

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2011030456001**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: FOLIO*fn* Investments, Inc., Respondent
CRD No. 48015

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, FOLIO*fn* Investments, Inc., ("Folio" or "the Firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Folio alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Folio hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Folio is a self-clearing broker-dealer with approximately 36 registered representatives, and offices in McLean, Virginia, Palmetto, Florida, and Paradise Valley, Arizona. Folio has been a FINRA member since December 1999. Folio engages in a range of business lines, including equity sales, mutual fund sales, private placements, as well as alternative web-based securities businesses.

OVERVIEW

Folio has provided web-based alternative trading systems or secondary trading platform services (the "Trading Platforms") for two non-FINRA members (the "Issuers") since 2008 and 2009. The Trading Platforms are the exclusive secondary markets for notes offered by the Issuers and are located directly on, and accessible exclusively through, the Issuers' websites. They provide only for

direct note sales from a Folio customer and Issuer member to another Folio customer and Issuer member.

Folio reviewed and approved the following content on the Issuers' websites: the Trading Platforms, links to the Trading Platforms, the Folio account opening process pages, as well as the text on those portions of the Issuers' websites that directly referenced Folio and/or the Trading Platforms (collectively, the "Communications"). The Communications were "communications with the public" pursuant to NASD Rule 2210, and were subject to FINRA's advertising rules.

From approximately October 2008 through September 2012 (the "Relevant Period"), portions of the Communications violated the content standards of NASD Rules 2210(d)(1)(A) and (B). Furthermore, the Firm violated NASD Rules 2210(b)(1) and (2) by failing to have a registered principal approve by signature or initial and date the Communications and by failing to adequately maintain the Communications in Folio's books and records. By violating these rules, Folio also violated NASD Rule 2110 (for conduct occurring before December 15, 2008) and FINRA Rule 2010 (for conduct occurring on and after December 15, 2008).

FACTS AND VIOLATIVE CONDUCT

The Issuers operate websites that offer marketplaces for the notes. On the Issuers' websites, borrowers post loan listings for fixed-rate unsecured personal loans ranging from approximately \$1,000 to \$35,000 with three or five year terms for various reasons, including debt consolidation, vacations, or car financing. Investors, in turn, purchase unsecured notes issued by the Issuers that fund the loans. In 2008 and 2009, respectively, the Issuers began offering their notes by prospectus under a continuous offering registered with the U.S. Securities and Exchange Commission under Form S-1, at which time Folio commenced providing the Trading Platforms.

Folio provides the exclusive secondary markets for the registered notes offered by the Issuers through the Trading Platforms. The Trading Platforms are accessible exclusively from hyperlinks located on the Issuers' websites, and only to members of the Issuers who also become Folio customers. During the Relevant Period, Folio reviewed and approved the Communications, as defined above.

During the Relevant Period, there were several risks associated with trading the notes on the Trading Platforms. Particular risks included:

- Repayment of the notes was dependent entirely on the Issuers' receipt of payments from borrowers. The loans were not secured or insured.

- Many notes available on the Trading Platforms were based on loans with borrower interest rates in the twenty and thirty percent ranges. Moreover, certain borrowers had subprime credit scores.
- Information supplied to the Issuers by borrowers regarding loan borrowers' income, employment, and other information may have been inaccurate and was not verified in many cases.
- The Issuers were in the early stages of their development and had a limited operational history. There was no significant historical performance data concerning the notes offered on the Trading Platforms.
- There was potential illiquidity involved with trading on the Trading Platforms because there was no guarantee that one would find a buyer for the notes at the offered price or any other price.

1. NASD Rule 2210(d)(1)(A) Violations (Communications That Were Unfair and Unbalanced and/or Did Not Provide a Sound Basis for Evaluating Facts)

NASD Rule 2210(d)(1)(A) requires that FINRA member communications be "based on principles of fair dealing and good faith" and "fair and balanced," and that they "provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service." Further, it states: "[n]o member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading."

During the Relevant Period, Folio violated NASD Rule 2210(d)(1)(A) by omitting and, in some instances, failing to prominently disclose in the Communications, particularly on the Trading Platforms: (1) that investors could lose their entire investment in the notes; (2) that the notes were risky and speculative investments; and (3) that only limited information was available about the notes. Omitting these risks and/or failing to prominently disclose these risks rendered the content unfair and unbalanced and/or without a sound basis for evaluating the facts in regard to the securities, industry, and/or services provided.

Folio also violated NASD Rule 2210(d)(1)(A) by failing to ensure that the Communications adequately and prominently disclosed how estimated returns were calculated. The Communications on one Issuer's website had the following statement: "*Choose from Three Ways to Invest in Individual Americans*" including "*Existing Notes: Online investing option available for advanced lenders.*" This page provided a link to the Trading Platform entitled "*Learn More.*" Next to the statement and link to the Trading Platform was a graph entitled "*Estimated Returns.*" A description of "*Estimated Returns*" was in a footnote at the bottom of the page. The footnoted description omitted material

information concerning how the estimated returns were calculated. The footnote stated, in pertinent part, that *"the calculation of Estimated Returns requires significant assumptions about the repayment of loans and lenders should make their own judgments with respect to the accuracy of these assumptions."* But the assumptions were not disclosed anywhere in the footnote or on the page. Accordingly, the Communication was without a sound basis for evaluating the facts in regard to the security, industry, and/or services provided.

In addition, in several instances on one Issuer's website, the notes were described as *"quality Notes."* For example, the Communication stated: *"Increase liquidity by selling some of your Notes or purchase quality Notes you missed out on the first time from other [Issuer] lenders."* Elsewhere it stated: *"benefits of becoming a member of the Folio Investing Note Trader include . . . ability to purchase quality notes you missed out on the first time."* Folio violated NASD Rule 2210(d)(1)(A) by allowing the notes to be described as "quality notes" without information sufficient to form a sound basis for evaluating the facts in regard to the notes.

2. NASD Rule 2210(d)(1)(B) Violations (False, Exaggerated, Unwarranted, and/or Misleading Statements)

NASD Rule 2210(d)(1)(B) prohibits members from making any "false, exaggerated, unwarranted or misleading statement or claim in connection with any communication."

The Communications on one Issuer's website had a section entitled *"How to Invest"* that described *"Three Ways to Invest on [Issuer],"* one of which was *"Trade Existing Notes"* on the Trading Platform. The content on the page contained false, exaggerated, unwarranted, and/or misleading statements in violation of NASD Rule 2210(d)(1)(B), including:

- *"Become a part of driving America's economy by joining the thousands of [Issuer] lenders who are already helping fellow Americans get loans at fair rates on [Issuer] – the most transparent lending community in the world."* The Communication was exaggerated and/or unwarranted to describe interest rates that included those above twenty and thirty percent as "fair rates" and to describe the Issuer as "the most transparent lending community in the world."
- *"[Issuer] enables people to invest money in loans in a safe and transparent manner."* This Communication was exaggerated, and/or unwarranted because the investments were not necessarily safe in light of the risks described above.
- *"[Issuer's] borrowers are people with good credit (a credit score of 640 and above) who want a loan at a fair rate."* This statement was

exaggerated and/or unwarranted because a FICO score of 640 is not necessarily reflective of "good credit." Moreover, during the Relevant Period, the Issuer's underwriting criteria for certain borrowers required a minimum credit score of 600 that did not drop "more than a specified number of points (currently twenty to forty points, depending on the borrower's credit score range at the time the existing loans was obtained)." Because borrowers could have credit scores that were less than 640, it was therefore false, unwarranted and/or misleading for the Communication to state otherwise.

- *"It is quick and easy to establish a brokerage account for trading."* This statement is exaggerated and/or unwarranted in light of the fact that regulatory and other requirements must have been met before individuals were authorized to use the Trading Platform.

Next, the Communication on one Issuer's website stated in response to the question, *"Do I need to keep my investment tied for 5 years?"*: *"No. Turn your Notes into cash anytime: it takes less than 5 days to sell Notes on the secondary market. [Issuer's] investors can sell both 3-year and 5-year Notes on our Trading Platform, operated by FOLIOfn."* This statement was exaggerated or unwarranted in light of the liquidity risk associated with the Trading Platform. There was no guarantee that one would find a buyer for the notes at the offered price or any other price.

3. NASD Rule 2210(b)(1) Violations (Principal Approval of Communications)

NASD Rule 2210(b)(1) provides that a "registered principal of the member must approve by signature or initial and date each advertisement, item of sales literature and independently prepared reprint before the earlier of its use or filing with NASD's Advertising Regulation Department." A registered principal of Folio did not approve by signature or initial and date the Communications prior to their use, in violation of NASD Rule 2210(b)(1).

4. NASD Rule 2210(b)(2) Violations (Record-Keeping of Communications)

NASD Rule 2210(b)(2) provides that FINRA members "must maintain all advertisements, sales literature, and independently prepared reprints in a separate file for a period beginning on the date of first use and ending three years from the date of last use." Folio did not maintain the Communications in a separate file beginning on the date of first use, in violation of NASD Rule 2210(b)(2).

5. NASD Rule 2110 and FINRA Rule 2010 Violations (Commercial Honor and Principles of Trade)

By virtue of Folio's above violations of NASD Rule 2210, Folio also violated NASD Rule 2110 (for conduct through December 14, 2008) and FINRA Rule 2010 (for conduct starting December 15, 2008).

B. Folio also consents to the imposition of the following sanctions:

1. A censure;
2. A fine in the amount of \$35,000; and
3. An undertaking by Folio to render the following language in the Communications currently on one Issuer's website more prominent not later than 15 business days after acceptance of this AWC: *"Notes are highly risky and only limited information is available about them. They are suitable only for investors whose investment objective is speculation. You could lose most or all of the money you invest in them. Folio has no role in the original issuance of the notes and is not responsible for and does not approve, endorse, review, recommend or guarantee the notes or the accuracy, reliability, or completeness of any data or information about the notes."* Furthermore, Folio will undertake to display prominently a similar risk disclosure in any future retail communications that describe the features or benefits of the Trading Platforms and/or the services provided by Folio for the Issuers.

Folio agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Folio has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Folio specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Folio specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Folio specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Folio further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Folio understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Folio; and
- C. If accepted:
 - 1. this AWC will become part of Folio's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Folio;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Folio's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 6. Folio may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Folio may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Folio's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Folio may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. I understand that I may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Folio, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Folio has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Folio to submit it.

4-11-2014

Date (mm/dd/yyyy)



FOLIO Investments, Inc.

By: MICHAEL J. HOGAN

AS CEO & PRESIDENT AND
NOT AS AN INDIVIDUAL CAPACITY

Accepted by FINRA:

5/5/2014

Date (mm/dd/yyyy)

Signed on behalf of the
Director of ODA, by delegated authority



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