

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. CAF040025
v.	:	
	:	HEARING PANEL DECISION
STEVEN C. KIRSCH	:	
(CRD No. 708676)	:	Hearing Officer – SW
	:	
Respondent.	:	Dated: April 15, 2005

Respondent was barred for (i) violating NASD Conduct Rule 2110 and Procedural Rule 8210 by testifying falsely at an NASD on-the-record interview, and (ii) violating NASD Conduct Rule 2110 by performing supervisory duties while subject to a 30-day supervisory suspension. In light of the bars, no separate sanction was imposed on Respondent for violating NASD Conduct Rules 2110 and 3010 by failing to reasonably supervise his research department prior to his 30-day suspension.

Appearances

Jeffrey P. Bloom, Esq., Regional Counsel, and Gary M. Lisker, Esq., Regional Counsel, Washington, DC, for the Department of Enforcement.

Steven C. Kirsch, pro se.

DECISION

I. Procedural Background

On April 2, 2004, the Department of Enforcement (“Enforcement”) filed a three-count Complaint against Respondent Steven C. Kirsch (“Respondent”). Count one of the Complaint alleges that Respondent violated NASD Conduct Rule 2110 by performing supervisory duties at NASD member firm Sterling Financial Investment Group, Inc. (“Sterling Financial” or the “Firm”) while subject to an NASD 30-day supervisory suspension.

Count two of the Complaint alleges that Respondent violated NASD Conduct Rule 2110 and NASD Procedural Rule 8210 by testifying falsely to the NASD staff at a February 27, 2003 on-the-record interview.

Count three of the Complaint alleges that, prior to his 30-day suspension, Respondent violated NASD Conduct Rules 2110 and 3010 by failing to reasonably supervise Sterling Financial's research department when he approved in 2002 the issuance of a research report update that contained inaccurate and misleading information.

Respondent admitted the allegations of counts one and two of the Complaint. With respect to count three of the Complaint, Respondent also admitted that the research report update contained inaccurate information, but he denied that his supervision was unreasonable.

The Hearing Panel, consisting of two current members of the District 7 Committee and a Hearing Officer, conducted a Hearing in Boca Raton, FL, on December 6, 2004.¹

II. Findings of Fact

There are no material facts in dispute.

A. Jurisdiction

Respondent first became associated with an NASD member firm in 1982. (CX-1, p 1). Respondent was registered with Bear, Stearns & Co. Inc. from February 1982 until December 1996. (CX-1, p. 5).

Respondent was registered with Sterling Financial from January 2000 until August 2003. (CX-1, p. 4). Subsequently, Respondent was registered with Axiom Capital Management, Inc.

¹ "Tr." refers to the transcript of the Hearing held on December 7, 2004; "CX" refers to the exhibits submitted by Enforcement.

(“Axiom Capital”) from September 2, 2003 until September 19, 2003. (CX-1, p. 3).

Respondent has not been associated with any NASD member since September 19, 2003, but he remains subject to NASD jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of the NASD By-Laws, because (1) the Complaint was filed on April 2, 2004, within two years after Respondent’s termination of registration with Axiom Capital, and (2) the Complaint charges Respondent with misconduct while he was associated with Sterling Financial.

B. Background

In 1999, Respondent joined Sterling Financial to establish an institutional sales, trading, and research department. (Tr. p. 20). On January 12, 2000, Respondent became registered with Sterling Financial as a general securities representative. (CX-1, p. 4). Subsequently, on December 6, 2000, Respondent became registered as a general securities principal with Sterling Financial. (CX-1, p. 4). During 2002, Respondent was Sterling Financial’s Director of Research and Director of Institutional Sales. (Tr. pp. 165, 255). Respondent referred to Sterling Financial’s research department as his “baby.” (Tr. p. 166).

On September 20, 2002, Respondent executed a Letter of Acceptance, Waiver and Consent (“AWC”) with NASD for his inadequate supervision of Sterling Financial’s research department, specifically his supervision of a research report issued by research analyst David Risk. (CX-2). Pursuant to the AWC, NASD suspended Respondent in any principal or supervisory capacity for a period of 30 days and required him to pay a \$10,000 fine. (CX-2, p. 5).

On October 22, 2002, NASD sent Respondent a letter advising him that his 30-day suspension would commence on November 18, 2002 and conclude on December 17, 2002. (CX-3). Respondent acknowledged that he received the suspension letter and stated that, while

on suspension, he realized he could only interact with the research department in the same manner as any other institutional salesman. (CX-7, p. 25).

1. Sterling Financial Issued an Inaccurate Human Genome Research Report and Update

Prior to the commencement of his suspension, Respondent authorized the issuance on October 17, 2002 of Sterling Financial's research report on Human Genome Sciences, Inc. ("Human Genome"). The research report contained a sell/short recommendation based on the company's perceived short-term need for cash.² (CX-10).

After the issuance of the Human Genome research report, Respondent participated in a conference call on October 17, 2002 and received emails, which stated that there were inaccuracies in the research report, including (i) a miscalculation of the company's net cash, and (ii) an inaccurate discussion of the impact a proposed accounting treatment would have on the company's net cash. (Tr. pp. 107-108). Specifically, during the conference call, Human Genome's CFO stated that Sterling Financial's analyst had double counted in computing the company's net cash by deducting both restricted cash and the debt related to that cash. (Tr. p. 108). A customer of Sterling Financial sent an email to Respondent in which the customer stated that there was a double counting error in the Human Genome research report. (Tr. p. 110).

In response to the claim of inaccuracies, Respondent asked Sally Yanchus, an experienced research analyst who had prepared the research report, whether she was sure she was accurate.³ (Tr. p. 201). Ms. Yanchus stated that she was sure. (Id.). Respondent took no further actions. (Tr. p. 209). Respondent did not conduct an independent review of the information in

² After the issuance of the research report, shares of Human Genome traded down 17.7% on volume of 9 million shares compared to an average daily sales volume of 2.3 million shares. (CX-15, p. 3).

³ On October 17, 2002, Ms. Yanchus sent an email to Respondent confirming her calculations. (CX-17, p. 1).

the report. (Tr. p. 261).

On October 22, 2002, after receiving Ms. Yanchus' reassurance, Respondent authorized the issuance of an update to the October 17, 2002 Human Genome research report (the "Update"), which included the same inaccuracies as the original research report.⁴ (Tr. p. 201).

The NASD staff received a complaint concerning the inaccuracies in Sterling Financial's Human Genome research report and Update. (Tr. pp. 30-31; CX-10; CX-11). Upon receipt of the complaint, the NASD staff began an investigation. (Tr. pp. 30-31).

Subsequently, Ms. Yanchus admitted that the original Human Genome research report and the Update were inaccurate, and that the inaccuracies included the misapplication of proposed FASB Statement 147, errors in computing Human Genome's "net cash," and misquoting of the company's SEC filing so as to change the meaning of the quote.⁵ (Tr. pp. 199-200, 203-204).

2. Respondent Performed Supervisory Duties During His Suspension

During its investigation of the Human Genome matter, the NASD staff received a tip in December 2002 that Respondent was acting in a supervisory capacity during his period of suspension. (Tr. pp. 38, 134).

On December 3, 2002, an issue arose at Sterling Financial with regard to a company named Regeneron. (Tr. pp. 151, 187-188). In preparing a research report about the company, Sterling Financial's research analyst, Dr. Aaron Rollins, contacted Regeneron's head of investor

⁴ The Update also failed to disclose that Sterling Financial was a market maker in Human Genome as required by NASD Conduct Rule 2210. (CX-11). Respondent acknowledged that he was the individual responsible for placing such disclosure on the research reports. (Tr. p. 275).

⁵ Ms. Yanchus executed an AWC on February 23, 2004 regarding violations of NASD Conduct Rules 2110, 2210, and 2711 for drafting the October 17, 2002 research report and the October 22, 2002 Update on Human Genome, both of which contained material errors. (CX-18).

relations, and based on his conversation believed that Regeneron would bring legal action if the research report was issued. (Tr. pp. 151, 187-188). When Dr. Rollins did not receive a satisfactory answer about how to respond to Regeneron's legal threat from Sterling Financial's acting director of research, Jordan Estra, Dr. Rollins contacted Respondent, who stepped into the breach. (Tr. pp. 152-153, 183).

In an attempt to settle the issue, Respondent participated in conference calls with Regeneron, participated in conference calls with Sterling Financial's outside counsel regarding Regeneron, and provided his opinion as to what action Sterling Financial should take. (CX-5, pp. 2-18). Ultimately, Sterling Financial decided not to publicly issue the research report on Regeneron. (Tr. p. 156).

Respondent also performed other supervisory duties. On December 6, 2002, Respondent discussed with a Sterling Financial research analyst which types of research reports could be provided to portfolio managers in order to solicit research business for Sterling Financial. (CX-5, pp. 61-62; Tr. pp. 75, 77-78). On December 16, 2002, Respondent directed another analyst to prepare a research report. (Tr. pp. 84-85).

In attempting to explain his actions, Respondent testified that he was never told what he could and could not do other than not signing new account forms and not signing off on research reports. (Tr. p. 238). Respondent further testified that he was "put in a position to fail" when NASD suspended him only in his principal capacity rather than in all capacities. (Tr. pp. 258-259). Respondent also testified that if had ignored his partners' advice and refused to sign the original AWC, he would not have had the problem of being suspended because he was not responsible for Mr. Risk's misconduct. (Tr. p 243).

3. Respondent Provided False Testimony to NASD about His Activities

As part of its investigation, the NASD staff conducted an on-the-record interview of Respondent on February 27, 2003. (CX-6). At the on-the-record interview, in addition to questions regarding the Human Genome research report and Update, the NASD staff specifically asked Respondent what, if anything, he knew about Sterling Financial's proposal to issue a research report regarding Regeneron. (CX-6, pp. 52-53). Respondent explicitly stated that he did not become aware of an issue with Regeneron until after December 17, 2002, the date his suspension ended. (*Id.*). Respondent also explicitly stated that he did not have any meetings with a Sterling Financial research analyst regarding Regeneron during his suspension. (CX-6, p. 53). Both statements were false.

Subsequent to the February 27, 2003 on-the-record interview, the NASD staff received from Sterling Financial copies of tape recordings of telephone conversations of Sterling Financial employees, including Respondent. (Tr. p. 39). The tape recordings of certain of Respondent's telephone conversations proved that Respondent had been aware of and had participated in discussions with Sterling Financial's counsel regarding whether the Regeneron research report should be issued. (CX-5). The tape recordings also provided evidence that Respondent had performed other supervisory duties while subject to the 30-day suspension. (CX-5).

In July 2003, Respondent terminated his employment with Sterling Financial, and retained private legal counsel.⁶ (CX-1, p. 4; Tr. pp. 269-270). Respondent's counsel informed him that the NASD staff had Sterling Financial's telephone recordings, and advised Respondent to correct any misstatements he made during his February 27, 2003 on-the-record interview.

(Tr. pp. 268-270). Respondent's new counsel contacted the NASD staff to arrange another interview. (Tr. p. 72).

In the October 7, 2003 on-the-record interview with the NASD staff, Respondent admitted that his statements on February 27, 2003 regarding Regeneron were not true. (CX-7, p. 72). Respondent also admitted that he was concerned that his activities may have crossed the line and that he had engaged in supervisory activities during his suspension. (CX-7, p. 75).

C. Respondent Violated NASD Conduct and Procedural Rules

1. Respondent Violated NASD Conduct Rule 2110 and Procedural Rule 8210 by Making False Statements to the NASD Staff

NASD Procedural Rule 8210 requires a member, person associated with a member, or person subject to NASD's jurisdiction to provide information orally, in writing, or electronically in response to requests from NASD staff in connection with an investigation, complaint, examination, or proceeding authorized by the NASD By-Laws or the Rules of NASD. The requirement to respond truthfully to NASD inquiries is subsumed in Rule 8210's obligation to provide requested information. Accordingly, failing to testify truthfully in an on-the-record interview is thus a violation of Rules 8210 and 2110.⁷

In his October 7, 2003 on-the-record interview, Respondent admitted that he lied to the NASD staff during his February 23, 2003 interview. (Tr. p. 263). In addition to Respondent's admission, there is irrefutable independent evidence that Respondent lied at his February 27, 2003 interview. Accordingly, the Hearing Panel finds that Respondent violated NASD Conduct

⁶ At his February 27, 2003 on-the-record interview, Respondent was accompanied by counsel for Sterling Financial. (Tr. p. 269).

⁷ Marlowe Robert Walker, III, Complaint No. C10970141, 2000 NASD Discip. LEXIS 2, at *26-27 (NAC Apr. 20, 2000).

Rule 2110 and Procedural Rule 8210 when he intentionally made misstatements to the NASD staff at the February 27, 2003 on-the-record interview regarding his activities while suspended.

2. Respondent Violated NASD Conduct Rule 2110 by Performing Supervisory Duties while Subject to a 30-Day Suspension

NASD Conduct Rule 2110 states, in its entirety, “A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.” Conduct Rule 2110 “is not limited to rules of legal conduct but rather . . . it states a broad ethical principle.”⁸ Consequently, if the surrounding facts and circumstances indicate that conduct is unethical, the conduct is viewed as a violation of Conduct Rule 2110.

When NASD takes the step of suspending a firm or a registered person, it is entitled to require complete and precise compliance with its directive.⁹ It is a violation of NASD Conduct Rule 2110 to violate a suspension of which the respondent has received notice.¹⁰

In determining whether an individual is acting as a supervisor, the SEC looks at the activities the individual actually performs.¹¹ The excerpts of Respondent’s telephone conversations that were included in the record constitute undisputed evidence that Respondent performed supervisory duties while subject to an NASD suspension.

Respondent’s only explanation for his conduct was that he had been put in a bad situation because he was the “go to guy,” and he could not turn his back on the research department because the people in the department meant too much to him. (Tr. pp. 259-260). This does not qualify as an excuse for disregarding the terms of the suspension.

⁸ Timothy L. Burkes, 51 S.E.C. 356 (1993), aff’d mem., 29 F.3d 630 (9th Cir. July 24, 1994).

⁹ Michael A. Usher, Complaint No. C3A980069, 2000 NASD Discip. LEXIS 5, at *13 (NAC Apr. 18, 2000).

¹⁰ Id.

¹¹ John H. Gutfreund, Exch. Act Rel. No. 31,554, 1992 SEC LEXIS 2939 (Dec. 3, 1992).

The Hearing Panel finds that Respondent violated NASD Conduct Rule 2110 when he performed supervisory duties while subject to a 30-day supervisory suspension.

3. Respondent Violated NASD Conduct Rules 2110 and 3010 when He Failed to Adequately Supervise the Issuance of the Humane Genome Update

NASD Conduct Rule 2210 of the Advertising Rules governs the dissemination of written or electronic communications to the public, and prohibits members and associated persons from making exaggerated, unwarranted or misleading statements or claims in their public communications. All public communications must be based upon the principles of fair dealing and good faith, provide a sound basis for evaluating the facts discussed, and not omit material facts or qualifications that would cause the communication to be misleading in light of its context.¹² An omitted or misstated fact is material if it would have been viewed by a reasonable investor as having altered the “total mix” of information available.¹³

The Hearing Panel finds that the Human Genome Update failed to meet NASD Conduct Rule 2210’s requirements because it contained substantive errors that a reasonable investor would have considered material.

NASD Conduct Rule 3010 requires that members establish, maintain, and enforce a supervisory system with written procedures and that these procedures be “reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules

¹² In 2002, sub-part (A) of Conduct Rule 2210(d)(1) required “[a]ll member communications with the public [to] be based on principles of fair dealing and good faith and [to] provide a sound basis for evaluating the facts in regard to any particular security or securities or type of security, industry discussed, or service offered.” It further provided that “[n]o material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the communication to be misleading.” (See NASD Notice to Members 98-83).

Sub-part (B) of Rule 2210(d)(1) prohibited members from using “exaggerated, unwarranted or misleading statements or claims” in all “public communications,” and it also forbade members to “directly or indirectly, publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.” (Id.).

¹³ See TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

of [NASD].” The standard of “reasonableness” is determined based on the particular circumstances of each case.¹⁴ NASD Conduct Rule 3010(a)(5) requires “[t]he assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person’s activities.”

Respondent acknowledged that he was the person with supervisory responsibility for the research department, which included Ms. Yanchus. (Tr. p. 245). The SEC has emphasized that a supervisor has an obligation to respond promptly and diligently to indications of irregularity, and not ignore “red flags.”¹⁵ After several persons brought the possibility of errors in the Human Genome research report to the attention of Ms. Yanchus and Respondent, Respondent’s only action was to ask the analyst whether she was sure that her calculations and conclusions were correct; the failure to take further action constituted inadequate supervision in the face of “red flags.” In light of the red flags, by allowing Sterling Financial’s repetition of the October 17, 2002 errors in the October 22, 2002 Update, Respondent failed to exercise reasonable supervision over Ms. Yanchus.

Accordingly, the Hearing Panel finds that Respondent violated NASD Conduct Rules 3010 and 2110 by failing to reasonably supervise Ms. Yanchus in the issuance of the Human Genome Update.

III. Sanctions

A. Respondent Made False Statements to the NASD Staff

The NASD Sanction Guideline for “Failure to Respond or Failure to Respond Truthfully, Completely, or Timely to Requests Made Pursuant to NASD Procedural Rule 8210”

¹⁴ Christopher Benz, Exchange Act Rel. No. 38440, 1997 SEC LEXIS 672 (Mar. 26, 1997); Consolidated Investment Services, Inc., Exchange Act Rel. No. 36687, 1996 SEC LEXIS 83 (Jan. 5, 1996).

recommends a fine of \$25,000 to \$50,000 for failure to respond or failure to respond truthfully.¹⁶

The Guideline states that a bar should be standard if the individual did not respond in any manner. The National Adjudicatory Counsel has advised that “untruthful responses [are] as harmful as a complete failure to respond and, as such, . . . a bar is the appropriate sanction.”¹⁷

The Hearing Panel finds that Respondent’s misstatements were egregious and warrant a bar because of: (i) the subject matter of the misstatements, that is, the circumstances surrounding Respondent’s failure to abide by an NASD supervisory suspension; (ii) Respondent’s knowledge of the importance of compliance with NASD conduct rules because of his 20 years of experience in the securities industry; and (iii) Respondent’s failure to correct his misstatements until after he knew the NASD staff had independent evidence of his misstatements.

B. Respondent Violated His 30-Day Supervisory Suspension

The NASD Sanction Guidelines do not address the issue of an associated person violating an NASD imposed suspension. The most similar guideline is the Guideline for a “Disqualified Person Associating with a Firm Prior to Approval.”¹⁸ While noting that the disqualification violation is similar, the NAC has held that violating a suspension is actually a more serious violation.¹⁹ Enforcement argued that this was an egregious violation because Respondent was not drawn into the violation against his will but rather affirmatively decided to perform his supervisory duties.

¹⁵ Robert Grady, Exchange Act Rel. No. 41309, 1999 SEC LEXIS 768 (Apr. 19, 1999) (“[a] failure to supervise can arise where a supervisor was aware only of “red flags” or “suggestions of irregularity”).

¹⁶ NASD Sanction Guidelines, p. 35 (2005).

¹⁷ Walker at *31.

¹⁸ NASD Sanction Guideline, p. 46 (2005).

¹⁹ Usher at *13.

Respondent decided that it was more important to provide guidance to the research department, than to honor his agreement. It was a calculated risk that he intentionally took. Respondent's attempt to shift the blame for his actions to the principals of Sterling Financial indicates a refusal to take responsibility for his own actions. Accordingly, the Hearing Panel finds that his actions were egregious and warrant a bar.

C. No Separate Sanction for the Supervisory Violation

In light of the bars imposed on Respondent for lying to the NASD staff and for violating his suspension, the Hearing Panel will not impose a separate sanction for Respondent's failure to supervise. Such a sanction would be redundant and would serve no remedial purpose.

IV. Conclusion

Respondent is barred. The Hearing Panel also orders Respondent to pay the \$2,460.25 costs of the hearing, which include an administrative fee of \$750 and hearing transcript costs of \$1,710.25.

If this Hearing Panel Decision becomes the final disciplinary action of NASD, the bars shall become effective immediately.²⁰

HEARING PANEL

By: _____
Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
April 15, 2005

Copies to:
Steven C. Kirsch (via Federal Express and first class mail)
Jeffrey P. Bloom, Esq. (via electronic and first class mail)

²⁰ 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.

Gary M. Lisker, Esq. (via electronic and first class mail)
Thomas B. Lawson, Esq. (via electronic and first class mail)
Rory C. Flynn, Esq. (via electronic and first class mail)