

**STATE OF ILLINOIS  
SECRETARY OF STATE  
SECURITIES DEPARTMENT**

IN THE MATTER OF:	)	)	)	)	)
LPL FINANCIAL LLC,	)	)	)	)	)
RESPONDENT.	)	)	)	)	)

**FILE NO. 1800307**

**NOTICE OF HEARING**

TO RESPONDENT:

LPL Financial LLC  
c/o Neal E. Sullivan, Partner  
Sidley Austin, LLP  
nsullivan@sidley.com

You are hereby notified that pursuant to Section 11.F of the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act") and 14 Ill. Adm. Code 130, subpart K, a public hearing will be held at 69 West Washington Street, Suite 1220, Chicago, Illinois 60602, on January 23, 2018 at the hour of 10:00 a.m., or as soon thereafter as possible before James L. Kopecky, Esq. or such other designated Hearing Officer as the Secretary of State may appoint.

Said hearing will be held to determine whether an Order shall be entered to permanently prohibit Respondent **LPL Financial, LLC** from offering or selling securities in or from the State of Illinois and/or granting such other relief as may be authorized under the Act, including but not limited to, the imposition of a monetary fine in the maximum amount pursuant to Sec. 11.E(4) of the Act, payable within ten (10) days of the Order.

The grounds for such proposed action are as follows:

**I. FINDINGS OF FACT**

**A. BACKGROUND, CONTRACT WITH BSDC:**

1. Every broker-dealer is required to have a supervisory system that is reasonably

designed to ensure that the broker-dealer complies with all state and federal laws, rules and regulations, including laws that prohibit the offer or sale of unregistered, non-exempt securities. Securities issued by companies listed on major national exchanges (*e.g.*, NYSE, AMEX, NASDAQ) and securities issued by registered investment companies (*e.g.*, mutual funds) are in most instances exempt from the Blue Sky requirements at issue here.

2. A reasonably designed system at a minimum includes written policies and procedures governing the offer and sale of securities by registered persons, training for all associated persons, and supervisory procedures and designated supervisors responsible for ensuring compliance.
3. In January 2000, LPL entered into an agreement with Blue Sky Data Corporation ("BSDC"), by which BSDC was obligated to supply LPL with data for LPL's use in compliance and supervisory efforts related to Blue Sky laws, rules, and regulations (the "Subscription Agreement"). The Subscription Agreement was amended in 2006.
4. As executed in January 2000 and amended in mid-2006, the Subscription Agreement included data for equity securities, but not for fixed income securities.
5. From at least January 2000 forward, the Subscription Agreement provided for a data feed that, if properly utilized, would allow for the review of trades to ensure that equity securities were properly registered in the customer's state. The subscription also provided online access for authorized personnel to query a specific CUSIP to determine its registration status in each U.S. state and territory. As described in more detail below, although the contract would enable such review, LPL failed to ensure during the relevant period that the data was comprehensively utilized and that its systems were properly configured to effectively make use of the data.

**B. BLUE SKY COMPLIANCE EFFORTS:**

6. LPL has represented that for a number of years, through at least October 2006, LPL's Surveillance Department conducted a manual review of certain solicited equities trades to confirm Blue Sky compliance. This involved the use of various reports and reference to registration and exemption data from BSDC, as a result of the state securities registration subscription described above, and resulted in LPL identifying certain violations and taking certain remedial actions.
7. At some point after October 2006 the manual Blue Sky Review process described above lapsed. Records reflect that LPL thereafter failed to meet Blue Sky compliance obligations and failed to address registration and exemption requirements in the states.
8. Records reflect that in 2006, LPL supplemented its subscription with BSDC to, among other things, include automated checks (a/k/a "edits") to review orders

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against data from BSDC. Records reflect that the Subscription Agreement was amended based on an assumption by certain LPL personnel that, with this supplemental data feed feature, a front-end order entry block (i.e., an automated mechanism that would prevent the execution of trades of unregistered, non-exempt securities) could be implemented with a fair degree of ease.

9. Lacking necessary training, supervision and process implementation of various order entry systems, including the role of both proprietary systems and vended, third-party systems, LPL personnel failed to accomplish the additional steps that would be required to implement a front-end order entry hard block. While it appears from LPL records that the implementation difficulties were recognized by certain personnel and some efforts to resolve the technological obstacles were undertaken over a period of time, these efforts were not successful as the efforts were not given the appropriate stature within LPL, necessary training, or appropriate and adequate supervision.
10. As reflected in various records, poor intradepartmental and interdepartmental communications and a lack of integrated supervision and governance over vendor agreements, order entry systems controls, and Blue Sky compliance contributed to the failure of certain personnel in both Trading and Compliance to recognize at various points in time that Blue Sky hard blocks had not been implemented into LPL's order entry systems.
11. Records reflect that, during the relevant period, other personnel appeared to place reliance on other surveillance reviews that were designed for purposes of complying with certain LPL internal policies (for example, surveillance reviews pertaining to compliance with LPL's internal prohibition of solicited trades of low-priced and certain unlisted securities) as a means of capturing Blue Sky violations. LPL failed to ensure there was a review specifically designed to address state securities registration requirements.
12. The groups and functions that are required for ensuring Blue Sky compliance were not integrated and were fragmented across the organization, particularly in a period during which LPL was experiencing significant growth. Moreover, LPL lacked and failed to provide institutional Blue Sky expertise or experience in the form of an individual or individuals with particularized knowledge of industry-wide standards, policies, procedures and processes. This resulted in a failure by LPL to comprehensively address Blue Sky compliance needs and to develop and fund what should have been a centralized set of Blue Sky compliance controls.

### **C. CANCELLATION AND REINSTATEMENT OF BSDC DATA FEED:**

13. In or around January 2014, LPL's Procurement Department ("Procurement") undertook a review of various vendor contracts. Procurement identified the

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Subscription Agreement, at a cost of \$31,200 per year, and inquired whether LPL had a need for the service and who within LPL used the subscription. The purpose of this inquiry was to determine whether Procurement could cancel or not renew the BSDC subscription.

14. Procurement was directed to LPL's Governance, Risk & Compliance Department ("Compliance"), specifically a vice president in Compliance ("VP Compliance").
15. Without adequate controls in place to ensure that the inquiry was conducted properly, VP Compliance and an assistant vice president in Compliance sent a series of separate emails to various personnel within LPL's Registrations, Trading, Compliance, and Operations departments to determine whether LPL had a continued need for the BSDC subscription or whether the contract could be cancelled.
16. None of the personnel consulted indicated that the BSDC subscription was critical to compliance with Blue Sky state registration requirements.
17. Following these inquiries, in February 2014, VP Compliance wrote to Procurement that it was "ok to discontinue" LPL's subscription to the Subscription Agreement.
18. In March 2014, Procurement provided written notice to BSDC to terminate the Subscription Agreement and LPL paid the final April 2014 invoice.
19. Email records reflect that on October 23, 2014, a trader on LPL's Equity Trading desk ("Equity Trading") reviewed a screen that contained information showing a particular security to be restricted as a result of not being registered for sale or exempt from registration in the particular jurisdiction (which information appears to have been populated to the system before the BSDC contract was terminated). The trader shared the screen with a Manager in Equity Trading who in turn contacted BSDC in an effort to determine whether the particular restriction was valid. Through this outreach to BSDC, that Manager learned that LPL's subscription to the state securities registration data had been cancelled months earlier.
20. On October 24, 2014, Equity Trading requested by email that the subscription be immediately reinstated. In that email, Equity Trading explained that it relied on the data to determine if over-the-counter securities are Blue Sky-compliant in the U.S. and territories, stating: "[w]e would like to request to have this subscription renewed as quickly as possible as this is a critical part of our day to day business."
21. In December 2014, LPL and BSDC reinstated the Subscription Agreement and in February 2015, LPL was again receiving up-to-date data into its equity trading system from BSDC.

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22. Both before and after the contract cancellation, alerts relating to potential Blue Sky registration violations for equity securities were visible only to the trading desk and not to financial advisors who placed trades directly and, as noted above, notwithstanding that LPL had access to BSDC data for equity securities, LPL's systems did not operate to prevent a trade that was not Blue Sky-compliant (*i.e.*, a front-end block).
23. While the reinstated Subscription Agreement obligated BSDC to provide LPL with data for both equity and fixed income securities, at no point prior to December 2014 did the Subscription Agreement include data for fixed income securities.

### **D. POST-REINSTATEMENT REVIEW AND REMEDIAL MEASURES:**

24. Following the reinstatement of the BSDC contract, LPL conducted a review of certain equities and fixed income trades and identified certain Blue Sky violations requiring remediation. LPL attempted repurchase or damages offers to affected investors identified through this limited review. In connection with the making of these offers, LPL contacted securities regulators in certain jurisdictions about the offers.
25. As reflected in various records, poor intradepartmental and interdepartmental communications and a lack of integrated supervision and governance resulted in LPL's failure at that time to conduct a sufficient analysis to determine the root cause of the identified violations and compliance and supervisory shortcomings.
26. LPL has represented that following the reestablishment of the BSDC contract, LPL implemented several Blue Sky controls.
27. LPL has engaged several consultants to conduct a comprehensive review of its current Blue Sky compliance program and to assist LPL with implementation of recommendations, which is ongoing.
28. LPL has represented that it has designed and began implementing Blue Sky training for Compliance, Trading, Operations and Legal personnel and hired a senior-level Blue Sky compliance expert as a full-time employee, who has responsibilities for establishing and implementing the enhanced Blue Sky compliance program as guided by the independent consultants.

## **II. CONCLUSIONS OF LAW**

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1. The Department has jurisdiction over this matter pursuant to the Illinois Securities Law of 1953 [815 ILCS 5/1 *et seq.*] ("Act").
2. LPL failed to invest sufficient and appropriate resources in personnel, expertise, systems, and operations to adequately comply with Blue Sky laws, rules, and regulations, in violation of Section 8.E(1)(e)(IV) of the Act.
3. LPL failed to reasonably supervise the flow of information to ensure full and proper compliance with state securities registration requirements, in violation of Section 8.E(1)(e)(iv) of the Act.
4. LPL failed to maintain adequate systems to reasonably supervise agents, staff, and employees to prevent the sale of unregistered, non-exempt securities, in violation of Section 8.E(1)(e)(iv) of the Act.
5. LPL failed to supervise agents, staff, and employees in the performance of duties with respect to systems operation, process, and checks and balances to ensure compliance with Blue Sky laws, rules, and regulations, in violation of Section 8.E(1)(e)(iv) of the Act.
6. LPL acted negligently in canceling certain third-party services critical for compliance with Blue Sky laws, rules, and regulations, in violation of Section 8.E(1)(e)(iv) of the Act.
7. LPL failed to maintain books and records necessary to ensure full and proper compliance with Blue Sky laws, rules, and regulations, in violation of Section 8.E(1)(q) of the Act.
8. LPL failed to conduct appropriate and necessary due diligence regarding the retention, use, and subsequent cancellation of certain third-party services critical for compliance with Blue Sky laws, rules, and regulations, in violation of Sections 8.E(1)(e)(iv) and 8.E(1)(q) of the Act.
9. Relief is appropriate and in the public interest.

You are further notified that pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130) (the "Rules"), **you are required to file an answer to the allegations outlined above within thirty (30) days of the receipt of this notice.** A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing. The answer and all other pleadings and motions must be filed with the Illinois Securities Department by addressing them to:

Paula Bouldon  
Enforcement Attorney  
Illinois Department of Securities  
69 West Washington, Suite 1220  
Chicago, Illinois 60602

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Furthermore, you may be represented by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to so appear shall constitute default unless Respondent has upon due notice moved for and obtained a continuance.

The Rules promulgated under the Act and pertaining to Hearings held by the Office of the Secretary of State, Securities Department may be viewed online at <http://www.cyberdriveillinois.com/departments/securities/lawrules.html>.

Delivery of notice to the designated representative of Respondent constitutes service upon such Respondent.

Dated: This 6<sup>th</sup> day of December 2018.

Handwritten signature of Jesse White in black ink, written over a horizontal line. To the right of the signature is a handwritten number '91'.

JESSE WHITE  
Secretary of State  
State of Illinois