

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2012032643701**

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

RE: EDI Financial, Inc., Respondent
CRD No. 15699

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent EDI Financial, Inc. ("EDI" 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 Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent 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

EDI has been a registered broker-dealer with the SEC since 1984 and a member of FINRA since 1986. The Firm conducts general securities business, including sales of private placements and mutual funds. It has 70 registered representatives and 22 branch offices, with headquarters in Irving, Texas.

RELEVANT DISCIPLINARY HISTORY

EDI has no relevant disciplinary history.

OVERVIEW

Selling unregistered private offerings ("private placements") is a significant part of EDI's business. From approximately January 2008 through November 2014 (the "relevant period"), a substantial portion of the Firm's revenue came from sales of private placements. Despite the importance of private placement sales to EDI, the Firm failed in several important respects to have adequate policies and procedures to oversee its private placement activities.

During the relevant period, EDI failed to adopt and implement supervisory systems and procedures reasonably designed to achieve compliance with the Firm's suitability obligations for the solicitation and sale of private placements. For example, the Firm lacked adequate written procedures concerning the proportion of a customer's assets that could be allocated to private placements. Additionally, the Firm did not effectively monitor customers' exposure to private placements. The Firm also, during the relevant period, lacked adequate supervisory systems and procedures for conducting due diligence on private placements. The Firm's written supervisory procedures did not provide adequate guidance concerning how due diligence was to be documented, and the Firm failed to sufficiently document due diligence conducted on private placements. Consequently, the Firm could not effectively supervise whether adequate due diligence was performed on private placements. By failing to adequately supervise the solicitation and sale of private placements, EDI violated NASD Rules 3010(a) and (b) and 2110 and FINRA Rule 2010.¹

In addition, in 2013, EDI failed to supervise adequately mutual fund switches and maintained inaccurate records concerning mutual fund switches by certain customers. The Firm's written supervisory procedures required that, when a customer switched between mutual funds, the Firm obtain a "letter from the customer acknowledging the consequences of the switch" (a "switch letter"). In 2013, the Firm did not consistently obtain switch letters when customers switched between mutual funds. When the Firm became aware that switch letters had not been obtained for certain customers, one of the Firm's registered representatives attempted to document the Firm's files by obtaining the customers' signatures on the switch letters. These forms were signed and dated by the registered representative, the customers and a principal of the Firm as of the date of the original transaction rather than the date the forms were signed. The switch letters were then placed in the Firm's files and maintained as part of the Firm's books and records. As a result, EDI violated NASD Rules 3010(a) and (b) and FINRA Rule 2010.

Between approximately July 2013 and August 2014, EDI failed to maintain adequate written procedures concerning internal inspections of non-branch locations. In 2013, EDI failed to timely inspect certain non-branch locations. As a result, EDI violated NASD Rule 3010(c) and FINRA Rule 2010.

In addition, between approximately July 2013 and January 2014, EDI failed to properly designate one of its branch offices, which supervised the activities of registered representatives in another branch office, as an office of supervisory jurisdiction. As a result, EDI violated Article IV, Section 8 of FINRA's By-

¹ FINRA Rule 2010 replaced NASD Rule 2110 on December 15, 2008. Accordingly, the conduct described herein occurring before December 15, 2008 violated NASD Rule 2110, and the conduct occurring on or after December 15, 2008 violated FINRA Rule 2010.

Laws, NASD IM-1000-4 and FINRA Rule 2010.

In addition, in 2014, EDI failed to timely produce documents and information in response to a request for documents and information under FINRA Rule 8210. As a result, EDI violated FINRA Rules 8210 and 2010.

FACTS AND VIOLATIVE CONDUCT

1. EDI Lacked Adequate Systems and Procedures Regarding the Solicitation and Sale of Private Placements.

NASD Rule 3010(a) requires each member firm to “establish and maintain a system to supervise the activities of each registered representative, registered principle, and other associated person that is reasonably designed to achieve compliance” with FINRA Rules. Under NASD Rule 3010(b), each member firm must “establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principles, and other associated persons that are reasonably designed to achieve compliance” with FINRA Rules. Among other things, Rule 3010 requires each member firm to establish and maintain supervisory systems and procedures to ensure compliance with NASD Rule 2310 and FINRA Rule 2111, which address each member firm’s obligations to ensure that securities solicited and sold by the firm are suitable for customers.²

During the relevant period, sales of private placements were responsible for a significant portion of the Firm’s revenue. Private placements generally entail greater risk and provide less liquidity than traditional investments. In light of these risks, EDI failed to adopt and implement adequate supervisory systems and procedures to ensure that the Firm’s registered representatives solicited and sold investments in private placements that were suitable for the Firm’s customers.

a. EDI Failed to Adequately Supervise Whether Customers’ Assets Were Overly Concentrated in Private Placements.

NASD Rule 2310 requires that, prior to recommending an investment, a registered representative have reasonable grounds for believing that the investment is suitable for the customer, given the customer’s financial situation, including the customer’s other investments. Given the risk and relative illiquidity of private placements, it is unsuitable for a customer’s assets to be overly concentrated in private placements. Many of EDI’s customers invested in multiple private placements, creating a heightened risk that those customers’ assets could be overly concentrated in private placements. Despite this risk, EDI had no written policies or procedures concerning the proportion of a customer’s assets that could be allocated to private placements. Thus, the Firm’s registered

² FINRA Rule 2111 replaced NASD Rule 2310 on July 9, 2012.

representatives had insufficient written guidance for determining whether and how much to recommend that a particular customer invest in a private placement.

In addition, EDI lacked adequate systems and procedures for monitoring the proportion of each customer's assets that was invested in private placements. While Firm supervisors could determine how much of a customer's assets were allocated to any one private placement, the Firm did not maintain adequate documentation concerning a customer's cumulative exposure to private placements. Thus, if a customer invested in multiple private placements, the Firm's registered representatives and supervisors could not adequately determine whether the customer's assets were overly concentrated in private placements.

As a result, EDI violated NASD Rules 3010(a) and (b) and 2110 and FINRA Rule 2010.

b. EDI Failed to Adequately Supervise Whether Sufficient Due Diligence was Conducted on Private Placements.

NASD Rule 2310 requires that, prior to recommending an investment to any customer, a registered representative have a reasonable basis to believe, based on a reasonable investigation, that the investment is suitable to at least some customers. Given the risks posed by private placements, it is particularly important that firms and registered representatives conduct thorough investigations, or due diligence, before recommending that customers invest in private placements. Documenting such investigations can allow a firm to conduct supervisory reviews to ensure that sufficient due diligence is being conducted by its registered representatives and principals.

During the relevant period, EDI's written supervisory procedures required that Firm supervisors "[d]ocument the file regarding due diligence" on private placements. The Firm's written procedures, however, failed to provide adequate guidance concerning how due diligence was to be documented. For example, the written procedures did not specify the types of documents that were to be retained or require that the process or results of due diligence be documented.

In practice, EDI did not sufficiently document due diligence conducted on private placements. During the relevant period, Firm supervisors and registered representatives failed to adequately document the process and results of due diligence, including what documents were reviewed, who conducted any such reviews and whether and when meetings were conducted or attended, among other investigative steps. Consequently, Firm supervisors could not effectively review whether adequate due diligence had been performed on private placements.

As a result, EDI violated NASD Rules 3010(a) and (b) and 2110 and FINRA Rule 2010.

2. EDI Failed to Adequately Supervise and Maintained Inaccurate Records Concerning Mutual Fund Switches.

a. EDI Failed to Adequately Supervise Mutual Fund Switches.

In 2013, EDI's written supervisory procedures required that, when a customer switched between mutual funds, the Firm obtain a switch letter "from the customer acknowledging the consequences of the switch." Switch letters not only informed customers of any fees and charges resulting from mutual fund switches but also allowed Firm supervisors to review mutual fund switches for suitability. The Firm's procedures required that switch letters be signed by the customer, the registered representative and a Firm principal and kept on file with the Firm.

Despite the Firm's written procedures requiring switch letters, in 2013, EDI failed to consistently obtain switch letters when customers switched between mutual funds. This prevented Firm supervisors from confirming that customers received material facts regarding fees and charges incurred by customers from switching investments. By failing to obtain the switch letters at the time of the exchanges, EDI violated NASD Rules 3010(a) and (b) and FINRA Rule 2010.

b. EDI Maintained Inaccurate Records Concerning Mutual Fund Switches.

In or around October 2013, the Firm became aware that mutual fund switch letters had not been obtained for six customers of one of the Firm's registered representatives in connection with mutual fund switches that had occurred in January and February 2013. Upon learning that switch letters had not been obtained in accordance with Firm policy, the registered representative obtained switch letters from each of the six customers in or around October 2013. Each customer's signature was dated to reflect the date each transaction took place rather than the date each switch letter was signed. The switch letters were also signed by the registered representative and a Firm principal and dated to reflect when the transactions took place rather than when the letters were signed. After being signed, the switch letters were maintained in the Firm's files as part of its books and records. As a result, EDI violated FINRA Rule 2010.

3. EDI Lacked Adequate Written Procedures Concerning Non-Branch Inspections and Failed to Timely Inspect Non-Branch Locations.

NASD Rule 3010(c)(1)(C) requires each member firm to "inspect on a regular periodic schedule every non-branch location." Rule 3010(c)(1)(C) further requires that a "schedule and an explanation regarding how the member determined the frequency of the examination schedule," for non-branch locations, be "set forth in the member's written supervisory and inspection procedures." Between approximately July 2013 and August 2014, EDI's written supervisory

procedures failed to provide a schedule describing the frequency of non-branch inspections. During this period, EDI's written procedures also failed to provide an explanation of how the Firm determined examination schedules for non-branch locations. The relevant written procedures stated only that "[o]ffices are inspected as required under Rule 3010."

Additionally, in 2013, the Firm failed to inspect two non-branch locations in accordance with a regular periodic schedule.

As a result, EDI violated NASD Rule 3010(c) and FINRA Rule 2010.

4. EDI Failed to Properly Designate an Office of Supervisory Jurisdiction.

Article IV, Section 8 of FINRA's By-Laws provides that each branch office of a member firm "shall be registered with and listed upon the membership roll" of FINRA and requires each member firm to "promptly advise" FINRA of, among other things, a "change in designated activities of any branch office." NASD IM-1000-4 provides that each member firm must designate to FINRA "offices of supervisory jurisdiction . . . in accordance with the standards set forth in Rule 3010." NASD Rule 3010(a) requires each member firm's supervisory system to provide for, among other things, "[t]he designation as an office of supervisory jurisdiction (OSJ) of each location that meets the definition contained in paragraph (g) of this Rule." In turn, Rule 3010(g) defines "Office of Supervisory Jurisdiction" as "any office of a member" that has "responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member."

From approximately January 2009 to January 2014, EDI's Fort Worth, Texas office supervised the activities of registered representatives in the Firm's Stratford, Connecticut branch office. Between approximately July 2013 and January 2014, EDI did not designate the Firm's Fort Worth office as an office of supervisory jurisdiction. As a result, EDI violated Article IV, Section 8 of FINRA's By-Laws, NASD IM-1000-4 and FINRA Rule 2010.

5. EDI Failed to Timely Produce Documents Pursuant to a Request Under FINRA Rule 8210.

FINRA Rule 8210(a) gives FINRA staff authority to require a member firm "to provide information orally, in writing, or electronically" and to "inspect and copy the books, records, and accounts" of a member firm in connection with an investigation. Rule 8210(c) provides that "[n]o member or person shall fail to provide information or testimony or to permit an inspection and copying of books, records, or accounts pursuant to this Rule."

On February 7, 2014, FINRA staff sent a request to EDI under Rule 8210 for

documents and information, including certain branch examination reports. The due date for the Firm's response was initially February 24, 2014 but was extended, at the Firm's request, to March 7, 2014. On March 7, 2014, the Firm provided documents in response to FINRA's request. The Firm failed to provide certain requested branch examination reports, which were over three years old, and represented that files that were over three years old were purged when the Firm moved its headquarters from Dallas, Texas to Irving, Texas in January 2014.

In December 2014, EDI discovered the requested branch examination reports that the Firm had failed to provide in its March 7, 2014 response. EDI had not previously discovered the reports because the Firm had failed to conduct an adequate search for documents in response to FINRA's request. The Firm produced the reports to FINRA on December 10, 2014, more than nine months after the Firm's response was due. By failing to timely provide a complete response to FINRA's request for documents and information, EDI violated FINRA Rules 8210 and 2010.

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

- A censure; and
- A fine in the amount of \$100,000.

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

Respondent 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

Respondent 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, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, 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.

Respondent 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

Respondent understands that:

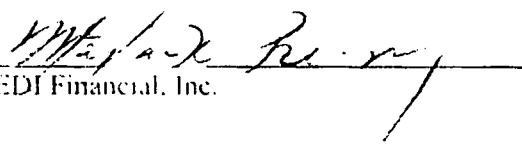
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (“ODA”), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will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

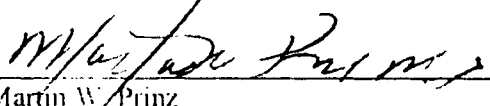
4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding 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 Respondent'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. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it 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.

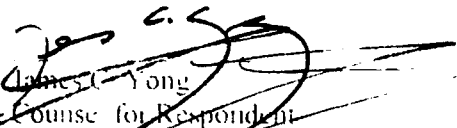
The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understand all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, 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 the Firm to submit it.

02/04/2015
Date (mm dd yyyy)


EDF Financial, Inc.

By: 
Martin W. Prinz
President

Reviewed by

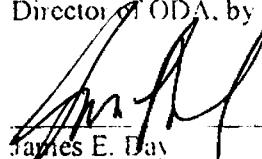

James C. Yong
Counsel for Respondent
Baugh Dalton Carlson & Ryan, LLC
135 S La Salle St., Suite 2100
Chicago, IL 60603
(312) 863-3675

Accepted by FINRA

2/25/18

Date

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

A handwritten signature in black ink, appearing to read "James E. Day", is written over a horizontal line.

James E. Day
Vice President & Chief Counsel
FINRA Department of Enforcement
15200 Omega Drive, 3rd Floor
Rockville, MD 20850
(301) 258-8520