

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2016047823901**

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

**RE: Avalon Investment & Securities Group, Inc., Respondent
Member Firm
CRD No. 6281**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Avalon Investment & Securities Group, Inc. ("Avalon" 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 Avalon alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Avalon 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

Avalon has been a member of FINRA since August 1972. Avalon is headquartered in Muscle Shoals, Alabama and conducts a limited securities business in variable contracts, mutual funds, municipal bonds, private placements, and direct investments through approximately 28 registered representatives in one branch office.

RELEVANT DISCIPLINARY HISTORY

The firm has no relevant disciplinary history.

OVERVIEW

From November 1, 2013 through May 31, 2016 (the "Relevant Period"), Avalon failed to establish, maintain and enforce a supervisory system and written supervisory procedures reasonably designed to ensure that representatives' recommendations of variable annuities complied with applicable securities laws and regulations, and FINRA Rules. As a result, the Firm violated FINRA Rules 2330(c) and (d), NASD Rule 3010 (for

conduct before December 1, 2014), FINRA Rule 3110 (for conduct on and after December 1, 2014), and FINRA Rule 2010.

In addition, during the Relevant Period, Avalon failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to ensure suitability of its registered representatives' recommendation of mutual fund share classes and the proper application of mutual fund sales breakpoint levels in violation of NASD Rule 3010 (prior to December 1, 2014) and FINRA 3110 (after November 30, 2014) and FINRA Rule 2010.

Finally, from June 1, 2014 to May 31, 2016, the Firm failed to properly register one Office of Supervisory Jurisdiction and nine branches in violation of NASD Rule 3010(g) (prior to December 1, 2014) and FINRA Rule 3110(f) (after November 30, 2014) and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

During FINRA's routine examination of Avalon's sales practices, FINRA staff detected multiple systemic supervisory failures relating to the Firm's sale of variable annuities, mutual funds and its registration of offices.

Failure to Reasonably Supervise the Sale of Variable Annuities

NASD Rule 3010(a) required member firms to "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD [and now FINRA] Rules." NASD Rule 3010(b) required member firms to "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 principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD [and now FINRA]." FINRA Rule 3110, which superseded NASD Rule 3010 effective December 1, 2014, contains the same requirements.

Variable annuities are complex products that permit customers to choose among a variety of contract features and options. Due in part to the complexity of these products and the inherent risk of sales practice violations they present, FINRA issued Rule 2330 to require that firms enhance their supervisory systems, and provide more comprehensive and targeted protection to investors who purchase or exchange variable annuities. Thus, in addition to the general supervisory requirements of NASD Rule 3010 and FINRA Rule 3110, FINRA Rule 2330(d) specifically requires that member firms "establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in [Rule 2330]."

FINRA Rule 2111 requires each member firm or an associated person to have a reasonable basis to believe that a recommended transaction is suitable for a customer based upon the customer's investment profile. FINRA Rule 2330 also requires that no firm or associated person recommend the purchase or exchange of a variable annuity unless the member or person has a reasonable basis to believe that the transaction is suitable in accordance with FINRA Rule 2111, and, "in particular, there is a reasonable basis to believe that"

- (1) "the customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty . . . ; mortality and expense fees . . . ; potential charges for and features of riders . . . ;"**
- (2) "the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit;" and**
- (3) "the particular deferred variable annuity . . . and riders and similar product enhancements, if any, are suitable . . . for the particular customer."**

FINRA Rule 2330(c) also requires that a firm principal review all recommendations to purchase or exchange a variable annuity to determine whether the recommendation is suitable for the customer in light of the factors outlined above. This principal review must be documented and signed by the registered principal.

Finally, FINRA Rule 2330(d) also requires firms to "implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws."

Avalon is a small firm, engaging in only 189 transactions during the period June 1, 2014 to May 31, 2016. Avalon does not hold customer funds, instead selling only variable annuities that are held directly with the issuer. During the Relevant Period, Avalon incorrectly believed it had limited responsibility for supervising the sales of variable annuities for suitability because it did not hold the annuities directly. As a result, the Firm failed to establish, maintain and enforce a reasonable supervisory system and procedures to ensure that its registered representative's variable annuity purchase and exchange recommendations were suitable.

Specifically, although Avalon required a principal's signature on the variable annuity applications, in practice, the Firm did not conduct any supervisory suitability review of variable annuity applications. Rather, the Firm's principals relied on its registered representatives to determine if a recommendation was suitable. During the Relevant Period, Avalon's principals never questioned the suitability of any of its variable annuity transactions. Instead, Avalon incorrectly believed it could rely on the issuers of the variable annuities to review for suitability, assuming that the issuer would reject any

unsuitable transactions.

As a result, although Avalon's written supervisory procedures required its registered representatives to document information required by Rule 2330(b) and (d), the Firm's registered representatives and principals routinely failed to ensure that such documentation was complete and accurate. Specifically, during the Relevant Period, Avalon routinely had inconsistencies in its variable annuity application documentation relating to whether:

- a) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders);
- b) the customer would benefit from any product enhancements and improvements;
- c) the customer had another variable annuity exchange within the preceding 36 months;
- d) the customer would benefit from certain features of the variable annuity, such as tax-deferred growth, annuitization, or a death or living benefit; and
- e) the variable annuity as a whole, the underlying subaccounts to which, and riders or other product enhancements are suitable for the particular customer.

Avalon's principal review and approval of variable annuity purchases and exchanges also failed to meet the requirements of Rule 2330(c) in that its principals, in multiple instances, approved variable annuity purchases and exchanges without having sufficient information to determine there was a reasonable basis to believe the transaction was suitable. For example, one of the Firm's registered representatives, JS, failed in all 14 of his variable annuity exchange transactions to complete the Firm's required Variable Product Replacement Form; yet, the Firm's principals approved all 14 transactions. Similarly, JS failed in 12 of those exchange transactions to provide the Firm with a comparison of the features of the proposed contract to those of the existing contract so that the principal could determine if "the customer would benefit from product enhancements and improvements". Also, in 10 of JS's variable annuity transactions, JS failed to obtain the customer's signature on a Variable Annuity Disclosure Form as required by Avalon's written supervisory procedures. As a result, there was no documentation that "the customer [had] been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty . . . ; mortality and expense fees . . . ; potential charges for and features of riders . . ." Despite the absence of this required documentation, Avalon approved these 10 variable annuity transactions.

In other instances, Avalon principals approved variable annuity transactions despite conflicting information on the applications. In three applications submitted by registered representative, FN, the documents provided inconsistent information regarding the

customers' liquidity needs and time horizon. In each instance, the application documentation reflected that the customer anticipated taking the first distribution from the investment within one to five years. This was inconsistent with other information in the application, stating that the customer had no current financial or liquidity needs. It was also inconsistent with new account documentation providing a stated time horizon of over ten years. In fact, each customer made withdrawals that incurred surrender charges during the first three years of ownership of the variable annuity contracts. Despite the conflicting information and high concentration percentages reflected in the variable annuity application documents, the Firm did not question the suitability of FN's recommendations.

Finally, although Avalon's written supervisory procedures required heightened review and supervision for exchanges where the customer was of an advanced age or where the investment would represent a substantial percentage of the customer's net worth, Avalon's principals approved transactions that resulted in a customer investing 67% to 80% of the customer's liquid net worth in a variable annuity, including one 75 year old customer whose remaining liquid assets were only \$15,000. Avalon erroneously relied upon the variable annuity issuers to conduct a suitability review, rather than conducting its own review to ensure that the variable annuity recommendations were suitable.

In addition, Avalon failed to implement any surveillance system to determine if its registered representatives had rates of variable annuity exchanges that raised for review whether such rates of exchange may be inappropriate under Rule 2330, or other FINRA rules or applicable securities laws.

By virtue of the foregoing, Avalon violated FINRA Rules 2330(c) and (d), NASD Rule 3010 (prior to December 1, 2014), FINRA Rule 3110 (after November 30, 2014) and FINRA Rule 2010.

Failure to Reasonably Supervise the Sale of Mutual Funds

During the Relevant Period Avalon also failed to establish, maintain and enforce a reasonable supervisory system to ensure that the mutual fund share class recommended was suitable for the customer given the customer's investment profile. Specifically, Avalon's principals failed to review the suitability of its registered representatives' mutual fund share class recommendations, and failed to require any documentation of such suitability reviews. In one instance, registered representative WF recommended purchases in class A-shares for two customers, but provided no justification for the A-share class selection as opposed to another share class offered. Although the customers indicated they were each unaware of circumstances that might affect their need for liquidity, each customer also indicated he or she had substantially low liquid net worth of \$1,300 to \$5,000. Furthermore, in the new account forms, each customer indicated he or she had recently become unemployed. Despite the conflicting information regarding the need to access the funds invested in the class A-shares, there was no evidence that Avalon's principals questioned the suitability of the sales.

In addition, Avalon failed to establish, implement and maintain an adequate supervisory system and written supervisory procedures with regard to the monitoring of appropriate sales breakpoint levels given to its customers. A review of 11 household account files for the review period from June 1, 2014 to May 31, 2016, revealed that two household accounts were not given the appropriate sales breakpoint, totaling \$1,515.00, for their mutual fund investments.

By virtue of the foregoing, Avalon violated NASD Rule 3010 (prior to December 1, 2014) and FINRA Rule 3110 (after November 30, 2014) and FINRA Rule 2010.

Failure to Register OSJ and Branches

From June 1, 2014 to May 31, 2016, Avalon failed to register one location as an Office of Supervisory Jurisdiction (OSJ) and nine locations as branch offices. Specifically, in April 2016, WA became the Firm's designated general securities principal and municipal securities principal. In this role, he began supervising the activities of persons associated with Avalon at one or more other branch offices. However, despite WA's change in responsibilities, the Firm failed to register his location as an OSJ pursuant to FINRA Rule 3110(f).

Pursuant to FINRA Rule 3110(f) (formerly NASD Rule 3010(g)) a branch office is any location where an associated person "regularly conducts the business of effecting transactions in any security." Specifically excluded from the definition is "any location that is the associated person's primary residence, "provided that . . . the locations is not held out to the public as an office." The Firm relied upon the non-branch exemption for numerous locations that are the primary residence of the associated person. In nine instances, the branches did not meet the exemption, because the associated persons held out the residential address as the location of his securities business on his business card.

By virtue of the foregoing, Avalon violated NASD Rule 3010(g) (prior to December 1, 2014) and FINRA Rule 3110(f) (after November 30, 2014) and FINRA Rule 2010.

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

- A censure;
- a \$12,000 fine;¹
- a requirement that Avalon pay a total of \$1,515 in restitution to customers; and
- The following undertaking:

¹ Consistent with FINRA's *Sanction Guidelines* and the *General Principles Applicable to All Sanctions Determinations*, FINRA considered the Firm's small size, its financial resources, ability to pay and other factors in tailoring sanctions that are appropriately and proportionally remedial, but not punitive, and which will remedy the misconduct and discourage the recurrence of the misconduct. See also Notice to Members 06-55.

a. Avalon shall:

- (1) Retain, within 30 days of the date of the Notice of Acceptance of this AWC, an Independent Consultant, not unacceptable to FINRA staff, to conduct a comprehensive review of the adequacy of the Firm's policies, systems and procedures (written and otherwise) and training relating to the violations identified in this AWC:**
 - (a) Variable annuity sales and exchanges;**
 - (b) Mutual funds sales and application of breakpoints; and**
 - (c) Registration of OSJ and branch offices.**
- (2) The Independent Consultant, any firm with which the Independent Consultant is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties, shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the date of the Notice of Acceptance of this AWC;**
- (3) Exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant;**
- (4) Cooperate with the Independent Consultant in all respects, including by providing staff support. Avalon shall place no restrictions on the Independent Consultant's communications with FINRA staff and, upon request, shall make available to FINRA staff any and all communications between the Independent Consultant and the Firm and documents reviewed by the Independent Consultant in connection with his or her engagement. Once retained, Avalon shall not terminate the relationship with the Independent Consultant without FINRA staff's written approval; Avalon shall not be in and shall not have an attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports or documents to FINRA;**
- (5) At the conclusion of the review, which shall be no more than 120 days after the date of the Notice of Acceptance of this AWC, require the Independent Consultant to submit to the Firm and FINRA staff a Written Report. The Written Report shall address, at a minimum, (i) the adequacy of the Firm's policies, systems, procedures, and training relating to the violations identified in this AWC; (ii) a description of**

the review performed and the conclusions reached, and (iii) the Independent Consultant's recommendations for modifications and additions to the Firm's policies, systems, procedures and training; and

- (6) Require the Independent Consultant to enter into a written agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any other employment, consultant, attorney-client, auditing or other professional relationship with Avalon, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any firm with which the Independent Consultant is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performing his or her duties pursuant to this AWC, shall not, without prior written consent of FINRA staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Avalon or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.
- b. Within 90 days after delivery of the Written Report, Avalon shall adopt and implement the recommendations of the Independent Consultant or, if it determines that a recommendation is unduly burdensome or impractical, propose an alternative procedure to the Independent Consultant designed to achieve the same objective. The Firm shall submit such proposed alternatives in writing simultaneously to the Independent Consultant and FINRA staff. Within 30 days of receipt of any proposed alternative procedure, the Independent Consultant shall: (i) reasonably evaluate the alternative procedure and determine whether it will achieve the same objective as the Independent Consultant's original recommendation; and (ii) provide the Firm with a written decision reflecting his or her determination. The Firm will abide by the Independent Consultant's ultimate determination with respect to any proposed alternative procedure and must adopt and implement all recommendations deemed appropriate by the Independent Consultant.

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

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

Restitution is ordered to be paid to the customers listed on Attachment A hereto in the total amount of \$1,515, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from June 22, 2015, until the date this AWC is accepted by the NAC.

A registered principal on behalf of Avalon shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Laura Leigh Blackston, 1100 Poydras Street, Suite 850, New Orleans, Louisiana 70163, either by letter that identifies Avalon Investment & Securities Group, Inc. and Exam number 2016047823901, or by e-mail from a work-related account of the registered principal of Respondent firm to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason Respondent cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Respondent shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution and interest to the appropriate state authority.

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

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

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

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Complaint issued specifying the allegations against the Firm;

- 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, Avalon 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.

Avalon 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

Avalon 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 the Firm; and**
- C. If accepted:**
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;**
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;**

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
4. The Firm 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. The Firm 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 the Firm'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. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm 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 understands 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.

09/20/2018
Date (mm/dd/yyyy)

Avalon Investment & Securities Group, Inc., Respondent

By: 

Reviewed by:

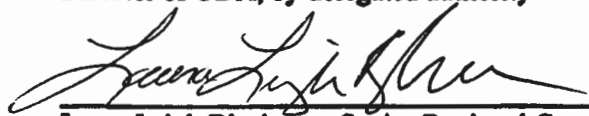

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Accepted by FINRA:

October 25, 2018

Date

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

A handwritten signature in black ink, appearing to read 'Laura Leigh Blackston', written over a horizontal line.

**Laura Leigh Blackston, Senior Regional Counsel
FINRA Department of Enforcement
1100 Poydras Street
Energy Centre, Suite 850
New Orleans, Louisiana 70163-1108
Phone: 504/412-2408; FAX: 504/522-4077**

ATTACHMENT A

Restitution is ordered to be paid to the following customers:

Initials	Restitution Amount plus interest as set forth in the Letter of Acceptance, Waiver & Consent
DS	\$1,500.00
MH	\$15.00