

In the Matter of LPL FINANCIAL CORPORATION, formerly known as LINSICO/PRIVATE LEDGER CORP., Respondent

**ADMINISTRATIVE PROCEEDING File No. 3-13181
SECURITIES AND EXCHANGE COMMISSION
SECURITIES EXCHANGE ACT OF 1934 Release No. 58515
INVESTMENT ADVISORS ACT OF 1940 Release No. 2775**

September 11, 2008

ACTION: ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AS TO LPL FINANCIAL CORPORATION

TEXT:

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21 C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against LPL Financial Corporation, formerly known as Linsco/Private Ledger Corp. ("Respondent" or "LPL"). n1

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order as to LPL Financial Corporation ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds n2 that

Summary

These proceedings arise out of the violations by LPL, a registered broker-dealer, investment adviser, and transfer agent, of the safeguards rule of Regulation S-P (17 CFR § 248.30(a)) (the "Safeguards Rule"), which requires broker-dealers and SEC-registered investment advisers to adopt written policies and procedures reasonably designed to protect customer information. Despite its being aware as early as 2006 that it had insufficient security controls to safeguard customer information at its branch offices, LPL failed to implement adequate controls, including some security measures, which left customer information at LPL's branch offices vulnerable to unauthorized access. Between mid-July 2007 and February 2008, LPL experienced a series of computer system security breaches in which an unauthorized person(s) accessed and traded, or attempted to trade, in the customer accounts of several of LPL's registered representatives. As of the date of the "hacking" incidents, LPL had failed to implement increased security measures and adopt policies and procedures reasonably designed to safeguard customer information as required by Regulation S-P. LPL detected the breaches and absorbed the losses

in the customer accounts. Nonetheless, LPL's failures left customer information vulnerable to identity thieves or other unauthorized users at the firm's branch offices.

Respondent

1. Respondent is registered with the Commission as a broker-dealer, investment adviser, and transfer agent (respectively, file nos. 8-17668; 801-10970; and 84-5637). LPL is a privately-held company and a subsidiary of LPL Holdings, Inc. It is headquartered in San Diego and Boston. LPL has about 8,100 independent contractor registered representatives operating from approximately 3,600 registered branch offices. LPL conducts business in all 50 states, and provides brokerage, custody and clearing services for more than 1,000,000 customer accounts, effecting an average of approximately 775,000 trades per month in those customer accounts.

Background

2. LPL does not provide an online trading platform directly to its customers. Instead, LPL provides its independent contractor registered representatives ("RRs") with online access via its proprietary trading platform called "BranchNet. " LPL RRs use BranchNet to place customer trades, open new accounts, review detailed account and commission information, and research materials. With password and user name authorization, BranchNet is accessible through the World Wide Web from any computer with a Web browser application and an Internet connection. During the time of the security breaches, BranchNet allowed for simultaneous log-ins from different computers.

3. Between July 17, 2007 and February 15, 2008, an unauthorized person(s) logged into BranchNet and gained access to the on-line accounts of thirteen of LPL's RRs located in multiple states. The perpetrator(s) placed, or attempted to place, 209 unauthorized trades in 68 customer accounts some of which were held in the names of individuals. Altogether, the perpetrator(s) attempted to place over \$ 700,000 in trades in securities of nineteen different companies. The perpetrator(s) targeted the login information of the RRs. Once logged in to the BranchNet platform, the perpetrator(s) accessed the customer accounts and may have had access to non-public information of at least 10,000 customers.

4. LPL detected the unauthorized and inappropriate trade requests by the perpetrator(s). Most of the unauthorized trade requests were blocked by LPL's trading apparatus and produced no trade executions. In some cases, however, unauthorized trades were executed in or through LPL customer accounts. LPL promptly reversed or eliminated the resulting customer positions and compensated the customers for the resulting trading losses, which totaled approximately \$ 98,900.

LPL Fails to Safeguard Customer Information

5. Regulation S-P became effective on November 13, 2000. On July 1, 2001, compliance with Regulation S-P became mandatory. The Safeguards Rule of Regulation S-P required the adoption of policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information, and required that these policies and procedures must be reasonably designed to: (1) insure the security and confidentiality of customer records and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer. LPL failed to have a customer information policy for its employees and branch RRs describing its overall program that was reasonably designed to protect customer records and information as required by the Safeguards Rule. When Regulation S-P was amended in 2005 to require that such policies and procedures be written, LPL failed to comply.

6. Although LPL had some documents that formed its policies of safeguarding customer records and information, none of these policies were reasonably designed to protect customer records and information. These documents did not include, either individually or in combination, a complete set of LPL's policies and procedures addressing administrative, technical, and physical safeguards reasonably designed to protect customer records and information at the branch offices. Instead, LPL distributed to

its branch offices limited and insufficient written materials (and, in some instances, only suggestions or recommendations, as opposed to mandates) regarding safeguarding customer information.

7. LPL's security policies and procedures for safeguarding customer information at its branch offices were deficient in several key areas. In particular, LPL did not have written policies and procedures addressing issues related to the security of customer information accessible from its BranchNet system. Until mid-2006, LPL failed to reasonably evaluate security controls at BranchNet, even though it had retained outside information technology consultants to perform various vulnerability tests on other corporate systems. LPL failed to conduct such an evaluation despite its knowledge of a data breach incident involving conduct by a RR in a branch office in March 2006.

LPL's Inadequate Response to Known Deficiencies And Anticipated Security Threats

8. From July through September 2006, LPL conducted an internal audit of BranchNet to evaluate important security and controls such as access controls, input controls, processing controls, disaster recovery, backup, server security, and pertinent policies and procedures. The audit revealed deficiencies concerning users' password complexity and session inactivity parameters.

9. Regarding password complexity, LPL's internal auditors identified the following weaknesses concerning the BranchNet application: (1) RR passwords did not meet industry standards for so-called "strong" passwords, because, among other things, the passwords had no requirements on length or alphanumeric/special character combinations; (2) passwords were not set to expire after a certain period of time; (3) users could not change their own passwords; and (4) there was no automatic lockout feature related to unsuccessful login attempts. Additionally, over 300 LPL information technology employees had access to a list of BranchNet passwords, and a number of former employees likely had access to such a list before leaving the firm.

10. With respect to BranchNet session inactivity, LPL's internal auditors observed that the automatic session timeout was set at eight hours, which LPL's internal auditors believed was significantly longer than the timeout periods used by other financial services firms for similar applications. LPL internal auditors also noted that the timeout periods should be shortened.

11. The audit concluded that weaknesses in the BranchNet system would increase the likelihood that an unauthorized person(s) would obtain confidential information and unauthorized trades could occur. The audit further specifically identified the risk of account intrusions.

12. LPL's internal audit department performed its work between early July to mid-September 2006. A written report was finalized and provided to LPL's Chief Information Officer in December 2006. In early 2007, the report was shared with members of LPL's senior management, and later in May 2007, the report was presented to the executive risk committee. Among the specific risks identified for both senior management members and the executive risk committee were risks that (a) an intruder could hack into the BranchNet application and cause financial loss to advisers and customers; and (b) an unauthorized individual could steal client information or execute unauthorized trades. LPL executives were further warned that more than 90% of all security breaches involved loss of information in digital form. In addition, LPL's enterprise risk management organization cautioned that further review of the BranchNet access control issues identified in the audit report could lead to a finding or opinion by its independent auditors that LPL had ineffective controls.

13. LPL's internal audit department reported that the firm could elect to (a) implement password complexity controls and session inactivity controls to the BranchNet System at an estimated cost exceeding \$ 500,000; or (b) not adopt these enhancements if it determined that such measures would not be cost-effective. In June 2007, LPL created a separate committee to evaluate and implement security for BranchNet.

14. Nonetheless, LPL failed to take immediate corrective action. As a result, as of the time of the security breach in July 2007, LPL, in reckless disregard of the regulatory requirements, had not implemented increased security measures and policies and procedures in response to the internal audit.

15. As a result of the conduct described above, Respondent willfully violated Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a)), which requires broker-dealers and registered investment advisers to have written policies and procedures that are reasonably designed to safeguard customer records and information.

Remedial Efforts

16. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

Undertakings

17. Respondent has undertaken to:

- a. Devise and implement, within 30 days after the issuance of this Order, a policy and a set of procedures for training its employees and all registered representatives regarding safeguarding customer records and information.
- b. Retain, within ten (10) days of the date of entry of this Order, the services of an Independent Consultant not unacceptable to the staff of the Commission. LPL shall exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant. LPL shall retain the Independent Consultant to: (i) review LPL's written policies and procedures relating to the Safeguards Rule of Regulation S-P; and (ii) make recommendations concerning these policies and procedures with a view to assuring compliance with the Safeguards Rule of Regulation S-P.
- c. No later than ten (10) days following the date of the Independent Consultant's engagement, provide to the Commission staff a copy of an engagement letter detailing the Independent Consultant's responsibilities pursuant to paragraph 17b above;
- d. Arrange for the Independent Consultant to issue its report within 90 days after the date of the engagement. Within ten (10) days after the issuance of the report, LPL shall require the Independent Consultant to submit to Diana Tani of the Commission's Los Angeles Regional Office a copy of the Independent Consultant's report. The Independent Consultant's report shall describe the review performed and the conclusions reached and shall include any recommendations deemed necessary for changes in or improvements to LPL's written policies and procedures and a procedure for implementing the recommended changes or improvements.
- e. Within 30 days of receipt of the Independent Consultant's Report, adopt all recommendations contained in the Report and remedy any deficiencies in its written policies and procedures; provided, however, that as to any recommendation that LPL believes is unnecessary or inappropriate, LPL may, within fifteen (15) days of receipt of the Report, advise the Independent Consultant and the Commission's staff in writing of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that LPL considers unnecessary or inappropriate, LPL shall propose in writing an alternative policy or procedure designed to achieve the same objective or purpose.
- f. With respect to any recommendation with which LPL and the Independent Consultant do not agree, attempt in good faith to reach an agreement with the Independent Consultant within 30 days of receipt of the Report. In the event that LPL and the Independent Consultant are unable to agree on an alternative proposal acceptable to the Commission's staff, LPL will abide by the original recommendation of the Independent Consultant.
- g. Within 180 days of the entry of this Order, submit an affidavit to the Commission's staff stating that it has implemented any and all recommendations of the Independent Consultant, or explaining the circumstances under which it has not implemented such recommendations.

h. Cooperate fully with the Independent Consultant and provide the Independent Consultant with access to its files, books, records and personnel as reasonably requested for the Independent Consultant's review.

i. LPL shall require the Independent Consultant to enter into an 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 employment, consultant, attorney-client, auditing or other professional relationship with LPL, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he is affiliated or of which he is a member, and any person engaged to assist the Independent Consultant in performance of his duties under this Order shall not, without prior written consent of the Commission's staff in the Los Angeles Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with LPL, 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.

j. For good cause shown, and upon timely application from LPL or the Independent Consultant, the Commission's staff may extend any of the procedural dates set forth above.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent LPL's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent LPL shall cease and desist from committing or causing any violations and any future violations of Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a)).

B. Respondent LPL is censured.

C. IT IS FURTHER ORDERED that Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$ 275,000.00 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies LPL as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Michele Wein Layne, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

D. Respondent shall comply with the undertakings enumerated in Section III. 17 a-i above.

By the Commission.

Footnotes

n1 On January 9, 2008, Linsco/Private Ledger Corp. changed its name to LPL Financial Corporation.

n2 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.