INITIAL DECISION RELEASE NO. 914
ADMINISTRATIVE PROCEEDING
FILE NO. 3-16344

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of EDGAR LEE GIOVANNETTI	INITIAL DECISION November 6, 2015

APPEARANCES: Paul T. Kim and Pat Huddleston II, for the Division of Enforcement, Securities and Exchange Commission

David Wade and Robert E. Orians of Martin, Tate, Morrow & Marston, P.C., for Edgar Lee Giovannetti

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on January 16, 2015. Edgar Lee Giovannetti filed an answer on February 18, 2015, and a hearing occurred May 26 through May 29, 2015.[1] The Division presented five witnesses and Giovannetti presented three. The final brief was filed on August 17, 2015.

Issues

The issues are whether Giovannetti: (1) willfully violated Section 206(1) and (2) of the Investment Advisers Act of 1940 (Advisers Act); (2) violated Section 207 of the Advisers Act and willfully aided and abetted and caused his investment adviser firm's violations of Section 207, between April 21, 2009, and December 30, 2011; and (3) caused his investment adviser firm's violation of Section 207 after December 30, 2011. OIP at 5-6.

Facts

The factual findings and legal conclusions are based on the entire record. I applied preponderance of the evidence as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 101-

[1] In this decision, I cite the transcript of the hearing as "Tr. __." I cite to the Division's and Respondent's exhibits as "Div. Ex. __," and "ELG Ex. __," respectively. I reference the post-hearing briefs as Div. Br., ELG Br., and Div. Reply Br.

04 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

Giovannetti, age fifty-nine and a graduate of the University of Tennessee, co-founded Consulting Services Group, LLC (CSG), with some other E.F. Hutton & Co. employees in 1988.[2] Tr. 20, 152, 283; Div. Ex. 7, Sch. F at Item 6; Div. Ex. 260 at 2. CSG was a registered investment adviser headquartered in Memphis, Tennessee, from 1990 until October 4, 2013. Tr. 20-21; Div. Ex. 7 at 1; ELG Ex. 15 at 2. The firm did not directly invest client funds, but recommended money managers to clients. Tr. 39. CSG represented that it provided clients with independent and unbiased advice about how to invest funds and which investment managers to retain. Tr. 22; Div. Ex. 1. In 2009, CSG had over 100 clients, including some twenty public pension funds, and sixty to seventy employees. Tr. 239; Div. Ex. 619 at 2. CSG used the term "consultant" to refer to people, including Giovannetti, who recommended potential money managers to clients. *See, e.g.*, Tr. 47-48.

On December 31, 2008, CSG became part of a holding company, CSG Holdings, LLC. Tr. 26-27; ELG Ex. 22. D. Canale & Company (Canale),[3] a passive investor, owned 32.5 percent of CSG Holdings.[4] Tr. 26; ELG Ex. 22 at Sch. A. The holding company owned 100 percent of CSG and a broker-dealer, Trading Services Group, Inc., later known as Commerce Security Trading, LLC, or Commerce Square Trading (collectively CST), and other companies.[5] Tr. 476-78, 569, 921; Div. Ex. 9, Sch. F at Item 8. There was a synergistic relationship between CSG and CST; their compliance departments were comingled and the staffs of both units assisted each other. Tr. 1042-43.

Edward R. Balsmann, who joined CSG in 2007 as chief compliance officer (CCO) and general counsel for the holding company and related entities, recommended the holding company structure.[6] Tr. 556-58, 565-66. Balsmann was also secretary to the executive management committee. Tr. 542.

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[2] Giovannetti was associated with Merrill Lynch & Company in 1978 and later with E.F. Hutton & Co., where he was a vice president in consulting services. Div. Ex. 7, Sch. F at Item 6.

[3] Most of the references in this decision to Canale refer to the company, however, Canale may also refer to members of the Canale family.

[4] Giovannetti and seven other partners owned CSG Holdings, including attorney Mike Robinson, president and CEO of Canale, who owned twenty percent. Tr. 30, 280, 1153; ELG Ex. 22 at Sch. A. Canale and Robinson together owned more than fifty percent of CSG Holdings and acted jointly. Tr. 280-82.

[5] One other company was Commerce Advisors, LLC, a related registered investment adviser. Tr. 662; Div. Ex. 504 at 7.

[6] Balsmann earned bachelor's of science and juris doctor degrees from Southeast Missouri State and the University of Mississippi, respectively, and was CCO and general counsel for all CSG Holdings companies from 2007 until July 31, 2010. Tr. 470, 472. Balsmann was hired to effect

Giovannetti was CSG Holdings' CEO and chair of the executive management committee, which consisted of Giovannetti, Brian Jones, and Miles Slocum Fortas, who owned 20.05 percent, 4.32 percent, and 5.1 percent, respectively, as voting members. Tr. 562, 614, 924-25; ELG Ex. 22 at Schs. A, D. Each executive management committee member had one vote and a majority vote governed; however, Giovannetti controlled the holding company and its underlying entities by his strong persona: he had a "large personality, very strong, bullyish at some points, very verbal"; "everyone knew when he was around because you could hear him"; "all the employees knew he was, you know, the head honcho"; and at times Giovannetti could scream and intimidate people by bullying. Tr. 283-84, 563, 605, 609-13, 1014-15. Giovannetti often directed people in a loud voice to "get things done." Tr. 285, 542-44. More often than not, Giovannetti's opinion prevailed in executive management committee meetings; he set the agenda and direction of the firm. Tr. 934-35.

Jones was president of CSG and managed the consulting practice with the consultants reporting to him. Tr. 283, 929-30; Div. Ex. 9, Sch. F at Item 6. Fortas was chief financial officer of CSG Holdings and related entities from 1998 until September 2013.[7] Tr. 544, 566, 612, 919; Div. Ex. 9, Sch. F at Item 6. In the early 2000s, Fortas assumed chief operating officer responsibilities, and he became CCO when Balsmann left on July 31, 2010. Tr. 472, 919-20, 1008.

Giovannetti was CSG Holdings' second largest equity owner and the only one making day-to-day operational decisions for CSG; Canale and Robinson were not involved. Tr. 35-37, 228. Giovannetti focused on analyzing the performance of money managers and recommended money managers to clients. Tr. 38-39, 567. CSG's Form ADV Part II dated July 6, 2010, stated that "Giovannetti specializes in manager evaluation and research and development of new investment strategies for CSG's institutional and private clients." Tr. 929; Div. Ex. 9, Sch. F at Item 6. A registered investment adviser is required to provide investors with an updated Form ADV Part 2A or firm brochure or a summary of material changes annually and at other times when an amendment adds disclosure of a disciplinary event or materially revises information already disclosed about an event.[8] Tr. 973-74; *see* 17 C.F.R. § 275.204-3(b)(2), (4);

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changes in compliance after the Commission found problems with actions of the former CCO, Joe Meals. Tr. 548. In 2009, the compliance function consisted of Balsmann, a paralegal, and a consultant. Tr. 500, 554.

[7] Fortas, a CPA, holds a bachelor's degree in business administration and a master's degree in accountancy from Rhodes College. Tr. 918. He has Series 27 and 28 securities licenses that are presently inactive. Tr. 918. Fortas remembers becoming a member of the executive management committee after Fred Hodges, a firm founder, retired. Tr. 920, 958.

[8] Previously, Form ADV Part 2 was designated as Part II; the Commission revised its rules related to Forms ADV and investment adviser disclosures in 2010. *See* Amendments to Form ADV, 75 Fed. Reg. 49,234, 49,234 & n.5 (Aug. 12, 2010) (to be codified at 17 C.F.R. pts. 275, 279). The Commission revised these rules to "allow clients and prospective clients to evaluate the risks associated with a particular investment adviser, its business practices, and its investment strategies" by requiring advisers to provide clients with "a narrative plain English brochure that

Amendments to Form ADV, 75 Fed. Reg. 49,234, 49,246-47 (Aug. 12, 2010) (to be codified at 17 C.F.R. pts. 275, 279).

Giovannetti knew that he and CSG owed a fiduciary duty to CSG's clients and that CSG's Form ADV required disclosure of all conflicts and potential conflicts of interest. Tr. 40-42, 232. Giovannetti held Series 7 and 63 licenses and was a broker associated with CST from 2009 until the end of 2011. Tr. 42-43, 636; Div. Ex. 7, Sch. F at Item 6. Giovannetti relied on the compliance function to file the Forms ADV and he believed it had the proper information to do so. Tr. 1159-60.

CSG did due diligence on the money managers it recommended.[9] Tr. 44-45. An in-house research board comprised of senior consultants (such as Giovannetti), maybe a junior consultant, and analysts selected the money managers to recommend to clients; each client relationship usually had a team of two or three people deeply involved in the recommendations. Tr. 47-48, 347. If Giovannetti managed the account, then he delivered the money manager recommendations to the client. Tr. 49-50, 347.

As a pass-through entity, the holding company did not have any retained earnings and it distributed earnings to its partners periodically. Tr. 941. Giovannetti needed both his CSG base salary, which was $275,000 or $300,000, and the holding company's earnings distributions to meet his financial obligations.[10] Tr. 105, 136, 139, 949. Giovannetti was not compensated based on revenue streams, and did not receive bonuses or commissions on investments with money managers. Tr. 950, 1081-82.

CSG Holdings' business was successful in the years prior to 2009. Tr. 545, 1109. In 2007, CSG and the broker-dealer had total revenues of $21,586,560, net income of $6,383,470, and it distributed $5,255,332 to the partners. Tr. 939; ELG Ex. 10 at 4-5. In 2008, CSG and the broker-dealer had total revenues of $15,942,022, net income of $3,939,959, and it distributed $5,328,220 to the partners. Tr. 941-43; ELG Ex. 10 at 4-5. In 2009, CSG Holdings' total revenues fell to $10,574,801, net income fell to $178,649, and only $514,753 was distributed to

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describes the adviser's business, conflicts of interest, disciplinary history, and other important information." *Id.* at 49,234-35. The rule permits an adviser who has not filed any interim amendments to its brochure since the last annual amendment and whose brochure continues to be accurate in all material respects to refrain from providing an annual update to clients. *Id.* at 49,247.

[9] Giovannetti's ballpark estimate of the number of money managers CSG recommended was fifty to 100. Tr. 43.

[10] Giovannetti indicated that his personal financial situation was a result of the financial support he gave Giovannetti Development Corporation, a construction business run by his brother. Tr. 256, 260-01, 281. In 2009, Giovannetti had income tax obligations, as well as obligations on a yacht and property in the British Virgin Islands, and properties in Park City, Utah, in the Florida Panhandle, and in Memphis. Tr. 139-40, 524-25.

the partners. Tr. 945-46; ELG Ex. 11 at 4-5. CSG Holdings froze the distribution of earnings sometime in 2009 because of uncertainty on how adverse publicity would impact business. Tr. 104, 135-38, 281, 1129.

On March 19, 2009, the Commission filed a complaint concerning a scheme demanding payments from money managers to do business with New York's state pension fund. Tr. 106-07; Div. Ex. 254; ELG Ex. 1. CSG was not a named defendant, but the complaint alleged that CSG failed to disclose that it agreed to pay thirty percent of the management fees it received from the New York State Common Retirement Fund for managing fund assets. Tr. 593-94, 1026; ELG Ex. 1 at 14. Fortas testified that within twelve months of the complaint, CSG lost from twenty-five to thirty percent of its client base, incurred legal and other expenses, morale deteriorated, and employees left. Tr. 961-63. Giovannetti considered the complaint a "game-changer," the resulting publicity was extremely bad for business, and he became totally engaged in dealing with the consequences.[11] Tr. 207, 1110.

In May and June 2009, newspaper stories reported that CSG had a problem with conflicts of interest. Tr. 200. For instance, on May 21, 2009, Forbes published a critical article, "Tainted Pension Fund Advice" with the lede, "In the eternally sleazy pension consulting industry, some of the guys allegedly taking kickbacks are going away in handcuffs. That could crimp the business model of outfits like Consulting Services Group." Div. Ex. 260. On May 28, 2009, CSG received a Wells notice from the Commission, which Giovannetti described as "a torpedo right in the engine room."[12] Tr. 596, 1117; ELG Ex. 4.

In 2010, CSG Holdings had total revenues of $10,993,269 and net loss of $843,170.[13] Tr. 945; ELG Ex. 11 at 4. Richard Nummi, who replaced Balsmann as general counsel, recalled eight or nine different examinations, investigations, or lawsuits going on concurrently from 2010 through 2012.[14] Tr. 319-20, 1021-22, 1040-41.

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[11] Following an extended investigation, in which CSG expended a great deal of effort and expense to defend itself, the Commission issued a termination of investigation letter on February 28, 2012. Tr. 675-76, 963-64, 1023-31; ELG Exs. 2, 9.

[12] CSG engaged two law firms to submit a Wells submission on June 30, 2009. ELG Ex. 8.

[13] The net loss resulted in only $40,000 in distributions to the partners. Tr. 948-49; ELG Ex. 11 at 5.

[14] Nummi holds associate's, bachelor's, master's, and juris doctor degrees. Tr. 1018. Past employers include the United States Navy, Dean Witter Reynolds, INVEST Financial Corp., Jefferson Pilot Securities, the Commission's Office of Compliance Inspections and Examinations, and GunnAllen Financial. Tr. 1018-19. CST contracted with Nummi in 2010 to do an anti-money laundering examination. Tr. 1020. According to Nummi, CSG was required to hire a compliance consultant, Vicki Lawson, by terms of a settlement regarding former CCO Meals's compliance deficiencies. Tr. 1021. Nummi was hired to fill the consultant position when Lawson became CCO at the broker-dealer. Tr. 1021. Nummi did not have a Series 24 license required to be a CCO. Tr. 1058-59.

In a letter dated May 22, 2009, which was reviewed by all the partners, CSG represented to clients that "information regarding money manager relationships with CSG and [CST] are set forth in CSG's Form ADV Part II on the CSG website www.csgllc.com" and that "[d]uring the past two years[,] CSG has undertaken a comprehensive review of its business including corporate policies and procedures, addressing conflicts of interest . . . ." Tr. 606-08, 683-84; Div. Ex. 269. The letter was written in response to the Forbes article and noted that the performance of Shelby County, Tennessee's pension plan and the New York State Common Retirement Fund – both CSG clients – had received accolades. Tr. 1116; Div. Ex. 269.

Giovannetti's bleak financial situation in 2009 was known to persons at CSG, and he received advances that were unavailable to others. Tr. 524, 544-45, 599. By his own account, on November 1, 2009, Giovannetti had over $2.4 million in current liabilities and $697,000 in current assets. Div. Ex. 19 at 5.

Giovannetti's Relationship with Argonaut Capital Management

Argonaut Capital Management, registered with the Commission as an investment adviser as Argonaut Management, L.P., is a money manager operating hedge funds that CSG recommended to clients. Tr. 482. In addition, Argonaut had a trading relationship with CST. Tr. 634. Giovannetti was CSG's main relationship person with Argonaut and he had known David Gerstenhaber, Argonaut's president, since the late 1980s.[15] Tr. 45, 47, 57, 482-83, 1119.

On or about July 31, 2008, Giovannetti redeemed the total proceeds of his personal investment in Argonaut's Aggressive Global Fund holdings and invested those funds in Argonaut's Global Equities Fund.[16] Tr. 53-54; Div. Ex. 106. Giovannetti's Global Equities Fund holding was his single Argonaut holding in 2009 and a significant part of Giovannetti's liquid assets. Tr. 74, 84, 97; Div. Ex. 207.

[15] Giovannetti understood that Gerstenhaber was an owner and managing partner of Argonaut and that Jarrett Posner was the chief operating officer. Tr. 45-46, 72. Giovannetti testified that he and Canale met Gerstenhaber while he was with Tiger Management Company before he began his own company. Tr. 1122.

[16] The Aggressive Global Fund was also known as the Flagship Fund or the Macro Fund. Tr. 53. The Global Equities Fund was also known as the Long/Short Fund. Tr. 53-54. Between November 30, 2008, and June 30, 2009, the value of Giovannetti's Argonaut account fell from $91,756 to $84,761. Tr. 57, 68-69, 82, 89, 95, 97, 102; Div. Exs. 115, 207, 264, 266, 268, 270, 305. In January 2009, Giovannetti complained to Gerstenhaber about the loss in value, but he accepted the explanation that the timing of his redemption of one fund and purchase of the other made the drop in the value entirely possible. Tr. 73-75, 79-81, 92-93; Div. Exs. 203, 206; *see* Div. Ex. 210. Giovannetti did not blame Gerstenhaber for his bad luck, and CSG continued to recommend the Aggressive Global Fund to clients. Tr. 86-87, 93-94; Div. Exs. 207, 212.

April 22, 2009, Promissory Note

On April 20, 2009, Giovannetti emailed Gerstenhaber:

> I'm in a difficult cash position right now because I had to send the IRS 250k last week and my firm is not able to pay me yet for over 350k in earnings from last year. Any way I can draw down 50k out of the global fund and replace it in July? I have to cover the IRS check. If you can help me let me know.

Tr. 133; Div. Ex. 220. Giovannetti needed funds to cover a $250,000 check he had written the IRS for a federal income tax payment due April 15, 2009.[17] Tr. 105, 153-54. Because of his financial situation, Giovannetti did not think he would be able to get a bank loan, but believed he could have borrowed from a number of people. Tr. 265-66. Giovannetti testified that he originally hoped to temporarily redeem $50,000 from his Argonaut investment, which he would reinvest in July, once he received his partner distribution from CSG Holdings. Tr. 1129-30.

Posner replied for Gerstenhaber that Argonaut could not provide a mid-month redemption, but stated that "[w]e can loan you the $50,000 from the management company and you agree to pay it back by July 1 either directly or via redemption in the fund (which is quarterly)." Tr. 144; Div. Ex. 221.

Giovannetti responded to Posner on April 20, 2009, "I really appreciate this effort and it confirms the relationship we have. That will be fine and I will pay the loan down without redeeming unless I have no other options. Please understand how much this means to me." Tr. 145; Div. Ex. 221. On April 20, 2009, Gerstenhaber told Giovannetti he was glad they could make it work and "[a]lways there to help!" Div. Ex. 222. Giovannetti replied, "I love you." *Id.* Posner sent Giovannetti a ninety-day promissory note at an annual rate of 3.10 percent on April 21, 2009. Div. Ex. 223. A message accompanying the note stated, "[a]s discussed, you can choose to pay this back directly or via a partial redemption from your investment in global equities at the end of the quarter." *Id.*

Giovannetti testified that at the time he signed the note, he did not view the promissory note as a loan; instead, he viewed it as "an advance to what ended up being a redemption." Tr. 120-22. Although Giovannetti did not make a formal redemption request, he testified that he had a conversation with Gerstenhaber in which he made it clear to Gerstenhaber that his options were full or partial redemption because he needed $50,000; Gerstenhaber said he would work it out. Tr. 155. Giovannetti also testified that he understood that if he did not pay the note back directly, it would be paid through redemption of his account. Tr. 1133.

On April 22, 2009, Giovannetti signed the Argonaut note without seeking permission from anyone at CSG. Tr. 160; Div. Ex. 225 at 5. Giovannetti emailed Kristi Jernigan, Argonaut's marketing director, "[c]an we get this done ASAP. I don't want anyone to be aware

[17] Giovannetti estimated that he had over $1 million in debts in April 2009. Tr. 154.

of this but you and me."[18] Tr. 161; Div. Ex. 224. Giovannetti did not consider borrowing from Argonaut to be a conflict of interest. Tr. 203.

Giovannetti's Actions Related to Argonaut After the Argonaut Note

Gerstenhaber and his wife planned to visit Memphis to attend a conference sponsored by CSG. Tr. 350. Within a few days of signing the Argonaut note, Giovannetti offered Gerstenhaber the use of his Memphis condominium as well as arranged for Gerstenhaber to meet with members of two wealthy Memphis families who were CSG clients and Argonaut investors: Wilson and Canale. Tr. 350-54; Div. Ex. 233. Giovannetti did not tell either client about the Argonaut note. Tr. 354-55; Div. Ex. 316.

In May 2009, Gerstenhaber spoke at CSG's client conference and Giovannetti set up meetings for Argonaut's Jernigan with members of the Wilson and Canale families. Tr. 406-08; Div. Ex. 249; *see* Div. Ex. 242 at 1. Giovannetti requested that Jernigan tell Gerstenhaber that he helped her make contacts in the industry. Tr. 359-61, 363-64, 368-69, 374; Div. Ex. 242. Giovannetti discussed CSG's Argonaut clients with Argonaut, and he provided contact information for Shelby County, Tennessee, and another CSG client to Gerstenhaber and Jernigan, who thanked Giovannetti for his help. Tr. 376-99, 406-08; Div. Exs. 246, 248, 249. Giovannetti did not consider discussing CSG clients or disclosing information about a CSG client to a money manager a breach of fiduciary duty. Tr. 382-83, 391. On July 30, 2009, after learning that CSG's client, the Municipal Employees Retirement System for the State of Louisiana (MERS), had added $10 million to its Argonaut investment for August 2009, Giovannetti emailed Jernigan and copied Gerstenhaber and Posner:

> I can assure you I am constantly talking to my colleagues about Argonaut and in many cases their clients as well. In the case of MERS I had direct conversations with two of the trustees. The reason for this is because I believe in David Gerstenhaber and in his ability to manage capital in a superior fashion. I spoke with a prospect Monday (Carriage House) that is considering an investment with Argonaut and I told him exactly how I felt. You are with good people that know how to manage assets. Your future is bright. . . . In town Tuesday the 11th and off to New Orleans after lunch on the 12th. I have dinner with some of the trustees of MERS that evening and two meetings in N.O. the next day.[19]

[18] Giovannetti testified that he did not intend to send this email to Jernigan and that he thinks he might have meant to send it to Posner. Tr. 163-64, 373, 424. Giovannetti introduced Jernigan, who was from Memphis and acquainted with some of CSG's clients, to Gerstenhaber who then hired her. Tr. 164, 359, 403-05. Giovannetti told Gerstenhaber he would help Jernigan meet people. Tr. 359.

[19] Giovannetti denied that he recommended Argonaut to MERS and testified that MERS trustees talked to him after Gerstenhaber spoke at CSG's May 2009 conference and that the MERS dinner was canceled and did not happen. Tr. 442-47, 449-50. Giovannetti also denied that he

Tr. 440-51; Div. Ex. 318.

In an email to Gerstenhaber on August 20, 2009, Giovannetti reported that an Argonaut investor had been impressed with Argonaut's presentation and stated, "[w]e make a good team." Tr. 410; Div. Ex. 323. Gerstenhaber responded with "[a]lways a pleasure working with you partner." Div. Ex. 323. Giovannetti explained that his team comment was in reference to his promise to help Jernigan in her efforts to market Argonaut's business and he did this by making introductions to Argonaut. Tr. 411-12. On August 31, 2009, Giovannetti informed Gerstenhaber that he had worked with Jernigan on her business plan to attack the U.S. pension market. Tr. 420-23; Div. Ex. 324.

On November 25, 2009, Giovannetti advised Gerstenhaber:

> I have been on the phone with Kristi Jernigan ever since your conference call ended this morning with Abu Dabhi. We have some real opportunities brewing with some pension funds. I also heard from Alan Schechter of the Fruchthandler family and I'm told they will be adding to their investment Jan. 1st. Just to let you know I'm working.

Tr. 435-36; Div. Ex. 334.

In September 2010, Giovannetti spoke about Argonaut to non-CSG clients looking for investments. Tr. 416-18; Div. Ex. 416.

Giovannetti Redeems his Argonaut Holdings

On June 3, 2009, Giovannetti requested liquidation of his interest in the Global Aggressive Fund and directed that the funds, which he knew were about $85,000, minus a ten percent hold back, be sent to his bank account. Tr. 173-75; Div. Ex. 255. Giovannetti did not instruct Argonaut to deduct the amount he owed on his outstanding $50,000 loan from the redemption. Tr. 177, 180. Giovannetti testified that he intended "to redeem [his] investment and, you know, pay the advance and move on." Tr. 1134.

On July 29, 2009, Giovannetti asked his secretary, Deborah West, whether he had received the redemption from Argonaut. Tr. 182; Div. Ex. 311 at 1. West informed Giovannetti that the redemption amount of $76,284 was received July 24, 2009, and deposited in his personal account at Independent Bank, which had an $84,417 balance. Tr. 182-83; Div. Ex. 311 at 1.

At the hearing, Giovannetti acknowledged that if the $50,000 note had been paid out of his Argonaut account as part of the redemption, he would not have received $76,284. Tr. 176-78. Giovannetti consistently insisted, however, that on July 29, 2009, he believed the distribution was net of the promissory note and the note was canceled based on an unwritten agreement he had with Gerstenhaber. Tr. 193-95, 197-99, 205-08, 211-13, 1139.

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recommended Argonaut to Carriage House, explaining that Argonaut gave Carriage House his name to act as an investor reference for Argonaut. Tr. 447-49.

CSG Compliance's Knowledge of the Argonaut Loan

According to the CSG's Code of Ethics:

> The SEC and the courts have stated that registered investment advisers have a fiduciary responsibility to their clients. In the context of securities investments, fiduciary responsibility should be thought of as the duty to place the interests of the client before that of the person providing investment advice. Failure to do so may render the adviser in violation of the anti-fraud provisions of the Advisers Act. Fiduciary responsibility also includes the duty to disclose material facts that might influence an investor's decision . . . to engage the adviser to manage the client's investments. . . . An adviser's duty to disclose material facts is particularly important whenever the advice given to the client involves a conflict, or potential conflict, of interest between the employees of the adviser and its clients.

Div. Ex. 21 at 2; Tr. 512. Balsmann testified that every employee, including Giovannetti, acknowledged receiving the Code of Ethics, which required disclosure of conflicts of interest and potential conflicts of interest. Tr. 492-93, 510-14, 539-40. CST's written policies and procedures required persons to seek preapproval before borrowing money from a customer and to disclose any loans. Tr. 720-21. Giovannetti did not seek preapproval of the Argonaut loan. Tr. 488.

On August 5, 2009, Balsmann informed Giovannetti that a review of electronic communications indicated that in April 2009, Giovannetti entered into a promissory note with Argonaut, a registered investment adviser and manager of CSG client assets.[20] Tr. 486-87, 616-17; Div. Ex. 316. The August 5, 2009, notification attached the unsigned version of the promissory note and stated:

> A review of Q1 2009 CSG client assets indicates that Argonaut Management LP provides investment advisory services, through a managed limited partnership, to the following CSG clients which include some relationships that you work on:
>
> 1. Canale Beverage Holdings, Inc.;
> 2. D. Canale & Co.;
> 3. JDC Investments, LP;
> 4. Firefighters' Retirement System of Louisiana [(FRS)];
> 5. MERS;
> 6. Michael S. Starnes; and,
> 7. Spence L. Wilson.

Div. Ex. 316 at 1. Balsmann's notification also stated:

[20] Giovannetti was aware that electronic surveillance of emails occurred. Tr. 1141-43.

> While CSG's Code of Ethics does not specifically restrict borrowing money from investment managers, the borrowing of money by CSG employees from investment managers that manage CSG client assets creates a potential conflict of interest in that such CSG employee may be more inclined to recommend the utilization of such investment manager due to the personal indebtedness to such investment manager.
>
> Therefore, in order to mitigate such potential conflict of interest, please inform me as to the current state of this indebtedness – i.e., has it been extinguished or is it still in place?[] If the indebtedness is still in place, a brief disclosure to the clients that you work with that invest in Argonaut will be in order.

Id.; Tr. 201-02, 489-94, 573-77; *see* Tr. 51-52; Div. Exs. 21, 619 at 2. Giovannetti acknowledged working on the Canale Beverage, Canale, Starnes, and Wilson accounts, all of which involved wealthy Memphis families and sophisticated investors. Tr. 267, 1121-25, 1143-44; *see* Div. Ex. 108.

Giovannetti read Balsmann's August 5, 2009, memo as meaning that his Argonaut loan did not violate CSG's Code of Ethics, that it could need to be disclosed to CSG clients that Giovannetti worked with if the indebtedness was still in place, and that it did not necessarily have to be disclosed in CSG's Form ADV. Tr. 204, 208-210, 1144-46. Balsmann testified that if the indebtedness was still in place, it would be an actual conflict of interest and CSG would need to disclose it in its Form ADV. Tr. 494. Giovannetti testified that he understood the potential conflict of interest as of August 5, 2009. Tr. 202-04.

On August 7, 2009, CSG sent clients a Form ADV dated August 6, 2009, that contained a new paragraph:

> CSG and its related persons may have invested, and may continue to invest, their personal funds in investments similar to those recommended by CSG or money managers recommended by CSG for the management of client assets. CSG's Code serves to limit conflicts of interest in these cases through transaction monitoring.

Tr. 582-85; Div. Ex. 7, Sch. F at Item 9.A, B, E; Div. Ex. 315.[21] Balsmann did not recall whether the new language was added because Giovannetti told him he had an investment with Argonaut. Tr. 585-86.

On August 8, 2009, Giovannetti informed Balsmann and Vicki Lawson that he had paid the Argonaut loan on July 1, 2009, when he had redeemed his fund investment.[22] Tr. 217-18,

[21] Transcript reference to Schedule F, Item 9.D is incorrect. Tr. 582.

[22] Lawson began as a compliance consultant to CSG Holdings in the fall of 2008, and was CCO and president of CST from 2010 to August 2012. Tr. 473, 623. Lawson has a BBA in finance from the University of Memphis and is a certified regulatory compliance professional. Tr. 622.

498-99; Div. Ex. 320. Balsmann emailed Giovannetti on August 8, 2009, writing "I will place a copy of this email in the file and we will close this matter," also noting that CSG's Form ADV disclosure was being amended "to reflect that from time to time certain firm employees may be investors in the same private investment vehicles, mutual funds and money managers as recommended to clients." Div. Ex. 321. Balsmann and Lawson did not verify Giovannetti's representation that he had paid the loan. Tr. 499, 631; Div. Ex. 321. As head of compliance, Balsmann was responsible for filing Forms ADV. Tr. 275, 528-29. According to Balsmann, if Giovannetti had acknowledged the existence of the Argonaut loan, CSG would have filed another Form ADV. Tr. 587.

Giovannetti provided testimony to the Division in June 2013 that (1) he told Balsmann he was going to sign the promissory note and received Balsmann's approval; (2) he definitely told compliance about the note before he received Balsmann's August 5, 2009, memo; and (3) he talked with Balsmann after receiving the August 5, 2009, memo and told him the status of the loan. Tr. 311-13, 459-63, 501-08. Balsmann denied Giovannetti's investigative testimony. Tr. 501-08. At the hearing, Giovannetti testified that in 2013, he believed that he had told Balsmann about the promissory note in 2009; while he admitted that he did not directly tell Balsmann about the loan in April 2009, he did not know what Balsmann knew in 2009. Tr. 310, 312, 459-60, 463-65. Both Balsmann and Lawson testified that compliance learned about the loan from an email review; Balsmann denied that Giovannetti told him about the loan in April 2009.[23] Tr. 503-04, 508, 624-25.

CSG's Code of Ethics included a "note" and "evidence of indebtedness" in the definition of a "covered security" and CSG's partners and officers were required to report executed securities transactions quarterly and to list their holdings of covered securities annually. Tr. 515; Div. Ex. 21 at 4-5, 7-8. There is no evidence that Giovannetti did either with respect to his Argonaut investment and Argonaut loan. *See* Tr. 517. Balsmann testified that Giovannetti should have disclosed his personal Argonaut investment. Tr. 573. Balsmann could not recall whether the fact that Giovannetti had a personal investment with Argonaut was picked up in compliance's email surveillance. Tr. 572.

CST's annual questionnaire asked employees if they had borrowed from a customer and required each registered person to sign an employee certification that they understood, and would abide by, the firm's policy and procedures. Tr. 632-33, 636. Argonaut was a customer of CST from a broker-dealer perspective. Tr. 636. Lawson testified that Giovannetti should have disclosed the loan from Argonaut on the CST form. Tr. 637. Giovannetti did not disclose the Argonaut loan on the CST forms he filled out in 2009 and 2010. Tr. 637.

Lawson holds Series 7, 24, 53, 55, and 99 securities licenses, and licenses with the State of Tennessee Department of Insurance. Tr. 622. Lawson has twenty-eight years' experience in the securities industry. Tr. 622. Before beginning Securities Regulation Consulting, LLC, in 2008, Lawson was compliance officer, chief compliance officer, and senior vice president of FTN Financial for seven years. Tr. 622-23, 679.

[23] There was one email screening program for all of the CSG Holdings entities. Tr. 1043-44.

In March 2010, Giovannetti provided Balsmann with information about his personal financial difficulties, which everyone in the firm generally knew. Tr. 519. Giovannetti prepared a "Personal Financial Statement," dated November 1, 2009, which he shared with Balsmann in February 2010, that does not show his promissory note to Argonaut. Tr. 523; Div. Ex. 19. Giovannetti testified he only intended the financial statement to cover his commercial debts. Tr. 254-56. Balsmann testified that when he left CSG in July 2010, Giovannetti had not disclosed to compliance that he was in default on the Argonaut promissory note. Tr. 508-09; *see* Tr. 298. Fortas replaced Balsmann as CCO for CSG and Lawson became CCO for CST. Tr. 298-300, 623, 967.

Argonaut Reminds Giovannetti that the Note Remains Unpaid

Giovannetti defaulted on the $50,000 ninety-day Argonaut note on July 22, 2009, and interest began accruing at eight percent. Tr. 170-71. On July 27, 2009, Posner emailed Giovannetti and wrote, "[j]ust to give you a heads up, our cfo will be sending you the note for repayment after your recent redemption. If you have any issues with this, please call me." Div. Ex. 307A. Giovannetti testified that he probably did not spend a lot of time on Posner's July 27, 2009, email, but he took it to mean "we're going to process your redemption; we're going to retire the note; we're going to send you a copy of the [canceled] note and the redemption." Tr. 196-97, 1138-41.

Also on July 27, 2009, Brian Kessler, CFO of Argonaut, emailed Giovannetti's secretary West and wrote, "I have attached the invoice for the repayment of the below note. Do you have any questions?" Tr. 1150-51; Div. Ex. 311. West forwarded the email and said she would give a printout of the message to Giovannetti on July 27, 2009. Tr. 181-82; Div. Ex. 311.

On September 1, 2009, Kessler emailed West again, noting repayment had not been received. Tr. 221; Div. Ex. 326. West forwarded Kessler's email to Giovannetti and responded to Kessler on the same day, "Lee is aware that he has not yet made the payment on the loan. He is working on arrangements to clear the debt." Tr. 1150-52; Div. Ex. 326. On September 9, 2009, West sent Giovannetti a copy of her response to Kessler. Tr. 223-26; Div. Ex. 326.

Giovannetti testified that at this time he called Posner and learned that the Argonaut note was outstanding. Tr. 1152. It did not occur to Giovannetti to notify Balsmann that the information he had provided on August 8 was false or to disclose his indebtedness to his clients invested in Argonaut. Tr. 215-16, 225-27, 1155-56. At the hearing, Giovannetti admitted his conduct was wrong and CSG should have disclosed his indebtedness to clients who invested with Argonaut, but when he realized in 2009 that Argonaut had not been paid, his focus was on getting that issue resolved and with things going on within the firm. Tr. 231-36, 241.

On October 2, 2009, Giovannetti sent Gerstenhaber an email from his CSG email account labeled as confidential and stating:

> Your management company loaned me $50K until I was able to redeem my Argonaut investment in Aug. I have not been able to pay it back yet due to the major legal expenses the firm has incurred protecting ourselves in the NYS

> matter. I feel terrible about it but we have not been in a position to distribute over $1m in profits from last year . . . I may not have the liquidity to pay this off until year end.

Tr. 244; Div. Ex. 329. Gerstenhaber replied that it was no problem to wait until then, to which Giovannetti replied, "I appreciate and will not forget it." Tr. 241-42; Div. Ex. 329.

Gerstenhaber emailed Giovannetti on December 21, 2009, stating that note needed to be cleaned up before the end of the calendar year.[24] Div. Ex. 339. Giovannetti responded that it would not be possible. Tr. 245-46; Div. Ex. 339.

On or about May 13, 2010, Giovannetti signed a statement, requested by Argonaut's auditors, acknowledging that he owed Argonaut $50,000 as of December 31, 2009. Tr. 246-47; Div. Ex. 409. Giovannetti did not inform Balsmann or anyone else in compliance that the indebtedness remained outstanding. Tr. 247-48.

Compliance Learns that the Argonaut Loan Is Unpaid

On February 11, 2010, Giovannetti disclosed to Balsmann, Robinson, and his attorney, Robert Orians, that he was in a deep financial hole. Tr. 519-20; Div. Exs. 19, 400. They tried to devise a solution that would keep the firm's line of credit open with the bank and prevent Giovannetti from going into bankruptcy. Tr. 250-51, 255; Div. Exs. 400, 402. Giovannetti did not believe he had violated any company covenants and he refused to meet and explain the situation to his partners because he did not "really want to go through the pain of having to lay everything out." Tr. 270-73; Div. Ex. 402. Giovannetti's communications do not mention any concern for clients and he did not disclose the Argonaut loan to his partners or compliance at that time because he had other things on his mind. Tr. 266, 272-74.

Lawson testified that in 2011, Giovannetti denied in a quarterly compliance meeting that he had any loans other than two non-Argonaut loans he had disclosed, and represented that he had paid the Argonaut loan.[25] Tr. 637-39, 643-45. Neither Fortas nor Nummi confirmed that Lawson told them of this conversation and Giovannetti did not recall telling Lawson in February-March 2011 that he had paid the Argonaut promissory note. Tr. 300-01, 1003, 1071, 1156-57.

At a meeting with a Commission examiner on August 19, 2011, Giovannetti shocked Fortas by stating that he had confirmed a loan obligation with Argonaut's auditors, which meant the Argonaut note was outstanding.[26] Tr. 301-03, 969-71, 973, 976-77. Balsmann and Fortas

[24] Kessler wanted Giovannetti's note paid before year end 2009, else it would appear on Argonaut's balance sheet and Argonaut's auditors would need an explanation. Div. Ex. 339.

[25] Lawson's representation that Giovannetti told her he had repaid Argonaut is based on her FINRA testimony in 2012. Tr. 639, 642-45.

[26] The Commission initiated an examination of CSG in 2011. Tr. 968.

testified that no one at CSG knew before August 2011 that the Argonaut note was outstanding. Tr. 546, 1008. Fortas had the file with the note and Giovannetti's statement that it had been paid. Tr. 971. Within an hour after the meeting closed, Fortas and Nummi, CSG's acting general counsel, told the Commission examiner that they had been unaware of the outstanding loan and it needed to be disclosed. Tr. 971-72.

Fortas considered it urgent that CSG disclose a loan from a money manager that managed client funds, and Fortas and Nummi filed a modification to CSG's Form ADV Part 2A on August 24, 2011, based on information from Giovannetti, that disclosed the Argonaut loan as a potential conflict of interest.[27] Tr. 1009-11, 1051-53, 1061, 1097; Div. Ex. 15 at 10. To the best of Fortas's knowledge, neither Giovannetti nor Argonaut informed CSG that the loan was in default. Tr. 1011-12. Nummi testified that he called Argonaut and confirmed that the loan was outstanding and the original principal amount was due. Tr. 1048. Nummi did not specifically recall asking about the interest rate, but believed he had a conversation along those lines and was informed that the default interest rate was not in effect at that time and that Argonaut just wanted the principal back. Tr. 1048-50.

Following the "Argonaut bombshell," compliance found that Giovannetti should have disclosed five or six additional loans and a judgment. Tr. 650-52. Fortas, Lawson, and Nummi met with Giovannetti on September 28, 2011. Tr. 656; Div. Ex. 509. According to Lawson, Giovannetti became furious at questions about his outstanding loans, directed Lawson not to contact customers as part of her internal review, and stated, "I will not allow FINRA and SEC to force this firm to do business a certain way." Tr. 659-60; Div. Ex. 509. Giovannetti explained that this comment was made in reference to compliance calling one of Giovannetti's clients about a matter he was involved in without informing him. Tr. 289-90. Giovannetti felt that everyone at the firm should have been working together and that the firm had a responsibility to run its own business within the confine of the rules, not FINRA or the SEC. Tr. 290-91, 293.

On October 10, 2011, Giovannetti explained to Fortas:

> I was an investor in [Argonaut's Global Equities Fund] and submitted a redemption notice early in 2009. Due to the terms of the partnership[,] redemption was not offered until after the close of the second quarter. The general partner made arrangements to advance me $50,000 under a loan provision with the partnership, with my interest in the partnership as collateral. The intentions were for the loan to be retired from my partnership redemption. This was communicated to the Chief Compliance Officer by me. You have referenced an email from me to Ed Balsmann in which I stated the loan had been paid off. As I recall Ed ask[ed] me the status of the loan in early July 2009 and I responded that it was paid off from my redemption request. Subsequent to this I received a full redemption from the partnership which in

[27] Nummi testified that he went into "full investigation mode right after [Giovannetti] disclosed [the unpaid Argonaut note] to the SEC"; Nummi asked Giovannetti for his version of events and had a brief and limited conversation with Argonaut asking, "[w]hat's the outstanding debt that Lee Giovannetti owes you?" Tr. 1048-50, 1066, 1094-96, 1098.

> turn was used to pay taxes. The general partner told me at the time he would make personal arrangements to resolve the loan in the partnership and I could pay him back with my distributions from CSG at year end 2009. I might add that it was my understanding that I was the only investor in the partnership outside of the general partner and close immediate family members. . . . It wasn't until recently that I was able to retire the loan due to the untimely decline in CSG's profits and therefore no personal distributions.

Div. Ex. 519. Fortas knew that Giovannetti's October 10, 2011, explanation was inaccurate because he was working closely with Nummi, there was no mechanism in place for Giovannetti to pay the loan, and he knew that Giovannetti's financial situation was dire. Tr. 984, 996. Nummi testified that he might have told Giovannetti that he thought he could raise the funds to pay off the loan. Tr. 1075-79. Giovannetti testified that his response was accurate as he believed Nummi was making arrangements to pay off the loan. Tr. 316-18, 1163-64.

On July 20, 2012, Giovannetti sent Argonaut a check for $63,044 in payment of the promissory note. Div. Ex. 614.

Giovannetti resigned as CSG Holdings' CEO in December 2011, but continued as a firm employee in positions that did not require principal registration.[28] Tr. 745-46, 1003; Div. Ex. 528. Later, Giovannetti was associated with a registered investment adviser and a registered broker-dealer. Tr. 455-56.

CSG's Forms ADV

As CCO, Balsmann, and later Fortas and Nummi, prepared the Forms ADV that were filed with the Commission and sent to clients.[29] Tr. 534, 1071. CSG's Forms ADV Part II, later 2A, dated August 6, 2009, December 15, 2009, July 6, 2010, and March 31, 2011, did not disclose that Giovannetti had a promissory note with Argonaut because compliance either did not know of, or believed that Giovannetti had repaid, the loan. Tr. 325-26, 529-39, 732, 1008-09; Div. Exs. 7, 8, 9, 10, 13, 315, 413.

Balsmann testified that if Giovannetti had told him about the Argonaut loan in April 2009, Balsmann would have disclosed it in the Form ADV as a conflict of interest. Tr. 616. Lawson and Nummi testified that Giovannetti's Argonaut loan, even if paid, should have been disclosed on the Form ADV or to the client. Tr. 626, 721, 1087, 1090-91.

In a Form ADV Part 2A, dated August 24, 2011, CSG disclosed, "[i]n 2009, Mr. Giovannetti borrowed $50,000 at 3.10 % interest as an advance of a redemption related to his

[28] The executive management committee structure changed and Robert A. Longfield, Jr, a 5.71 percent owner became chair. Tr. 925; ELG Ex. 22 at Sch. A.

[29] According to Balsmann, in the period August 2009 to July 2010, the Form ADV Part II or 2A was filed by maintaining a copy in the firm's records. Tr. 539.

investment in Argonaut's long / short hedge fund. Repayment has not been made and is pending." Div. Ex. 15 at 10. A Form ADV Part 2A dated March 28, 2012, contains similar language.[30] Div. Ex. 16 at 10.

Public Witnesses

Robert Lawrence Rust has been executive director of MERS, a voluntary retirement system for all city workers in Louisiana, for about twelve years.[31] Tr. 796-97. Responsibility for MERS' investments lies with a nine-member board of trustees, which receives advice from Rust and outside investment consultants.[32] Tr. 798. As a public retirement system, MERS has to make sure that information as to its operations is available to the public. Tr. 801-02. In investing funds, MERS is interested in potential return, safety, and liquidity. Tr. 799-800. MERS relied on its investment adviser for knowledge, integrity, and honesty. Tr. 800-01. As its fiduciary, MERS expected its investment adviser to put MERS' interests ahead of its own. Tr. 802-03.

MERS retained CSG as its investment adviser in about 2006, when it was looking for expertise in alternative investments. Tr. 803-04. Soon afterwards, at CSG's recommendation, MERS invested $10 million with Argonaut. Tr. 805-06. In 2009, again at CSG's recommendation, MERS invested another $10 million with Argonaut. Tr. 808-09.

Between August 2009 and August 2011, the MERS board reviewed its entire investment portfolio monthly and reviewed each investment in the portfolio in more detail annually. Tr. 806-10. Meals, CSG's executive vice president, attended almost every MERS board meeting, and met regularly with Rust. Tr. 823-25, 839; Div. Ex. 7, Sch. F at Item 6. Neither Meals nor the Forms ADV that MERS received during this period disclosed Giovannetti's loan from Argonaut. Tr. 819-20. Rust emphasized that MERS expected that its investment adviser would disclose a potential conflict of interest, such as Giovannetti's loan from Argonaut, before the

[30] On January 16, 2015, the Commission issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Advisers Act, Making Findings, and Imposing a Cease-and-Desist Order. *Consulting Servs. Grp., LLC*, Advisers Act Release No. 4000, 2015 SEC LEXIS 251 (ELG Ex. 15). That Order found that CSG failed to disclose the Argonaut note and the material conflict of interest it presented to clients in Forms ADV Part II dated August 6, 2009, and July 6, 2010, and in Form ADV Part 2A, dated March 31, 2011, and that CSG's Forms ADV Part 2A, dated August 24, 2011, and March 28, 2012, were false and misleading. Tr. 979-82; ELG Ex. 15 at 4.

[31] Rust is a graduate of Louisiana State University (LSU) with a degree in finance and holds a Chartered Financial Analyst accreditation. Tr. 795.

[32] The board is composed of elected officials, city employees, the president of the Louisiana Municipal Association, and chairs of the Louisiana House and Senate retirement committees. Tr. 798. Two non-voting members are the representatives from the governor's and treasurer's offices. Tr. 798-99.

adviser recommended an Argonaut investment and that MERS should not learn about a potential conflict of interest from the adviser's Form ADV. Tr. 804-05, 809-10, 837-39, 842-44. MERS depends on its adviser to discover conflicts of interest and to disclose them to MERS. Tr. 843-44.

Rust learned of the Argonaut loan in late 2012 or 2013 from a third-party source and confronted CSG and requested full disclosure. Tr. 821-22. Rust testified that the MERS board expected its investment adviser to be completely open and honest and provide immediate information about any relationship it had with firms it was recommending. Tr. 804-05. MERS terminated its adviser relationship with CSG after it learned of the Argonaut loan; MERS still had an investment with Argonaut as of May 2015. Tr. 822-23.

Steven Stockstill[33] has been executive director and general counsel of FRS, one of thirteen public retirement systems in Louisiana, since November 2011.[34] Tr. 857-58. A ten-member FRS board of trustees is the fund's fiduciary responsible for retaining the fund's investment adviser.[35] Tr. 861-63. Stockstill testified that by law and contract, all investment managers and investment advisers are fiduciaries. Tr. 861-62.

FRS retained CSG in 2004, in part because CSG represented itself as a pure consulting firm with experience in alternative investments such as hedge funds. Tr. 866. At CSG's recommendation, FRS invested $10 million with Argonaut in 2006. Tr. 880-81. Meals was CSG's main contact with FRS, but its contract for an investment adviser was with CSG. Tr. 909.

It was highly important to FRS that its investment consultant be free of conflicts of interest, and it considered CSG to be its first line of defense against conflicts of interests that money managers might have who sought to invest FRS funds. Tr. 865, 868. FRS expected CSG to disclose any conflict of interest to the FRS trustees, who CSG met with regularly once a month. Tr. 869-70. To promote full disclosure, including information about fees or commissions, Revised Louisiana Statute Title 11:269 requires an investment consultant or manager to disclose any income or funds received to the retirement system. Tr. 863-64, 897-98; *see* La. R.S. § 11:269.

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[33] Because of weather conditions, Stockstill was forced to spend the night in the airport so as to attend the hearing in Memphis.

[34] Stockstill has a degree in business from Southeastern Louisiana University and a joint law degree from Southern University and LSU. Tr. 854-55. Stockstill served as counsel and later senior counsel to the Louisiana House of Representatives, with primary responsibility for the retirement committee, during which he sat as the designee of the house retirement committee chairman at meetings of the state's thirteen retirement systems, and was involved in drafting legislation. Tr. 855-57.

[35] The trustees include representatives from the governor's and treasurer's offices, the Senate and the House of Representatives, and two mayors. Tr. 863.

Stockstill testified that CSG should have disclosed the Argonaut note directly, as opposed to in a Form ADV, so that the FRS trustees could have performed their fiduciary duties and explored any conflicts of interest. Tr. 884-85, 892. CSG's Forms ADV Part II, received or dated August 11, 2009, December 15, 2009, and July 15, 2010, and CSG's Form ADV Part 2A dated March 31, 2011, did not disclose the Argonaut note. Tr. 885-91; Div. Exs. 322, 336, 414, 504.

FRS trustees learned that CSG's CEO had taken a loan from a money manager that CSG recommended in May 2012 through a questionnaire distributed to FRS' investment advisers annually. Tr. 874. The trustees proceeded to ask questions regarding the loan, and CSG's representative was forthcoming, explaining the nature of the loan and the fact that, at that time, it had not been repaid. Tr. 874-75. FRS considered it a betrayal of trust and the trustees collectively were shocked and outraged when they learned about the loan, that CSG had failed to disclose the loan, and that Giovannetti had lied to CSG compliance. Tr. 870-72, 875. Stockstill testified that an investment adviser's personal investments with a money manager should be disclosed as they constitute a potential conflict of interest. Tr. 902. Stockstill is familiar with the language in CSG's Form ADV that CSG and its related persons may invest personal funds in investments similar to those it recommends, but Stockstill expected that if investments occurred, CSG would disclose them to FRS directly rather than just in the Form ADV. Tr. 905, 907-08.

Meals or Ronnie Partain from CSG attended monthly meetings with the trustees and did not mention the relationship between Giovannetti and Argonaut. Tr. 881-82, 909. FRS terminated its relationship with CSG soon after May 2012. Tr. 877-79. It continued its relationship with Argonaut until 2013. Tr. 879.

Arguments of the Parties

The Division argues that Giovannetti fits the broad definition of an investment adviser and committed primary violations of Advisers Act Sections 206(1) and (2) and 207, and that he aided and abetted and caused CSG's Advisers Act Section 207 violations. Div. Br. at 1, 13-23. The Division contends that Giovannetti has admitted to conduct needed to establish the alleged violations. *Id.* at 1-3. The Division argues that Giovannetti admitted that: he owed fiduciary duties to CSG clients and was required to disclose all potential and actual conflicts of interest; in early 2009, due to his cash flow difficulties he needed funds to cover a $250,000 check to the IRS; in April 2009, he borrowed $50,000 from Argonaut, an investment manager that he and others at CSG recommended, without signing a pledge or collateral agreement giving Argonaut a claim to his personal Argonaut investment; the $50,000 ninety-day loan created a conflict of interest that Giovannetti was under a duty to disclose and CSG was under a duty to disclose in its Forms ADV; Giovannetti did not disclose this loan to CSG's compliance department or his clients; and he incorrectly advised compliance on August 8, 2009, that he had paid off the loan from his Argonaut redemption proceeds. *Id.*

The Division further maintains that Giovannetti's many admissions show that he acted with scienter, i.e., a culpable mental state. Div. Br. at 3-4. For instance, Giovannetti received monthly account statements demonstrating that he knew it was mathematically impossible for him to receive $76,284 when he redeemed his Argonaut investment in July 2009 if his $50,000

loan had been paid from the redemption proceeds. *Id.* at 3, 8-9. The Division also argues that Giovannetti's scienter is confirmed by the actions he took to conceal the loan from others, such as repeatedly failing to notify CSG's compliance personnel that the loan had not been paid off and affirmatively and falsely representing that it had been paid off. *Id.* at 3-4, 10.

The Division contends that Giovannetti is liable for primary violations of Advisers Act Section 207 as to CSG's filings of Forms ADV Part II and 2A on August 6, 2009, July 6, 2010, and March 31, 2011. Div. Br. at 19. The Division states:

> By Giovannetti's concealment, CSG and Giovannetti failed to meet the requirements relating to disclosure of the loan in accordance with Item 9, Schedule F to CSG's Forms ADV Part II dated August 6, 2009, and July 6, 2010; and, Item 10 in its Form ADV Part 2A, dated March 31, 2011. Likewise, after Giovannetti had disclosed the loan to the SEC exam staff, the Firm's Forms ADV Part 2A, dated August 24, 2011, and March 28, 2012, at Item 10, contained untrue and misleading statements of material facts about the loan. Thus, CSG's Forms ADV Part II (August 2009 - July 2010) and Part 2A (March 2011 - March 2012) were false when filed with the Commission in violation of Section 207. As a result, CSG and Giovannetti violated Section 207 of the Advisers Act.

Id. at 20 (footnotes omitted).

The Division additionally asserts that Giovannetti is liable for primary violations of Advisers Act Section 207 as to CSG's August 24, 2011, Form ADV filing. Div. Br. at 21-22. The Division also argues that Giovannetti is liable for willfully aiding and abetting and causing CSG's violations of Advisers Act Section 207 as to CSG's August 6, 2009, July 6, 2010, March 31, 2011, and August 24, 2011, filings. *Id.* at 22. Finally, the Division would find Giovannetti liable for causing CSG's violations of Section 207 as to CSG's March 28, 2012, filing of Form ADV Part 2A. *Id.* at 23.

The Division seeks: (1) a cease-and-desist order; (2) second-tier civil penalties for six CSG Forms ADV filings made between August 2009 and March 31, 2012, and for recommending that MERS invest in Argonaut without disclosing his conflict of interest, for a total of $350,000; and (3) a full industry bar. Div. Br. at 25-27.

Giovannetti's post-hearing brief argues that the Division's sanctions are unduly harsh under the circumstances. ELG Br. at 1. Giovannetti admits to being an investment adviser with the duty to disclose all material conflicts of interest and that the Argonaut loan resulted in a conflict of interest that should have been disclosed in CSG's Forms ADV. *Id.* at 13. Giovannetti maintains that he did not disclose the loan on August 5, 2009, because he believed it had been repaid; he admits that he should have disclosed the loan after September 1, 2009, when he discovered it had not been repaid, but represents that he was consumed with trying to save CSG. ELG Br. at 2.

During the hearing, Giovannetti repeatedly contended that he requested a partial redemption of his Argonaut holdings in April 2009, and that, for various reasons, Argonaut could not do a redemption and instead suggested "we'll give you a promissory note to help you with your issue, and then you can either pay the promissory note back in the future, or you can make a redemption to cover the promissory note." Tr. 121. Giovannetti professed to believe that he had an agreement with Gerstenhaber that the loan would be "retired from [his] partnership redemption." Tr. 310. Giovannetti insists that based on his conversation with Gerstenhaber in April 2009, he believed that the note was paid off as part of the redemption process:

> And it was my opinion, it was my understanding that they would redeem my investment, pay the promissory note off, send me the net proceeds and that would be it. That's what I believed to be the case, which obviously wasn't the case.

Tr. 191. Giovannetti viewed his Argonaut loan "as an advance from a . . . future redemption," which he eventually redeemed and did not believe the situation created a conflict of interest. Tr. 119-21.

Giovannetti admits violating Advisers Act Section 206(2) and accepts responsibility for omissions that caused Section 207 violations in CSG's Forms ADV filed before August 19, 2011. ELG Br. at 13-14.

Giovannetti maintains that he did not violate Advisers Act Section 206(1) because he did not act with scienter. *Id.* at 9-12. Giovannetti claims that when Balsmann questioned him in August 2009, Giovannetti incorrectly believed that Argonaut had paid the loan from his redemption proceeds. *Id.* at 10-11. Moreover, Giovannetti represents that Balsmann did not tell him that "it would be necessary to make a disclosure of his indebtedness to Argonaut and the resulting conflict of interest in CSG's Form ADV." *Id.* Giovannetti acknowledges that when he later learned that the loan had not been repaid, he did not disclose this fact to his clients or to Balsmann because he was under "relentless pressure of managing CSG through the turmoil created by the New York State matter and the fight for the firm's survival which had consumed him." *Id.* at 11. Giovannetti argues that his "mental state was on preserving his firm and the livelihood it provided for its 60 employees and not on an intent to deceive, manipulate, or defraud the firm's clients." *Id.*

Giovannetti devotes almost a third of his brief to the appropriate relief that should be ordered. ELG Br. at 16-23. He defends his conduct by explaining that he was "[c]aught between the Scylla of personal financial challenges caused by not receiving distributions from CSG and the Charybdis of the devastating effects that the New York Common Retirement Fund Complaint and subsequent Wells Notice had on CSG's business." *Id.* at 16. Giovannetti argues that there are four mitigating factors in this case that should be considered in assessing sanctions: (1) he accepts responsibility for not timely informing three clients and Balsmann of his indebtedness, understands an investment adviser is a fiduciary who must disclose all conflicts of interest, and has offered assurances that these failures would not occur in the future; (2) he "was not driven by a desire to conceal the Argonaut loan from CSG's compliance department or to defraud or injure CSG's clients"; (3) he informed Commission staff and CSG's compliance officers on August 19,

2011, that the Argonaut loan had not been repaid and remained outstanding; and (4) there is no evidence that any CSG client lost money investing with Argonaut, that the investing public was harmed, or that Giovannetti or CSG was unjustly enriched. *Id.* at 16-18.

Giovannetti believes a cease-and-desist order and a twelve-month suspension from association with an investment adviser is appropriate to protect the investing public and accomplish future compliance. ELG Br. at 18-23. In arguing against imposition of a civil money penalty, Giovannetti reiterates that: there is no evidence of financial harm by any client or prospective client of CSG or the investing public or in the marketplace; Giovannetti was not unjustly enriched because he has repaid the Argonaut loan with interest; as a result of the allegations related to CSG, CSG ceased operations on October 4, 2013; and Giovannetti has resigned from his position as CEO of CSG Holdings and from all management positions of its registered operating subsidiaries and is currently unemployed. *Id.* at 22-23.

The Division's reply brief focuses on Giovannetti's alleged violations of Advisers Act Sections 206(1) and 207 for CSG's Form ADV filings in August 2011 and March 2012.[36] The Division argues that Giovannetti's many attempts to hide his actions evidence his scienter. Specifically, the Division argues that from April 2009 through August 2011, Giovannetti lied on several occasions, claiming that the Argonaut debt had been paid off; even after September 2009, when he acknowledged knowing that the loan still existed, Giovannetti failed to disclose the loan in the February 2010 personal financial statement he prepared for Balsmann, who was trying to help him. Div. Reply Br. at 3-9.

The Division contends that Giovannetti's position that he believed the loan had been paid from the redemption proceeds has no support in the record because Giovannetti never raised this claim with Argonaut. *Id.* at 10-11. The Division notes that Giovannetti lied to the Division in investigative testimony in June 2013 and in a Wells submission on July 21, 2014. *Id.* at 13-14.

The Division argues that CSG's Forms ADV filed on August 24, 2011, and March 31, 2012, incorrectly stated that "[i]n 2009, Mr. Giovannetti borrowed $50,000 at 3.10 percent interest as an advance of a redemption related to his investment in Argonaut's long-short hedge fund." Div. Reply Br. at 15. The Division notes that in fact, the $50,000 loan was not an advance of a redemption, and the applicable interest at the time of the Form ADV filings was the default rate of 8 percent. *Id.* at 15-16. The Division alleges that Giovannetti aided and abetted and caused these false statements because Giovannetti was the source of CSG's information. As such, the Division argues that Giovannetti should not be absolved from responsibility because someone else at CSG was responsible for the Form ADV filings that contained the false information he provided. *Id.* at 15-18.

The Division rejects Giovannetti's proposed twelve-month suspension as inadequate and purports to distinguish many of the cases Giovannetti cites in support. *Id.* at 14, 18-21.

[36] The Division notes that Giovannetti has finally conceded liability for many alleged violations, and has abandoned his assertion that some charges are barred by the statute of limitations, 28 U.S.C. § 2462. Div. Reply Br, at 1, 3.

Conclusions of Law

Giovannetti willfully violated Section 206(1) and (2) of the Advisers Act.[37]

Section 206(1) and (2) of the Advisers Act provides that:

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly –
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client; [or]
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client[.]

15 U.S.C. § 80b-6(1), (2). Courts have interpreted Advisers Act Section 206 as imposing a fiduciary duty on investment advisers to act at all times in the best interest of their clients and obligating investment advisers to provide "full and fair disclosure of all material facts" to their clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191, 194, 200-01 (1963). Section 206 is designed "to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested." *Id.* at 191-92.

Scienter, defined as an intent to deceive, is required to prove a Section 206(1) violation but not for a violation of Section 206(2), which requires only negligence. *Montford & Co.*, Advisers Act Release No. 3829, 2014 SEC LEXIS 4597, at *55 (May 2, 2014), *pet. denied*, 793 F.3d 76 (D.C. Cir. 2015). Scienter may be established by recklessness – an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the actor or is so obvious that the actor must have been aware of it. *Id.* at *56 n.108 (citing *David Henry Disraeli*, Advisers Act Release No. 2686, 2007 WL 4481515, at *8 (Dec. 21, 2007)).

Giovannetti and CSG used the mails and instrumentalities of interstate commerce to conduct business with clients in states outside of Tennessee. *See, e.g.*, Div. Exs. 7 (August 2009 Form ADV Part II with list of clients it was mailed to), 12 (Form ADV Parts I and II emailed to Pasadena, California). Much of the evidence consists of interstate email communications by persons at CSG; the evidence shows clients located in many states outside Tennessee, such as MERS and FRS, who were at least annually mailed updated Forms ADV Part II and Part 2A; Giovannetti estimated that CSG recommended from fifty to 100 money managers, some of them, like Argonaut, were located outside Tennessee; and its related broker CST had various types of agreements with many firms located around the country. Tr. 43, 636; Div. Exs. 7, 315; ELG Ex. 18.

[37] A willful violation of the securities laws does not mean "done with a bad purpose"; rather, "it means no more than that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

Giovannetti agrees that during the relevant period, he met the statutory definition of an investment adviser and as such, he had a duty to disclose all material conflicts of interest that should have been disclosed in CSG's Forms ADV. ELG Br. at 13; *see* 15 U.S.C. § 80b-2(a)(11). Information is material if a reasonable investor would have viewed it as "significantly alter[ing] the 'total mix' of information made available" about his investment. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc*., 426 U.S. 438, 449 (1976)); *see also Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003) (stating that even "potential conflicts of interest are 'material' facts with respect to clients and the Commission").

Giovannetti's failure to disclose his loan with Argonaut was material. A reasonable investor would have wanted to know that his investment adviser owed a debt to a money manager he was recommending to clients. In fact, the two public witnesses gave unequivocal testimony that they considered Giovannetti's undisclosed loan with Argonaut as material information they would have wanted to know, as it represented a conflict of interest by a fiduciary to their public pension funds.

Giovannetti has conceded his liability as to Advisers Act Section 206(2) because he and CSG, which he controlled, failed to disclose until August 24, 2011, his $50,000 loan from Argonaut, which created a conflict of interest. ELG Br. at 13. Giovannetti contests the Division's position that he also violated Advisers Act Section 206(1), arguing that he did not act with scienter. *Id.* at 9-12.

The preponderance of the evidence is that Giovannetti acted with scienter. When these events began in April 2009, Giovannetti was a college graduate with over thirty years of securities industry experience. Tr. 40, 152. He was a founder and the hands-on manager of CSG, a major investment adviser firm with revenue in the multi-millions of dollars, for almost twenty years. He was aware that in 2007, CSG agreed to the entry of a cease-and-desist order and a $20,000 fine for violations of the Advisers Act by Meals. *Consulting Servs. Grp., LLC*, Exchange Act Release No. 56612, 2007 SEC LEXIS 2354, at *14-15 (Oct. 4, 2007); ELG Br. at 10; ELG Ex. 15 at 2. Furthermore, the evidence establishes that every CSG employee, including Giovannetti, acknowledged receiving the firm's Code of Ethics, which required disclosure of conflicts of interest and potential conflicts of interest.

Given this background, it is implausible that Giovannetti did not know in April 2009 that a personal loan from a money manager created a conflict of interest situation that he should have disclosed to compliance and to his clients, and that CSG needed to fully disclose circumstances surrounding the loan in its Form ADV filings. It is also implausible that Giovannetti believed what he told compliance on August 8, 2009, i.e., that the loan had been repaid, given that Argonaut began efforts to collect the overdue loan on July 27, 2009, Giovannetti knew his monthly statements for his Argonaut account before redemption showed a value of about $85,000 in June 2009, and Giovannetti knew he received $76,284 from the redemption in July 2009, so there was no way $50,000 could have been deducted from the Argonaut account proceeds.[38] He testified, "I knew that—or I know—I know that the math doesn't work, okay? I

[38] Ten percent was withheld. Tr. 175.

know that the math doesn't work. What I am testifying to is that at this point in time, right, I don't think I was focused on any of this at all." Tr. 194.

Giovannetti's conduct after September 2009, when, according to Giovannetti's version of events, he realized the loan had not been paid, until he disclosed the unpaid loan to compliance and the Commission on August 19, 2011, was extremely reckless. For almost two years, Giovannetti failed to disclose a material issue to compliance and investors. Given the stress that Giovannetti and CSG were under, it is understandable that Giovannetti did not want to add to the company's woes, but that does not change the fact that his conduct was reckless vis-à-vis investors, some of which were public pension funds.

The evidence is that Giovannetti violated Advisers Act Section 206(1) and (2).

Advisers Act Section 207

Advisers Act Section 207 provides:

> It shall be unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission under Section 203 or 204, or willfully to omit to state in any such application or report any material fact which is required to be stated therein.

15 U.S.C. § 80b-7. A Form ADV is a required report, and the Commission has stated that "Form ADV and its amendments embody a basic and vital part in our administration of the Advisers Act, and it is essential in the public interest that the information required by the application form be supplied completely and accurately." *Montford & Co.*, 2014 SEC LEXIS 4597, at *68 (internal quotation marks and alteration brackets omitted); *see* 17 C.F.R. §§ 275.203-1, .204-1. Scienter is not required to find a violation of Advisers Act Section 207. *Id.*

The uncontroverted evidence is that CSG filed Forms ADV Part II and 2A on the following dates:

Part II dated August 6, 2009;
Part II dated December 15, 2009;
Part II dated April 10, 2010;
Part II dated July 6, 2010;
Part 2A dated March 31, 2011;
Part 2A dated August 24, 2011; and
Part 2A dated March 28, 2012.

Div. Exs. 7-16, 315, 322, 336, 413-14, 504.

CSG's Forms ADV Part II and 2A filed before August 19, 2011, were false and misleading because they did not disclose the conflict of interest that arose out of Giovannetti's $50,000 Argonaut loan. The Forms ADV Part 2A filed after August 19, 2011, were false and

misleading because they did not describe the loan accurately based on information supplied by Giovannetti.

Giovannetti was not a primary violator of Advisers Act Section 207.

Giovannetti did not commit a primary violation of Advisers Act Section 207 because he was not the person at CSG responsible for filing Forms ADV; that responsibility belonged to the compliance function. Tr. 431-33, 528-29, 1071, 1159-60. Giovannetti was never involved in filing CSG's Forms ADV. Top management received copies for review, but they were not responsible for the filings and the evidence does not establish that Giovannetti had ultimate authority over Form ADV statements. Accordingly, it cannot be said that Giovannetti "ma[d]e any untrue statement of a material fact in" a Form ADV filing. 15 U.S.C. § 80b-7; *see Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) ("[T]he maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.").

It is uncontested that Giovannetti aided and abetted and caused CSG's violations of Advisers Act Section 207 between April 22, 2009, and August 19, 2011.

To establish an aiding and abetting violation it must be shown that (1) a primary violation of the securities laws was committed; (2) the alleged aider and abettor provided substantial assistance to the primary violator; and (3) the alleged aider and abettor provided such assistance with the necessary scienter, i.e., he rendered such assistance knowingly or recklessly. *See Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *Montford & Co.*, 2014 SEC LEXIS 4597, at *70; *Eric J. Brown*, Securities Act of 1933 (Securities Act) Release No. 9299, 2012 SEC LEXIS 636, at *33 (Feb. 27, 2012). For causing liability, three elements must be established: (1) a primary violation was committed; (2) an act or omission by the respondent was a cause of the primary violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. *Robert M. Fuller*, Securities Act Release No. 8273, 2003 SEC LEXIS 2041, at *13-14 (Aug. 25, 2003), *pet. denied*, 95 F. App'x 361 (D.C. Cir. 2004). One who aids and abets a primary violation is necessarily a cause of that violation. *Montford & Co.*, 2014 SEC LEXIS 4597, at *71; *Eric J. Brown*, 2012 SEC LEXIS 636, at *33.

Giovannetti admitted that his Argonaut loan created a conflict of interest that CSG failed to disclose in its Forms ADV, and that he was responsible for the non-disclosure prior to August 19, 2011, the date on which he informed compliance and Commission staff that the loan was outstanding.[39] ELG Br. at 13-14. All the elements necessary for an aiding and abetting and causing violation are present: CSG committed a primary violation; Giovannetti acknowledged that CSG should have disclosed the Argonaut loan; and he knowingly and substantially caused the violations by not disclosing the information.

[39] The Division argues that this conflict should have been disclosed in Item 9 of Schedule F of Form ADV Part II and in Item 10 of Form ADV Part 2A. Div. Br. at 20.

Giovannetti aided and abetted and caused CSG's violations of the Advisers Act Section 207 after August 19, 2011, i.e., for Forms ADV dated August 24, 2011, and March 28, 2012.

As CCO, Fortas was responsible for filing CSG's Forms ADV after August 19, 2011, and worked with Nummi on gathering information for the filings. *See* Tr. 1071. Fortas was a credible witness. Fortas's unrefuted testimony is that he believed it urgent to make the August 24, 2011, Form ADV filing because the outstanding loan was "from a money manager that managed money for our clients," and he believed CSG would be better off to make disclosure as quickly as possible. Tr. 1009. Giovannetti did not tell Fortas about the Argonaut loan when Fortas took over for Balsmann as CCO. Tr. 1008.

CSG's Forms ADV Part 2A, dated August 24, 2011, and March 28, 2012, contained substantially similar disclosures and stated:

> Potential Conflict - Loan from Argonaut Management, L.P. to Lee Giovannetti, CEO of CSG Holdings, LLC[, a parent company of CSG]. In 2009, Mr. Giovannetti borrowed $50,000 at 3.10% interest as an advance of a redemption related to his investment in Argonaut's long / short hedge fund. Repayment has not been made and is [pending.] This presents a potential conflict in that CSG may recommend Argonaut over other money managers as a result of the loan.

Div. Exs. 11 at 10, 15 at 10.

The disclosure is misleading for two reasons. First, at the time this statement was made, Giovannetti had already redeemed his Argonaut investment without repaying the loan. Second, at the time this statement was made, the loan had been in default for over two years, meaning that the 3.10 percent interest rate no longer applied and interest was actually accruing at the default interest rate of eight percent. *See* Div. Ex. 223. A reasonable investor would find it important to know these circumstances. The fact of the loan default alone would suggest an even greater or potentially more troublesome potential conflict of interest.

Giovannetti argues that he is not responsible for the false and misleading information because he did not participate in drafting or editing the language prepared by Fortas and Nummi. ELG Br. at 14. Giovannetti, however, was the source of the false information in both Forms ADV Part 2A that the loan was made in advance of a redemption and the interest rate was 3.10 percent. Tr. 1010, 1013-14. Neither Giovannetti nor Argonaut told Fortas or Nummi that the loan was in default and the interest rate had risen to the eight percent rate. Tr. 1010-13.

Based on these facts, I find that Giovannetti aided and abetted and caused CSG's Advisers Act Section 207 violation in connection with its Form ADV dated August 24, 2011, and caused CSG's Advisers Act Section 207 violation in connection with its Form ADV dated March 28, 2012. Giovannetti knew that the information he provided was false and misleading and that it would be included in a Commission filing. Furthermore, after the filing of the August 24, 2011, Form ADV Part 2A, Giovannetti did not take any steps to correct this false and misleading information in advance of the creation of the March 28, 2012, Form ADV Part 2A.

Sanctions

This proceeding was instituted pursuant to Securities Exchange Act of 1934 Section 15(b), Advisers Act Section 203(f) and (k), and Investment Company Act of 1940 Section 9(b). *See* 15 U.S.C. §§ 78*o*(b), 80a-9(b), 80b-3(f), (k). These provisions encompass a variety of measures that the Commission can employ to protect the public interest where it finds a person has violated the securities statutes. On brief, the Division has relied only on Advisers Act Section 203, so I consider that it has abandoned relief allowed by the other statutory provisions. Div. Br. at 25-28; Div. Reply Br. 18-22. The Division seeks the entry of a cease-and-desist order, seven second-tier civil penalties totaling $350,000, and a full industry bar. Div. Br. at 25-27.

Cease-and-desist order

Advisers Act Section 203(k)(1) authorizes the Commission to issue a cease-and-desist order against any person who has violated, or caused violations of, the Advisers Act. 15 U.S.C. § 80b-3(k)(1).

This Initial Decision finds that Giovannetti has committed and caused Advisers Act violations. *See supra*. Giovannetti does not oppose the entry of a cease-and-desist order and states that "the public interest would be served by the entry of a cease-and-desist order." ELG Br. at 21-22. Because Giovannetti does not object and it would be in the public interest to order one, I will order Giovannetti to cease and desist from committing or causing violations of Advisers Act Sections 206(1) and (2) and 207. *See infra* (public interest factors analysis).

Civil penalties

Advisers Act Section 203(i) authorizes the Commission to impose a civil money penalty in a cease-and-desist proceeding under Section 203(k) where, as here, the respondent violated, or caused violations of, the Advisers Act. 15 U.S.C. § 80b-3(i)(1)(B). The same provision also authorizes a civil money penalty if the violations were, as here, willful and such penalty would be in the public interest.[40] *Id.* § 80b-3(i)(1)(A). The statute sets out a three-tiered system for determining the maximum civil penalty. During the relevant period in this case, a maximum first-tier penalty of $7,500 for a natural person is permitted for each act or omission. 15 U.S.C. § 80b-3(i)(2)(A); 17 C.F.R. § 201.1004, Subpt. E, Table IV. A maximum second-tier violation of $75,000 for a natural person is permitted if the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. 15 U.S.C. § 80b-3(i)(2)(B); 17 C.F.R. § 201.1004, Subpt. E, Table IV. "To impose second-tier penalties, the Commission must determine how many violations occurred and how many are attributable to each person." *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012).

[40] To the extent certain violations predate the July 22, 2010, effective date of the Dodd-Frank Wall Street Reform and Consumer Protection Act, I rely on Section 203(i)(1)(A), which predates Dodd-Frank and requires willful violations before imposing penalties.

The Division recommends that Giovannetti be ordered to pay $50,000 for each of seven second-tier civil penalties for a total of $350,000.[41] Div. Br. at 25-26. The Division describes the distinct violations as follows: one penalty for recommending MERS increase its investment in Argonaut without disclosing the conflict of interest; four penalties for CSG's false and inaccurate Forms ADV Part II and 2A filed in August and December 2009, July 2010, and March 2011; and two penalties for false and inaccurate Forms ADV Part 2A filed on August 24, 2011, and March 28, 2012. Div. Br. at 29.

In considering whether a penalty is in the public interest, the Commission may consider (1) whether the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm caused to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. 15 U.S.C. § 80b-3(i)(3).

The following is relevant to these considerations. Giovannetti's willful violations involved at the very least a reckless disregard of the statutory requirements, as interpreted by the courts, for disclosure of conflicts of interest by an investment adviser. With respect to harm caused to others, there is no evidence of economic harm to any CSG customer. Argonaut was a reputable money manager. ELG Ex. 18. MERS and FRS terminated their investment adviser relationship with CSG because CSG breached its fiduciary relationship when it did not disclose Giovannetti's loan. Neither MERS nor FRS testified that it suffered any economic loss from the advice CSG provided. FRS terminated its relationship with CSG after it learned of Giovannetti's loan in May 2012 and terminated Argonaut in 2013. MERS terminated CSG in 2012-2013 and continued its Argonaut investment in 2015. There is no evidence that Giovannetti was unjustly enriched by his actions or any evidence of prior disciplinary actions against Giovannetti.

It is settled that the purpose of sanctions is to protect the public in the future and not to punish for past actions. *Leo Glassman*, Exchange Act Release No. 11929, 1975 SEC LEXIS 111, at *7 (Dec. 16, 1975); *A.J. White & Co.*, Exchange Act Release No. 10645, 1974 SEC LEXIS 1819, at *4, *6 & n.14 (Feb. 15, 1974). It is difficult to see how a sizeable civil monetary penalty in the amount of $350,000 is necessary to protect the public or would have an additional deterrent effect given the other sanctions ordered, as well as the collateral consequences to Giovannetti. It is a fact that Giovannetti and CSG each experienced widespread adverse publicity from these events and others, which led to the loss of clients and subsequent demise of CSG.

However, some civil penalty is required given the length of Giovannetti's repetitious conduct from April 22, 2009, to August 19, 2011, and after August 19, 2011, for CSG's August 24, 2011, and March 28, 2012, Forms ADV Part 2A that were false and misleading based on information that Giovannetti provided. Giovannetti did not raise an inability to pay defense. *See* 17 C.F.R § 201.630.

[41] The Division recommended penalties at the second tier rather than the third tier, which requires substantial losses or risk of substantial losses to other persons. 15 U.S.C. § 80b-3(i)(2)(C).

Penalties at the second tier are appropriate given the nature of the violations, and I agree that Giovannetti committed or caused at least seven violations which are subject to civil penalties. All the violations occurred after March 3, 2009, when the maximum amount of a civil penalty for each act or omission was $75,000 for a natural person. *See* 17 C.F.R. § 201.1004, Subpt. E, Table IV. The statute does not set a minimum amount, and within any particular tier, the Commission has the discretion to set the amount of the penalty. *See Brendan E. Murray*, Advisers Act Release No. 2809, 2008 SEC LEXIS 2924, at *42 (Nov. 21, 2008); *Phlo Corp.*, Exchange Act Rel. No. 55562, 2007 SEC LEXIS 604, at *60 (Mar. 30, 2007).

I conclude that a total penalty of $50,000, approximately $7,143 for each of the seven violations, is appropriate on these facts.

Industry or collateral bar

Advisers Act Section 203(f) authorizes the Commission to bar or suspend any person from the securities industry[42] if such person was associated with an investment adviser at the time of the alleged misconduct, such sanction is in the public interest, and such person (1) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in any application for registration or report required to be filed with the Commission; or (2) has willfully violated or aided and abetted a violation of the Advisers Act. 15 U.S.C. § 80b-3(e)(1), (5), (6), (f). In making a public interest determination, the Commission considers: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *Montford & Co.*, 2014 SEC LEXIS 4597, at *77. The Commission's inquiry is flexible, and no one factor is dispositive. *Montford & Co.*, 2014 SEC LEXIS 4597, at *77; *see Ross Mandell*, Exchange Act Release No. 71668, 2014 SEC LEXIS 849, at *7-9, *14 (Mar. 7, 2014). The Commission also considers the age of the violation, the degree of harm to investors and the marketplace resulting from the violation, and deterrence. *See Schield Mgmt. Co.*, Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35 (Jan. 31, 2006); *Marshall E. Melton*, Advisers Act Release No. 2151, 2003 SEC LEXIS 1767, at *4-5 (July 25, 2003).

The Division recommends that Giovannetti be subject to a full industry bar. Div. Br. at 26-27; Div. Reply Br. at 18-22. Giovannetti contends that anything more than a twelve-month suspension from association with an investment adviser is unnecessary to protect the public and achieve future compliance. ELG Br. at 16-21. In determining whether to impose a full industry bar, it should be considered whether the respondent's "misconduct is of the type that, by its nature, 'flows across' various securities professions[,] poses a risk of harm to the investing

[42] The associated entities are an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization (industry bar). Because a sizable portion of Giovannetti's misconduct post-dated the July 2010 effective date of Dodd-Frank, the retroactivity concern expressed by *Koch v. SEC*, 793 F.3d 147, 157-58 (D.C. Cir. 2015), does not apply.

public," and "demonstrates the need for a comprehensive response in order to protect the public." *Ted Harold Westerfield*, Exchange Act Release No. 41126, 1999 SEC LEXIS 433, at *21 (Mar. 1, 1999). A full industry bar is typically imposed where the respondent's misconduct demonstrates an unfitness to work in the securities industry "in any capacity." *Alfred Clay Ludlum, III*, Advisers Act Release No. 3628, 2013 SEC LEXIS 2024, at *26-29 (July 11, 2013) (internal quotation marks and italics omitted). Such bar would not serve its remedial purpose if imposed inflexibly for every type of violation.

My determination is based on the following. Giovannetti's violations all stemmed from one reckless breach of his fiduciary duty, during a time when he was under great stress for funds.[43] Giovannetti's failure to disclose his singular breach of a fiduciary duty for over two years was the reason material information went undisclosed to investors in numerous instances, such as CSG's Forms ADV.

Giovannetti's actions were not egregious in the sense that he borrowed a relatively small sum of $50,000, which he eventually repaid with interest, and there was no evidence of financial losses to investors, or harm to the capital markets. Tr. 1171. It is significant that when he borrowed the money in April 2009, CSG, previously a successful business, was the subject of adverse publicity relating to a Commission lawsuit in which CSG was not a named defendant. Tr. 1109-10. The Commission also was investigating CSG around that time. As a result of publicity caused by these events, CSG suspended partnership distributions and Giovannetti found himself in 2009 suddenly without the considerable income necessary to support his lifestyle. It appears possible that the April tax payment, the stated reason for the Argonaut loan, was to pay taxes on Giovannetti's undistributed income.

In addition, as a result of the Commission investigation, CSG had to respond to a Wells notice issued to CSG by the Commission on May 28, 2009, that ultimately did not result in any formal charges against the firm. Because CSG operated as a pass-through entity, the enormous cost of defending CSG was born by Giovannetti and the other owners. After more than two-and-a-half years, the Commission issued a termination of investigation letter on February 28, 2012. CSG was never able to recover and has withdrawn its adviser registration. Giovannetti testified that if allowed to remain in the industry, he will use his experience of the last four or five years to operate in full disclosure, be more upfront with clients, and to overall operate in a more compliant environment. Tr. 467. He said that he "would make every effort possible to do everything by the rules" and that he does not "want to ever do this again." Tr. 1191. During the hearing, Giovannetti repeatedly recognized that what he had done was wrong and expressed regret that he did not do the right thing at the time. *E.g.*, Tr. 231-36, 241, 1188-89. In his post-hearing brief, he accepted liability for violating or causing violations of Advisers Act Sections 206(2) and 207. ELG Br. 13-14.

[43] In July 2009, Giovannetti was focused on making sure there was money in his checking account. He explained that "I probably was asked by my wife, 'When are we going to get some money in the account?'" Tr. 194.

Finally, the purpose of this sanction is to protect the public interest and not to punish. Given the other measures taken in this Initial Decision, I consider a twelve-month suspension to be in the public interest. As honesty is paramount in all areas of the securities profession and in view of Giovannetti's misconduct, the suspension encompasses all areas covered by Advisers Act Section 203(f).[44]

Record Certification

Pursuant to Commission Rule of Practice 351(b), 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on October 21, 2015, and in addition, Division Exhibit 21, CSG's Code of Ethics dated June 2009.[45]

Order

I ORDER that, pursuant Section 203(k) of the Investment Advisers Act of 1940:

> Edgar Lee Giovannetti shall cease and desist from committing or causing violations, and any future violations, of Sections 206(1) and (2) and 207 of the Investment Advisers Act of 1940.

I FURTHER ORDER that, pursuant to Section 203(i) of the Investment Advisers Act of 1940:

> Edgar Lee Giovannetti shall pay a civil money penalty in the amount of $50,000.

I FURTHER ORDER that, pursuant to Section 203(f) of the Investment Advisers Act of 1940:

> Edgar Lee Giovannetti is suspended for a period of twelve months from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization.

Payment of civil penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at

[44] The Division's strong reaction to Giovannetti's prolonged failure to acknowledge wrongdoing and its request for severe sanctions are understandable from an enforcement perspective.

[45] Division Exhibit 21 was identified on May 27, 2015, and offered into evidence on May 29, 2015. Tr. 479, 1193. Opposing counsel objected on grounds of timeliness; I failed to rule. Tr. 479-81, 1193. The exhibit is admitted into evidence. There is no question as to its authenticity and it is relevant. *See* 17 C.F.R. § 201.320.

http://www.sec.gov/about/offices/ofm.htm; or (3) by certified check, United States postal money order, or bank cashier's check, payable to the Securities and Exchange Commission.

Any payment by certified check, United States postal money order, or bank cashier's check shall include a cover letter identifying the Respondent and Administrative Proceeding No. 3-16344, and shall be mailed or hand-delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Brenda P. Murray
Chief Administrative Law Judge