BEFORE THE BOARD OF GOVERNORS

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Merrimac Corporate Securities, Inc., Respondent.	DECISION Complaint No. 2007007151101 Dated: May 2, 2012

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. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Leo F. Orenstein, Esq., David B. Klafter, Esq., Michael A. Gross, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Alan M. Wolper, Esq., Martin W. Jaszczuk, Esq., Locke Lord Bissell & Liddell LLP

Decision

Pursuant to FINRA Rule 9311, Merrimac Corporate Securities, Inc. ("Merrimac") appeals a FINRA Hearing Panel's December 8, 2010 decision. The Hearing Panel found that Merrimac: (1) violated NASD Rules 1017 and 2110 by selling four categories of securities that the firm was not permitted to sell pursuant to its membership agreement; (2) violated NASD Rules 3010 and 2110 by having inadequate supervisory procedures for sales of the four categories of securities and variable annuities; (3) willfully violated Section 17(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110 by failing to maintain adequate books and records with respect to electronic communications; and (4) willfully violated Section 17(a) of the Exchange Act, Exchange Act Rules 17a-3 and 17a-4, and NASD Rules 3110 and 2110 by failing to maintain

and keep purchase and sale blotters for its direct application mutual fund and variable annuity businesses.[1] For these violations, the Hearing Panel fined Merrimac $18,500.

After an independent review of the record, we affirm the Hearing Panel's findings and uphold the sanctions imposed.

I. Background

Merrimac became a FINRA member in 1993. Merrimac currently operates a general retail securities business and employs approximately 60 registered persons and one non-registered person. Stephen Pizzuti ("Pizzuti"), David Matthews ("Matthews"), and Mark Thomes ("Thomes") serve on Merrimac's management team. Pizzuti served as a branch manager for Merrimac from 2003 to 2008 and has been Merrimac's chief executive officer since 2008. Between approximately 2003 and 2007, Matthews served as Merrimac's president and chief compliance officer. Since 2003, Thomes has served as Merrimac's chief financial officer and Financial and Operations Principal ("FINOP"). Thomes also was in charge of preserving the firm's business-related communications, including e-mails, during the relevant time period.[2]

II. Procedural History

The Department of Enforcement ("Enforcement") filed a five-cause complaint in this matter on September 24, 2009. Cause one of the complaint alleged that Merrimac sold private placements, REITs, limited partnerships, and direct participation programs (the "Four Products") that the firm was not permitted to sell under its membership agreement, thereby violating the terms of its membership agreement and NASD Rules 1017 and 2110. Cause two alleged that Merrimac did not establish, maintain, or enforce written procedures to supervise the sale of the Four Products, thereby violating NASD Rules 3010(a), 3010(b), and 2110. Cause three alleged that Merrimac did not establish, maintain, or enforce written procedures to supervise the variable annuity business in which it engaged, thereby violating NASD Rules 3010(a), 3010(b), and 2110. Cause four alleged that, between 2004 and October 2006, Merrimac did not properly preserve all of its business-related e-mails in electronic format because the firm did not preserve incoming e-mails on its server, and the outgoing e-mails stored on its server were not stored in a non-rewriteable, non-erasable format. Cause four also alleged that, between 2004 and October 2006, Merrimac did not properly preserve all of its business-related e-mails in hard copy because the firm did not preserve all the required business-related e-mails, and the hard copy business-related e-mails that were preserved were not preserved in an easily accessible place. Cause four further alleged that, between November 2006 and October 2007, Merrimac did not preserve its business-related e-mails in a non-rewriteable, non-erasable format. For failing to properly preserve all of its business-related e-mails, cause four alleged that Merrimac willfully violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110.

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[1] The conduct rules that apply are those that existed at the time of the conduct at issue.

[2] The relevant conduct occurred between 2004 and October 2007 unless otherwise noted.

Cause five alleged that Merrimac failed to maintain itemized daily blotters for its direct application mutual fund and variable annuity business, thereby willfully violating Section 17(a) of the Exchange Act, Exchange Act Rules 17a-3 and 17a-4, and NASD Rules 3110 and 2110.

The Hearing Panel found in favor of Enforcement with respect to all causes. Merrimac appealed the Hearing Panel's findings and sanctions with respect to causes one, four, and five.

III. Facts

A. The Continuing Membership Application

In about 1993, Pizzuti formed Allen Douglas Securities ("Allen Douglas"), a FINRA member firm. The management team at Allen Douglas consisted of Pizzuti, Matthews, and Thomes. Allen Douglas was a full-service retail brokerage firm, selling stocks, bonds, options, and the Four Products. Allen Douglas's membership agreement permitted it to sell the Four Products.

In 2003, Pizzuti sought to acquire another firm primarily to conduct online business, and he identified Merrimac as meeting his requirements. Like Allen Douglas, Merrimac at the time was permitted to sell the Four Products. Merrimac filed a Continuing Membership Application ("CMA") with FINRA that sought approval for a change in ownership and management to permit Team Advisory Corporate, Inc. ("Team Advisory") to purchase Merrimac and the Allen Douglas management team to operate the firm.[3]

On June 5, 2003, FINRA staff sent a letter to Merrimac requesting information and documentation pertaining to Merrimac's CMA. Among other things, the letter requested additional information regarding the underwriting activities and private placement activities to be undertaken at Merrimac. On July 3, 2003, Matthews responded on behalf of Merrimac and represented that Merrimac would not engage in underwriting or private placement activities. He wrote: "With respect to the proposed underwriting activities, and private placement activities, we respectfully request deferring these activities until a later time period. Accordingly, our business plan has been amended to exclude these functions." In a previous paragraph of the same letter, however, Matthews appeared to suggest that Merrimac intended to include the sale of private placements in its business plan. Specifically, Matthews wrote: "The firm plans to offer on-line, all of the products and services described in our business plan. These include . . . private placements, and best efforts underwriting." Matthews testified that he intended to say in the letter, and believes the letter did in fact convey, that Merrimac did not intend to underwrite private placements, but the firm did intend to sell private placements.

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[3] Team Advisory is owned by Kristen Pizzuti, Stephen Pizzuti's wife. Thomes is Kristen Pizzuti's brother. Kristen Pizzuti does not have any securities licenses.

On July 11, 2003, FINRA staff conducted a membership interview with Pizzuti, Matthews, and Thomes, who comprised the prospective management team for Merrimac.[4] At the interview, Pizzuti, Matthews, and Thomes told FINRA staff that Merrimac wanted to continue to sell the Four Products and conduct the same types of business that Allen Douglas was authorized to conduct, including selling the Four Products. Thomes testified that Merrimac did not receive approval to conduct any particular type of business at the interview, but he assumed Merrimac would be approved to sell the Four Products.

B. The Membership Agreement

Merrimac's new membership agreement did not authorize Merrimac to sell the Four Products. On September 8, 2003, Matthews, as Merrimac's president, and Thomes, as Merrimac's FINOP, signed the membership agreement. By executing the membership agreement, Matthews and Thomes certified that the information contained therein was "currently accurate and complete" and further "[agreed] that the information contained in the [Uniform Application for Broker-Dealer Registration ("Form BD")] will be kept current and accurate."

The membership agreement provided that Merrimac would engage in the following types of business:

- Broker retailing corporate debt securities;
- Broker retailing corporate equity securities over-the-counter on an agency or riskless principal basis;
- U.S. government securities broker;
- Investment advisory services;
- Mutual fund retailer on an application basis or through a clearing firm;
- Municipal securities broker;
- Non-exchange member arranging for transactions in listed securities by exchange member;
- Put and call broker;
- Broker selling variable life insurance or annuities; and
- Provider of online brokerage services through a clearing firm.

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[4] FINRA staff may require a member that has filed a CMA to participate in a membership interview. NASD Rule 1017(f)(1). During the membership interview, FINRA staff reviews the application with the member. NASD Rule 1017(f)(4). FINRA staff issues a written decision on the application within 30 days after the membership interview or the filing of additional information or documents. NASD Rule 1017(g)(2).

The membership agreement further provided: "Any activity that does not conform to the provisions set forth in this Agreement may form the basis for disciplinary action by [FINRA] against Merrimac, its owners, or associated persons." The agreement remained in effect and bound Merrimac, unless the agreement was "changed, removed, or modified pursuant to applicable [FINRA] rules."

C. Communications Regarding the Scope of Merrimac's Business Activities

Matthews testified that Allen Douglas ceased to exist on December 31, 2003. In 2004, several Allen Douglas representatives sought to register with Merrimac, and Allen Douglas sought to transfer the majority of its customer accounts to Merrimac.[5] On May 17, 2004, FINRA staff sent two letters to Matthews. The subject matter of one letter read: "Continuing Membership Application for Allen Douglas." In this letter, FINRA advised Matthews that Allen Douglas's application to transfer substantially all of its assets to Merrimac was not complete and requested additional information so FINRA could process the application. The subject matter of the other letter read: "Materiality of Change in Business Operations and Management for Merrimac." In this letter, FINRA advised Matthews:

> [FINRA] concluded that the [asset transfer arrangement between Allen Douglas and Merrimac] did not constitute a material change in operations. As a result, your firm is not required to file an application pursuant to NASD Rule 1017. This determination is based upon representations made to the staff by the firm regarding the proposed change.

Matthews testified that FINRA was confused in the first letter, but Matthews believed FINRA acknowledged in the second letter that Merrimac indeed could sell the Four Products.

On November 11, 2004, Thomes filed an amended Form BD on behalf of Merrimac. In section 12 of the form, Thomes checked off those types of business in which Merrimac engaged. On January 26, 2005, a FINRA examiner advised Merrimac by e-mail that certain types of business checked off on Merrimac's Form BD should be removed from the firm's Form BD.[6] The e-mail provided: "Per our conversation, the following items are not listed as approved business activities for the firm per its membership agreement and should be removed from the firm's Form BD." The e-mail listed the following types of business: "(1) Underwriter/selling group participant; (2) US government securities dealer; (3) Broker or dealer selling tax shelters

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[5] A FINRA member must file an application for approval of the direct or indirect acquisition or transfer of 25 percent or more of the member's assets. Rule 1017(a)(3).

[6] The e-mail was sent to "L. Benally," a Merrimac operations employee, but text within the body of the e-mail was addressed to Matthews. Benally delivered the e-mail to Thomes because it referred to the firm's Form BD and Thomes was responsible for the Form BD. Although the body of the e-mail was addressed to Matthews, Matthews testified he never saw the e-mail. Thomes testified he discussed the e-mail with Matthews.

or limited partnerships primary distribution; (4) Broker or dealer selling tax shelters or limited partnerships in the secondary market; (5) Private placement of securities."

Thomes testified that he had a conversation with this FINRA examiner, who provided Thomes with a copy of the firm's membership agreement and told Thomes to remove various business lines from the firm's Form BD. Thomes testified that, before that conversation, he never knew the membership agreement and Form BD needed to correspond.

On March 8, 2005, Thomes filed an amended Form BD. Thomes unchecked the boxes for "Underwriter or selling group participant (other than mutual funds)," "Broker or dealer selling tax shelters or limited partnerships in the secondary market," and "Private placement of securities," thereby acknowledging that Merrimac did not engage in those types of business. On April 11, 2005, Thomes filed another amended Form BD, this time removing "Broker or dealer selling tax shelters or limited partnerships in primary distributions."[7]

In November 2005, nearly 10 months after FINRA staff notified Merrimac that certain lines of business on Merrimac's Form BD were not listed as approved business activities on Merrimac's membership agreement, Matthews wrote two letters to FINRA's Boca Raton office concerning the types of business in which Merrimac was authorized to engage.[8] In the November 8, 2005 letter, Matthews wrote, "[i]n routine review of our B/D CRD, it is probably a good idea for us to clarify activities in which the firm may engage relative to Membership Agreement B (3) item two." Matthews described a private placement transaction and asserted Merrimac's classification of a private placement as an "Other" type of business on the firm's Form BD "[was] not really a material change in our business mix." Matthews then requested

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[7] At the hearing, Thomes testified that he had a general idea about what products Merrimac sold because he, as the firm's FINOP, received all the funds for commissions. Thomes testified that after he made the amendments to the Form BD, Merrimac did not sell anything he believed were private placements or limited partnerships. Thomes did not believe that the investments Merrimac sold were private placements because Merrimac's investments were registered with the Commission, which, to him, meant that they were not private companies, but public companies. Thomes also testified that the investments looked more like they were retail and corporate securities sold over the counter or broker or dealer selling debt securities, all of which were types of business in which Merrimac engaged and which were checked off on its Form BD.

[8] It is unclear why Matthews wrote the letters. Matthews testified he wrote the letters because he believed that Merrimac was approved to sell private placements and wanted to be sure that he and FINRA were on the same page. Matthews also testified Thomes was responsible for the firm's Form BD and he was unaware that Thomes had removed various business lines from the Form BD. Later Matthews testified he wrote the letters because he was aware that Thomes spoke with FINRA about the firm's Form BD and Thomes told him there was a need to clarify the activities permitted under the membership agreement.

that "this B/D CRD clarification be done without a [NASD] Rule 1017 filing."[9] Matthews did not receive a response to this letter. In the November 14, 2005 letter, Matthews acknowledged that Merrimac's membership agreement did not permit it to sell private placements and requested that its continued sale of private placements not be considered a material change subject to the provisions of NASD Rule 1017. Matthews again did not receive a response.

Matthews testified that, based on the July 2003 membership interview and the lack of negative response to his letters, he assumed that Merrimac could sell private placements without filing a CMA. Matthews testified that as of November 2005, he knew Merrimac was not approved to sell private placements under its membership agreement, but after receiving no response to his letters he "considered the matter documented."

In October 2007, FINRA conducted a routine examination of Merrimac. During this examination, a FINRA examiner requested documents from Thomes about Merrimac's private placement activities. On October 19, 2007, while the examiner was on site at Merrimac, Merrimac amended its Form BD to provide that Merrimac sold private placements. Shortly thereafter, the examiner told Merrimac to stop selling the Four Products and to file a CMA to seek permission from FINRA to sell the Four Products. Merrimac complied, and ultimately it was approved to sell the Four Products.

D. Merrimac Sold the Four Products

Between 2004 and September 2007, Merrimac sold the Four Products. The total sales for the Four Products were $25,020,994.12, and Merrimac received $1,723,922.59 in commissions for the sales during this timeframe.

IV. Discussion

A. Merrimac's Membership Agreement

For the reasons discussed below, we affirm the Hearing Panel's finding that Merrimac violated NASD Rules 1017 and 2110 by selling the Four Products in violation of its membership agreement.

1. NASD Rule 1017

NASD Rule 1017(a)(5) requires firms to file an application with FINRA's Department of Member Regulation ("Member Regulation") for approval of any material change in business operations. A firm is prohibited from implementing a material change in business operations

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[9] In his letter, Matthews confused the Form BD and the membership agreement. The Form BD lists specific types of business in which a firm believes it is engaged, and a membership agreement provides the types of business in which a firm has been authorized by FINRA to engage.

unless the change is approved by FINRA, either by agreement with Member Regulation or as a result of a membership proceeding. NASD Rule 1017(g), (i).

NASD Rule 1011(k) defines "material change in business operations" as "[including], but . . . not limited to: (1) removing or modifying a membership agreement restriction; (2) market making, underwriting, or acting as a dealer for the first time; and (3) adding business activities that require a higher minimum net capital under SEC Rule 15c3-1." In an October 2000 Notice to Members ("Notice"), FINRA noted it was not possible "to develop an exhaustive definition of the term 'material change in business operations.'" *NASD Notice to Members 00-73*, 2000 NASD LEXIS 82, at *8 (Oct. 2000). The Notice provided that, "[i]n instances when a member intends to add a line of business, staff experience has shown that this type of expansion is often a significant event that has an impact on the firm's supervisory and compliance infrastructure, personnel, and/or finances." *Id.* at *9. Whether an expansion into a particular line of business constitutes a material change "[is] to be evaluated on a facts and circumstances, case-by-case basis." *Id.* at 7.

The Notice set forth a non-exhaustive list of criteria that may be considered when determining whether the addition of a line of business amounted to a material change in business operations:

- the nature of the proposed expansion;
- the relationship, if any, between the proposed new business line and the firm's existing business;
- the effect the proposed expansion is likely to have on the firm's capital;
- the qualifications and experience of the firm's personnel; and
- the degree to which the firm's existing financial, operational, supervisory, and compliance systems can accommodate the proposed new business line.

Id. at *9.

2. The Sale of the Four Products Was a Material Change

Merrimac's membership agreement—which described Merrimac's authorized, existing business—did not permit Merrimac to sell the Four Products. Although firms are not strictly limited to engaging in the lines of business explicitly listed in their membership agreement, *see id.* at *10, the Four Products each have features that make them materially different from the ordinary equities that Merrimac was approved to sell in accordance with its membership agreement.

Merrimac concedes that there are various differences between ordinary equities and the Four Products, but Merrimac asserts it did not materially change its business operations because both Allen Douglas and Merrimac, prior to its acquisition by Team Advisory, were approved to sell the Four Products. Merrimac is incorrect. Although it is undisputed that both Allen Douglas and Merrimac, prior to its acquisition by Team Advisory, were approved to sell the Four Products, that background is irrelevant. The issue is what Merrimac was approved to sell under its membership agreement.

Merrimac's membership agreement did not allow Merrimac to sell the Four Products. A key purpose of creating a written membership agreement is to provide FINRA and the member with a memorialization of the specifics of the agreement. Merrimac cannot escape the express language of the membership agreement by arguing that its principals failed to read it carefully or understand its express terms. Merrimac further cannot escape the express language of the membership agreement by relying on its intention to communicate in the July 3, 2003 letter, and at the July 11, 2003 membership interview, that Merrimac planned to sell the Four Products. Merrimac's principals executed the membership agreement after the July 3, 2003 letter and membership interview, and Merrimac is bound by the terms of the agreement. By executing the membership agreement, Merrimac's principals certified that the information contained therein was accurate, current, and complete and agreed that Merrimac's failure to conform to the terms set forth in the agreement could form the basis of a disciplinary action by FINRA.

Merrimac also argues that it relied on the March 17, 2004 letter from FINRA staff that it was not required to file an application pursuant to NASD Rule 1017. The March 17, 2004 letter addresses the fact that personnel and other assets from Allen Douglas would be transferred to Merrimac. The letter concludes that a NASD Rule 1017 application with respect to the asset transfer was not necessary provided that Merrimac's activities remained the same and Merrimac complied with certain conditions. The letter did not conclude that Merrimac did not need to file a NASD Rule 1017 application with respect to adding new lines of business (e.g., selling the Four Products).

Merrimac further argues that FINRA's failure to respond to Merrimac's November 2005 letters excused Merrimac's conduct. We reject Merrimac's attempt to shift responsibility to FINRA. FINRA was not obligated to inform Merrimac that it disagreed with Merrimac's conclusion that the sale of the Four Products did not amount to a material change. Merrimac cannot use FINRA's silence as approval to conduct lines of business that were not permitted under its membership agreement. *See Dep't of Enforcement v. FCS Secs.*, Complaint No. 2007010306901, 2010 FINRA Discip. LEXIS 9, at *18 (FINRA NAC July 30, 2010), *aff'd*, Exchange Act Rel. No. 64852, 2011 SEC LEXIS 2366 (July 11, 2011) (holding that respondent could not shift responsibility to FINRA when FINRA failed to respond to respondent's letter seeking FINRA's advice), *appeal docketed*, No. 11-4062 (2d Cir. Oct. 4, 2011).

Merrimac's sale of the Four Products constituted a material change in business operations from the lines of business permitted by the firm's membership agreement. *See Dep't of Enforcement v. CMG Inst. Trading*, Complaint No. 2006006890801, 2010 FINRA Discip. LEXIS 7, at *28 (FINRA NAC May 3, 2010). Nevertheless, Merrimac sold the Four Products without filing a NASD Rule 1017 application and receiving FINRA approval. Accordingly, we find that the Respondents violated NASD Rules 1017 and 2110.[10]

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[10] It is well established that a violation of a NASD rule constitutes a violation of NASD Rule 2110. *See, e.g., Dep't of Enforcement v. Robert Conway*, Complaint No. E102003025201, 2010 FINRA Discip. LEXIS 27, at *29 (FINRA NAC Oct. 26, 2010), *appeal docketed*, SEC Admin. Proceeding No. 3-14146 (Nov. 24, 2010).

B. Merrimac's Written Supervisory Procedures

The Hearing Panel found that Merrimac failed to establish, maintain, and enforce written procedures to supervise the sale of the Four Products and variable annuities, in violation of NASD Rules 3010 and 2110. Merrimac did not appeal these findings and the corresponding sanction. After an independent review of the record, we affirm the Hearing Panel's findings without discussion.

C. E-mail Retention

1. Relevant Facts

From 2004 to October 2007, approximately 25 registered representatives at Merrimac used e-mail. Of those 25 users, approximately 17 used e-mail only to receive commission runs and notices from Merrimac, and eight were more active users. Every new e-mail user received instructions not to communicate with clients via e-mail, and every user received a reminder notice about the policy four times a year. The policy did not apply to brokers who handled online clients. Notwithstanding any policy, it is undisputed that at least some Merrimac representatives corresponded with clients via e-mail.

Merrimac's e-mail retention changed during the relevant period. In 2004, Merrimac representatives, who recently transferred from Allen Douglas, used their Allen Douglas e-mail addresses, mainly to communicate with clearing firms.[11] In the first quarter of 2005, Merrimac installed its own server, and Merrimac representatives began communicating using Merrimac e-mail addresses.

From 2004 to October 2006, Merrimac stored its outbound e-mails electronically on the server until Thomes believed there was a sufficient quantity to save to a non-rewriteable, non-erasable disk. While the outbound e-mails were stored on the server, they were rewriteable and erasable. In or about October 2005, Thomes stopped Merrimac's server from storing incoming e-mails because of an excessive spam problem.[12] Thomes intended to stop storing incoming e-mails on the server only temporarily, but he testified that he forgot until a FINRA examiner asked him about Merrimac's e-mail procedures in October 2006.

At the hearing, Thomes testified that, while incoming e-mails were not being stored on the server, he nonetheless printed the business-related e-mails he believed Merrimac was required to preserve. These e-mails then were placed in client and operational files. Thomes used a set of criteria he prepared to determine whether to print and save a particular e-mail.

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[11] The parties did not present evidence of the record retention policies while the representatives used the Allen Douglas e-mail addresses.

[12] It is not clear from the record if Merrimac saved incoming e-mails prior to October 2005 and, if so, how Merrimac saved the e-mails. Resolving this issue would not affect our decision.

According to his criteria, all e-mails from clients were printed and saved. At the hearing, Thomes admitted that, as a result of printing and placing the e-mails in client files, a FINRA examiner who wanted to review all e-mails for a given time period would need to examine thousands of client and operational files.[13]

Merrimac did not print and save a variety of e-mails. For instance, Merrimac did not print and save e-mails from annuity and mutual fund companies, even those companies with whom Merrimac conducted business. If an e-mail from an annuity or mutual fund company contained information about their offerings, the e-mail was not considered worth saving because Merrimac retained hard copies of the offering documents. Merrimac did not print and save incoming parent e-mails that sent attachments because it considered the parent e-mails useless. For example, if the e-mail said "see attached form," only the attached form was printed and saved. Merrimac typically did not print and save e-mails between Merrimac's operations department and its clearing firm, but Merrimac printed and saved the attachments to operations department e-mails.[14] Merrimac also did not print and save internal e-mails sending attached files because the attached files were otherwise available.

In November 2006, Thomes bought new software, and Merrimac began storing both incoming and outgoing e-mails on its server. All e-mails, including parent e-mails, were stored electronically on the server, and Merrimac no longer printed and saved e-mails. Only Thomes had access to the e-mails stored on the server. While the e-mails were stored on the server, they could be altered or deleted. Thomes planned to save the e-mails stored on the server annually to a non-rewriteable, non-erasable disk. At the time of the 2007 FINRA examination, more than nine months of e-mails were stored on the server waiting to be saved to disks.

In November 2007, Thomes notified FINRA that Merrimac was using electronic storage media. Merrimac did not send notification of its use of electronic storage prior to November 2007.

2. Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rule 3110

FINRA members must preserve business-related communications. Exchange Act Section 17(a)(1) requires members to make, keep, and furnish such records of its operations as the Commission, by rule, prescribes as necessary and appropriate in the public interest and for the protection of investors. Pursuant to Exchange Act Rule 17a-4, a member must "preserve for a period of not less than three years, the first of two years in an easily accessible place . . .

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[13] There is a factual discrepancy regarding whether Merrimac indeed printed and saved any incoming e-mails during this period. Even if we give Merrimac the benefit of the doubt and assume Merrimac did in fact print and save business-related incoming e-mails, Merrimac nonetheless committed a violation for the reasons provided herein. *See infra* Part IV.C.3.

[14] For example, an e-mail from the clearing firm that said "done" was not saved, but if the attachment related to a client, the attachment was printed and saved in the client's file.

[o]riginals of all communications received and copies of all communications sent by such member . . . (including inter-office memoranda and communications) relating to their business as such." The Commission has stated that electronic mail communications, such as e-mail, relating to a member's "business as such" fall within the purview of Exchange Act Rule 17a-4 and that, for the purposes of Exchange Act Rule 17a-4, "the content of the electronic communication is determinative" as to whether that communication is required to be retained and accessible. *Reporting Requirements for Broker or Dealers under the Securities Exchange Act of 1934,* Exchange Act Rel. No. 38245, 1997 SEC LEXIS 266, at *17 (Feb. 5, 1997). If the member preserves the communications electronically, the member must notify FINRA and save the records in a non-rewriteable, non-erasable format. 17 C.F.R. § 240.17a-4(b)(4).

NASD Rule 3110(a) requires FINRA members to make and preserve correspondence and other records as prescribed by Exchange Act Rule 17a-3 and in accordance with the format, medium, and retention period set forth in Exchange Act Rule 17a-4.

The Commission has long emphasized the importance of maintaining records, noting that the recordkeeping rules are "a keystone of the surveillance of brokers and dealers by Commission staff and by the securities industry's self regulatory bodies." *Edward J. Mawod & Co.*, Exchange Act Rel. No. 13512, 46 S.E.C 865, 873 n.39 (1977); *see also Elec. Storage of Broker-Dealer Records*, Exchange Act Rel. No. 47806, 2003 SEC LEXIS 1088, at *4 (May 7, 2003) ("[Recordkeeping] requirements are integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws."). The Commission further has stated "[p]rompt access to a broker-dealer's books and records is fundamental to the Commission's ability to discharge its examination, investigative and law enforcement responsibilities." *Banc of Am. Secs. LLC*, Exchange Act Rel. No. 49386, 2004 SEC LEXIS 548, at *20 (Mar. 10, 2004).

3. Merrimac Failed to Maintain Adequate Books and Records with Respect to E-mails

For the reasons discussed below, we affirm the Hearing Panel's finding that Merrimac violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110 by failing to maintain adequate books and records with respect to e-mails.

i. Merrimac Failed to Preserve All Business-Related Incoming and Internal E-mails from October 2005 to October 2006

Exchange Act Rule 17a-4 requires members to preserve originals of all communications received and copies of all communications sent relating to the member's "business as such." 17 C.F.R. § 240.17a-4(b)(4). Even if we were to assume that Merrimac printed business-related incoming e-mails based on Thomes's criteria, Merrimac failed to preserve all business-related incoming e-mails. From October 2005 to October 2006, Merrimac, at the very least, failed to preserve incoming e-mails from Merrimac's clearing firm, incoming e-mails from annuity and mutual fund companies with whom Merrimac conducted business, incoming parent e-mails that sent attachments, and internal e-mails.

Communications from Merrimac's clearing firm and annuity and mutual companies with whom Merrimac conducted business unquestionably related to Merrimac's broker-dealer business. Merrimac argues that it did not need to preserve these e-mails because they contained no substantive information. Exchange Act Rule 17a-4 does not allow the member to make a determination about whether it considers the e-mail important or worth saving. If the communication relates to the firm's "business as such," it must be preserved. *See* 17 C.F.R. § 240.17a-4(b)(4).

Parent e-mails with business-related attachments also unquestionably related to Merrimac's broker-dealer business. If an attachment relates to the firm's "business as such," then sensibly the parent e-mail does as well. Preserving only a hard copy of the attachment is insufficient under the applicable rules. For purposes of an investigation, the fact that a particular e-mail was sent or received could be important for purposes of determining whether or when a firm or an associated person had notice of the information contained in the attachment. Without the parent e-mail, FINRA is unable to effectively monitor compliance with applicable securities laws.

Internal communications between Merrimac employees relating to the firm's broker-dealer business also must be preserved. *See NASD Notice to Members 03-33*, 2003 NASD LEXIS 40, at *7 (June 2003). Thomes testified that, during the period 2004 to September 2007, Merrimac did not have a method to capture e-mails between representatives or between a representative and the operations department. On appeal, Merrimac argues that there was no evidence that the internal business-related e-mails were not saved. Even taking into account the relatively small number of employees who used e-mail, we do not believe that there was not a single internal business-related e-mail between Merrimac employees for more than three years. Moreover, Thomes testified that Merrimac did not preserve internal parent e-mails that sent business-related attachments because the attached files were otherwise saved. For the reasons explained above, internal parent e-mails with business-related attachments unquestionably related to Merrimac's broker-dealer business.

Based on the foregoing, Merrimac violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110 by failing to preserve all business-related incoming e-mails from October 2005 to October 2006.

ii. Merrimac Failed to Preserve its Business-Related E-mails in an Easily Accessible Place from October 2005 to October 2006

Exchange Act Rule 17a-4 requires members to preserve originals of all business-related communications received and copies of all business-related communications sent in an "easily accessible place." 17 C.F.R. § 240.17a-4(a). Even if we were to assume that Merrimac printed business-related incoming e-mails, Thomes admitted that it would be difficult for a FINRA examiner to review all the e-mails for a specific time period because the e-mails were dispersed across various client files. By storing the e-mails in individual client files, both Merrimac and an examiner would be unable to quickly identify and segregate correspondence from a given time period. Pulling thousands of files for an examiner to review, even on the same day as the request, does not constitute making the communications easily accessible.

Accordingly, Merrimac violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110 by failing to preserve its business-related e-mails in an easily accessible place from October 2005 to October 2006.

iii. Merrimac Failed to Preserve its E-mails in Non-Erasable, Non-Rewriteable Format from October 2005 to October 2007

Exchange Act Rule 17a-4 requires that, if a member preserves its communications electronically, the member must preserve the records "exclusively in a non-rewriteable, non-erasable format." 17 C.F.R. § 240.17a-4(f)(2)(ii)(A). Merrimac's procedure of storing e-mails on its server, on which the e-mails were rewriteable and erasable, for a year before saving the e-mails to non-rewriteable, non-erasable disks violates the applicable requirements. At the time of the 2007 examination, some e-mails had been on the server for approximately nine months, waiting to be saved to non-rewriteable, non-erasable disks by Thomes.

It is not a defense that only Thomes had access to e-mails stored on the server. By limiting who could access the e-mails, Merrimac merely mitigated the risk an e-mail would be overwritten or erased, which is insufficient under Exchange Act Rule 17a-4(f). *See Elec. Storage of Broker-Dealer Records*, Exchange Act Rel. No. 47806, 2003 SEC LEXIS 1088, at *7-8 (May 7, 2003) (providing that "storage systems that only mitigate the risk a record will be overwritten or eased" are non-compliant with Exchange Act Rule 17a-4).

Accordingly, Merrimac violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110 by failing to preserve its e-mails in non-erasable, non-rewriteable format from October 2005 to October 2007.

iv. Merrimac Failed to Notify FINRA of its Use of Electronic Media to Preserve Records

Exchange Act Rule 17a-4 requires that a member using electronic storage media notify FINRA prior to using electronic storage media. 17 C.F.R. § 240.17a-4(f)(2)(i). Despite using electronic storage as early as the first quarter of 2005, Merrimac did not notify FINRA until November 2007.

Merrimac argues it was not required to notify FINRA because it was using CD-ROMs to store its e-mails. Merrimac has misread the applicable rule. The applicable rule provides that any member using electronic storage media must notify its examining authority prior to employing electronic storage media, and any member employing any electronic storage media other than optical disk technology (including CD-ROM) must notify its examining authority at least 90 days prior to employing such storage media. *Id.* The use of CD-ROMs as the method of electronic storage only relieves the member of its obligation to notify FINRA 90 days in advance, not of its obligation to notify FINRA of its use of electronic storage. *See id.*

Based on the foregoing, Merrimac violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110.

4. Merrimac's Violations Were Willful

The complaint alleged that Merrimac willfully violated Section 17(a) of Exchange Act and Exchange Act Rule 17a-4 by failing to preserve all of its business-related e-mails, by failing to preserve them in the requisite format and manner, and by failing to file timely notification of its use of electronic storage media. Pursuant to Sections 3(a)(39)(F) and 15(b)(4)(D) of the Exchange Act, a firm is deemed statutorily disqualified if it is found in a proceeding by a self-regulatory organization to have willfully violated the federal securities laws.

Willfulness means "'intentionally committing the act which constitutes the violation' but does not require knowledge that such actions constitute a rule or statutory violation." *vFinance Invs., Inc.*, Exchange Act Rel. No. 62448, 2010 SEC LEXIS 2216, at *48-49 (July 2, 2010) (*quoting Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). It does not matter that Merrimac was attempting to comply with the rules. *See Richard A. Neaton*, Complaint No. 2007009082902, 2011 FINRA Discip. LEXIS 13, at *18-19 (FINRA NAC Jan. 7, 2011) ("We need not find that [respondent] intended also to violate FINRA rules to find that he acted willfully."), *aff'd*, Exchange Act Rel. No. 65598, 2011 SEC LEXIS 3719 (Oct. 20, 2011).

Based on the well-established definition of willfulness, Merrimac's record keeping violations were willful. Although Thomes may have intended to stop storing incoming e-mails on the server only temporarily, he did, in fact, voluntarily stop storing incoming e-mails initially. And through his inaction, Thomes caused Merrimac not to retain incoming business-related e-mail for at least 12 months. After that time, even if we assume Merrimac printed business-related incoming e-mails based on Thomes's criteria, Merrimac voluntarily failed to preserve all business-related incoming e-mails and to preserve the e-mails in an easily accessible place when it chose to print only some business-related e-mails and place them in individual client files. Merrimac also voluntarily failed to preserve its e-mails in non-erasable, non-rewriteable format when it chose to leave the e-mails on the server for approximately nine months.

In light of the willfulness finding, Merrimac is statutorily disqualified.

D. Merrimac's Purchase and Sale Blotters

1. Relevant Facts

The complaint alleges that Merrimac failed to maintain daily purchase and sale blotters for its direct application mutual fund and variable annuity business from 2004 to September 2007.

At the hearing, Merrimac contended that its commission runs constituted blotters maintained by Merrimac. The commission runs were prepared by the issuers, and they typically included several days' worth of transactions. The commission runs provided the customer's name, the date of each transaction, the securities bought or sold, and the amount of the purchase or sale. The commission runs, however, were not aggregated by transaction date across all issuers, but instead included transactions for a single issuer over a range of dates. Merrimac

typically received the commission runs from the issuers every week, but it depended on the issuer. In order to review all direct application transactions for a particular day, the examiner would need to review the commission runs for each issuer for that particular day. Merrimac was able to instantaneously obtain the daily commission runs for a particular issuer online.

At the hearing, Matthews testified that, from 2004 to October 2007, Merrimac maintained its information for its direct application mutual fund and variable annuity business in physical customer folders. In an effort to make the folders easier to find, Merrimac would place a different colored sticker on each customer folder, depending on whether the customer completed a direct application mutual fund or variable annuity transaction. If an examiner wanted to review the direct application mutual fund or variable annuity business, Merrimac would pull the appropriate folders from several hundred client folders using its color-coded system.

2. Exchange Act Rule 17a-3

FINRA member firms must make and preserve blotters. Exchange Act Rule 17a-3 requires members to:

> make and keep current . . . [b]lotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records shall show the account for which each such transaction was effected, the name and amount of securities, the unit and aggregate purchase or sale price (if any), the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered.

17 C.F.R. § 240.17a-3(a)(1). Pursuant to Exchange Act Rule 17a-4, members must "preserve for a period of not less than six years, the first two years in an easily accessible place" the required blotters. 17 C.F.R. § 240.17a-4(a).

The Commission has provided guidance regarding the preparation of certain books and records prescribed in Exchange Act Rule 17a-3(a), including blotters. *See Statement Regarding the Maint. of Current Books and Records by Brokers and Dealers,* Exchange Act Rel. No. 10756, 1974 SEC LEXIS 3290, at *3 (Apr. 26, 1974). The Commission stated: "The blotters . . . itemize each day's transactions in a format that facilitates posting to the . . . ledgers. Blotter records relating to securities transactions—e.g., daily purchase and sale blotters—should reflect all transactions as of the trade date and should be prepared no later than the following business day." *Id.*

3. Merrimac Failed to Maintain Blotters

We disagree that Merrimac's reliance on issuers' commission runs satisfies the requirements of the applicable rules. First, Merrimac typically did not receive the commission runs from individual issuers until several days after the transactions occurred, and the commission runs comprised several days' worth of transactions. *See Statement Regarding the*

Maint. of Current Books and Records by Brokers and Dealers, 1974 SEC LEXIS 3290, at *3. Accordingly, the commission runs were not timely. Second, Merrimac's commission runs did not qualify as records that reflected all the transactions on a trade date. Instead, they showed a limited number of transactions across a range of dates. *Cf. DBCC v. Smith Benton*, Complaint No. C3A950073, 1997 NASD Discip. LEXIS 57, at *15-16 (NASD NBCC Dec. 29, 1997) (finding that reliance on records other than a blotter created by the firm still required that the information be "arranged in appropriate sequence and in appropriate form"). Finally, Merrimac did not maintain the commission runs in an easily accessible place. *See* 17 C.F.R. § 240.17a-4(a). If a FINRA examiner requested the firm's blotters, he would be directed to individual records maintained within several hundred client files, which is not a single place nor an easily accessible place.

Based on the foregoing, Merrimac violated Section 17(a) of the Exchange Act, Exchange Act Rules 17a-3 and 17a-4, and NASD Rules 3110 and 2110.

4. Willfulness

The complaint alleged that Merrimac willfully violated Section 17(a) of Exchange Act and Exchange Act Rules 17a-3 and 17a-4 by failing to maintain itemized daily blotters for its direct application mutual fund and variable annuity business. In light of the willfulness finding with respect to the failure to preserve communications, and subsequent statutory disqualification, we choose not to address willfulness here.

V. Sanctions

For violating NASD Rules 1017 and 2110, the Hearing Panel fined Merrimac $5,000. For violating NASD Rules 3010 and 2110, the Hearing Panel fined Merrimac $2,500. For willfully violating Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110 with respect to e-mails, the Hearing Panel fined Merrimac $10,000. For willfully violating Section 17(a) of the Exchange Act, Exchange Act Rules 17a-3 and 17a-4, and NASD Rules 3110 and 2110 with respect to blotters, the Hearing Panel fined Merrimac $1,000. We affirm these sanctions.

A. Financial Considerations

Merrimac presented evidence at the hearing of its financial condition and argued that the firm would go out of business if it paid more than a $5,000 fine. The Hearing Panel considered the financial condition of Merrimac when determining sanctions, but it is unclear to what degree the Hearing Panel reduced the sanctions from what it otherwise would have imposed.

We have reviewed the evidence concerning the financial condition of Merrimac, and we discuss it here to clarify the basis of our decision. Merrimac has not satisfied its burden of demonstrating a bona fide inability to pay. A respondent has the burden of introducing evidence sufficient to prove bona fide inability to pay. *See Dep't of Enforcement v. Anthony Cipriano*, Complaint No. C07050029, 2007 NASD Discip. LEXIS 23, at *43-44 (NASD NAC July 26, 2007) (*citing Toney L. Reed*, 52 S.E.C. 944, 947 n.12 (1996)). A respondent claiming an inability to pay must show that—in seeking to pay a fine—it is unable to obtain the needed funds by, among other things, reducing expenses and salaries, raising capital, or borrowing money. *See DBCC v. Escalator Secs., Inc.*, Complaint No. C07930034, 1998 NASD Discip LEXIS 21, at *12-13 (NASD NBCC Feb. 19, 1998). Here, we find that Merrimac has the ability to reduce expenses or borrow money in order to pay the fine. Thomes testified that Merrimac had not applied to any bank to borrow money. Thomes also testified that Merrimac had a 93 percent payout rate to its representatives. Based on the evidence, we believe Merrimac is able to pay the imposed fine.

To protect investors and insure market integrity, sanctions must be commensurate with a respondent's violative conduct. *Id.* at *12 ("[A] fine that otherwise appropriately sanctions a firm's violative conduct . . . may not be limited by claims that the payment will cause the firm to be in noncompliance with its net capital requirement, or to close its doors. Because of the overriding public interest, member firms should be appropriately sanctioned based on their violative conduct, and not merely on the projected effect of the monetary sanction on the firm's balance sheet."); *FINRA Sanction Guidelines*, 5 (2011) (General Principles) http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/ p011038. pdf [hereinafter *Guidelines*] (2011) ("Although Adjudicators must consider a respondent's bona fide inability to pay when the issue is raised by a respondent, monetary sanctions imposed on member firms need not be related to or limited by the firm's required minimum net capital."). We accordingly reject respondent's position that its amount of excess net capital is an important aspect of measuring its inability to pay the fine. As recently as 2007, Merrimac generated revenue of approximately $2.8 million. Based on our finding that Merrimac does not have a bona fide inability to pay, we do not reduce or otherwise modify the sanctions discussed herein because of Merrimac's financial condition.

B. Membership Agreement Violation

The FINRA Sanction Guidelines ("Guidelines") for member agreement violations recommend a fine of $2,500 to $50,000.[15] In a case involving a serious breach of a restrictive agreement, the Guidelines recommend suspending the firm for up to two years. In egregious cases, the Guidelines recommend expulsion.[16] The Guidelines provide three principal considerations specific to violations of membership agreements: (1) whether the respondent breached a material provision of the agreement; (2) whether the respondent breached a provision

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15 *Guidelines*, 44.

16 *Id.*

of the agreement that contained a restriction that was particular to the firm; and (3) whether the firm had applied for, was in the process of applying for, or had been denied a waiver of a restriction at the time of the misconduct.[17]

We find that Merrimac's misconduct under cause one was serious, although we do not characterize it as egregious. Merrimac breached a material provision of the firm's membership agreement by engaging in the sale of securities it was not authorized to sell.[18] The membership agreement explicitly authorized the sale of certain products, but it did not authorize the sale of the Four Products. Further, Merrimac did not stop selling the Four Products until a FINRA examiner told it to.[19]

At the hearing, Matthews testified that he always believed Merrimac was authorized to sell the Four Products, and, although the Four Products were not expressly listed in the firm's membership agreement, he believed private placements were encompassed by other authorized types of business. The Hearing Panel did not find Matthews to be credible in this regard, and we find no reason to disturb the Hearing Panel's credibility finding. *See Geoffrey Ortiz*, Exchange Act Rel. No. 58416, 2008 SEC LEXIS 2401, at *18 (Aug. 22, 2008) ("We give great weight and deference to credibility determinations by a Hearing Panel, which can only be overcome by substantial record evidence."). Instead, the Hearing Panel found it more likely that Matthews assumed Merrimac was approved to sell the Four Products and did not read the membership agreement when he signed it. We agree. Thomes, on the other hand, testified he did not think Merrimac was selling private placements or limited partnerships, so he did not believe Merrimac was violating its membership agreement. Both Matthews, as Merrimac's president and chief compliance officer, and Thomes, as Merrimac's FINOP, negligently failed to discharge their basic duties as principals of Merrimac when they failed to read or otherwise comprehend the membership agreement.[20]

The unauthorized sale of the Four Products represented a large portion of Merrimac's business over a significant period of time. Merrimac sold the Four Products without authorization from 2004 until October 2007. The total sales of the Four Products amounted to $25,020,994.12, and Merrimac received $1,723,922.59 in commissions for the sales during this timeframe.[21]

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17 *Id.*

18 *See id.*

19 *See id.*

20 *See Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 12, 13).

21 *See id.* at 6-7 (Principal Considerations in Determining Sanctions, No. 9, 17, 18).

The unauthorized sale of the Four Products continued for several years after a FINRA examiner alerted Merrimac about the discrepancy between the firm's membership agreement and Form BD.[22] From January 2005 to October 2007, despite knowing that the membership agreement and Form BD must correspond, Thomes amended Merrimac's Form BD four times, one time while a FINRA examiner was on site and only after she requested information regarding the firm's private placement activities.[23] In the November 14, 2005 letter, Matthews acknowledged that Merrimac was not authorized to sell private placements and sought a waiver to do so.[24] Whereas we give credit to Matthews for voluntarily writing to FINRA, this credit is diminished by the fact that it took Matthews 10 months to write to FINRA after Merrimac was notified about the discrepancy between the membership agreement and Form BD and that Matthews used FINRA's failure to respond as implicit approval to conduct unauthorized lines of business.

We conclude that the sanctions imposed by the Hearing Panel, which are within the ranges recommended in the applicable Guidelines, are appropriate and reflect the seriousness of the violation.

C. Supervisory Procedures Violation

The Guidelines for deficient written supervisory procedures recommend a fine of $1,000 to $25,000.[25] In egregious cases, the Guidelines recommend consideration of a suspension of the firm with respect to the relevant activities for up to 30 business days.[26] The Guidelines instruct adjudicators to consider: (1) whether the deficiencies allowed violative conduct to occur or to escape detection; and (2) whether the deficiencies made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance.[27]

After an independent review of the record, we agree with the Hearing Panel that Merrimac's failure to have adequate written supervisory procedures was not egregious and conclude that the $2,500 sanction imposed by the Hearing Panel is appropriately remedial.

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22 *See id.* (Principal Considerations in Determining Sanctions, No. 9, 15).

23 *See id.* (Principal Considerations in Determining Sanctions, No. 10, 15).

24 *See* id. at 6 (Principal Considerations in Determining Sanctions, No. 2, 4).

25 *Id.* at 104.

26 *Id.*

27 *Id.*

D. Recordkeeping Violation with Respect to E-mails

The Guidelines for recordkeeping violations recommend a fine of $1,000 to $10,000 and consideration of suspending the firm for up to 30 business days.[28] In egregious cases, the Guidelines recommend a fine of $10,000 to $100,000 and consideration of a lengthier suspension up to two years or expulsion.[29] The Guidelines instruct adjudicators to consider the nature and materiality of inaccurate or missing information.[30]

The Hearing Panel found that the violation with respect to e-mail preservation was serious, but not egregious, because, among other things, all incoming e-mails from clients were preserved and there was no evidence that any e-mails were erased or rewritten. We, too, consider the violation serious. The failure to maintain e-mail communications frustrates FINRA's ability to protect investors. *See Elec. Storage of Broker-Dealer Records*, 2003 SEC LEXIS 1088, at *4 ("[Recordkeeping] requirements are integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws.").

Even if we assume that Merrimac printed certain business-related e-mails, Merrimac failed to preserve all business-related incoming e-mails for at least one year.[31] Also taking into account the relative small number of active e-mail users, the misconduct undoubtedly led to a large amount of communications not being preserved.[32] In October 2006, Merrimac attempted, though unsuccessfully, to remedy its misconduct when Thomes bought new software and began storing all incoming and outgoing e-mails on the firm's server.[33] Although the e-mails on the server were erasable and rewriteable, only Thomes had the ability to erase and rewrite e-mails. While this procedure does not comply with the applicable rules, it demonstrates an attempt by Merrimac to minimize erasures and rewriting of its business-related communications.[34]

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28 *Id.* at 29.

29 *Id.*

30 *Id.*

31 *See Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 9).

32 *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 18).

33 *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 5).

34 *See id.* (Principal Considerations in Determining Sanctions, No. 5).

Although the Firm's primary liability under Section 17(a) need not be based on a scienter finding, the evidence that Merrimac failed to appreciate the importance of the rules as opposed to purposeful evasion weighs in favor of a smaller fine. *Cf. vFinance Invs., Inc.*, 2010 SEC LEXIS 2216 (relying on the evidence that respondents knew they were violating the securities law and recklessly disregarded their regulatory obligations weighed in favor of meaningful remedial sanctions). Accordingly, we conclude that the $10,000 fine imposed by the Hearing Panel, which is within the range recommended in the applicable Guidelines, is appropriate.

E. Recordkeeping Violation with Respect to Blotters

The applicable Guideline for the blotter recordkeeping violation is the same as the e-mail recordkeeping violation.[35] Merrimac's commission runs were not blotters, and the commission runs were not maintained in an easily accessible place. Again, we note that Merrimac's misconduct is the result of its principals' failure to appreciate the importance of the recordkeeping rules as opposed to purposeful evasion. Accordingly, we agree with the Hearing Panel that Merrimac's failure to make, keep, and preserve blotters is a less serious violation and conclude that the $1,000 sanction imposed by the Hearing Panel is appropriately remedial.

VI. Conclusion

We affirm the Hearing Panel's findings that Merrimac: (1) violated NASD Membership Rules 1017 and 2110 by selling four categories of securities that the firm was not permitted to sell pursuant to its membership agreement; (2) violated NASD Rules 3010 and 2110 by failing to establish and maintain adequate written supervisory procedures for the sales of five categories of securities; (3) willfully violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4, and NASD Rules 3110 and 2110 by failing to maintain adequate books and records with respect to communications by e-mail; and (4) violated Section 17(a) of the Exchange Act, Exchange Act Rules 17a-3 and 17a-4, and NASD Rules 3110 and 2110 by failing to maintain and keep purchase and sale blotters for its direct application mutual fund and variable annuity businesses. As a result of the willful violation of Section 17(a) of the Exchange Act and Exchange Act Rule 17a-4, Merrimac is statutorily disqualified. For these violations, we fine Merrimac $18,500.00, affirm the Hearing Panel's assessment of costs of $4,676.80, and impose appeal costs of$1,485.00.[36]

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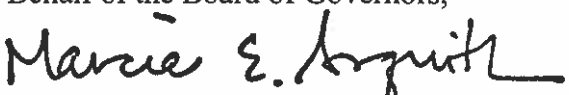
[35] *Guidelines*, at 29.

[36] Pursuant to FINRA Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. We have considered and reject without discussion all other arguments advanced by the parties.

On Behalf of the Board of Governors,



Marcia E. Asquith, Senior Vice President
and Corporate Secretary