FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. JEFFREY S. GERACI (CRD No. 1839469), Respondent.	Disciplinary Proceeding No. 2010023044101 Hearing Officer – MC **HEARING PANEL DECISION** January 18, 2013

Respondent Jeffrey S. Geraci made an unsuitable recommendation to a customer, in violation of NASD Conduct Rule 2310, NASD IM-2310-2, and FINRA Conduct Rule 2010. The Hearing Panel suspends Geraci for two business days and orders that he pay restitution of $50,000, plus accrued interest.

Appearances

Thomas M. Huber, Regional Counsel, Philadelphia, Pennsylvania, and Marc P. Dauer, Deputy Litigation Counsel, New Orleans, Louisiana, for the Department of Enforcement.

Todd Ratner, Esq., Richmond, Virginia, for Respondent.

I. Introduction

The controversy in this case concerns the suitability of a recommendation Respondent Jeffrey S. Geraci made to a customer to invest in a speculative private placement issued by MICG Wealth Management, LLC, the parent company of his failing employer broker-dealer, MICG Investment Management, LLC ("MICG"). The Hearing Panel concludes that because of the high degree of risk inherent in the investment, Geraci's recommendation was unsuitable for the customer, based upon her investment objectives, risk profile, and financial circumstances.

II. The Customer

Customer MGS, a widow and retired bookkeeper for a beer distributor, is an unsophisticated investor.[1] During her marriage, MGS and her husband had no investments. When her husband died in 1993, MGS received an insurance payment of $96,000.[2] Uncertain of what to do with the money, MGS waited a year before she placed it in her first investment account at a bank.[3]

In 2007, MGS decided to transfer her funds to MICG, where her daughter and son-in-law held an account that was doing well.[4] MGS's MICG account information form calculated her annual income at $51,000 and her total net worth at $600,000. The form described her risk tolerance as "Accepting some degree of Risk – Moderate," with no need for income from her portfolio, and no expectation of making withdrawals. When MGS opened her account, her objective was "moderate growth."[5]

In 2009, when Geraci became her broker, MGS was 64, and living with her daughter and her son-in-law, whom she paid $1,000 per month for rent.[6] Shortly before she met Geraci, MGS sold her house and decided to add the proceeds of the sale to her portfolio. This gave MGS a total of $166,000 in additional funds to invest.[7] MGS testified that her MICG account information form from 2007 remained accurate: she continued not to need income from the

[1] Tr. 21-22, 24-25. References to the testimony at the hearing are designated "Tr." with transcript page numbers. References to the joint exhibits of the parties are designated "JX-__."

[2] Tr. 20-21.

[3] Tr. 34-36.

[4] Tr. 36.

[5] JX-3, at 1, 3.

[6] Tr. 62.

[7] Tr. 117, 212.

portfolio, and did not intend to withdraw money from it.[8] She remained willing to accept a moderate degree of risk.[9] MGS had been losing money in her account before Geraci became her advisor, so she understood the risk of loss inherent in any investment.[10] In February 2010, relying on Geraci's recommendation, MGS invested $50,000 in the MICG Wealth Management private offering.

III. The Respondent

Geraci is a West Point graduate and former United States Army Ranger who developed an interest in being a financial advisor while serving in the military.[11] He first registered with FINRA in June 1998. He subsequently obtained certification as a Certified Financial Planner.[12]

In August 2008, former FINRA member firm MICG contacted Geraci to recruit him. Jeffrey Martinovich, the firm's chairman, chief executive officer, and manager, was a military academy graduate and was interested in bringing on military academy graduates as brokers at MICG.[13] Martinovich hired Geraci in October 2008.[14] Geraci was favorably impressed by Martinovich, and was attracted to MICG as a relatively small "one-stop shop" designed to provide its clients with a wide array of financial planning services.[15]

[8] Tr. 76-77.

[9] Tr. 77.

[10] Tr. 140-42.

[11] Tr. 239-41.

[12] Tr. 251.

[13] Tr. 249-50.

[14] Tr. 255.

[15] Tr. 252-53.

In the summer of 2009, a number of MICG representatives, some of whom were part of Martinovich's team, suddenly left MICG. Martinovich decided to bring Geraci onto his team as a replacement, and to make him a branch manager.[16]

Geraci was registered with MICG as a General Securities Representative until he resigned, on May 4, 2010.[17] He is currently registered with another FINRA member firm.[18]

IV. The Firm

When Geraci joined MICG in October 2008, the firm had 40 to 45 brokers. By late 2009, the number of brokers had dwindled to 12 or 13.[19] MICG had experienced annual operating losses for several years. Losses in 2008 totaled approximately $756,000.[20] Approaching the end of 2009, MICG anticipated revenues would fall by 50% from 2008, for a total of over $4 million, resulting in an operating loss of $1.2 million for the year.[21] In addition, MICG was under investigation by FINRA.[22]

In September 2009, Martinovich informed employees that the firm needed to raise capital to attract new brokers and new business. To do so, Martinovich announced that MICG Wealth Management, LLC, which owned MICG and was completely controlled by Martinovich, would commence a private offering to raise $6 million to recruit and hire additional financial advisors.[23]

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[16] Tr. 262-64.

[17] Tr. 304-05.

[18] Tr. 309; JX-1, at 3.

[19] Tr. 325-26.

[20] Tr. 204.

[21] Tr. 207, 317.

[22] Tr. 303-04.

[23] Tr. 183-84; JX-6, at 4-5.

The effort failed to save MICG. By December 2009, few had invested in the private placement.[24] MICG went out of business on May 7, 2010.[25]

Subsequently, FINRA concluded its investigation of the firm and entered into a settlement in which MICG consented to expulsion and findings that it had violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5, and a number of FINRA and NASD rules, in connection with sales of investments in and management of a hedge fund. The expulsion became effective on February 7, 2011.[26] Martinovich filed for bankruptcy three days later.[27]

MGS's $50,000 investment is among a number of outstanding claims listed in a schedule of creditors holding unsecured nonpriority claims filed in the bankruptcy proceeding.[28]

V. The Offering

Geraci had worked at MICG for slightly less than a year when Martinovich announced the MICG Wealth Management private offering. Martinovich explained that, in the unsettled climate of the securities industry in 2008 and 2009, MICG had an opportunity to improve its deteriorating financial condition caused by the departure of its brokers. The Firm could do so by attracting new brokers, dissatisfied with their big firms, to the advantages offered by MICG's small "boutique firm" identity. Doing so, however, would require capital.[29] The purpose of the offering was to generate that capital.

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[24] Tr. 197.

[25] Tr. 303.

[26] JX-2, at 2. The regulatory action leading to the settlement was unrelated to the private placement at issue in this case. According to Central Registration Depository records, on February 3, 2011, Martinovich accepted a bar from associating with any FINRA member firm in any capacity for, among other violations of FINRA rules, misusing customer funds in connection with the hedge fund.

[27] JX-17, at 1.

[28] JX-18, at 3.

[29] Tr. 184-86.

MICG Wealth Management proposed to do so through the private placement by offering the opportunity to participate in a "very speculative" series of three-year convertible debt instruments which would mature in December 2012.[30] MICG Wealth Management would pay investors nine percent interest annually in quarterly installments and, at maturity, investors had the option of converting to MICG stock at 80 percent of market price.[31]

By its terms, the offering was suitable only for accredited investors, but Martinovich said that up to 35 eligible non-accredited investors could participate.[32] The private placement memorandum described eligible non-accredited investors as people who were, themselves or with their representatives, "capable of evaluating the merits and risks" of the investment.[33]

The investments were illiquid.[34] The proceeds were to be used primarily to hire financial advisors for MICG and to provide it with working capital.[35] The private placement memorandum disclosed that Martinovich personally controlled MICG Wealth Management and the use of the offering proceeds.[36]

At the firm-wide meeting when he announced the offering, Martinovich also mentioned that a sinking fund would be established to ensure that MICG Wealth Management would be able to make the quarterly interest payments and return principal to investors at maturity.[37] Martinovich "emphatically" represented that MICG Wealth Management would successfully pay

[30] Tr. 123, 183, 185-86; JX-6, at 1-2.

[31] Tr. 221-23; JX-6, at 1-3.

[32] Tr. 185.

[33] JX-7, at 1-3.

[34] Tr. 312-13.

[35] JX-6, at 3.

[36] *Id.* at 8.

[37] Tr. 186.

the interest, but he was unclear about whether the payments would come from investors or from MICG's current revenues.[38]

When MICG began promoting the offering, the firm provided brokers with no written information detailing the firm's financial condition. MICG's chief financial officer, however, stated that the firm was doing well, had succeeded in reducing expenses, and was increasing its net income.[39] As Geraci wrote in a letter to a FINRA examiner during the investigation of this matter, he "trusted that the information" given by Martinovich and others was "truthful."[40]

Martinovich met with Geraci and his team of brokers weekly or biweekly, and briefed the team on the status of sales at each meeting. A junior broker on the team maintained a "cash list" of "all the clients' available cash in money markets" and Martinovich's focus was on recommending clients to invest any available funds in the offering. Geraci testified that because Martinovich was the leader of the firm, the team was under "pressure" to "help the company" by promoting the offering, and the team was therefore "looking at everybody with cash." Geraci testified that he felt obliged to broach the idea of investing in the offering with all of his customers who were on the cash list.[41] This testimony is consistent with statements Geraci made in his letter to the FINRA examiner, that there was pressure on the "CEO's team" to "lead the company…and to finance the $6 million bond as soon as possible."[42] It was in this context that MGS's name came up as a potential investor because her account balance showed she had over $50,000 in available cash.[43]

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[38] Tr. 188-89.

[39] Tr. 190.

[40] JX-19, at 4.

[41] Tr. 329-30.

[42] JX-19, at 2-3.

[43] Tr. 199.

VI. The Recommendation

Geraci met with MGS for the first time in October 2009. MGS's daughter accompanied her to the meeting. Geraci had familiarized himself with MGS's account information and financial circumstances.[44] The initial meeting lasted approximately an hour and a half.[45] Geraci assessed MGS as possessing a conservative risk profile with investment objectives of moderate growth and "possible income." He noted she expressed a wish to purchase a new car, and that this was the "only known short term requirement for money not covered by her income." He also understood that MGS did not have any experience with private placements.[46] Because of her good health and life expectancy, he understood MGS to have a long-term investment horizon. She had adequate income and her assets were diversified, and most were invested conservatively.[47]

At their initial meeting, Geraci made no specific recommendations to MGS. Following the meeting, he prepared an "action plan for 2010."[48] Because MGS wanted to avoid becoming a burden to her daughter in the future, Geraci recommended that she purchase a long-term care insurance policy.[49] He also decided that the MICG Wealth Management private offering was a suitable investment for MGS.[50]

Geraci's plan called for MGS to purchase a $50,000 bond to generate income to offset the cost of the rent MGS said she paid her daughter. In addition, under the plan, MGS would

[44] Tr. 182, 191-92.

[45] Tr. 271.

[46] JX-19, at 2.

[47] Tr. 272-73.

[48] Tr. 274; JX-5.

[49] Tr. 209-10.

[50] Tr. 333.

maintain $124,000 in the "moderate-conservative growth funds" already in the account and use $80,000 to purchase the long-term care policy.[51]

Because MGS was a non-accredited investor, Geraci met with MICG's compliance officer to review the suitability of the recommendation.[52] Geraci testified that he appreciated that non-accredited investors like MGS needed to understand two things: how the offering "worked" and that they could lose all of their money.[53]

When Geraci and the compliance officer met, they discussed MGS's non-accredited status, and the fact that she had only approximately half of the total net worth of an accredited investor. Geraci and the compliance officer reviewed MGS's portfolio, discussed the risks of the offering, the yield, and Geraci's assessment of MGS's desire for cash flow for rent.[54]

Notably, Geraci and the compliance officer did not discuss MGS's assertion that she had no need for additional income.[55] Geraci conceded at the hearing that MGS's annual income at the time was sufficient to pay for rent.[56] He felt, however, that MGS nevertheless was attracted to the prospect of earning income in the form of the quarterly interest promised to investors.[57]

The compliance officer approved of the recommendation, and provided Geraci with a numbered private placement memorandum and other documents to give to MGS.[58]

Geraci presented the action plan to MGS at their second meeting in December 2009.[59]

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[51] Tr. 214-15; JX-5, at 1.

[52] Tr. 213.

[53] Tr. 286.

[54] Tr. 216.

[55] Tr. 218.

[56] Tr. 218-19.

[57] Tr. 217.

[58] Tr. 288.

[59] Tr. 274; JX-5, at 1.

The meeting lasted approximately two hours. Once again, MGS's daughter accompanied her.[60]

At this meeting, Geraci again reviewed MGS's long-term care needs and her financial situation. Geraci then presented MGS with the offering summary. He testified that he also presented her with the confidential private placement memorandum.[61]

Geraci told MGS that to purchase the bond was to make an investment in MICG, and that she could lose all her money if the firm went out of business. He advised her, however, that if the firm failed, the more likely scenario was that it would sell its assets and, as stated in the offering summary, return her principal plus 11 percent interest.[62]

Geraci stated that he also disclosed MICG's negative cash flow over the previous several years. He informed MGS that the firm's financial problems were caused by the downturn in the financial industry and the departure of brokers from the firm, but that the funds raised by the offering would be used to attract successful brokers from other firms with substantial books of business to bring to MICG. He explained that the bond was a three-year investment, with an option to convert to MICG stock at 80% of the market price. But because he felt that MGS did not understand the concept of conversion, he did not recommend the conversion option.[63] Despite the risks, Geraci expressed his confidence to MGS that MICG Wealth Management would repay investors their principal. Geraci testified that he believed MGS understood the

[60] Although MGS's daughter accompanied her to all of her meetings with Geraci, both MGS and her daughter testified that MGS made the decisions about what to do with her money. Tr. 66, 109.

[61] Tr. 219-20.

[62] Tr. 220.

[63] Tr. 221-23.

risky nature of the bond.[64] At the conclusion of the December meeting, MGS deferred a decision on the bond, but chose to proceed with the purchase of the long-term care policy.[65]

Geraci met for a third time with MGS and her daughter in January 2010. He did not know if MGS would choose to invest, but prepared the documents for her to sign in the event she decided to do so.[66] By the time she arrived at the meeting, MGS had decided to make the purchase. However, when Geraci presented the paperwork, MGS's daughter became upset when she saw that the papers misspelled MGS's last name, and as a consequence, MGS declined to sign the papers. MGS did, however, complete her purchase of the long-term care policy. When MGS left, Geraci did not know what she would decide about the bond.[67]

MGS returned to Geraci's office for a final meeting in February 2010.[68] At the outset of the meeting, MGS seemed uncertain about what to do. Geraci said her options were to invest in the bond or to place the funds into her managed account. At that point, MGS decided to purchase the bond. Geraci then went through all of the offering paperwork, including the suitability questionnaire, with MGS, and discussed the accredited investor requirement. Geraci filled out the forms as he and MGS reviewed them.[69]

It is undisputed that when she decided to purchase the bond, MGS relied on Geraci's recommendation,[70] and it was her trust in Geraci that made her comfortable with the decision.[71]

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[64] Tr. 220-23.

[65] Tr. 225.

[66] Tr. 227-28, 289.

[67] Tr. 226-27, 290.

[68] Tr. 290.

[69] Tr. 290-91, 294.

[70] Tr. 51, 238.

[71] Tr. 82, 85.

VII. The Recommendation Was Unsuitable

The operative suitability rule at the time Geraci made his recommendation to MGS was NASD Rule 2310. It stated, in relevant part:

> In recommending to a customer the purchase … of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.[72]

To assess the suitability of Geraci's recommendation to MGS, therefore, the Panel must evaluate: (i) MGS's financial condition, investment objectives, and risk profile; (ii) Geraci's reasonable due diligence, or lack of it, in investigating and informing himself of the risks inherent in the MICG Wealth Management offering; and (iii) the appropriateness of those risks for MGS given her circumstances. Taking these factors into consideration, applying the applicable rule and case law, the Panel concludes that the bond was an unsuitable investment for MGS, and that Geraci's recommendation was therefore unsuitable.

A. The Recommendation Was Inconsistent with the Customer's Financial Interests

A "broker's recommendations must be consistent with his customers' best interests"[73] and must be tailored to their financial profiles and investment objectives.[74] Geraci understood MGS's risk tolerance to be "moderate-conservative"[75] and that the "the actual portfolio she

[72] The Complaint alleges that Geraci violated NASD Rule 2310, NASD IM-2310-2, and FINRA Rule 2010. IM-2310-2 imposes on all registered representatives a "fundamental responsibility for fair dealing" in their relationships with customers. Similarly, FINRA Rule 2010, successor to former NASD Rule 2110, imposes a generally applicable high standard of ethical conduct on members. A violation of Rule 2310, or of any NASD or FINRA rule, violates Rule 2010. *Dep't of Enforcement v. Cody*, No. 2005003188901, 2010 FINRA Discip. LEXIS 8, at *26 (N.A.C. May 10, 2010), *aff'd*, Release No. 64565, 2011 SEC LEXIS 1862 (May 27, 2011); *Stephen J. Gluckman* 54 S.E.C. 175, 185 (1999).

[73] *Raghavan Sathianathan*, Exchange Act Rel. No. 54722, 2006 SEC LEXIS 2572, at *21 (Nov. 8, 2006), *aff'd*, 304 F. App'x 883 (D.C. Cir. 2008).

[74] *Scott Epstein*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at *43 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010).

[75] Tr. 195.

invested in [was] conservative" with a moderate risk profile.[76] The MICG Wealth Management offering's high-risk, speculative nature was fundamentally inconsistent with MGS's risk profile and the remainder of her portfolio.

By its own terms, the offering was primarily appropriate for accredited investors. Non-accredited investors needed to be "capable of evaluating the merits and risks."[77] As one of Geraci's colleagues testified, this meant a non-accredited investor should be sophisticated, experienced, and "capable of evaluating" the bond.[78] MGS was unsophisticated and ill-equipped by her experience to evaluate the bond, which is why she relied entirely on Geraci's recommendation.

Geraci contends that he recommended the bond to provide MGS with income to pay rent; yet MGS had made clear that her current income sufficed to meet this need.[79] He defends the recommendation on the basis that he balanced the greater risk of the bond against the lesser risks of the rest of her portfolio, with money in "very, very safe stuff,"[80] and felt the bond was, in context, consistent with the "Harvard and Yale theory" of investing and "modern portfolio theory."[81] Yet he concedes that placing nine percent of a customer's assets into a single asset position at risk of total failure is "probably not" consistent with the theory.[82]

[76] Tr. 276.

[77] JX-7, at 2.

[78] Tr. 383, 389.

[79] Tr. 277-78, 282, 319-20; JX-3, at 3.

[80] Tr. 216.

[81] Tr. 278.

[82] Tr. 311-12.

It is true that Geraci warned MGS that she could lose her investment if MICG failed, and that she knew that there was a risk of loss when she accepted Geraci's recommendation.[83] These facts, however, did not render the investment suitable for MGS. The suitability rule "requires more from a broker than mere risk disclosure."[84] Even if MGS had wished to engage in risky trading, a broker has a "duty to refrain from making recommendations that are incompatible with the customer's financial profile."[85] As the SEC has stated, a "recommendation is not suitable merely because the customer acquiesces in the recommendation. Rather, the recommendation must be consistent with the customer's financial situation and needs."[86] Geraci's recommendation was inconsistent with MGS's financial situation and needs.

B. Geraci Failed to Adequately Inform Himself of the Risks

To ensure that a recommendation is suitable, a financial advisor must take the steps necessary to make certain that he understands the potential risks posed by the investment.[87] Geraci failed to inform himself adequately of the risks associated with the MICG Wealth Management offering.

Geraci insists that he conducted a satisfactory due diligence inquiry into the offering, given the information available to him. Citing a Notice to Members addressing the "Sales Practice Obligations in Sales of Bonds and Bond Funds," Geraci argues that he satisfied his obligations because he acquainted himself with the "type, term and yield of the bond; when and

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[83] MGS denied that Geraci warned her of the potential loss associated with the MICG bond, but the Panel finds, on the basis of Geraci's credible testimony and MGS's daughter's corroborative testimony, that Geraci clearly informed MGS she could lose her entire investment.

[84] *Dep't of Enforcement v. Chase*, No. C8A990081, 2001 NASD Discip. LEXIS 30, at *17 (N.A.C. Aug. 15, 2001), *aff'd*, 56 S.E.C. 149 (2003) (*citing Patrick G. Keel*, 51 S.E.C. 282, 286 (1993)).

[85] *Dep't of Enforcement v. Murphy*, No. 2005003610701, 2011 FINRA Discip. LEXIS 42, at *72 n.56 (N.A.C. Oct. 20, 2011), *appeal docketed*, No. 3-14609 (S.E.C. Oct. 28, 2011).

[86] *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *24 (Feb. 10, 2004).

[87] *Cody*, *supra* note 72, at *19-20.

if periodic interest payments will be made; … the conditions under which the holder may redeem the bond; [and] the collateral securing the bond."[88]

However, the Notice also points out that the risk levels of bonds vary widely, and that some "high-yield, high-risk products may be suitable for recommending to only a very narrow band of investors capable of evaluating and being financially able to bear those risks."[89] The MICG Wealth Management bond was such an instrument; MGS was not such an investor. The Notice goes on to state that "in the case of individual bonds, customers should be advised as to the credit risk, or risk of default, associated with a particular issuer, and how that risk might affect the safety of the invested principal."[90] Here, Geraci failed to sufficiently inform himself of the circumstances giving rise to a substantial risk of default, and therefore was unable to adequately warn MGS of the risk.

As Geraci knew, investors were essentially investing in MICG, whose failure could cost them their entire investment.[91] Accordingly, Geraci should have insisted on obtaining details of the underlying financial condition of MICG, in order to make an informed assessment about the likelihood that MICG Wealth Management would be able to make the promised quarterly interest payments and repay investors.

Geraci's due diligence fell short of providing him with sufficient information to justify his confidence that MICG would survive its clearly evident challenges. As Geraci himself admits, he had "no knowledge of the Firm's exact finances."[92] He chose to rely on Martinovich's self-interested representations about the firm's prospects. For example, although

[88] Respondent's Pre-Hearing Submission 7(*quoting NASD Notice to Members 04-30* (April 2004)).

[89] *Notice to Members 04-30*.

[90] *Id.* at 341.

[91] Tr. 220.

[92] Answer ¶ 5.

Martinovich and other MICG principals portrayed the Firm's financial condition in a positive light, Geraci never asked for, and they never presented, any financial statements that would corroborate or belie the positive portrayals.[93] And Geraci never attempted to confirm that Martinovich had established the sinking fund that he referred to when he introduced the offering to MICG's brokers.[94] Without knowledge of the firm's financial status, Geraci was incapable of making an informed judgment regarding MICG Wealth Management's ability to make MGS's quarterly interest payments and repay MGS's principal.

In addition, Geraci was aware of objective indicia of MICG's precarious financial situation, which should have prompted him to dig more deeply. He knew that the firm was steadily losing money. He knew, or should have known, as one of his colleagues testified, that recruiting more brokers was crucial to MICG's survival.[95] He was sufficiently concerned about MICG's future to approach Martinovich personally and ask "before we put any money in this thing … is this thing going to work and do you have all the numbers?" But when Martinovich responded with general assurances that "[w]e've got a plan … Don't worry about it," Geraci did not press for details.[96]

Instead, Geraci relied primarily on what MICG's principals told him, and ignored other "red flags" visible in the circumstances surrounding the offering. Although he read the private placement memorandum, he failed to pay heed to its warnings of risk.[97] The memorandum described MICG's annual, increasing operating losses. When Geraci mentioned those losses to

[93] Tr. 189-90, 201.

[94] Tr. 313-14.

[95] Tr. 355-56.

[96] Tr. 201.

[97] Tr. 202.

Martinovich, Martinovich merely said that "we would recruit over it."[98] When Geraci spoke to another MICG advisor, who had been with the firm for 17 years and was a CPA, the advisor said that Martinovich's plan for MICG would work, *if* the recruiting was successful. Geraci did not give sufficient consideration to what would happen if the recruiting efforts should fail.[99] As noted above, Martinovich signaled that the future of the firm largely depended upon the success of the offering in generating funds to attract new financial advisors, and underscored this when he pressed Geraci and his MICG team members repeatedly to recommend the bond to every customer with $50,000 in available cash. These are all factors that should have prompted Geraci to delve further into the firm's financial condition, and to assess the risk posed to investors by the potential failure of the firm.

Geraci did not "shed his independent suitability-related responsibilities" merely by consulting with firm personnel.[100] It was not enough for him to rely on the self-serving statements of Martinovich and MICG principals and to defer to their presumed knowledge of the investment they were urging him to recommend.[101]

C. The Recommendation Was Inordinately Risky

Geraci testified that the recommendation was suitable despite its risks, when he balanced those risks against the moderate and conservative nature of the rest of MGS's portfolio.[102] Geraci contends that $50,000 was not an inordinately large sum for MGS to commit, and points

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[98] Tr. 205.

[99] Tr. 207-08.

[100] *Cody*, *supra* note 72, at *25.

[101] *Kenneth R. Ward*, 56 S.E.C. 236, 264-65 (2003), *aff'd*, 75 F. App'x 320 (5th Cir. 2003)(the encouragement of others, even supervisors, does not relieve a representative from the fundamental duty to make sure a recommendation is suitable); *Dan King Brainard*, 47 S.E.C. 991, 996-97 (1983); *Patrick G. Keel*, 51 S.E.C. 282, 284-85 (1993).

[102] Tr. 279.

out that MGS's investment constituted only approximately nine percent of her total net worth. [103] Therefore, Geraci argues, MGS was capable of withstanding, and has withstood, the complete loss of her investment.[104]

Given MGS's overall circumstances, including her age, the size of her portfolio, and her net worth, the Panel disagrees and finds that $50,000 represented a significant portion of MGS's assets. Her $50,000 investment amounted to roughly 30 percent of the $166,000 she brought to MICG when Geraci became her advisor.[105] In addition, the bond was illiquid, leaving MGS with no ability to sell if a contingency arose and she needed funds.[106]

Even if the Panel were to agree that the bond purchase placed at risk a reasonably small portion of MGS's available assets, which she could afford to lose, that would not render Geraci's recommendation suitable. It is well established that the test for suitability depends upon the appropriateness of the recommendation for a particular investor, not on whether the investor can afford to lose the investment.[107]

For the reasons set forth above, therefore, the Panel finds that Geraci's recommendation to MGS was unsuitable, and that by making it, Geraci violated NASD Rule 2310, IM-2310-2, and FINRA Rule 2010, as alleged in the Complaint.

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[103] Tr. 238, 318.

[104] Respondent's Pre-Hearing Submission 5-6; Tr. 417 ("… she could afford to lose it, she is doing just fine.").

[105] MGS devoted $166,000 to Geraci's action plan for her. Tr. 212. $50,000 is approximately 31 percent of $166,000. Viewing it in the context of Geraci's action plan, JX-5, at 1, the bond investment constituted approximately 19 percent of her portfolio. The action plan reflects Geraci's recommendations that MGS retain $124,000 invested in "Conservative Growth Model," $80,000 in the long-term care policy, and $50,000 in the bond. The total portfolio therefore consists of $254,000 in investments. Viewed in either context, the Panel finds that the MICG bond investment represented a significant portion of MGS's assets.

[106] Tr. 312-14.

[107] *Larry Ira Klein*, 52 S.E.C. 1030, 1037-38 (1996); *David Joseph Dambro*, 51 S.E.C. 513, 517 (1993)(the fact that an investment amounted to only 2.5 percent of a customer's net worth did not make it suitable).

VIII. Sanctions

FINRA's Sanction Guidelines for unsuitable recommendations suggest a fine ranging from $2,500 to $75,000 and a suspension of ten business days to one year.[108] Enforcement requests a suspension of 20 business days, a fine of $2,500, and a restitution order. Enforcement concedes Geraci did not intentionally violate the suitability rule, but argues that the extent of his negligence in recommending the bond to "an elderly, unaccredited investor," and the resultant harm she suffered, requires a suspension.[109]

Not unexpectedly, Geraci deems Enforcement's recommended sanctions "improper and unjust." He argues that imposing any sanctions would be inappropriate.[110]

The Panel notes that the Sanction Guidelines "do not provide fixed sanctions for particular violations" and "are not intended to be absolute."[111] Indeed, the Sanction Guidelines explicitly state that we "may consider in determining, for each case, where within the range the sanctions should fall or whether sanctions should be above or below the recommended range."[112]

The Panel agrees with Enforcement that although Geraci was negligent, he did not intend the harm his recommendation caused to MGS. The Panel accepts the sincerity of Geraci's representation that he tried to do "the right thing" for MGS.[113] Furthermore, Geraci did not make his recommendation in order to reap a profit for himself. Geraci earned a fee of only $160.00 on MGS's investment; personal gain was not his motive.[114]

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[108] *FINRA Sanction Guidelines* 94 (2011).

[109] Complainant's Pre-Hearing Submission 11-12.

[110] Tr. 411.

[111] *Kent M. Houston*, Exchange Act Rel. No. 66014, 2011 SEC LEXIS 4491, at *26 (Dec. 20, 2011)(*quoting Guidelines*, at 1).

[112] *Guidelines*, at 1.

[113] Tr. 310.

[114] Tr. 282.

The Panel also concludes, based on his demeanor and the substance of his testimony, that Geraci accepts responsibility for making the recommendation that caused MGS's loss, and that he sincerely regrets the resulting economic injury.[115]

The Panel is mindful of the obligation, when appropriate, to order restitution.[116] "Where quantifiable customer harm has been demonstrated…[FINRA] generally will order restitution."[117] When a customer makes an unsuitable investment upon the recommendation of a representative, the representative responsible for the customer's loss should make the customer whole.[118] This is an appropriate case for doing so.

Taking these factors into consideration, the Panel imposes a suspension of two business days, and orders Geraci to pay restitution to MGS.

IX. Conclusion

For making an unsuitable recommendation, in violation of NASD Conduct Rule 2310, NASD IM-2310-2, and FINRA Conduct Rule 2010, the Panel suspends Respondent Jeffrey S. Geraci from associating in any capacity with any FINRA member firm for two business days, and orders him to pay restitution in full to MGS in the amount of $50,000, with interest.[119] Restitution shall be payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action.

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[115] Geraci acknowledged that MGS relied on his recommendation in making her investment. Tr. 238. He has apologized to MGS for her financial loss and offered to discuss repaying her for a portion of the loss. Tr. 322.

[116] *Guidelines*, at 4 (General Principles Applicable to All Sanction Determinations, No. 5).

[117] *NASD Notice to Members 99-86* (Oct. 1999).

[118] *Dambro, supra* note 108, at *14.

[119] MGS received one interest payment of $604.11 on April 7, 2010, representing a pro rata share of the first quarterly interest payment due her after investing on February 10, 2010. Tr. 302; JX-16, at 11. Therefore, interest should be computed from April 8, 2010, until the date of repayment. Interest shall be paid at the rate set forth in the Internal Revenue Code at 26 U.S.C. 6621(a)(2). The interest rate, which is used by the Internal Revenue Service to determine interest due on underpaid taxes, is adjusted each quarter and reflects market conditions. Customer MGS is identified in the Addendum to this Decision, which is served only on the parties.

If this Hearing Panel Decision becomes FINRA's final disciplinary action Respondent Geraci's suspensions shall become effective with the start of business on March 18, 2013, and terminate at the close of business on March 19, 2013.[120]

HEARING PANEL.

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By: Matthew Campbell
Hearing Officer

[120] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.