March 1, 2006, the Hearing Panel issued its decision in which it found that Strong engaged in the misconduct as alleged in causes one through four of the complaint. This appeal followed.

### III. Facts

#### A. Jesup

In early 2001, prior to joining Jesup, Moreno was the vice president of finance and the financial and operations principal (“FINOP”) for NASD member firm Broadmark Capital (“Broadmark”). Broadmark lost its offices in New York City as a result of the terrorist attacks on September 11, 2001, and was looking to reestablish its business. In April 2002, Broadmark acquired the assets and employees of Jesup. After Broadmark’s acquisition, Moreno became Jesup’s co-president, chief financial officer, FINOP, and compliance officer. Jesup employed approximately 40 people, including 25 brokers who engaged in retail and institutional sales, market making, investment banking, and two research analysts who engaged in research activities.

Beginning in the summer of 2002, Moreno focused primarily on expanding Jesup’s business and was unable to dedicate time to compliance responsibilities. Moreno hired Strong in July 2002 to serve as the Firm’s chief compliance officer. Moreno testified that Strong was expected to “come in and take over [the compliance] position, review, modify, improve the written supervisory procedures, implement them and . . . oversee that activity for the firm.” Moreno further stated that he was not regularly involved with compliance issues once Strong joined the Firm. According to Moreno, Strong was responsible for supervising research activities at the Firm, including reviewing the trading activity of the Firm’s research analysts, and was expected to review research reports issued by the Firm for compliance with Conduct Rule 2711.

#### B. NASD Conduct Rule 2711 Takes Effect

In May 2002, the SEC approved NASD Conduct Rule 2711 related to research analysts and research reports. The rule was intended to “improve the objectivity of research and provide investors with more useful and reliable information when making investment decisions” and “restore investor confidence in a process that is critical to the equities markets.” *NASD Notice to Members 02-39* (July 2002). On July 9, 2002, six days before Strong joined Jesup, the majority of the provisions of Conduct Rule 2711 relevant to this decision became effective.<sup>3</sup> *See id.* Jesup did not have procedures in place related to Rule 2711 until after Strong joined the Firm.

---

<sup>3</sup> Also applicable here, Conduct Rules 2711(c)(2) and 2711(h)(6) became effective on September 9, 2002. *NASD Notice to Members 02-39*.

C. Strong's Activities at Jesup Related to Research

Shortly after Strong joined the Firm, he began issuing memoranda to Firm employees to advise them on the requirements of Conduct Rule 2711. In late July 2002, Strong addressed a memo to Davis and others at the Firm that summarized the rule and attached the complete rule text. Strong stated that he would be "discussing with the appropriate people what changes may need to be made" as a result of the rule. Strong issued another memo to remind all Firm employees to submit copies of all personal brokerage account statements to him in order for him to ensure that Firm staff was not trading securities included on the Firm's restricted list. Strong's review of employee trading was limited to comparing an employee's trades with the securities on the Firm's restricted list. Strong testified that he did not receive account statements for Davis until sometime during the second quarter of 2003. In February 2003, Strong sent a memo to Moreno and Davis, among others, as a reminder to include required disclosures in any research report, including whether an analyst held shares in the subject company or if the Firm made a market in the covered security. In an April 2003 memo, Strong reminded the Firm's research analysts that he must be notified at least 10 days prior to the release of a research report and that all research reports must be submitted to him for review prior to release "to ensure that the proper disclosures are made."

Strong also amended the Firm's written supervisory procedures, first in October 2002 and again in August 2003. The Firm's October 2002 written supervisory procedures ("October WSPs") provided that the chief compliance officer would review the Firm's research reports to ensure compliance with Conduct Rule 2711. The October WSPs further stated that the compliance officer was required to give prior approval of transactions in the accounts of research personnel.<sup>4</sup> In addition, the October WSPs stated that the compliance officer would retain evidence of securities ownership at the time a research report was issued and would "review trading activity at appropriate times to ensure compliance with the holding requirement." The compliance officer would "retain evidence of the review and note any action taken." The October WSPs also included a chart with types of orders that required supervisory approval and listed the corresponding supervisor responsible for that approval. The October WSPs listed "compliance" as the designated supervisor for giving "[p]rior to entry" approval of a "[b]uy or sell order for research associated person accounts."

Strong again revised the Firm's WSPs in August 2003 ("August WSPs"). The August WSPs designated Strong as the principal responsible for the Firm's research activity.

D. Davis's Trading Activity

From October 2002 through September 2003, Davis executed 41 sales of securities from his personal accounts of seven companies that were the subjects of "buy" or "strong buy"

---

<sup>4</sup> The Firm's WSPs used the abbreviations "CO" (compliance officer) and "CCO" (chief compliance officer) interchangeably. Strong testified that both CO and CCO referred to him.

recommendations contained within his most recent research reports for these companies.<sup>5</sup> From December 2002 through March 2003, Davis also executed four purchase transactions of three companies that were subjects of his research reports within 30 days of his issuance of a research report regarding the companies.<sup>6</sup> Davis placed these personal trades directly with the Firm's trading desk.

#### IV. Discussion

##### A. Strong's Failure to Supervise Davis's Personal Trading

The first cause in the complaint alleged, and the Hearing Panel found, that Strong failed to supervise the personal trading in Davis's research analyst account.<sup>7</sup> We affirm this finding. Conduct Rule 3010(a) requires member firms to establish and maintain a supervisory system that is reasonably designed to achieve compliance with the applicable securities laws, rules, and regulations. The October WSPs assigned the compliance department as the designated supervisor of research responsible to provide "[p]rior to entry" approval of a "[b]uy or sell order for research associated person accounts." Additionally, the research section of both the October and August WSPs required Strong, as the chief compliance officer, to provide prior approval of transactions in the accounts of research personnel.

As previously noted, Davis executed 41 sales in his personal accounts that were inconsistent with the recommendations contained in the Firm's relevant research reports. NASD Conduct Rule 2711(g)(3) prohibits a research analyst account from selling a security "in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member."<sup>8</sup> *NASD Notice to Members 02-39*. Davis also

---

<sup>5</sup> Davis had three personal accounts at Jesup. The details of Davis's 41 transactions are attached to this decision as "Exhibit A." Exhibit A identifies the covered companies, the settlement date of the trades, the number of shares sold, and the date of the relevant research reports.

<sup>6</sup> Specifically, Davis purchased 100 shares of AVI BioPharma Inc. ("AVI") on December 13, 2002, which was four days before the Firm issued an AVI research report. Davis purchased 2,000 shares of Collagenex Pharmaceutical, Inc. ("Collagenex") on February 4, 2003, and the Firm issued a Collagenex research report on February 27, 2003. Davis made two separate purchases of Natestch Pharmaceutical Company ("Natestch"), totaling 4,000 shares on March 18, 2003, three days before the Firm issued a Natestch research report on March 21, 2003.

<sup>7</sup> A research analyst account, defined by NASD Conduct Rule 2711(a)(6), is "any account in which a research analyst . . . has a financial interest, or over which such analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940." *NASD Notice to Members 02-39*.

<sup>8</sup> During the relevant period, Conduct Rule 2711(a)(8) defined a research report as "a written or electronic communication which includes an analysis of equity securities of individual

executed four purchase transactions during the “blackout period.” In relevant part, NASD Conduct Rule 2711(g)(2) prohibits a research analyst account from purchasing “any security issued by a company that the research analyst follows . . . for a period beginning 30 calendar days before . . . the publication of a research report concerning the company.”<sup>9</sup> *NASD Notice to Members 02-39*.

Strong concedes that Davis’s trading was in contravention to the Firm’s research report recommendations and that Davis made several trades without permission during the blackout period imposed by Conduct Rule 2711. Strong argues, however, that he was not Davis’s “line” supervisor, but rather that he functioned solely as a compliance officer. We agree that Strong was not Davis’s “line” supervisor at the Firm. “Compliance officers do not become ‘supervisors’ solely because they occupy the position of compliance officer.” *Dep’t of Mkt. Regulation v. Yankee Fin. Group, Inc.*, Complaint No. CMS030182, 2006 NASD Discip. LEXIS

---

[cont’d]

companies or industries, and which provides information reasonably sufficient upon which to base an investment decision and includes a recommendation.” *NASD Notice to Members 02-39*. In September 2003, NASD amended the definition of research report in which it deleted the requirement that the report contain a recommendation. *NASD Notice to Members 03-44* (Aug. 2003). The prior definition applies to this decision.

In March 2004, NASD adopted the Commission’s interpretation with respect to Regulation AC. Thus, “a client communication that analyzes individual securities or companies will be considered a research report if it provides information reasonably sufficient upon which to base an investment decision and is distributed to at least 15 persons.” *NASD Notice to Members 04-18* (Mar. 2004). Strong contends that eight of the communications at issue here were distributed to fewer than 15 persons and thus not research reports. We disagree. First, NASD did not adopt the Commission’s interpretation of Regulation AC until March 2004—after the misconduct at issue took place. Second, Davis testified that while he provided each research report to no more than 10 clients, he also made the reports available to all of the brokers at the Firm. Davis stated that the Firm generally made 100 copies of each report. We conclude that the communications at issue meet the definition of research report under Conduct Rule 2711. *See, e.g., Dep’t of Enforcement v. Asensio Brokerage Servs., Inc.*, Complaint No. CAF030067, 2006 NASD Discip. LEXIS 20, at \*21-22 (NAC July 28, 2006) (discussing definition of “research report”).

<sup>9</sup> NASD Conduct Rule 2711(g)(2)(B) allows a member to permit a research analyst to purchase securities of a subject company within 30 calendar days before the publication of a research report provided the member’s legal or compliance department pre-approves the research report and the report is made in response to significant news or a significant event. There is no evidence that the Firm gave Davis permission to purchase the covered securities within the 30-day period. Indeed, Davis testified that he did not recall receiving approval from anyone at the Firm to trade during the blackout period, and Strong concedes that he did not know about these trades at the time.

21, at \*36 (NAC Aug. 4, 2006), *appeal filed*, Admin. Proceeding No. 3-12402 (SEC Aug. 28, 2006). Strong, however, was responsible for pre-approving the trading done in the accounts of research analysts as set forth in the Firm's WSPs. Strong had the power to withhold approval of trades, cancel inappropriate transactions, or prevent the trading desk from executing Davis's trades absent Strong's approval. Thus, we find that the Firm's WSPs designated Strong as the person who was responsible for supervision of the Firm's research activities, including the personal trading of its research analysts. The WSPs added a supervisory function above and beyond the compliance functions in requiring the compliance officer to approve trades in accounts of research personnel.

Other evidence in the record further supports our conclusion that Strong was the supervisor for research activities. Moreno testified that Strong was the person at the Firm responsible for supervising research activity. Moreno stated that he told Davis that Strong was responsible for overseeing the Firm's research activities and directed him to submit research reports to Strong for review.<sup>10</sup> Strong indeed regularly received reports for review. Davis testified that he viewed Moreno as his general supervisor but that he went to Strong, not Moreno, if he had questions about the propriety of trading in his research analyst account. For example, in December 2002, Davis submitted a memo to Strong that acknowledged that he purchased shares of a subject company's securities during the blackout period. As the designated principal responsible for research activity, Strong was responsible for overseeing the Firm's research activity, including the personal trading of its research analysts. *See, e.g., John A. Chepak*, 54 S.E.C. 502, 510 (2000) (finding director of compliance responsible for supervision of firm's sales and trading department as assigned by the firm's supervisory procedures). Strong's role as the compliance person responsible for the Firm's research activity was, according to the Firm's WSPs, a supervisory function.

Strong conceded at the hearing below that he did not review Davis's trades as called for by the WSPs, but he stated that he was "trying to put in place" that procedure. Strong, however, did not begin receiving Davis's account statements until sometime during the second quarter of 2003, and even then, he did not realize that Davis was trading in covered securities until approximately August 2003. Instead of implementing a procedure that would ensure pre-approval of Davis's trades, Strong relied on Davis to come to him. Strong testified that if Davis failed to come to Strong with his trades, Strong would not be aware of them until Strong received Davis's account statements at the month's end.

Once Strong began reviewing Davis's statements and realized that Davis was trading subject companies' securities, Strong took no action to limit Davis's trading. Strong testified that, at that time, the trading desk and Davis came to him regarding whether Davis's trading was permissible. Strong stated that he deemed the trading to be "okay." He stated that he "didn't view it as something that was that controversial" and that it was unnecessary to ask for Moreno's views. Strong determined that Davis's sales transactions were not contrary to the Firm's "buy"

---

<sup>10</sup> While we do not view Moreno's beliefs by themselves as determinative on the issue of supervision, we find them relevant when coupled with other evidence to support the conclusion that Strong was the supervisor of research.

and “strong buy” recommendations, and therefore in his view Rule 2711(g) did not apply, because Davis continued to hold positions in the subject securities. Strong testified that he “saw huge positions and the trades in question were very small relative to those positions. And I just felt that was not inconsistent with his recommendation.” Strong concedes, however, that Davis sold his entire position of two subject companies. Moreover, Strong admits that he was unaware at the time that Davis was trading during the blackout period. Strong did not view Davis’s trading as problematic because he questioned whether Rule 2711 applied to the Firm’s research reports when Davis sent the reports to so few clients. As we noted previously, Rule 2711 did apply to the Firm’s communications. We reject Strong’s interpretation of Rule 2711(g). Rule 2711(g) prohibits individual securities transactions in a research analyst’s account that are contrary to the analyst’s recommendation as reflected in the analyst’s most recent research report. Strong concedes that he misapplied the rule.

We find that Strong’s inaction in the face of Davis’s trading was a failure to supervise and affirm the Hearing Panel’s finding that Strong violated Conduct Rules 3010 and 2110.<sup>11</sup>

B. Violations of NASD Conduct Rule 2711

Causes two through four relate to violations of specific provisions of Conduct Rule 2711. We address each cause in turn below.

1. Rule 2711(h)

The second cause of the complaint alleged, and the Hearing Panel found, that Strong, on behalf of the Firm, failed to include required disclosures or included insufficient or inaccurate disclosures in various research reports in violation of Conduct Rules 2711(h) and 2110. We affirm the findings of violation against Strong. We determine that Strong was the person responsible at the Firm for ensuring that the research reports included the disclosures required by Rule 2711’s provisions and that he failed to do so. Under the facts of this case, we conclude that Strong is liable not merely based upon the rule’s language but in combination with the fact that Strong immersed himself in the disclosure process at the Firm related to research reports and that he admitted to his responsibility.<sup>12</sup> Moreover, the October and August WSPs provide that Strong was responsible for reviewing the Firm’s research reports to “ensure compliance with NASD

---

<sup>11</sup> A violation of NASD’s supervisory rules also constitutes a violation of Conduct Rule 2110. See *Dep’t of Enforcement v. Levitov*, Complaint No. CAF970011, 2000 NASD Discip. LEXIS 12, at \*27 (NAC June 28, 2000). NASD Conduct Rule 115 extends NASD rule requirements to persons associated with a member.

<sup>12</sup> NASD has previously imposed liability on associated persons who were directly involved in the conduct that led to a firm’s violation as well as upon those persons whose involvement in the misconduct was “significant.” See *Dep’t of Enforcement v. Respondent*, Complaint No. CAF030042, 2005 NASD Discip. LEXIS 48, at \*11 & n.14 (NAC Dec. 30, 2005); see also NASD Rule 115.



Rule 2711” and that Strong (or Moreno) would review, initial, and approve the reports prior to dissemination.

Moreno testified that he only initialed some of the research reports but that he received copies of all of the reports after Strong completed the approval process. Moreno also stated in his investigative testimony that Strong did the full review of the research reports unless he was out of the office. Moreno testified at the hearing below that Strong was responsible for monitoring the disclosure items in the research reports. In addition, Davis testified that he was not responsible for including the disclosures in the reports but that he provided his input. Davis testified that Strong was responsible for adding the disclosures to the reports. Strong admitted at the oral argument before the subcommittee of the National Adjudicatory Council empanelled to consider this appeal that he regularly reviewed the disclosures and corrected errors in the research reports.

a. *Rule 2711(h)(1)(A)*

Conduct Rule 2711(h)(1)(A) requires a member to “disclose in research reports” if a research analyst holds “a financial interest in the securities of the subject company, and the nature of the financial interest.” *NASD Notice to Members 02-39*. Two of the Firm’s research reports failed to disclose that Davis held a financial interest in the subject companies.<sup>13</sup> Strong testified that he “made sure that a disclosure [was] being made,” but that he considered that the reports were complete when he received them from Davis and that they already included any necessary disclosures. Strong concedes that he did not make an independent determination as to whether Davis held a financial interest in the subject companies until sometime in the “latter part of the first quarter of 2003.” Strong, however, was the person who the WSPs charged with the responsibility of pre-approving an analyst’s trades and reviewing the research reports to ensure compliance with Rule 2711. Had Strong fulfilled his responsibilities, he would have known that Davis held a financial interest in the subject companies which was required to be disclosed. *See, e.g., John G. Harmann*, 51 S.E.C. 687, 689, 691 (1993) (holding compliance officer, who oversaw compliance with fair pricing requirements and regularly reviewed the firm’s trades, primarily liable for the firm’s fraudulent prices). Under these facts, we affirm the finding that Strong violated Rule 2711(h)(1)(A) when the February 19, 2003 Med-Design report and February 27, 2003 Collagenex report did not disclose that Davis held financial interests in these companies.

b. *Rule 2711(h)(4)*

Conduct Rule 2711(h)(4) requires a member to “define in its research reports the meaning of each rating used by the member in its rating system.” *NASD Notice to Members 02-*

---

<sup>13</sup> Davis held the following financial interests in subject companies that were not disclosed: (1) Davis received 13,520 Med-Design Corporation (“Med-Design”) warrants on February 18, 2003, which was one day before the Firm issued a Med-Design research report; and (2) Davis held 22,000 shares of Collagenex when the Firm issued its report dated February 27, 2003.

39. Three of the Firm's research reports failed to define the rating of "strong buy."<sup>14</sup> Strong admits that he was responsible for the failure to define the rating. With respect to this failure, Strong testified to the following at the hearing below: "I would say that I share a responsibility in that." "I should have caught the strong buy. It wasn't defined." We affirm the finding that Strong violated Rule 2711(h)(4) by failing to define "strong buy" in three research reports.

c. *Rule 2711(h)(6)*

Conduct Rule 2711(h)(6) requires that a member "present in any research report concerning an equity security on which the member has assigned any rating for at least one year, a line graph of the security's daily closing prices for the period that the member has assigned any rating or for a three-year period, whichever is shorter." *NASD Notice to Members 02-39*. The price chart must "be current as of the end of the most recent calendar quarter," "indicate the dates on which the member assigned or changed each rating or price target," and "depict each rating and price target." *Id.* Three of the Firm's research reports failed to include a sufficient price chart.<sup>15</sup> The evidence demonstrates that the Firm assigned ratings to AVI in July 2001, Nastech in March 2002, and Discovery in January 2002. Because the Firm assigned ratings to each of these securities for at least one year, the corresponding research reports were required to include a price chart as set forth by Rule 2711(h)(6). While these reports did include price charts, they were insufficient under the rule. The charts provided the daily closing prices for only six months for each security. Strong concedes that he did not include sufficient price charts. Strong testified that he was reviewing the research reports but it was not until "sometime in 2003 that [he] became aware that there had been some reports that had been covered for more than a year that should have [included sufficient price charts and] didn't." We determine that Strong violated Rule 2711(h)(6) when three of the Firm's research reports failed to include sufficient price charts.

d. *Rule 2711(h)(7)*

Conduct Rule 2711(h)(7) requires a member to "disclose in research reports the valuation methods used to determine a price target." *NASD Notice to Members 02-39*. The price target provided in the research report "must be accompanied by a disclosure concerning risks that may impede achievement of the price target." *Id.* Seven of the Firm's research reports failed to comply with Rule 2711(h)(7). Each of these seven research reports, which included a price

---

<sup>14</sup> The following three research reports did not define "strong buy": February 19, 2003 Med-Design report, March 21, 2003 Nastech report, and July 22, 2003 Discovery Laboratories Inc. ("Discovery") report.

<sup>15</sup> The complaint alleges that five of the research reports failed to comply with Rule 2711(h)(6). We find that two of the research reports (February 19, 2003 Med-Design report and April 30, 2003 Curative Health Services ("Curative") report) were not required to include a price chart because there is no evidence in the record demonstrating that the Firm had assigned ratings for these securities for at least one year as required to be covered by the rule.

target, failed to disclose the valuation methods used or the potential risks that could hinder reaching the target.<sup>16</sup> Strong disputes only this portion of cause two. Strong testified that he was not reviewing the text of the reports for this disclosure because he did not have the background to sufficiently evaluate the substance. Even if true, this would not absolve him from liability. Strong should have been alerted to the absence of these disclosures because they are required to appear on the front page of the research report or the front page must refer to the page on which the disclosures are found. *NASD Notice to Members 02-39*. In addition, we find it noteworthy that the Firm produced a limited quantity of research reports and the reports at issue here were an average of four pages in length thereby making the omissions fairly apparent.<sup>17</sup> Moreover, per the WSPs, Strong was the person at the Firm who was responsible for ensuring that the research reports complied with Rule 2711, which includes the valuation and risk factors disclosures. *See Respondent, 2005 NASD Discip. LEXIS 48, at \*11 & n.14* (imposing primary liability on persons at a firm who are directly involved in the misconduct). We affirm the finding that Strong violated Rule 2711(h)(7).

e. *Rule 2711(h)(8)*

Conduct Rule 2711(h)(8) requires a member to disclose in research reports whether the firm “was making a market in the subject company’s securities at the time that the research report was published.” *NASD Notice to Members 02-39*. On April 16, 2003, Jesup issued a research report for InKine. The report erroneously stated that the Firm was not acting as a market maker for InKine when in fact the Firm did make a market in this security. Jesup also made a market in Curative securities. The April 30, 2003 research report covering Curative, however, stated that the Firm “is not a market maker in the subject of this report.” Strong conceded that he was responsible for the accuracy of these disclosures. He testified that he looked for this disclosure in the research reports. He ultimately realized that he could not rely on the accuracy of the market maker information when he received a report from Davis. Thus, he stated that he later “took it upon [himself] to take steps to find out” and “would just go [ask] the trading desk.” We affirm the finding that Strong violated Rule 2711(h)(8) when two research reports erroneously stated that the Firm did not make a market in the subject securities.

\* \* \* \*

In sum, we find that Strong violated Conduct Rules 2711(h) and 2110 when the Firm’s research reports failed to comply with Rule 2711(h)’s disclosure requirements.<sup>18</sup>

---

<sup>16</sup> The specific reports at issue are as follows: the December 17, 2002 AVI report, the February 19, 2003 Med-Design report, the February 27, 2003 Collagenex report, the March 21, 2003 Natestech report, the April 16, 2003 InKine Pharmaceutical Company, Inc. (“InKine”) report, the July 16, 2003 Providian Financial report, and the July 22, 2003 Discovery report.

<sup>17</sup> Between August 2002 and August 2003, the Firm produced 35 research reports.

<sup>18</sup> A violation of NASD’s research analyst rules is also a violation of Conduct Rule 2110. *See Asensio, 2006 NASD Discip. LEXIS 20, at \*40*.

2. Rule 2711(c)

Enforcement alleged in the third cause of the complaint that Strong violated Conduct Rules 2711(c) and 2110 by submitting a draft research report that contained a research summary and a price target to the subject company before the report's publication. The Hearing Panel found that the evidence supported this allegation. We disagree that Enforcement met its burden of proving the allegation and dismiss the cause.

Conduct Rule 2711(c)(2)(A) allows a member to submit a draft research report to a subject company before publication in order for the company to verify the factual accuracy of the information provided that "the sections of the research report submitted to the subject company do not contain the research summary, the research rating or the price target." *NASD Notice to Members 02-39*. Enforcement entered into evidence a draft Jesup research report dated December 9, 2003, covering Discovery. The last page of the report included a summary and a price target. Strong testified that he received the report from Davis prior to Davis redacting the summary and price target and that Strong retained the unredacted version in his files. The record does not include any evidence, such as a fax receipt, e-mail correspondence, or verification from Discovery, to show that the research report was sent to Discovery in unredacted form for review. We conclude that Enforcement failed to prove this charge by a preponderance of the evidence. We therefore reverse the Hearing Panel's finding that Strong violated Conduct Rules 2711(c) and 2110.

3. Rule 2711(i)

Conduct Rule 2711(i) requires firms to adopt and implement written supervisory procedures that are designed to ensure compliance with the provisions of Conduct Rule 2711. *NASD Notice to Members 02-39*. The rule further requires that a senior officer of a firm must attest annually that the firm has adopted and implemented these procedures. *Id.* The Firm's attestation for calendar year 2002 was to be filed with NASD by December 31, 2002.<sup>19</sup> *See NASD Notice to Members, For Your Information* (Nov. 2002), [http://www.nasd.com/RulesRegulation/NoticestoMembers/2002NoticestoMembers/NASDW\\_003376](http://www.nasd.com/RulesRegulation/NoticestoMembers/2002NoticestoMembers/NASDW_003376) (view full pdf document). Strong filed this attestation on February 27, 2003. Strong does not dispute that he was responsible for the attestation and that it was filed untimely. We affirm the findings that Strong violated Conduct Rules 2711(i) and 2110.

---

<sup>19</sup> NASD amended Conduct Rule 2711(i) in July 2003. A firm must now file the annual attestation with NASD by April of each year that the firm adopted and implemented the procedures. *NASD Notice to Members 03-44*.

V. Sanctions

The Hearing Panel suspended Strong for nine months in all supervisory capacities and fined him \$15,000 for his violations of Conduct Rules 3010, 2711(c), 2711(h), 2711(i), and 2110.<sup>20</sup> Because we do not find Strong's violations to be egregious, we do not consider such severe sanctions to be warranted. Based on our reversal of certain of the Hearing Panel's findings against Strong as described above and given the facts and circumstances of this case, we modify the sanctions imposed by the Hearing Panel. We eliminate the nine-month suspension as a supervisor and reduce the fine to \$10,000.

We find it important to consider the circumstances under which Strong was operating and determine that the minimum sanction suggested in the Guidelines for the supervisory and disclosure violations is appropriate. We recognize that Strong engaged in misconduct that resulted in violations of NASD's rules. The Firm, however, placed Strong in a precarious situation. He was the sole compliance person in a 40-person firm that had previously neglected compliance. Prior to Strong's arrival, the Firm had no procedures in place with respect to Conduct Rule 2711 and was unaware that the research reports required certain disclosures, despite the fact that the majority of the rule's provisions went into effect *before* Strong joined the Firm. We consider mitigating that the misconduct at issue took place within months of Strong joining the Firm and when Strong was attempting to fulfill the broad-based compliance responsibilities put upon him.<sup>21</sup> It is evident that Strong was overwhelmed by the enormity of his responsibilities and that he was not equipped to undertake the responsibilities required of him at the Firm. In addition, the Firm's decision to hire a single compliance officer to oversee the Firm's entire operations was ill-conceived given its size and breadth of operations.

The NASD Sanction Guidelines ("Guidelines") for failure to supervise under Conduct Rules 3010, 2711(i), and 2110 recommend a fine of \$5,000 to \$50,000 and that adjudicators consider a suspension of the responsible individual in all supervisory capacities for up to 30 business days.<sup>22</sup> In an egregious case, the Guidelines recommend suspending the responsible

---

<sup>20</sup> The Hearing Panel found that the supervisory and disclosure violations flowed from a common underlying cause—the failure to comply with NASD's rules related to research—and imposed a unitary sanction. We disagree with that approach in this case. We instead sanction the violations separately.

<sup>21</sup> During the period that the misconduct occurred, Strong was responsible for myriad activities at the Firm. For example, Strong oversaw the membership approval process for the Broadmark-Jesup acquisition, which continued into 2003. He also oversaw examinations of the Firm by the SEC and NASD. He developed and implemented the Firm's anti-money laundering procedures and conducted a complete review of the Firm's business and compliance procedures.

<sup>22</sup> *NASD Sanction Guidelines* 97 & n.1, 108 (2006), [http://www.nasd.com/web/groups/enforcement/documents/enforcement/nasdw\\_011038.pdf](http://www.nasd.com/web/groups/enforcement/documents/enforcement/nasdw_011038.pdf) [hereinafter *Guidelines*].

individual for up to two years or imposing a bar.<sup>23</sup> In determining the proper remedial sanction, the Guidelines for supervisory violations recommend that adjudicators consider whether the responsible individual ignored “red flag” warnings that should have resulted in additional supervisory scrutiny and consider the nature, extent, and character of the underlying misconduct.<sup>24</sup> From October 2002 through September 2003, Davis engaged in 45 trades in contravention to Conduct Rule 2711(g). Strong testified that he viewed Davis’s trading as not inconsistent with the research report recommendations. We find that Strong had a good faith, but mistaken, belief regarding the interpretation of Conduct Rule 2711’s trading prohibition. The Hearing Panel determined that Strong’s misconduct was egregious.<sup>25</sup> We disagree. We find that Strong was attempting to comply with the then newly-effective research analyst rules by timely training staff, sending memoranda to relevant Firm staff, discussing the new rules with Davis, among others, and revising the Firm’s WSPs. We determine that a \$5,000 fine is an appropriate sanction for the supervisory violations.

The Guidelines for disclosure violations related to research reports under Conduct Rule 2711(h) recommend a fine of \$5,000 to \$100,000 and that the adjudicators consider suspending the responsible individual for up to 60 business days.<sup>26</sup> For intentional or reckless misconduct, the Guidelines recommend a fine of \$10,000 to \$200,000 and a suspension of 60 business days to two years or a bar if the misconduct was egregious.<sup>27</sup> The Guidelines list two factors relevant to this case to consider in determining the proper remedial sanctions for disclosure violations: whether the misconduct resulted from negligence or intentional/reckless behavior and whether the misconduct resulted in publication of research reports that omitted material information or contained misleading information.<sup>28</sup> We conclude, as did the Hearing Panel, that Strong’s violations resulted from negligence, not intentional or reckless misconduct. There is no evidence in the record that Strong was attempting to circumvent NASD rules or conceal his misconduct. We also note that there is no evidence that Strong personally benefited in any way. Strong’s misconduct did, however, result in the publication of inaccurate research reports not in compliance with NASD’s rules. Thus, we fine Strong \$5,000 for his violations of Conduct Rule 2711(h).

---

<sup>23</sup> *Id.* at 108.

<sup>24</sup> *Id.*

<sup>25</sup> In finding that Strong’s misconduct was egregious, the Hearing Panel considered that Strong did not accept responsibility for his failure to supervise Davis, that Strong failed to supervise Davis for a lengthy period, and that Strong failed to offer a reasonable explanation for his failure to implement adequate supervisory controls and procedures.

<sup>26</sup> *Id.* at 98.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 97.

Under the facts of this case, we conclude that a \$10,000 fine will satisfy NASD's remedial goals. Our decision should not be read to indicate that supervisory violations or violations of the research analyst rules warrant light sanctions. Rather, given the unique circumstances present here, we have imposed a sanction at the lowest amount recommended by the Guidelines.

VI. Conclusion

We determine that Strong failed to supervise Davis in violation of Rules 3010 and 2110; Strong violated Rules 2711(h) and 2110 when the Firm's research reports did not comply with disclosure requirements; and Strong failed to file timely the annual attestation of supervisory procedures for research analysts in violation of Rules 2711(i) and 2110. Accordingly, we fine Strong \$10,000. We affirm the Hearing Panel's imposition of hearing costs in the amount of \$3,723.54.<sup>29</sup>

On Behalf of the National Adjudicatory Council,

---

Marcia E. Asquith, Vice President  
and Deputy Corporate Secretary

---

<sup>29</sup> We also have considered and reject without discussion all other arguments of the parties.

Pursuant to NASD Procedural 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 nonpayment. 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 nonpayment.

## Exhibit A

Company	Trade Settlement Date	Shares Sold	Date of Relevant Research Report
Collagenex	03/19/2003	671	02/27/2003
Collagenex	04/01/2003	5,000	02/27/2003
Collagenex	06/03/2003	2,500	02/27/2003
Collagenex	06/26/2003	1,000	02/27/2003
Collagenex	07/17/2003	6,500	02/27/2003
Collagenex	07/24/2003	1,000	02/27/2003
Collagenex	08/01/2003	5,000	02/27/2003
Collagenex	08/01/2003	5,000	02/27/2003
Discovery	04/23/2003	5,000	01/02/2002
Discovery	09/09/2003	10,000	07/22/2003
Discovery	09/17/2003	8,000	07/22/2003
Nastech	10/08/2002	2,600	03/20/2002
Nastech	01/07/2003	1,755	03/20/2002
Nastech	01/30/2003	1,755	03/20/2002
Nastech	02/03/2003	1,576	03/20/2002
Nastech	02/05/2003	800	03/20/2002
Nastech	04/23/2003	4,000	03/21/2003
Nastech	06/03/2003	4,000	03/21/2003
Nastech	06/26/2003	1,200	03/21/2003
Nastech	07/24/2003	1,800	03/21/2003
Med-Design	10/18/2002	2,500	04/23/2002
Med-Design	01/02/2003	1,200	04/23/2002
Med-Design	04/28/2003	4,000	02/19/2003
Emisphere	03/10/2003	10,000	06/04/2002
Emisphere	03/11/2003	10,000	06/04/2002
Emisphere	03/14/2003	10,000	06/04/2002
Emisphere	03/18/2003	2,000	06/04/2002



Emisphere	03/20/2003	6,400	06/04/2002
AVI	12/30/2002	1,500	12/17/2002
AVI	02/27/2003	3,000	12/17/2002
AVI	03/18/2003	10,000	12/17/2002
AVI	05/01/2003	15,000	12/17/2002
AVI	05/06/2003	10,000	12/17/2002
AVI	05/13/2003	8,000	12/17/2002
AVI	05/19/2003	300	12/17/2002
AVI	06/16/2003	1,700	12/17/2002
AVI	06/24/2003	2,900	12/17/2002
AVI	08/25/2003	20,000	12/17/2002
AVI	08/25/2003	3,000	12/17/2002
AVI	08/26/2003	5,000	12/17/2002
InKine	05/08/2003	20,000	04/16/2003