

STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT

IN THE MATTER OF: LPL FINANCIAL LLC, f/k/a)
LPL FINANCIAL CORPORATION.) File No. 1200385
)

CONSENT ORDER

TO THE RESPONDENT: LPL Financial, LLC
c/o James Shorris, Deputy General Counsel
75 State Street, 24th Floor
Boston, MA 02109

WHEREAS LPL Financial, LLC (the "Respondent") on June 30, 2014 executed a certain Stipulation to Entry of Consent Order (the "Stipulation"), which hereby is incorporated by reference herein.

WHEREAS, by means of the Stipulation, the Respondent has admitted to the jurisdiction of the Secretary of State and service of the Notice of Hearing in this matter and the Respondent has consented to the entry of this Consent Order.

WHEREAS, the Secretary of State, by and through his designated representative, the Securities Director, has determined that the matter related to the aforesaid formal hearing may be dismissed without further proceeding.

WHEREAS, the Respondent has acknowledged, without admitting or denying the findings, and solely for the purposes of this proceeding, that the allegations contained in Paragraph VII of the Stipulation shall be adopted as the Secretary of State's Findings of Fact as follows:

Summary

1. From at least 2009 to 2013, LPL Financial failed to adequately maintain certain books and records documenting its variable annuity exchange business and failed to enforce its supervisory system and procedures in connection with the documentation of certain salespersons' variable annuity exchange activities. LPL Financial's conduct constitutes cause to impose sanctions pursuant to Sections 8.E.1(e) and (q) of the Illinois Securities Law of 1953, [815 ILCS 5/1 et seq.,] (the "Act") and violates Section 12.A of the Act.
2. Throughout the 2009 to 2013 period, LPL Financial failed to require documentation of certain variable annuity exchange transactions and certain advisors' recommendations. As a result, LPL Financial failed to identify when verification and correction of information entered in the AOE system was needed.

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3. As a result of these failures, LPL Financial, in connection with *certain variable annuity transactions*, has not adequately enforced written supervisory procedures reasonably designed to achieve compliance with applicable securities laws and regulations and has not adequately maintained its books and records.

Registration History

4. LPL Financial is a limited liability company with a principal place of business at 75 State Street, 24th Floor, Boston, Massachusetts 02109.
5. At all times relevant hereto, LPL Financial was registered as a dealer in Illinois.
6. At all times relevant hereto, LPL Financial was registered as a broker-dealer with the Financial Industry Regulatory Authority ("FINRA") and the Securities and Exchange Commission ("SEC").
7. As a dealer registered in the State of Illinois, LPL Financial is obligated under the Act (and by the SEC and FINRA) to supervise its employees and independent contractors in order to ensure compliance with applicable Federal, State, and self-regulatory organization laws, rules, and regulations.
8. Such duties include the requirements (i) to maintain certain books and records evidencing its compliance with applicable securities laws, rules, and regulations; (ii) to create, maintain, and enforce written supervisory procedures in order to ensure compliance with applicable securities laws, rules, and regulations; and (iii) to create and test internal controls to ensure the efficacy of the written supervisory procedures.

Variable Annuity Features

9. A variable annuity is a contract, between an investor and an insurance company. The insurance company agrees to make periodic payments to the investor, beginning immediately or at some future date. The investor's capital is placed in underlying sub-account investments, such as stock, bond, and money market investments. The sub-accounts are similar to retail mutual funds.
10. Variable annuities assess a mortality and expense risk charge and there may also be administrative fees, advisory fees, and distribution fees, in addition to the sub-account expenses. Additionally, if more than a set portion of the account value is withdrawn early, the company usually assesses a surrender charge. In general, the surrender charge is a percentage of the amount withdrawn that declines gradually over a period of years and is a type of deferred sales charge.
11. The basic insurance benefit associated with a variable annuity is the death benefit. However, there may also be insurance benefits that can be gleaned during the

investor's lifetime ("living benefits"), for a charge. Living benefits are complex and come with many limitations and conditions. Investment choices might be limited (effectively limiting the return on, and volatility of, the investment). Withdrawals may reduce the amount that otherwise would be paid under the living benefit.

12. Investors can do a tax-free exchange, or switch, of an existing annuity contract for a new annuity contract. Guarantees which have accrued might be forfeited when the existing contract is exchanged. Surrender charges payable to the Issuer will apply if the investment is being surrendered within the surrender charge period. If the new annuity has higher annual fees and charges than the old annuity, returns may be reduced, dependent on many factors including new investment choices, benefits and riders. Additionally, a new surrender charge period is typically imposed.

Variable Annuity Sales Regulation

13. FINRA and the SEC have issued numerous rules, advisory documents, and investor alerts about the sale of variable annuities, including bulletins advising investors to carefully consider the risks and costs of exchanging variable annuities.
14. A salesperson who makes a recommendation to a client is required by FINRA Rule 2330 to document the basis upon which the recommendation is made. The documentation required by FINRA Rule 2330 should provide a reviewing principal with sufficient information to assess whether the salesperson has complied with all requirements.

LPL Financial's Systems and Procedures

15. LPL Financial advisors are provided with multiple annuity research tools, including Morningstar® Annuity Intelligence™; Internal Brokerage Consultants; and the Investor Presentation & Proposal Tool.
16. All initial investment and exchange variable annuity transactions are to be submitted on the Annuity Order Entry (AOE) system for supervisor approval. The AOE system identifies transactions in the system based upon "reason codes" that may or may not indicate a need for further review.
17. LPL Financial's policies provide that when an advisor recommends the purchase or surrender of a variable annuity, all material facts are to be disclosed to the client, including fees and surrender charges. Variable annuity communications are to adhere to the following guidelines, among others.
 - a. Disclose fees and charges, including contingent deferred sales charges (also known as surrender charges), mortality and expense risk charges, administrative fees and annual contract fees.
 - b. Present complete comparisons.

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- c. Balance any discussion of liquidity with a description of the negative impacts of withdrawals.
18. The policies also provide that a detailed explanation of the underlying rationale for the suitability of the transaction and a clear financial benefit to the client, in the short- and long-term, is to be included in the transaction documentation. Furthermore, advisors are not to rely on any bonus as the justification for recommending an exchange. They are to make the client aware of all costs, expenses, and benefits associated with the replacement annuity.
19. LPL Financial's policies provide that consideration should be given to whether the financial gain or investment objective to be achieved by the switch is undermined by the transaction fees associated with the switch. The policies also provide that it is typically in the client's best interest to exchange funds within one fund family or sub-accounts within a variable annuity in order to avoid paying an additional commission or incurring additional surrender charges.

LPL Financial's Conduct

20. LPL Financial failed to identify when, in connection with certain variable annuity exchange transactions, its written supervisory procedures were not adequately enforced and its books and records were not adequately maintained.
21. The Department's investigation indicated that documentation maintained on file in connection with certain variable annuity exchange transactions and reviews of variable annuity exchange recommendations were often incomplete and/or contained inaccurate information. Certain AOE system entries reviewed by the Department contained inaccuracies, missing client information, and missing or incomplete fees for variable annuity exchange transactions. LPL Financial did not verify that information or correct it.
22. Records for several variable annuity exchange transactions identified the amount of the variable annuity being surrendered and the surrender charge as identical. For other transactions, disclosed surrender charges were inaccurate by thousands of dollars. Estimated surrender charges may vary due to market changes, but market fluctuations do not account for such substantial variance.
23. LPL Financial inadequately enforced its supervisory system and procedures in connection with the documentation of certain salespersons' variable annuity exchange activities. The Department's investigation indicated that supervisors were not always provided with complete and accurate documentation to ensure proper reviews of certain advisors' variable annuity exchange recommendations.
24. Advisors did not consistently document sufficient bases for their variable annuity exchange recommendations. Without enforcement of the policies, advisors failed to

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properly document recommendations in the AOE system, often using brief explanations which lacked sufficient information regarding the particular client's circumstances to gain approval. A Notes section was provided in the AOE system for comments and questions to facilitate the review process. However, within the AOE system, pertinent details of transactions, such as fees, options, and client objectives, were not consistently documented.

25. LPL Financial provided annuity research tools for its advisors, which would have assisted in documenting quantitative comparisons, but failed to require documentation evidencing the use of the tools. As a result, documented comparisons were generally qualitative.
26. On multiple occasions, advisors stated in the AOE system that they were unaware of the specific terms of the original annuity because they had not been the advisor at the time of the original transaction. There is no documentation indicating that the statements were addressed or that the advisors were required to obtain that information.
27. The Department notes LPL Financial's cooperation in its investigation and LPL Financial's remediation undertaken in advance of the Stipulation. LPL Financial has taken several actions in furtherance of the Department's concerns, including the termination of certain advisors who were registered as salespersons in Illinois due to their practices in connection with certain variable annuity transactions. LPL Financial also implemented the following actions, as previously described in a letter to the Department:
 - a. Undertook to offer compensation to certain LPL Financial clients who exchanged variable annuities between 2009 and 2013;
 - b. Undertook a comprehensive review of its supervisory system and procedures for variable annuity transactions, including but not limited to exchanges;
 - c. As a result of its review, made findings and conclusions regarding LPL Financial's practices, policies, and procedures, as well as recommendations for improvements and changes to such practices, policies, and procedures; and
 - d. Adopted, or is in the process of adopting, the following practices, policies, and procedures:
 - i. Creating a dedicated variable annuity review team to achieve consistent, centralized, and enhanced supervision of variable annuity transactions and documentation;
 - ii. Providing enhanced training of advisors, field OSJ managers, and supervisory principals regarding the sale and exchange of variable annuities;

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- iii. Implementing enhanced processes regarding: parameters for the approval of variable annuity sales and exchanges, taking into account factors such as client age and surrender charge amount; required input fields in the AOE system; independent validation of key transaction data; and review of client disclosure documents; and
- iv. Enhancing disclosures on variable annuity sales and exchange transaction documents.

Violations

28. LPL Financial's conduct in connection with certain variable annuity exchange transactions constitutes cause to impose sanctions pursuant to Sections 8.E.1(e) and (q) of the Act and violates Section 12.A of the Act.
29. Section 8.E.1(e) provides, *inter alia*, that the registration of a dealer, salesperson, or registered principal of a dealer may be suspended or revoked if the Secretary of State finds that the dealer, salesperson, or registered principal of a dealer has failed to maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of its salespersons that are reasonably designed to achieve compliance with applicable securities laws and regulations.
30. Section 8.E.1(q) provides, *inter alia*, that the registration of a dealer or salesperson may be suspended or revoked if the Secretary of State finds that the dealer or salesperson has failed to maintain the books and records required under this Act.
31. LPL Financial's supervisory system and procedures for certain variable annuity exchange transactions failed to identify when verification and correction of information entered in the AOE system was needed and when reviews of certain advisors' recommendations required further documentation. LPL Financial also failed to maintain accurate and complete documentation for certain variable annuity exchange transactions.
32. By virtue of the foregoing, the Respondent's registration is subject to suspension or revocation pursuant to Sections 8.E.1(e) and (q) of the Act.
33. Section 12.A of the Act provides, *inter alia*, that it shall be a violation of the Act for any person to offer or sell any security except in accordance with the provisions of the Act.
34. By virtue of the foregoing, the Respondent has violated Section 12.A of the Act.
35. Section 11.E(4) of the Act provides, *inter alia*, that if the Secretary of State, after finding that any provision of the Act has been violated, may impose a fine as

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provided by rule, regulation, or order; an order of censure; and charge all reasonable expenses as costs of investigation.

36. Section 11.F(1) of the Act provides, *inter alia*, that the Secretary of State may prohibit or suspend a dealer or salesperson from engaging in the business of selling or offering for sale securities or prohibit or suspend a person from acting as an investment adviser, federal covered investment adviser, or investment adviser representative after an opportunity for hearing is given.

WHEREAS, the Respondent has acknowledged that the allegations contained in Paragraph VIII of the Stipulation shall be adopted as the Secretary of State's Conclusions of Law as follows:

37. That by virtue of the foregoing the Respondent, LPL Financial, is subject to suspension or revocation.
38. That by virtue of the foregoing the Respondent, LPL Financial, violated Section 12.A of the Act.
39. That by virtue of the foregoing the Respondent, LPL Financial, is subject to a fine, an order of censure, and a charge of costs.

NOW THEREFORE IT IS HEREBY ORDERED THAT:

40. The allegations contained in Paragraphs VII and VIII of the Stipulation shall be and are hereby adopted as the Secretary of State's Findings of Fact and Conclusions of Law.
41. Respondent, LPL Financial, will, within one month after entry of this Consent Order, make every reasonable effort to offer restitution for all transactions in which accurate surrender charges or other determinations were not properly documented, as identified in Exhibit B of the Stipulation and in the amounts stated therein, including sending follow up letters and calling clients as may be necessary.
 - a. At a minimum, LPL Financial will attempt to make the offer to each client via first class mail and a phone call. If the client does not respond, a second attempt will be made in the same manner. If the client still does not respond, a third attempt will be made to call the client.
 - b. A registered principal of the firm will, on behalf of LPL Financial, submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution within four months after entry of this Consent Order. Said submission will be mailed or delivered to the Illinois Securities Department, Enforcement Division, 300 W. Jefferson St., Suite 300A, Springfield, Illinois 62702, and will reference File Number 1200385.

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- c. If, for any reason, LPL Financial cannot locate any client after reasonable and documented efforts, LPL Financial will forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the client was last known to have resided. LPL Financial will provide satisfactory proof of such action to the Department, in the manner described above, within 10 business days of forwarding the undistributed restitution to the appropriate state authority.
42. Respondent, LPL Financial, will provide the relevant clients with contact information for call center personnel trained to answer questions about the transactions and resulting surrender charges. LPL Financial will upon request assist the clients, to the extent it is able to do so, in verifying the amount of the surrender charge, including, if necessary, assisting clients with contacting the issuer directly to verify the amount.
- a. LPL Financial will notify the relevant clients that, if the surrender charge refunded by LPL Financial was inaccurate, the client should provide to the Department: (1) a correct mailing address; and (2) an unaltered, original version of a written document from the original variable annuity issuer which discloses the correct surrender charge and which provides basic identifying information for the transaction. All information must be mailed or delivered to the Illinois Securities Department, 300 W. Jefferson St., Suite 300A, Springfield, Illinois 62702, no later than December 31, 2014 and reference File Number 1200385. The Department will provide the information to LPL Financial. LPL Financial will, within one month of receipt of the Department's notification, issue additional restitution to make up the difference between the amount previously refunded and what should have been refunded.
 - b. A registered principal of the firm will, on behalf of LPL Financial, submit satisfactory proof of payment of the additional restitution within two months after receipt of the Department's notification. Said submission will be mailed or delivered to the Illinois Securities Department, Enforcement Division, 300 W. Jefferson St., Suite 300A, Springfield, Illinois 62702 and will reference File Number 1200385.
43. Respondent, LPL Financial, will make a monetary payment in the amount of \$2,000,000 (two million dollars) to the Illinois Secretary of State for deposit in the Securities Audit and Enforcement Fund. The check will, within 10 business days of entry of this Consent Order, be mailed or delivered to the Illinois Securities Department, 300 W. Jefferson St., Suite 300A, Springfield, Illinois 62702.
44. Respondent, LPL Financial, will be Censured.
45. Respondent, LPL Financial, will cease and desist from conduct in violation of the Act.

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46. The Department will retain jurisdiction over this proceeding for the sole purpose of enforcing the terms and provisions of the Stipulation.
47. This Consent Order is not intended to subject Respondent, or any of its affiliates and their current or former officers, directors, or employees, to any disqualifications under the laws of the United States, any state, the District of Columbia, Puerto Rico, or the U.S. Virgin Islands, or under the rules or regulations of any securities or commodities regulator or self-regulatory organization, including, without limitation, any disqualification from relying upon state or federal registration exemptions or safe harbor provisions. In addition, this Consent Order is not intended to form the basis for any such disqualification.
48. This Consent Order will not disqualify Respondent, or any of its affiliates and their current or former officers, directors, or employees, from any business that they otherwise are qualified, licensed, or permitted to perform under applicable securities laws or regulations of Illinois and any disqualifications from relying upon this state's registration exemptions or safe harbor provisions that arise from this Consent Order are hereby waived.
49. This Consent Order will be binding upon Respondent, its affiliates, successors, and assigns with respect to all conduct subject to the provisions above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events, and conditions.

ENTERED: This 30th day of June, 2014



JESSE WHITE
Secretary of State
State of Illinois

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