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July 28, 2009

VIA ELECTRONIC MAIL

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-09-09
Custody of Funds or Securities of Clients by Investment Advisers

Dear Ms. Murphy:

We appreciate the opportunity to comment on *Custody of Funds or Securities of Clients by Investment Advisers* issued by the U.S. Securities and Exchange Commission (the "SEC").[1] This letter responds to the SEC's request for comment on proposed amendments to Rule 206(4)-2 (the "Custody Rule") and related forms and rules (the "Proposal").

Background. LPL Financial Corporation ("LPL") is one of the nation's leading diversified financial services companies and the largest independent broker-dealer supporting more than 10,000 financial advisors nationwide. LPL is registered with the SEC as both an investment advisor and broker-dealer. We offer our clients a variety of fee-based investment advisory programs, including mutual fund asset allocation programs, separately managed account programs and unified managed account programs. LPL developed these advisory programs for retail "Main Street" investors. LPL provides advisory services to over 275,000 advisory clients and has over $40 billion in assets under management as of December 31, 2008.

LPL serves as a sponsor, investment advisor, executing broker-dealer and custodian with respect to our advisory programs. Self custody is not merely an incidental feature of LPL's advisory programs. It is critical to the design and operation of such programs. By tailoring our advisory, brokerage and custodial services to each advisory program we offer, we are able to meet the needs of our advisory clients in a streamlined, efficient and cost-effective manner. Because of the combination of investment advice, trading and execution, performance reporting, monthly statements and custody of assets on one

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1 SEC Release No. IA-2876, 74 Fed. Reg. 25354 (May 27, 2009).

platform, LPL is able to effectively oversee hundreds of thousands of client accounts and the advisory services being provided by thousands of financial advisors.

We also note that LPL serves as a custodian for client assets managed by independent investment advisory firms. In that role, we may be instructed by the client or the independent investment advisory firm to deduct advisory fees from the client's account.

As a dual registrant, LPL is subject to extensive regulatory oversight and strict internal controls that are designed to safeguard client assets. Because LPL serves as the broker-dealer and custodian for the advisory programs we sponsor, those advisory program assets are protected by such regulatory oversight and internal controls. As part of such regulations and controls:

- LPL's financial statements are audited annually by an independent public accountant and those financial statements are filed regularly with the SEC.
- LPL is required to maintain minimum net capital and to set cash aside as a reserve for the benefit of our clients.
- LPL is required to purchase a fidelity bond from an insurance company to provide a source of compensation to clients in the event of fraud or embezzlement by employees.
- LPL is required to send confirmations of transactions and monthly account statements to clients so they may monitor their assets.
- LPL is required to be a member of SIPC.
- LPL also purchases additional amounts of professional liability insurance and excess SIPC coverage.
- LPL engages an independent public account to perform a SAS 70 assessment.
- LPL provides our advisory program clients with quarterly performance reports.
- As a registrant under the Securities Exchange Act of 1934, LPL is subject to Sarbanes-Oxley and all of its financial and internal control requirements.

With this background, we offer the following comments:

1. **General Approach to Advisor Regulation.** We support the SEC's initiative in seeking additional measures to protect client assets. We also strongly support efforts to harmonize the regulations governing investment advisors and broker-dealers. We believe that reconciling certain differences between those regulations will address many of the concerns raised by the SEC in the Proposal. In particular, we believe additional requirements on investment advisors, such as audited financial statements, minimum capital requirements, and fidelity bonds, would go far to protect clients of investment advisors. We would encourage the SEC to act on the Proposal with an eye to the harmonization efforts. We hope that the Proposal is acted upon in a manner that takes into account whether any increased burdens on dual registrants would be rendered unnecessary after steps are taken on harmonization.

2. **Continued Permissibility of Self-Custody Arrangements.** As part of the Proposal, the SEC requests comment on whether, as an alternative to its proposal to impose additional conditions on advisors that serve as, or have related persons that serve as, qualified custodians for client assets, it should simply amend Rule 206(4)-2 to require that an independent qualified custodian hold client assets.

LPL strongly supports the SEC's decision not to propose amendments to Rule 206(4)-2 to require that an independent qualified custodian hold client assets. As discussed above, self-custody is a critical component to LPL's provision of advisory services to its clients. If an independent custodian were required, we believe this would introduce inefficiencies and greater costs to clients that we believe are unnecessary given the extensive controls and oversight currently in place for dual registrants.

In addition, because LPL's advisory assets are custodied at LPL, LPL is able to fulfill its regulatory and fiduciary obligations to oversee its advisory accounts and the advisory services being by provided by its financial advisors. LPL has invested substantial resources to build technology to surveil its advisory accounts; those surveillance systems are possible because the assets are held at LPL. If custody were required to be maintained with an independent custodian, LPL believes that client assets would potentially be exposed to greater risks rather than greater protection. We believe that, when assets are held away, it is much more difficult for an investment advisor to oversee client accounts and to build technology to surveil accounts on an automated basis.

3. **Imposition of Additional Controls Over Self-Custody Arrangements.** Under the Proposal, advisors who self-custody or maintain client assets with an affiliated custodian will be required to have an independent public accountant registered with, and subject to oversight by, the Public Company Accounting Oversight Board ("PCAOB") (i) conduct an annual surprise examination, and (ii) prepare a written internal control report including an opinion regarding the custodian's controls relating to custody of client assets.

It is our view that the existing oversight and regulation of dual-registrant custodians work well to protect client assets. We believe that the proposed requirements would not provide meaningful additional safeguards, in particular, in light of the financial and administrative burdens on dual-registrants that would result. Therefore, we believe that dual registrants should be exempt from these additional requirements.

However, if the SEC believes that further controls are required for dual-registrant custodians, LPL urges the SEC to require that either the surprise exam or written internal control report requirements be adopted; both are unneccesary and duplicative.

If the SEC determines that both requirements are necessary for dual-registrants, we ask that the SEC specifically confirm in the amended rule's adopting release that the same auditor would be permitted to perform the surprise exam and to prepare the written control report.

4. **Methodology of the Surprise Exam.** As noted, the Proposal would require all registered investment advisors with custody of client assets to engage an independent public accountant[2] to conduct an annual surprise exam of client assets.

As discussed above, LPL believes that a surprise exam will not provide additional meaningful controls over client assets in the context of a dual-registrant. However, if the SEC determines to advance this requirement, we believe that the proposed requirement should be modified. As noted above, LPL has custody for over 275,000 advisory accounts. We do not believe it is practical or necessary for an independent public accountant to verify all assets in that many accounts. We therefore believe that Generally Accepted Auditing Standards ("GAAS") should dictate the scope and methodology of the exam and that, where appropriate, the auditing of a reasonable sample of the accounts should be sufficient to meet this requirement. We further believe that the SEC should allow auditors to leverage safeguards and controls already in place (for example, the 17a-5(g) review of a broker-dealer's procedures for safeguarding securities or reviews conducted by a firm's compliance department) with respect to client assets when performing the exam.

5. **Withdrawal of Advisory Fee Situations**. Presently, the Custody Rule defines "custody" to include any registered advisor with authority or permission to withdraw client funds or securities maintained with a custodian upon instruction to the custodian. As such, under the Proposal, all registered advisors with the ability to receive payment of their advisory fees upon instruction to the custodian would be subject to the annual surprise exam requirement.

LPL believes that the surprise exam requirement as proposed is not the appropriate control to adopt in the context of advisory fee withdrawal situations, in particular, as it would significantly increase the administrative and financial burdens placed on advisors and qualified custodians. Rather, we believe that any additional requirements should be targeted to the verification of the fee calculation and fee instructions, instead of a comprehensive verification of all applicable client accounts and all client balances.

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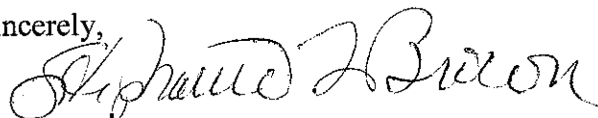
We thank you for the opportunity to comment on the Proposal. If you have any questions regarding this letter, please do not hesitate to contact me.

Sincerely,



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[2] The Proposal would define independent public accountant as a public accountant that meets the standards for independence described in Rule 2-01(b) and (c) of Regulation S-X.