

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

MERRIMAC CORPORATE SECURITIES,
INC.
(CRD No. 35463),

Respondent.

Disciplinary Proceeding
No. 2009017195204

Hearing Officer—LBB

HEARING PANEL DECISION

Date: November 19, 2013

Based on the parties' stipulations, the Hearing Panel finds that Respondent violated NASD Rules 3010 and 2110 by failing to supervise the outside business activities and private securities transactions of two registered representatives; and that Respondent violated NASD Rules 3010 and 2110, and FINRA Rule 2010, by failing to establish, maintain, and enforce written supervisory procedures that were reasonably designed to supervise the activities of its registered representatives. As the parties stipulated, Respondent is required to retain a consultant to review its written supervisory procedures, and is fined \$100,000. The Hearing Panel finds that Respondent is able to pay the entire amount of the fine, but establishes a payment schedule due to Respondent's financial condition.

Appearances

Aida Vernon, Esq., and David M. Monachino, Esq., for the Department of Enforcement.
Richard Nummi, Esq., for the Respondent.

DECISION

I. Introduction

The only disputed issue in this proceeding is whether Respondent Merrimac Corporate Securities, Inc. ("Merrimac" or "the Firm") has the financial ability to pay a fine of \$100,000 for the violations charged in the Complaint. The parties stipulated that the factual allegations set forth in the Complaint, with minor modifications, are true, and that Respondent committed the violations charged. The parties also stipulated that the appropriate sanctions for Respondent's

violations are to require the Firm to retain a consultant to review its written supervisory procedures, and pay a \$100,000 fine. The issue of Respondent's alleged inability to pay the full amount of the fine was reserved for a hearing.

Based on the parties' stipulations, the Hearing Panel finds that Respondent committed the violations charged in the Complaint, and that the stipulated sanctions are appropriate for the violations charged in this disciplinary proceeding. The Hearing Panel finds that Respondent has the ability to pay the \$100,000 fine, and that imposing the full amount of the fine is appropriately remedial, but establishes a payment schedule because of Respondent's financial condition.

II. Procedural Background

The Department of Enforcement filed the two-cause Complaint in this disciplinary proceeding on June 28, 2012. The First Cause of Action charges Respondent with failing to supervise two registered representatives who were engaged in outside business activities and private securities transactions. The Second Cause of Action charges Respondent with failing to establish and maintain adequate written supervisory procedures with respect to the supervision of the types of activities in which the two representatives engaged.¹ Respondent answered the Complaint on July 26, 2012. On August 21, 2013, Enforcement and Merrimac entered into a set of stipulations that limited the scope of the hearing to the issue of Respondent's ability to pay the full amount of the stipulated fine. JX-16.²

A hearing was conducted on August 27, 2013, before a Hearing Panel composed of a former member of the District 5 Committee, a former member of the District 7 Committee, and a Hearing Officer. Respondent called Stephen Pizzuti, the president of the Firm, and Mark

¹ The Complaint also named as respondents David Walton Matthews, Jr., and Stephen Douglas Pizzuti. Both Matthews and Pizzuti settled before the hearing. Accordingly, their names have been deleted from the case caption.

² The parties' stipulations were received in evidence as JX-16. The stipulations are attached to this decision, and incorporated by reference as findings of the Hearing Panel.

Thomes, Merrimac's financial and operations principal ("FINOP"), as witnesses. Enforcement called Blake Snyder, a FINRA examiner.

III. Findings of Fact and Merrimac's Violations

The Hearing Panel adopts the findings of fact to which Respondent and Enforcement stipulated, which the parties summarized in their stipulation as follows:

1. During 2006 to April 2009 (the "Relevant Period"), the Firm failed to reasonably supervise outside business activities and private securities transactions of two registered representatives at Merrimac. JX-16, Stip. 1.
2. Richard Pizzuti and his partner Daniel Voccia ("Voccia") operated a company known as WPH and sold investments in WPH away from the Firm. Richard Pizzuti and Voccia solicited approximately 30 individuals to invest in WPH during the Relevant Period. The aggregate amount raised from those investors during that period was over \$4 million. Richard Pizzuti and Voccia arranged for investors, many of whom were Firm customers, to hold their WPH investments away from Merrimac's clearing firm with non-broker-dealer custodians ("Outside Custodians"). JX-16, Stip. 2.
3. Richard Pizzuti also solicited investments in a second outside business, CMC Properties LLC. Richard Pizzuti was an owner of CMC. JX-16, Stip. 3.
4. The Firm failed to adequately implement the Firm's procedures regarding participation in outside businesses and participation in private securities transactions. The Firm also failed to implement reasonable procedures regarding the use of Outside Custodians. JX-16, Stip. 4.
5. The Firm failed to adequately inquire into Richard Pizzuti's and Voccia's outside business activities and involvement in private securities transactions, despite personal

knowledge about both. It further failed to follow up on red flags regarding these activities. JX-16, Stip. 5.

6. The Firm failed to supervise Richard Pizzuti and Voccia, two former registered representatives who have since been barred from the industry. JX-16, Stip. 6.
7. Accordingly, Respondent violated NASD Rules 3010 and 2110 (Inadequate Supervision) during the Relevant Period. Respondent also violated NASD Rules 3010 and 2110 during 2006 through December 15, 2008, and FINRA Rule 2010 from December 15, 2008, to April 2009 (Deficient Written Supervisory Procedures). JX-16, Stip. 7.

The Hearing Panel has considered the stipulated facts and finds that they establish the violations set forth in the Complaint. Accordingly, the Hearing Panel finds that Respondent violated NASD Rules 3010 and 2110 by failing to supervise the outside business activities and private securities transactions of two registered representatives. The Hearing Panel also finds that Respondent violated NASD Rules 3010 and 2110, and FINRA Rule 2010, by failing to establish, maintain, and enforce written procedures that were reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable FINRA rules.

IV. The Stipulated Sanctions Are Appropriate

In summary, the parties stipulated that the appropriate sanctions are to require Merrimac to retain a consultant to review its policies, systems and procedures, and training relating to outside business activity and private securities transactions; adopt and implement the consultant's recommendations or propose alternative procedures; and to pay a fine of \$100,000.³

The Hearing Panel finds that the stipulated sanctions are appropriately remedial for the violations

³ The specific procedures to which the parties stipulated are set forth in detail in the concluding section of this decision and adopted by the Hearing Panel as appropriate for the implementation of the consulting arrangement to which the parties agreed.

to which the parties stipulated, and imposes these sanctions, subject to the determination of Respondent's ability to pay, which is discussed below.

A. The \$100,000 Fine Is Appropriately Remedial

The parties stipulated that a \$100,000 fine is an appropriate sanction. The Hearing Panel has considered the stipulated facts and the FINRA Sanction Guidelines,⁴ and finds that the \$100,000 fine is appropriately remedial.

For failure to supervise, the Sanction Guidelines recommend a fine of \$5,000 to \$50,000.⁵ The Principal Considerations are:

1. Whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny. Consider whether individuals responsible for underlying misconduct attempted to conceal misconduct from respondent.
2. Nature, extent, size and character of the underlying misconduct.
3. Quality and degree of supervisor's implementation of the Firm's supervisory procedures and controls.

For deficient written supervisory procedures, the Sanction Guidelines recommend a fine of \$1,000 to \$25,000.⁶ The relevant Principal Consideration is whether deficiencies in the written supervisory procedures allowed violative conduct to occur or to escape detection.

Although the total stipulated fine is slightly above the combined amount recommended by the Sanction Guidelines for the two violations, the Hearing Panel finds that the amount of the fine is reasonable. Merrimac failed to supervise two representatives who raised more than \$4 million from investors in their activities away from the Firm over a three-year period. JX-16, Stip. 1, 2, 18. The Firm failed to follow up on red flags. For example, it did not follow up on

⁴ FINRA Sanction Guidelines (2011), *available at* www.finra.org/Industry/Enforcement/SanctionGuidelines.

⁵ Sanction Guidelines at 103. Greater sanctions are recommended for egregious violations. The Hearing Panel does not find that Respondent's violations were egregious.

⁶ Sanction Guidelines at 104. The Hearing Panel does not find that the deficiencies in the written supervisory procedures constituted an egregious violation, for which the recommended sanctions would be greater.

allegations on a website that one of the outside business activities was a Ponzi scheme. JX-16, Stip. 5, 39, 51, 52. In addition, the Firm did not follow its own procedures. For example, it did not require the representatives to seek written permission to engage in one of their outside business activities, or to submit a detailed written notice to the Firm of their involvement in the management of the outside activities. JX-16, Stip. 32, 36. The Firm also failed to take other steps to determine the nature of the outside business activities and to review the activities. See, e.g., JX-16, Stip. 37-38, 40, 41, 44-46.

The stipulations are sufficient to establish that deficiencies in Merrimac's written supervisory procedures allowed violative conduct to escape detection. It did not have systems in place to prevent brokers from using outside custodians to engage in selling away, or to require brokers to provide documentation of customer assets held with outside custodians. JX-16, Stip. 48-50.

In addition to the stipulations that are relevant to the determination of sanctions, the Hearing Panel considered Respondent's disciplinary history. In 2010, a hearing panel found that the Firm had committed a number of violations, a decision affirmed by the Board of Governors in 2012.⁷

The Hearing Panel finds that the \$100,000 fine to which the parties stipulated is appropriately remedial under the facts of this matter.

⁷ See *Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2007007151101 (O.H.O. Dec. 8, 2010), *aff'd*, 2012 FINRA Discip. LEXIS 43 (B.O.G. May 2, 2012) ("*Merrimac I*"). The Board of Governors summarized the findings as follows: "Firm violated FINRA rules by: (1) selling four categories of securities not permitted under its membership agreement; (2) maintaining inadequate supervisory procedures with respect to the sale of certain securities; (3) willfully failing to preserve e-mails; and (4) failing to maintain and keep purchase and sale blotters for its direct application mutual fund and variable annuity businesses."

B. The Required Review of Respondent’s Written Supervisory Procedures by a Qualified Consultant Is Appropriate

A requirement to retain a consultant is explicitly referenced in the Sanction Guidelines as an example of a sanction that may be imposed in an appropriate case.⁸ The retention of a consultant has been required in other cases.⁹ The Hearing Panel finds that due to the deficiencies in Respondent’s written supervisory procedures to which the parties have stipulated, the retention of a consultant is appropriate. The Hearing Panel requires Respondent to retain a consultant under the terms set forth in the parties’ stipulation.

V. Principles Applicable to Modifying Sanctions Based on Respondent’s Financial Condition

FINRA’s Sanction Guidelines require adjudicators to consider a respondent’s assertion that it is unable to pay a fine when properly raised by the respondent. “Adjudicators are required to consider a respondent’s *bona fide* inability to pay when imposing a fine or ordering restitution.”¹⁰

“It is well settled that a respondent bears the burden of demonstrating his or her inability to pay, and that [FINRA] is entitled to make a searching inquiry into any such claim.”¹¹ The burden of proof for a firm to establish an inability to pay is high. The firm “must be required to demonstrate that the fine or award is so large in relation to its actual capital that it is unable to obtain the additional capital to pay the fine or award by, among other things, reducing expenses

⁸ See Sanction Guidelines at 3 (authorizing adjudicators to craft appropriate sanctions, including those that “require a respondent firm to retain a qualified independent consultant to design and/or implement procedures for improved future compliance with regulatory requirements.”)

⁹ See, e.g. *ACAP Financial, Inc.*, Exchange Act Rel. No. 70046, 2013 SEC LEXIS 2156 (July 26, 2013).

¹⁰ Sanction Guidelines at 5.

¹¹ *Robert Tretiak*, Exchange Act Rel. No. 47534, 2003 SEC LEXIS 653, at *17 (Mar. 19, 2003) (rejecting defense of inability to pay arbitration award).

and salaries, raising capital, and/or borrowing money.”¹² Proof of an inability to pay, or that a fine will cause a firm to have a net capital deficiency, does not necessarily require adjudicators to reduce the amount of a sanction.¹³ “To protect investors and insure market integrity, sanctions must be commensurate with a respondent’s violative conduct.”¹⁴ Even if a respondent establishes that it is unable to pay the appropriate fine, “[p]roof of inability to pay need not result in a reduction or waiver of a fine, restitution or disgorgement order, but could instead result in the imposition of an installment payment plan or another alternate payment option.”¹⁵ Furthermore, the amount of a firm’s excess net capital is not a limitation on the amount of a fine that a firm should be required to pay. “A determination of ability to pay based solely on a firm’s minimum capital requirement would mean that both the SEC and [FINRA] would be precluded from imposing any monetary sanction on a broker/dealer in excess of its minimum capital requirement, thereby precluding them from effectuating the deterrence objective of appropriate sanctions.”¹⁶

VI. Merrimac Has the Ability to Pay a \$100,000 Fine on an Extended Payment Schedule

Respondent does not have sufficient funds, or the ability to raise funds quickly, to pay a \$100,000 fine within the time typically required for the payment of a fine. Respondent does have the ability pay the fine over time by cutting expenses.

Merrimac’s total revenue for the fiscal year ended September 30, 2012, was just over \$3 million, with a net loss of \$7,065. It ended the year with required net capital of \$18,384, and

¹² *Dist. Bus. Conduct Comm. v. Escalator Sec., Inc.*, No. C07930034, 1998 NASD Discip. LEXIS 21, at *12-13 (N.B.C.C. Feb. 19, 1998); *Merrimac I*, 2012 FINRA Discip. LEXIS 43, at *43-44.

¹³ *Merrimac I*, 2012 FINRA Discip. LEXIS 43, at *44.

¹⁴ *Merrimac I*, 2012 FINRA Discip. LEXIS 43, at *44.

¹⁵ Sanction Guidelines at 5.

¹⁶ *Escalator Sec.*, 1998 NASD Discip. LEXIS 21,*14 n.3; *see also Merrimac I*, 2012 NASD Discip. LEXIS 43, at *44-45.

excess net capital of \$28,814. RX-1. The Firm's revenue declined in the four months preceding the hearing. Its excess net capital during that period declined from \$55,000 to \$13,000. Tr. 154 (Thomes). The decline in revenue was attributable to a variety of factors, including problems experienced by Merrimac's clearing firm, the departure of two representatives who were strong producers, and economic factors. Tr. 184-186 (Thomes).

Merrimac has other issues that are likely to require expenditures. It is a respondent in pending arbitrations, and in another FINRA disciplinary matter. Tr. 133, 139, 141 (Pizzuti). In addition, the Firm will have expenses for the consultant imposed as a sanction in this matter.

Although Merrimac has not tried to raise capital, Pizzuti and Thames both testified that due, at least in part, to the Firm's FINRA issues, it is unlikely that the Firm can raise capital. Tr. 65 (Pizzuti), 165-166 (Thomes). It has no assets to post as collateral for a loan, and Pizzuti does not think the Firm can obtain a loan. Tr. 67 (Pizzuti). Given the Firm's current financial condition, the expenses of defending the arbitrations and the FINRA disciplinary action, the potential liability in those matters, and the expenses for the consultant required by this decision, the Hearing Panel also finds that it is unlikely that the Firm could raise sufficient capital or borrow enough to pay a \$100,000 fine in a short period of time.

The Firm has not attempted to borrow money. Pizzuti recently attempted to obtain a personal loan, but his bank declined to lend him \$10,000. RX-29; Tr. 43-44, 131 (Pizzuti). He cashed in his life insurance policy and 401(k) to support the Firm, and he has a \$100,000 IRS lien. Tr. 47, 89, 129 (Pizzuti). His attempt to obtain a loan was something of a perfunctory effort, but given his personal financial situation, it is unlikely that a more thorough search for a loan would lead to a substantially different result. If he were successful in borrowing any

money, it is unlikely that he would be able to borrow enough to enable the Firm to pay a \$100,000 fine.

The Hearing Panel finds that Merrimac does not have the financial ability to pay a \$100,000 fine in the short run. However, the Firm can cut certain expenses, largely personnel costs, including the commissions paid to Pizzuti. Merrimac has six employees. Their salaries range from about \$18,000 for administrative staff, to about \$120,000 for the Firm's FINOP, who also performs other duties, such as maintaining the Firm's information technology systems. Tr. 57-62 (Pizzuti). Overall, the level of compensation is modest, and there is not much that can be cut from salaries. However, if necessary, the Firm might be able to eliminate at least one position. Tr. 64 (Pizzuti). The FINOP's salary could be cut by a small amount, at least in the short term. Tr. 57 (Pizzuti). Merrimac has been paying a consultant approximately \$5,000 monthly, largely to respond to FINRA's requests for information. The Firm could reduce or eliminate the expense of the consultant, and has given the consultant notice that his services will not be required. Tr. 63-64, 143 (Pizzuti), 167 (Thomes).

The Firm has already raised fees to its brokers and reduced its payouts. Tr. 67-68 (Pizzuti). The Firm paid its representatives an average payout of about 78% of their commissions last year, but it has paid less in previous years. It pays a higher percentage to outside representatives, because they are responsible for more of their own expenses. Tr. 106 (Pizzuti), 155 (Thomes). It is unclear that Merrimac could pay its representatives less, or charge them more, without losing representatives. The Hearing Panel does not find that Merrimac could cut the commission payouts to its brokers.

In addition to the funds the Firm could raise by reducing personnel costs and the expense of the consultant who has been responding to FINRA requests, Merrimac could raise funds to

pay a fine by reducing the payout to Pizzuti. The Firm currently pays Pizzuti 100% of his commissions, partly due to Pizzuti's personal financial situation. Thomes plans to reduce the payout when Pizzuti's commissions increase. Tr. 154 (Thomes). Pizzuti reported income of \$148,344 in 2011. In 2012 and 2013, the Firm made substantial payments to Pizzuti and an entity he owns that performs services for Merrimac. Although it is unclear how much was income, as opposed to funds used for paying expenses of the Firm, the reduction in commission payments to less than 100% should provide additional funds for Merrimac. CX-82, CX-98, CX-99, CX-101, CX-102; Tr. 198-202 (Snyder), 103-104 (Pizzuti).

Typically a fine is payable on a date set by FINRA, but not less than 30 days after the hearing panel's decision becomes FINRA's final disciplinary action in the matter. The Hearing Panel finds that Merrimac would not be able to pay a \$100,000 fine in that amount of time. However, by reducing its consultant expenses, perhaps reducing staff, temporarily reducing the FINOP's salary, and reducing the payout to Pizzuti, the Firm should be able to make a payment of \$10,000 per month, especially if the first payment is delayed. Accordingly, the Hearing Panel imposes a fine of \$100,000, payable in ten installments of \$10,000. The first payment shall be due 60 days after the Hearing Panel's decision becomes FINRA's final decision. The second payment shall be due on the first business day of the next month, but not less than 30 days after the initial payment. Each subsequent payment shall be due on the first business day of each month thereafter.

VII. Order

The Hearing Panel imposes the sanctions to which the parties agreed, but modifies the payment schedule for the fine imposed.

A. The Hearing Panel Imposes the \$100,000 Fine and Establishes a Payment Schedule

The Hearing Panel imposes a fine of \$100,000, payable in ten installments of \$10,000, as follows:

1. The first payment shall be due 60 days after the Hearing Panel's decision becomes FINRA's final decision.
2. The second payment of \$10,000 shall be due on the first business day of the next month, but not less than 30 days after the initial payment.
3. Merrimac shall pay \$10,000 on the first business day of each subsequent month until it has paid a total fine of \$100,000.¹⁷

B. Merrimac Shall Retain a Consultant to Review Its Written Supervisory Procedures

The Hearing Panel finds that the retention of a consultant, under the terms to which the parties stipulated, is appropriate, and imposes the following requirements on Merrimac:

1. Merrimac shall:
 - a. Retain, within 30 days of the date of the conclusion of the hearing in this Disciplinary Proceeding,¹⁸ an Independent Consultant, not unacceptable to FINRA staff, to conduct a comprehensive review of the adequacy of the Firm's policies, systems and procedures (written and otherwise), and training relating to outside business activity and private securities transactions;
 - b. Exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant;
 - c. Cooperate with the Independent Consultant in all respects, including by providing staff support. Merrimac shall place no restrictions on the

¹⁷ FINRA may modify the payment schedule by extending, but not shortening, the time for any payments required by this decision.

¹⁸ "Conclusion of this Disciplinary Proceeding" is not defined in the stipulation. If Respondent has not yet implemented the undertakings required by the stipulation, Respondent is ordered to implement them within 30 days after the Hearing Panel's decision becomes FINRA's final disciplinary action in the matter, unless extended by FINRA staff pursuant to the terms of the parties' stipulation.

Independent Consultant's communications with FINRA staff and, upon request, shall make available to FINRA staff any and all communications between the Independent Consultant and the Firm and documents reviewed by the Independent Consultant in connection with his or her engagement. Once retained, Merrimac shall not terminate the relationship with the Independent Consultant without FINRA staff's written approval; Merrimac shall not be in and shall not have an attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports, or documents to FINRA;

- d. At the conclusion of the review, which shall be no more than 90 days after the date of the conclusion of the hearing in this Disciplinary Proceeding, require the Independent Consultant to submit to the Firm and FINRA staff a Written Report, require the Independent Consultant to submit to the Firm and FINRA staff a Written Report. The Written Report shall address, at a minimum: (i) the adequacy of the Firm's policies, systems, procedures, and training relating to outside business activities and private securities transactions; (ii) a description of the review performed and the conclusions reached; and (iii) the Independent Consultant's recommendations for modifications and additions to the Firm's policies, systems, procedures and training; and
 - e. Require the Independent Consultant to enter into a written agreement that provides for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any other employment, consultant, attorney-client, auditing or other professional relationship with Merrimac, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any firm with which the Independent Consultant is affiliated in performing his or her duties pursuant to the undertaking shall not, without prior written consent of FINRA staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Merrimac or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.
2. Within 30 days after delivery of the Written Report, Merrimac shall adopt and implement the recommendations of the Independent Consultant or, if it determines that a recommendation is unduly burdensome or impractical, propose an alternative procedure to the Independent Consultant designed to achieve the same objective. The Firm shall submit such proposed alternatives in writing simultaneously to the Independent Consultant and FINRA staff. Within 30 days of receipt of any proposed alternative procedure, the Independent Consultant shall: (i) reasonably evaluate the alternative procedure and determine whether it will achieve the same objective as the Independent Consultant's original recommendation; and (ii) provide the Firm with a written decision reflecting his or her determination. The Firm will abide by the Independent Consultant's ultimate determination with respect to any proposed alternative procedure and must adopt and implement all recommendations deemed

appropriate by the Independent Consultant.

3. Within 30 days after the issuance of the later of the Independent Consultant's Written Report or written determination regarding alternative procedures (if any), Merrimac shall provide FINRA staff with a written implementation report, certified by an officer of Merrimac, attesting to, containing documentation of, and setting forth the details of the Firm's implementation of the Independent Consultant's recommendations.
4. Upon written request showing good cause, FINRA staff may extend any of the procedural dates set forth above.

Merrimac is also ordered to pay the costs of the hearing in the amount of \$2,599.21, which includes a \$750 administrative fee and the cost of the transcript. The cost shall be payable on a date set by FINRA, but not less than 60 days after this decision becomes FINRA's final disciplinary action in this matter.

HEARING PANEL.

Lawrence B. Bernard
Hearing Officer

Copies to: Stephen Douglas Pizzuti (*via overnight courier and first-class mail*)
Richard Nummi, Esq. (*via electronic and first-class mail*)
Aida Vernon, Esq. (*via electronic and first-class mail*)
David M. Monachino, Esq. (*via electronic mail*)
Jeffrey D. Pariser, Esq. (*via electronic mail*)