

INVESTOR PROTECTION DIRECTOR
FOR THE STATE OF DELAWARE
SEP 22 2015

**Before the Investor Protection Director
of the State of Delaware**

In the Matter of:)
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LPL Financial LLC) IPU Case No. 13-5-1
)
) ADMINISTRATIVE CONSENT ORDER
)
Respondent)
)

WHEREAS, LPL Financial LLC (“LPL”) is a broker-dealer registered in Delaware, with Central Registration Depository (“CRD”) number 6413, and an investment adviser registered with the Securities and Exchange Commission and doing business in Delaware as a federal covered adviser; and

WHEREAS, the Delaware Investor Protection Unit (the “Unit”) has conducted an investigation into LPL’s use of leveraged and inverse leveraged exchange-traded funds (collectively, “Leveraged ETFs”); and

WHEREAS, LPL has cooperated with the Unit by responding to inquiries, providing testimony, documentary evidence, and other materials, and providing regulators with access to facts relating to the Unit’s investigation; and

WHEREAS, LPL has advised the Unit of its agreement to resolve the Unit’s investigation pursuant to the terms specified in this Administrative Consent Order (the “Order”); and

WHEREAS, LPL agrees to make certain changes in its supervisory system with respect to Leveraged ETFs and to make certain payments, each in accordance with the terms of this Order; and

WHEREAS, LPL elects to waive permanently any right to a hearing and appeal under 6 Del. C. §§ 73-304, 73-502, or 73-601 with respect to this Order; and

WHEREAS, solely for the purposes of resolving this investigation and settlement of the issues contained in this Order, without admitting or denying the findings of fact or conclusions of law contained in this Order, LPL consents to the entry of this Order;

NOW, THEREFORE, the Investor Protection Director for the State of Delaware (the “Director”), as administrator of the Delaware Securities Act (6 Del. C. Ch. 73) (the “Act”), hereby enters this Order:

FINDINGS OF FACT

1. LPL has offered Leveraged ETFs to certain of its retail clients in Delaware.
2. The Leveraged ETFs at issue are exchange traded funds that seek to return, on a daily basis, two hundred percent or, negative two hundred percent, of a particular index, commodity, currency, or economic sector. Leveraged ETFs typically do not invest directly in the underlying index or asset class but rather attempt to accomplish this daily objective by using financial derivatives, such as futures and swaps contracts.
3. When Leveraged ETFs are held for periods longer than a day, compounding (among other factors) typically causes the Leveraged ETFs return to diverge from that which might be expected from simply multiplying the change in the underlying index by the relevant factor.
4. This potential divergence is magnified in periods of greater volatility. Due to this divergence, an investor can lose money when holding Leveraged ETFs over long periods, even if the investor bets correctly on the direction of the relevant index over the same term.
5. Pro Shares Ultra S&P 500 (“SSO”) is a Leveraged ETF designed to return, on a daily basis before fees and expenses, two hundred percent of the daily performance of the S&P 500 index. The risk of SSO’s divergence from the underlying index is disclosed in the SSO prospectus. Specifically, the prospectus states: “. . . the Fund may incorrectly be expected to achieve a negative 40 percent return on a yearly basis if the Index return were negative 20 percent, absent the effects of compounding. However, [given a hypothetical] Index volatility of 50 percent, the Fund could be expected to return negative 50.2 percent under such a scenario.”
6. Similarly, Pro Shares Ultra Silver (“AGQ”), a Leveraged ETF designed to capture, before fees and expenses, two hundred percent of the daily movement of a silver price benchmark, discloses this risk of divergence through an example that shows how, over a

hypothetical 7-day period, a “Fund’s total return is more than 2x the loss of the period return of the benchmark. For the 7-day period the benchmark XYZ lost 3.26 percent while Fund XYZ lost 7.01 percent (versus -6.52 percent (or 2x - 3.26 percent).”

7. In 2009 FINRA issued FINRA Regulatory Notice 09-31 (hereinafter the “FINRA Notice”), advising investors and industry professionals to be aware of the unique risks of Leveraged ETFs when purchasing or recommending Leveraged ETFs for purchase in client accounts. The FINRA Notice provided the following discussion:

Most Leveraged and Inverse ETFs “reset” daily, meaning that they are designed to achieve their stated objectives on a daily basis. [fn omitted]. Due to the effect of compounding, their performance over longer periods of time can differ significantly from the performance (or inverse of the performance) of their underlying index or benchmark during the same period of time.

8. Due to this possible divergence, outside of certain trading strategies that incorporate frequent monitoring, Leveraged ETFs are typically unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets.

9. Notwithstanding the potential risks associated with tracking error in the use of Leveraged ETFs for long-term holdings, LPL did not monitor or systematically review the length of time its clients held Leveraged ETFs.

10. LPL provided its advisors with training materials that, in parts, suggested that Leveraged ETFs were appropriate for conservative accounts. LPL’s research department also in some instances recommended buying and holding the leveraged silver ETF AGQ without reminding financial advisors of the specific risks associated with holding Leveraged ETFs.

11. Late in 2012, LPL began an examination of certain of its financial advisors’ Leveraged ETF holding periods. This review continued through April 2013, and noted that over 50 percent of LPL’s Leveraged ETF holdings had been purchased 30 days or more prior, and

over 10 percent had been held for a year or more. Many of these Leveraged ETFs were held in accounts with conservative investment objectives.

12. LPL reached out to a number of its financial advisors who held significant assets in Leveraged ETFs to determine why they were being held for extended periods of time. The financial advisors' answers varied but generally were not consistent with either regulatory guidance or the disclosures included in the fund prospectus. Specifically, (a) certain financial advisors used Leveraged ETFs for speculative purchases and extended holds based solely on longer-term views of the underlying index; and (b) certain financial advisors considered Leveraged ETFs suitable for long-term hold strategies in volatile markets.

13. Certain LPL clients in Delaware experienced losses as a result of holding Leveraged ETFs for significant period of time.

14. For instance, a Lincoln, Delaware LPL client purchased 500 shares of ProShares Ultra Basic Materials ("UYM") for \$25,338.85 on June 29, 2011. The client held the Leveraged ETF for 854 days, before selling the position for \$23,124.59 on October 30, 2013. During this time, the underlying index decreased 0.64 percent. Multiplying the benchmark change by 2 would result in a 1.29 percent loss or \$326.49; in actuality, the value of the investment decreased by 8.74 percent, or \$2,214.26.

15. For much of the relevant time period, LPL failed to identify and examine potential issues concerning the suitability of client Leveraged ETF exposure for those of LPL's financial advisors who caused clients to hold Leveraged ETFs for extended periods of time. Until 2013, LPL's primary compliance and risk management tool deployed to address the risks of Leveraged ETFs was placing concentration limits on Leveraged ETFs in client accounts. Advisors were to receive a letter on the first instance of a client's Leveraged ETF allocation

exceeding these concentration limits, followed by a fine on the second instance. For much of this period, LPL would take no action regarding concentration limits until its advisors had exceeded its published limits by more than 5 percent. Moreover, LPL did not consistently adhere to its policy of imposing fines on LPL financial advisors who exceeded this concentration limit, sometimes issuing multiple warnings unaccompanied by any sanctions. In 2013, LPL banned new purchases of Leveraged ETFs in certain types of accounts.

CONCLUSIONS OF LAW

16. The Unit has jurisdiction over this matter pursuant to 6 *Del. C.* § 73-501.

17. Each LPL recommendation to purchase and hold Leveraged ETFs to clients for which they were unsuitable, and/or without adequate disclosure of the specialized risks of Leveraged ETFs, constitutes a dishonest or unethical practice within the meaning of 6 *Del. C.* § 73-304(a)(7).

18. Each LPL failure to enforce its warning and fine system with regard to its Leveraged ETF concentration limits constitutes a failure to supervise within the meaning of 6 *Del. C.* § 73-304(a)(10).

19. Each LPL failure to ensure that its financial advisers, including but not limited to Financial Adviser A, understood and explained the unique risks associated with Leveraged ETFs constitutes a failure to supervise within the meaning of 6 *Del. C.* § 73-304(a)(10).

20. Each LPL failure to adequately monitor or ensure the monitoring of client holding periods for Leveraged ETFs constitutes a failure to supervise within the meaning of 6 *Del. C.* § 73-304(a)(10).

21. Pursuant to 6 *Del. C.* § 73-601(b), the violations described above constitute bases for the assessment of an administrative fine against LPL.

22. The Unit finds the following relief appropriate and in the public interest.

ADMINISTRATIVE FINE

23. Within ten (10) days of the date of entry of this Order, LPL will pay an administrative fine in the amount of \$50,000.00. Payment shall be made by delivering a certified check payable to the Delaware Investor Protection Fund, which shall be delivered to Gregory C. Strong, Investor Protection Director, Delaware Department of Justice, 820 N. French Street, Wilmington, DE 19801.

REMEDICATION AND UNDERTAKINGS

24. LPL agrees to make a payment of \$150,000 to an escrow account (the "Settlement Fund") to be held in trust for the benefit of the Unit. The Settlement Fund shall be used to (a) provide restitution to certain Delaware LPL customers with accounts maintained at LPL who experienced certain losses as a result of holding Leveraged ETFs. To the extent there is money left in the Settlement Fund after all eligible claims are paid, such money shall be deposited into the Investor Protection Fund and used for purposes permitted by 6 *Del.C.* § 73-703(e). The Settlement Fund shall be overseen by an independent Escrow Agent (the "Escrow Agent"), to be selected by LPL, with the selection to occur within 14 (fourteen) days of the date of entry of this Order. The Unit shall have the right to veto any or all of LPL's choices of Escrow Agent. If LPL has been unable to select an acceptable Escrow Agent within 30 (thirty) days of the date of entry of this Order, the Unit shall choose the Escrow Agent in its sole discretion. The Escrow Agent shall deposit the Settlement Fund into interest bearing accounts such that, to the extent possible, (i) all of the funds are fully guaranteed by the Federal Deposit Insurance Corporation ("FDIC") or the United States Department of the Treasury, and (ii) the interest rates at the time of the aforementioned deposit are at least equal to the highest interest rate available from among the five largest banks in the City of Wilmington for a fully liquid federally insured deposit

account holding such a sum of money. The Escrow Agent will make investments of and disbursements from the Settlement Fund only with the consent of the Unit and may vary from the investment criteria of this paragraph only with the consent of the Unit. LPL will retain the Escrow Agent and will pay the Escrow Agent's fees and costs associated with its duties under this Order separate and apart from all other payments required under the Order.

25. Based on information previously obtained from LPL during the investigation, as well as other information developed as part of settlement implementation upon which the Unit chooses to rely, the Unit shall calculate final recovery amounts to be provided by check from the Settlement Fund to individual eligible LPL Delaware customers. These calculations and the timing of the submission of recovery amounts associated with eligible consumers to the Escrow Agent, shall be in the sole discretion of the Unit.

26. For each eligible consumer for whom the Escrow Agent receives authorization from the Unit, the Escrow Agent shall send an explanatory letter (in the form the Unit indicates) together with a check to the eligible consumer for the amount the Unit indicates. The Escrow Agent shall send such letter and check within 10 (ten) days of receiving the Unit's authorization. If, after a period of time to be determined by the Unit in its sole discretion but not to be less than 90 (ninety) days, the Unit determines that it is necessary to stop payment on the check, the Unit shall so inform the Escrow Agent, and the Escrow Agent shall stop payment on the check.

27. If LPL or the Escrow Agent receives any letters or forms in relation to this Order from any eligible consumer, LPL and/or the Escrow Agent shall forward such forms to the Unit even if such letters or forms are received outside of the time frames contemplated by this Order.

28. At a date to be determined by the Unit in its sole discretion, but in any event no earlier than 120 (one hundred twenty) days from the date of entry of this Order, any remaining

monies in the Settlement Fund shall be transferred by the Escrow Agent to the Unit and deposited into the Delaware Investor Protection Fund for the purposes of additional attempts to provide recovery amounts to eligible consumers, as well as any other purpose permitted by 6 *Del. C. § 73-703*.

29. LPL will make enhancements to its oversight of investments in Leveraged ETFs no later than 180 days from the entry of this Order, including: reviewing and enhancing training materials for Financial Advisors whose clients purchase Leveraged ETFs; enforcing restrictions on percentages of Leveraged ETFs held in client accounts; reducing the number of Leveraged ETFs that Financial Advisors and their clients may use; and notifying Financial Advisors whose clients hold such securities once they have been held for 30 days.

30. The enhancements to LPL's training program shall be conducted in accordance with the following approach: LPL will implement enhancements to its Leveraged ETF training programs and requirements for all Financial Advisors registered with Delaware through LPL or its affiliates whose clients are permitted to purchase or sell Leveraged ETFs. The training program will provide Financial Advisors with information about the risks associated with investments in Leveraged ETFs, including tracking error, and provide examples of appropriate and inappropriate uses of the products. Financial Advisors will undergo this training at least once every three years which will include a testing requirement that assesses the Financial Advisor's knowledge of Leveraged ETF product risks. LPL shall maintain records for each training session offered, which include the training materials, a copy of the test administered after each training, and the test results for each Financial Advisor.

31. The reduction in the number of eligible Leveraged ETFs shall be done in accordance with the following approach. Any Leveraged ETF that LPL chooses to make

available to Financial Advisors for purchase shall be annually reviewed and approved by LPL in writing. The review of each product shall include consideration of how the ETF has performed historically relative to the underlying benchmark. As part of this review, LPL will examine the degree of tracking error that the ETF has experienced and document its consideration of this tracking error as part of its decision to allow or disallow the ETF for purchase.

COOPERATION & RECORD KEEPING

32. LPL will cooperate with the Unit during the implementation of this Order and any related Unit monitoring, reviews, or compliance undertaken pursuant to this Order.

33. LPL will create and maintain, for a period of at least three (3) years from the date of entry of this Order, all records necessary to demonstrate LPL's compliance with its obligations under this Order and will provide such records to the Unit upon request.

MISCELLANEOUS PROVISIONS

34. The Unit will not proceed with or institute a civil action or proceeding based upon any alleged violation of the Act against LPL, or any of LPL's agents, subsidiaries and subdivisions, successors, assigns, or any purchasers of all or substantially all of its business assets, for LPL's actions prior to the date of entry of this Order regarding the allegations at issue in the Investigation.

35. The Order constitutes the entire agreement between the Unit and LPL and supersedes any prior communication, understanding, or agreements, whether written or oral, concerning the subject matter of the Order. This Order can be modified or supplemented only by a written document signed by both parties.

36. The Order will be binding upon LPL and any of LPL's agents, subsidiaries and subdivisions, successors, assigns, and/or purchasers of all or substantially all of LPL's business assets.

37. The Unit may extend any deadlines in this Order in its sole discretion.

38. The Order and its provisions will be effective on the date that it is signed by the Investor Protection Director.

LPL represents and warrants that it has the full legal power, capacity, and authority to bind the parties for whom it is acting, including its affiliates and subsidiaries. LPL shall not seek judicial review with respect to the terms of this Order.

IT IS SO ORDERED this 22nd day of September, 2015


Gregory C. Strong
Investor Protection Director

INVESTOR PROTECTION DIRECTOR
FOR THE STATE OF DELAWARE
SEP 22 2015

CONSENT TO ENTRY OF CONSENT ORDER

LPL Financial LLC ("LPL") hereby acknowledges that it has been served a copy of this Consent Order (the "Order"), has read the Order, is aware of its right to a hearing and appeal in this matter under 6 Del. C. §§ 73-304, 73-502, or 73-601, and waives this right.

LPL admits the jurisdiction of the Delaware Department of Justice Investor Protection Unit (the "Unit") in this matter, neither admits nor denies the findings of fact and conclusions of law contained in the Order, and consents to entry of the Order by the Unit as settlement of the issues contained in the Order.

LPL states that no promise of any kind or nature whatsoever was made to induce it to enter into the Order that is not contained within the Order and that it has entered into the Order voluntarily.

James Shorris represents that she/he is Executive Vice President, Deputy General Counsel of LPL and, as such, has been authorized by LPL to enter into the Order for and on behalf of LPL.

Dated this 15 day of September, 2015.

LPL FINANCIAL LLC

By:

[Signature]

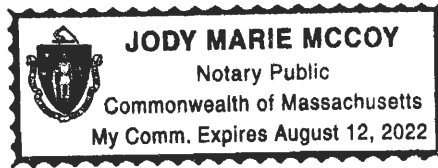
Title:

**JAMES S. SHORRIS
EXECUTIVE VICE PRESIDENT
DEPUTY GENERAL COUNSEL**

[Signature]
Notary Public

in and for the State of:

Massachusetts



My Commission Expires:

August 12, 2022