FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2016050751901

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

RE: LPL Financial LLC, Respondent
CRD No. 6413

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

I.

ACCEPTANCE AND CONSENT

A. LPL 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

LPL has been a FINRA member since February 1973. The Firm conducts a general securities business and is headquartered in Boston, Massachusetts. LPL has approximately 20,000 registered persons operating out of over 12,000 branch offices.

RELEVANT DISCIPLINARY HISTORY

In April 2015, LPL, without admitting or denying the findings, executed an AWC (No. 2013035109701) in which it consented to a censure, a fine of $10 million, restitution of $1,664,592.05 and findings that, among other things, its automated anti-money laundering ("AML") surveillance system failed to generate alerts about excessive withdrawals from automated teller machines ("ATMs"), and from ATMs in foreign jurisdictions. Those surveillance failures stemmed from the Firm's failure to detect, and then correct, flaws in the programming of the automated system that should have alerted the Firm to potentially suspicious customer ATM activity. Additionally, the AWC found that, from July 2011 through at least December 2012, the Firm failed to timely file associated persons'

Uniform Application for Securities Industry Registration or Transfer ("Form U4") amendments and Uniform Termination Notices for Securities Industry Registration ("Forms U5"), in violation of FINRA Rules 1122 and 2010, and Article V, Sections 2 and 3 of the FINRA By-Laws. In some of those instances, the Firm failed to amend its registered representatives' Forms U4 until FINRA staff notified the Firm that it had failed to make the required filings.

OVERVIEW

As a result of AML program and supervisory failures, the Firm failed to file with the government and with FINRA information critical to the protection of investors and the public.

First, as a result of its unreasonably designed AML program, the Firm failed to investigate certain attempts to gain unauthorized access to electronic systems and potential illegal activity carried out by electronic systems (collectively "cyber-related events") that should have resulted in the filing of Suspicious Activity Reports ("SARs"). This failure stemmed primarily from the Firm's use of a "fraud case chart" that provided inaccurate guidance to the Firm's AML employees concerning investigation and reporting requirements associated with suspicious activity related to incidents when third parties used electronic means to attempt to compromise a customer's email or brokerage account. As a result of employees' reliance on the inaccurate fraud case chart, among other things, the Firm failed to investigate certain cyber-related events and to file more than 400 SARs; over half of the subsequently filed SARs indicate that the cyber-events were unsuccessful.

Second, the Firm failed to file or amend Forms U4 or U5 to report certain customer complaints. Specifically, the Firm too narrowly interpreted the requirement that a complaint contain "a claim for compensatory damages of $5,000 or more." The Firm incorrectly interpreted this phrase to mean that it was not required to report any complaint that did not *expressly* request compensation, even in instances when the customer alleged a specific sales practice violation that caused him or her a loss of $5,000 or more, and the complaint, when viewed as a whole, made clear that the investor was seeking compensation for such loss. As a result, the Firm failed to report on Forms U4 and U5 at least 31 reportable customer complaints alleging sales practice violations involving the Firm's registered representatives. The Firm also failed to amend in a timely manner its registered representatives' Forms U4 and U5 to disclose at least 149 customer complaints and other reportable events, including judgments, bankruptcies, terminations, and regulatory and criminal actions.

By reason of the foregoing, LPL violated Article V, Sections 2 and 3 of the FINRA By-Laws, NASD Rule 3010 and FINRA Rules 3110, 3310 and 2010.

FACTS AND VIOLATIVE CONDUCT

A. FINRA's Investigation

This matter arose from three distinct investigations. In one, FINRA Staff (the "Staff") examined the compromise of an email account of an LPL customer that led to the customer's loss of $9,500. In response to the Staff's inquiry, LPL informed that Staff that it did not file a SAR to report the incident, but then determined that it should have done so. Shortly thereafter, LPL disclosed to the Staff that the Firm had identified widespread gaps in its investigations related to certain attempted and successful cyber-related events that may have resulted in missed SAR filings. As a result, the Firm voluntarily conducted a review of its SAR filing practices beyond cyber-related events and reported its review findings to FINRA.

In the second investigation, the Staff examined a customer complaint alleging that an LPL registered representative had made investment-related misrepresentations causing the customer losses of over $200,000. When the Staff inquired as to why LPL did not report this complaint on the representative's Form U4, the Firm responded that "a U4 amendment is not required to disclose this complaint because it does not contain a claim for compensatory damages.... Although the [customers] allege that their losses are over $200,000, their letter does not request the return of those funds or state any other claim for damages." The Staff disagreed with the Firm's explanation, and expanded its review.

The third investigation resulted from a trend analysis review by FINRA, which showed that LPL had more late Form U4 and Form U5 filings than the industry average. At the Staff's request, LPL provided information relating to the late filings during this period, which the Staff reviewed and analyzed.

B. LPL Failed to Establish and Implement an AML Program Reasonably Designed to Detect and Cause the Reporting of Potentially Suspicious Activity

FINRA Rule 3310 requires each FINRA member to "develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act...and the implementing regulations promulgated thereunder by the Department of the Treasury." The program must, at a minimum, "[e]stablish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder...." Broker-dealers are required to report suspicious activity pursuant to 31 C.F.R. § 1023.320.

The Financial Crimes Enforcement Network ("FinCEN"), a bureau of the Department of the Treasury, has issued guidance regarding financial institutions'

obligations to report cyber-related events. In December 2011, for example, FinCEN issued an Advisory to assist financial institutions with identifying and reporting account takeover activity, where cybercriminals attempt intrusions into a customer's account in order to steal the customer's funds.[1]

From at least January 1, 2013 through May 31, 2016, LPL failed to establish and implement an AML program reasonably designed to detect and cause the reporting of suspicious activity, including cyber-related events. During this period, the Firm provided its AML analysts with flawed internal guidance regarding the requirements for investigating and reporting cyber-related events, as set forth below.

The Firm's AML investigations unit prepared and utilized an internal "fraud case chart" (the "Chart"). The Chart summarized the SAR filing requirements applicable to certain fact patterns, including incidents where third parties used, or attempted to use, electronic systems to compromise a customer's email or brokerage account. The Firm's AML analysts relied on the Chart when determining, among other things, whether to investigate cyber-related events, and whether to file a SAR. The Chart, however, was inaccurate. The Chart suggested that AML analysts were not required to investigate cyber-related events if the customer did not incur a financial loss or if the attempted intrusion was not completed. This internal guidance was erroneous. 31 C.F.R. § 1023.320 requires broker dealers to file a SAR even where transactions are attempted, but not conducted.[2]

In addition, based on further erroneous internal guidance, the Firm's AML investigations unit did not investigate cyber-related events involving potential harm less than $25,000. The correct threshold for broker-dealers, however, is $5,000, not $25,000.[3]

For more than three years, LPL's AML analysts used these inaccurate internal guidelines to determine whether to investigate cyber-related events and to file a SAR.

Moreover, unrelated to the use of the Chart, some AML analysts failed to investigate "negative news" alerts concerning Firm customers because they mistakenly believed that they should investigate only those alerts that involved

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[1] *See* FinCEN Advisory FIN-2011-A016 "Account Takeover Activity" (Dec. 2011). *See also* Frequently Asked Questions Regarding the FinCEN Suspicious Activity Report (SAR) (May 2013), question number 17. FinCEN issued additional guidance in 2016, after the review period in this matter. *See* FinCEN Advisory FIN-2016-A005 "Advisory to Financial Institutions on Cyber-Events and Cyber-Enabled Crime" (Oct. 2016).

[2] *See* 31 C.F.R. § 1023.320(a)(2) ("A transaction requires reporting under the terms of this section if it is conducted or attempted by, at, or through a broker-dealer ...").

[3] *See id.* ("A transaction requires reporting under the terms of this section if ... it involves or aggregates funds or other assets of at least $5,000 ...").

financial crime or which might have a clear financial impact on customers' accounts.

As a result of the above failures, the Firm failed to investigate incidents and file more than 400 SARs with FinCEN.

Moreover, the Firm failed to establish reasonable procedures regarding analysts' reviews of AML-related referrals sent by Firm employees and registered representatives. The Firm used an electronic mailbox (the "Mailbox") as the central repository for, among other things, escalations of potentially suspicious activity by individuals across the Firm. The Firm estimates that the Mailbox received between 16,251 and 22,641 items each year between 2013 and 2016, including some that were referrals of potentially suspicious activities. The Firm's AML analysts reviewed the Mailbox on a rotating basis. During the Relevant Period, the analysts' determinations, however, were not tracked or monitored for quality control. There was no system in place, for example, to ensure that items were reviewed in a timely manner. Moreover, internal written procedures authorized analysts to discard email referrals that did not "warrant response," but failed to identify the circumstances when an analyst might appropriately discard a referral. The Firm's internal audit department identified concerns about the Mailbox in January 2016, but the Firm failed to promptly correct the issues.

By virtue of the foregoing, LPL violated FINRA Rules 3310(a) and 2010.

C. LPL Failed to Amend Forms U4 and U5

Article V, Section 2(c) of FINRA's By-Laws requires that every Form U4 "be kept current at all times by supplementary amendments," which must be filed "not later than 30 days after learning of the facts or circumstances giving rise to the amendment." Similarly, Article V, Section 3(b) of FINRA's By-Laws provides that, in the event a member learns of facts or circumstances causing any information set forth in a Form U5 filed with FINRA to become inaccurate or incomplete, the member must notify FINRA, within 30 days thereafter, of those facts or circumstances by means of an amendment to the Form U5. Filing false or incomplete Forms U4 or U5, or failing to amend them timely, violates Article V, Sections 2 and 3 of FINRA's By-Laws, as well as FINRA Rule 2010.

Maintaining an accurate Form U4 or Form U5 is critical to a self-regulatory organization's function in screening and monitoring registered representatives. Truthful and complete answers to Form U4/U5 questions are critical because these responses may serve as an early warning mechanism and may identify individuals with troubled pasts or suspect financial histories. In addition, the information that FINRA releases to the public through BrokerCheck, which helps investors make informed choices about the individuals and firms with whom they conduct business, is derived from FINRA's Central Registration Depository

("CRD"), and CRD relies on the accuracy of firms' and registered representatives' filings, including Forms U4 and U5.

At all relevant times, Question 14I(3) on Form U4 required the reporting of customer complaints, as follows:

> Within the past twenty-four (24) months, have you been the subject of an *investment-related*, consumer-initiated, written complaint, not otherwise reported under question 14I(2) above, which... alleged that you were *involved* in one or more *sales practice violations* and contained a claim for compensatory damages of $5,000 or more (if no damage amount is alleged, the complaint must be reported unless the *firm* has made a good faith determination that the damages from the alleged conduct would be less than $5,000), ...

Question 7E(3) on Form U5 required the reporting of customer complaints that would be reportable on Form U4, under Question 14I(3), if the events that are involved in the complaint occurred while the individual was still employed by the firm, and the complaint was not previously reported on the individual's Form U4.

From at least March 2013 through November 2017, LPL failed to amend its registered representatives' Forms U4 and U5 to disclose at least 31 reportable customer complaints alleging sales practice violations by an LPL registered representative.[4]

The principal reason LPL did not report the complaints on Forms U4 and U5 was that the Firm narrowly construed the Forms' requirement that a customer complaint contain "a claim for compensatory damages of $5,000 or more." The Firm incorrectly interpreted this phrase to mean that it was not required to report complaints that did not *expressly* request compensation even in instances when the complaint, when viewed as a whole, made clear that the investor was seeking compensation for his or her losses. As a result of this overly restrictive interpretation of its filing requirements, the Firm failed to report at least 31 reportable customer complaints, including the following:

- In 2015, LPL received a customer complaint alleging that an LPL registered representative had made investment-related misrepresentations causing customer losses of over $200,000.
- In late 2015, LPL received a customer complaint alleging that an LPL registered representative had made investment-related misrepresentations and engaged in unauthorized trading, stating that the representative

[4] This number of unreported customer complaints is based on a review of a small sample of the total number of complaints. For the period from March 1, 2013 through March 1, 2016, LPL received approximately 1,328 customer complaints alleging sales practice violations. The 31 unreported complaints cited in this AWC were identified by FINRA Staff after reviewing a sample of 137 complaints where the Firm made a filing to FINRA pursuant to FINRA Rule 4530 related to the complaint, but did not amend the representative's Form U4 to reflect the complaint.

"pushed" her into an investment and caused her to lose $17,000 of "the money that my deceased husband left me to live on."

- In the spring of 2017, an LPL registered representative received a customer complaint alleging that he had made investment-related misrepresentations and charged undisclosed, excessive commissions, causing the customers a loss of more than $11,000. The complaint expressly stated: "I feel that I deserve compensation for my losses."

There is no requirement that a complaint expressly demand relief in order to be reported on Forms U4 and U5. Moreover, the term "damages" is not used in a restrictive manner on Forms U4 and U5; it encompasses any claim for monetary relief. Furthermore, in some instances where complaints did not contain a specific damages amount, LPL failed to establish that it made a good faith determination that the damages from the alleged misconduct contained in complaints would be less than $5,000, as required.

In addition, LPL failed to file required amendments to Forms U4 or U5 in a timely manner in 149 instances from March 2013 through March 2017. Specifically, LPL failed to timely amend its registered representatives' Forms U4 and U5 to disclose 149 customer complaints and other reportable events. LPL was on notice of these customer complaints, judgments, bankruptcies, terminations, and regulatory and criminal actions, but failed to disclose them on Forms U4 or U5 within 30 days, as required, due to "firm error."

By virtue of the foregoing, LPL violated Article V, Sections 2 and 3 of FINRA's By-Laws and FINRA Rule 2010.

D. LPL Failed to Establish, Maintain and Enforce a Supervisory System and Written Supervisory Procedures Reasonably Designed to Achieve Compliance with Form U4 and U5 Reporting Requirements

FINRA Rule 3110(a), which replaced NASD Rule 3010(a) effective December 1, 2014, requires that each member shall 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 FINRA rules.

FINRA Rule 3110(b) and its predecessor, NASD Rule 3010(b), require each member 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 applicable FINRA rules.

LPL failed to establish and maintain a supervisory system reasonably designed to achieve compliance with the FINRA rules requiring firms to review customer

complaints and, when necessary, to disclose them on representatives' Forms U4 and U5. LPL's written supervisory procedures did not require that the Firm make a good faith determination of damages, as required, where the amount of damages was not specified in the complaint. Moreover, the decision whether to report a complaint on Forms U4 or U5 rested with each LPL reviewing employee individually, and there was unreasonable oversight of the process to ensure consistency among employees. As a result of these systemic supervisory failures, customer complaints that should have been reported on Forms U4 or U5 were not.

By virtue of the foregoing, LPL violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

OTHER FACTORS

In determining the appropriate monetary sanction, FINRA considered the Firm's cooperation and undertaking to remedy its violations.[5] Specifically, in resolving this matter, FINRA has recognized LPL's extraordinary cooperation in having: (1) initiated, on its own, an investigation to identify the scope and extent of its AML Program failures regarding SAR filings; (2) retained an outside law firm to conduct an extensive internal investigation, which included interviewing Firm employees and re-evaluating reporting determinations; (3) promptly remediated certain of the problems set forth above by filing 418 SARs that it determined should have been filed earlier, and agreeing to amend 31 Forms U4 and U5 to add customer complaint information; (4) initiated a review of its procedures regarding complaint reporting, AML investigations and SAR reporting, and a restructuring of its AML investigations unit; and (5) provided substantial assistance to FINRA in its investigation, including providing detailed presentations concerning the results of the Firm's internal investigations.

B. LPL consents to the imposition of the following sanctions:

- a censure;
- a fine in the amount of $2.75 million; and
- undertakings to:
    - review (1) 696 customer complaints identified by FINRA that were originally sent to LPL between January 2013 and November 2017, to achieve compliance with Article V, Sections 2 and 3 of FINRA's By-Laws and FINRA Rule 2010, and (2) the Firm's supervisory systems and written procedures relating to reporting customer complaints and other reportable events to ensure that they are reasonably designed to

[5] *See* FINRA Regulatory Notice 08-70 (Nov. 2008).

achieve compliance with Article V, Sections 2 and 3 of FINRA's By-Laws and FINRA Rule 2010; and

- submit, within 120 calendar days of the issuance of this AWC, to Ian McLoughlin, Senior Counsel, FINRA, 99 High Street, Suite 900, Boston, Massachusetts 02110, (1) a report containing the Firm's conclusions from the reviews described above (a) indicating which of the 696 customer complaints identified above LPL will report on Forms U4/U5 and which it will not, and for those it will not report, provide the Firm's rationale for not reporting them, and (b) identifying any and all changes made to the Firm's supervisory systems and written procedures relating to reporting customer complaints and other reportable events as a result of the review, and (2) a certification that the Firm's systems and written procedures regarding the review and reporting of customer complaints and other reportable events, as of the date of the certification, are reasonably designed to achieve compliance with Article V, Sections 2 and 3 of FINRA's By-Laws and FINRA Rule 2010.

Upon written request showing good cause, FINRA Staff may extend any of the procedural dates set forth above.

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

LPL 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

LPL 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, LPL 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.

LPL 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

LPL 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 LPL;

C. If accepted:

1. this AWC will become part of LPL's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against LPL;

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. LPL 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. LPL 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 LPL'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. LPL may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. LPL 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 LPL, 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 LPL 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 LPL to submit it.

LPL Financial LLC

09/29/2018
Date (mm/dd/yyyy)

By: Cecilia B. Havico
Name: Cecilia Baute Havico
Title: S.V.P., Head of Regulatory Inquiries & Strategy

Reviewed by:

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Accepted by FINRA:

October 29, 2018
Date

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

Ian McLoughlin

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