

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2013035036601**

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

RE: Lincoln Financial Securities Corporation, Respondent  
Member Firm  
CRD No. 3870

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

**I.**

**ACCEPTANCE AND CONSENT**

- A. Respondent 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**

LFS (through predecessor entities) has been a FINRA member since 1969. LFS is headquartered in Fort Wayne, Indiana and conducts a general securities business. The Firm has over 1,100 registered representatives operating from more than 500 branch locations.

**RELEVANT DISCIPLINARY HISTORY**

In February 2011, LFS entered into an AWC in which it agreed, without admitting or denying the findings, to a censure and \$450,000 fine for failing to establish adequate procedures to protect confidential customer information that was stored on its web-based electronic portfolio management system, failing to establish procedures requiring its registered representatives to install antivirus, encryption, and other security software on their computers, and failing to audit representatives' computers to gauge whether those computers may have been accessed without authority. As a result, the Firm violated Rule 30 of Regulation

S-P, NASD Rules 3010 and 2110, and FINRA Rule 2010.

### **OVERVIEW**

From at least 2011 to 2015, LFS failed to establish, maintain, and enforce a supervisory system, including written supervisory procedures (“WSPs”), reasonably designed to ensure the security of confidential customer information stored on electronic systems at the Firm’s branch offices in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010.

Further, from December 2010 through December 2013, LFS failed to establish, maintain, and enforce a supervisory system, including WSPs, reasonably designed to ensure the preservation, retention and review of consolidated reports produced by registered representatives and provided to Firm customers, and failed to retain certain consolidated reports. As a result, LFS violated Section 17(a) of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 17a-4 thereunder, NASD Rules 3010 and 3110, and FINRA Rules 4511 and 2010.

### **FACTS AND VIOLATIVE CONDUCT**

#### **1. LFS Failed to Reasonably Safeguard Confidential Customer Data**

Regulation S-P of the Exchange Act became effective on November 13, 2000 and compliance became mandatory on July 1, 2001. Rule 30 of Regulation S-P provides that “[e]very broker, dealer . . . must adopt policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information.” These written policies and procedures must be reasonably designed to: (a) insure the security and confidentiality of customer records and information; (b) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (c) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

NASD Rule 3010 and FINRA Rule 3110 require that member firms maintain a system, including WSPs, to supervise the activities of each registered person that is reasonably designed to achieve compliance with applicable securities laws and regulations.

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<sup>1</sup> NASD Rule 3010 was superseded by FINRA Rule 3110, effective December 1, 2014. Accordingly, NASD Rule 3010 applies to the Firm’s conduct on or before December 1, 2014. FINRA Rule 3110 applies to conduct beginning on December 1, 2014.

*In January 2012, an LFS Office's Computer Server Was Accessed without Authority*

In June 2011, an LFS Office of Supervisory Jurisdiction (“OSJ”) began to store records on a cloud-based computer server (the “Cloud Server”). The stored records included account applications and other brokerage records containing customers’ nonpublic personal information such as social security numbers. The Firm, however, failed to ensure that the third-party vendor retained by the OSJ to configure the Cloud Server properly installed antivirus software or data encryption for the stored documents. Subsequently, hackers with foreign Internet Protocol addresses were able to access the Cloud Server, exposing the confidential records and information of approximately 5,400 LFS customers.<sup>2</sup>

*LFS's Supervisory Deficiencies*

From at least 2011 to 2015, LFS failed to establish, maintain and enforce a supervisory system, including WSPs, reasonably designed to ensure the security of customer records stored on electronic systems at the Firm’s branch offices.

LFS failed to adopt WSPs regarding the storage of customer data on cloud-based systems until November 2012, several months after the breach of the Cloud Server. At that time, the Firm amended its data security policy to provide some guidance to representatives regarding the storage of customer data on cloud servers (the “Data Security Policy”). The Data Security Policy, however, was insufficient. The Data Security Policy, for example, provided: “Firewalls must be used to prevent unauthorized access . . . .” The Data Security Policy did not, however, provide guidance to representatives on what type of firewall was sufficient or how to install such a firewall. Instead, the Data Security Policy left it to the Firm’s representatives to interpret, understand and adequately apply the Data Security Policy’s general recommendations when many of the Firm’s representatives lacked the technical expertise to do so.

Further, the Firm failed to ensure that its registered representatives, or the third-party vendors retained by its representatives, adequately applied the Data Security Policy or otherwise protected the records and information stored on electronic systems at the Firm’s branch offices. As noted in Notice to Members 05-48, “[a]fter the member has selected a third-party service provider, the member has a continuing responsibility to oversee, supervise, and monitor the service provider’s performance of covered activities.” LFS relied on the vendors selected by its registered representatives to complete their assigned tasks and failed to take adequate steps to monitor or audit the vendors’ performance. Indeed, from at least 2011 through 2015, the Firm failed to adequately test and verify the security of information stored on cloud servers at the Firm’s branch offices. In addition,

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<sup>2</sup> LFS reported the breach to FINRA in or about August 2012. To date, LFS is not aware of any misuse of customer information stemming from the unauthorized access of the Cloud Server. LFS notified in writing the individuals who could have been affected and offered credit monitoring, without charge, for one year.

the Firm had no adequate way to learn if a computer server at one of the Firm's branches was breached.

As a result of the foregoing, LFS violated NASD Rules 3010(a) and 3010(b) (for conduct before December 1, 2014), FINRA Rules 3110(a) and 3110(b) (for conduct on and after December 1, 2014), and FINRA Rule 2010.

## **2. LFS Failed to Reasonably Supervise and Retain Consolidated Reports**

A "consolidated report" is a document provided by a broker to a customer that combines account information regarding most or all of a customer's assets. On April 8, 2010, FINRA issued Regulatory Notice 10-19. Notice 10-19 reminded member firms that consolidated reports are communications with the public by the firm and must be clear, accurate, and compliant with federal securities laws and FINRA Rules. The Notice cautioned that consolidated reports, "[i]f not rigorously supervised . . . can raise a number of regulatory concerns, including the potential for communicating inaccurate, confusing or misleading information to customers . . . and the use of these reports for fraudulent or unethical purposes." Accordingly, Notice 10-19 directed that any firm that permitted registered representatives to provide consolidated reports to customers "must ensure that the size and complexity of the consolidated reporting program does not exceed the firm's ability to supervise the activity and to subject it to a rigorous system of internal controls."

### *LFS Failed to Reasonably Supervise Consolidated Reports*

From December 2010 through December 2013, the Firm used a software program developed by an outside vendor to create consolidated reports for customers. This program allowed representatives to manually enter assets and asset values into the consolidated reports. Materials provided to representatives upon association with LFS provided that: (1) written authorization from the customer must be received before using the "manual entry" feature; (2) backup documentation for manually entered assets must be retained in a client file for "verification and audit purposes;" and (3) only certain "Approved Assets" could be entered manually. The materials also included an example of a customer manual asset authorization form.

The Firm had no WSPs governing the acceptable forms of "written authorization" required before manual entries were permitted, and did not have adequate supervisory systems or any WSPs to ensure compliance with this requirement. Similarly, the Firm had no WSPs outlining the backup documentation that was required to be maintained for manually entered assets, and had an inadequate system to check that such backup documentation was, in fact, retained. Also, the Firm conducted no specific review to ensure that only "Approved Assets" were listed on consolidated reports. Further, the Firm's WSPs did not require a review of manual entries on consolidated reports. Additionally, LFS had an inadequate

system to review the consolidated reports that the Firm's representatives sent to customers.

*LFS Failed to Preserve and Retain Some Consolidated Reports*

From December 2010 through December 2013, the Firm believed the outside vendor's software program could accurately reproduce consolidated reports at some later date. It could not in every case. The Firm later learned that if certain asset information on a consolidated report was updated or modified in the consolidated report system, the prior version of that report was overwritten. As a result, when the Firm attempted to reproduce that report in the consolidated report system, prior versions of it were lost and could not be recovered from the system. While some consolidated reports may have been kept by registered representatives on their own or retained by LFS's email journaling system if emailed to customers, LFS did not require its representatives to retain copies and they were not stored centrally at the Firm. LFS is unable to determine how many consolidated reports were generated that it failed to retain.

By failing to reasonably supervise consolidated reports, LFS violated NASD Rule 3010(a) and FINRA Rule 2010. By failing to retain some consolidated reports sent to customers, LFS violated Section 17 of the Exchange Act and SEC Rule 17a-4 thereunder, NASD Rule 3110 and FINRA Rules 4511 and 2010.<sup>3</sup>

B. Respondent also consents to the imposition of the following sanctions:

- (1) A censure; and
- (2) A monetary fine of \$650,000.

LFS also consents to the following undertaking:

- (3) Within 210 calendar days of the issuance of this AWC, an officer of LFS will certify to FINRA in writing that LFS has (a) completed a review of its WSPs and systems concerning the areas described in Section I.A.1.; and (b) implemented necessary revisions to such procedures and systems that are reasonably designed to achieve compliance with Rule 30 of Regulation S-P of the Securities Exchange Act of 1934. The certification shall describe the specific actions taken by the Firm, including the systems and written procedures developed and implemented. Upon written request showing good cause, FINRA staff may extend the procedural date set forth above.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has

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<sup>3</sup> NASD Rule 3110 was superseded by FINRA Rule 4511 effective December 5, 2011. Accordingly, NASD Rule 3110 applies to the Firm's conduct on or before December 4, 2011. FINRA Rule 4511 applies to conduct beginning on December 5, 2011.

submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent 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

Respondent 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, Respondent 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.

Respondent 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

Respondent 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 LFS;
- C. If accepted:
  - 1. this AWC will become part of Respondent’s permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
  - 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. Respondent 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. Respondent 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 its: (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; and
- D. LFS may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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 the Firm, 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 the Firm 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 the Firm to submit it.

Lincoln Financial Securities Corporation,  
Respondent

10/21/2016  
Date

By: Paul T. Chryssikos  
Paul T. Chryssikos,  
Vice President and Counsel

Reviewed by:

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Accepted by FINRA:

11/14/16  
Date

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

Stuart P. Feldman  
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**LINCOLN FINANCIAL SECURITIES CORPORATION**

**FINRA No. 2013035036601**

**CORRECTIVE ACTION STATEMENT**

Lincoln Financial Securities Corporation (“LFS”) hereby submits this Corrective Action Statement demonstrating corrective actions or enhancements undertaken with respect to the issues contained in the Letter of Acceptance, Waiver and Consent (“AWC”) entered into in connection with FINRA Examination No. 2013035036601.<sup>1</sup> LFS accepted and consented to the AWC, without admitting or denying the findings, solely for the purposes of this proceeding in contemplation of a proposed settlement of the allegations described in the AWC. In pertinent part, the AWC alleges that LFS was deficient in the following two areas: (1) from at least 2011 to 2015, establishing, maintaining, and enforcing a supervisory system, including written supervisory procedures, reasonably designed to ensure the security of confidential customer information stored on electronic systems at LFS’s branch offices; and (2) from December 2010 through December 2013, establishing, maintaining, and enforcing a supervisory system, including written supervisory procedures, reasonably designed to ensure the preservation, retention, and review of consolidated reports produced by registered representatives and provided to LFS customers, and failing to retain some consolidated reports.

LFS is committed to complying with applicable securities laws and regulations, and it has committed substantial monetary resources and personnel to meeting its regulatory obligations, including with respect to the areas identified in the AWC. As set forth below, LFS has implemented corrective actions or enhancements to address each alleged deficiency stated in the AWC. LFS believes that the actions described below, as well as other completed and planned actions, appropriately address the issues in the AWC.

**1. Security of Confidential Customer Information Stored on Electronic Systems**

With respect to the security of confidential customer information, LFS has undertaken the following corrective actions or enhancements.

- a. When LFS became aware in 2012 of unauthorized access to a cloud server at one of its branch offices, LFS promptly investigated the incident and took steps to disable the affected server environment and eliminate the potential for further unauthorized access to the server. LFS engaged an outside law firm and electronic forensic investigation firm to respond to the incident. To date, LFS is not aware of any misuse of customer information stemming from the unauthorized access of the cloud server. LFS notified in writing the individuals who could have been affected and offered credit monitoring, without charge, for one year. LFS reported the incident to FINRA in or about August 2012 and fully cooperated with FINRA in its investigation.

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<sup>1</sup> This Corrective Action Statement is submitted by Lincoln Financial Securities Corporation. It does not constitute factual or legal findings by FINRA, nor does it reflect the view of FINRA or its staff.

- b. LFS is hiring additional information security personnel and is implementing additional cybersecurity tools or safeguards.
- c. LFS enhanced its cybersecurity training for representatives.
- d. LFS engaged a renowned team of cybersecurity experts to perform an evaluation of LFS's cybersecurity systems, policies, procedures, and control environment and to work with the firm with respect to implementing enhancements to LFS's cybersecurity program.
- e. LFS is implementing enhancements to its branch audit procedures to collect information regarding the hardware, software, and server usage at branch offices.
- f. LFS's compliance and information security groups meet quarterly regarding the security of confidential customer information stored on LFS's electronic systems.

## **2. Consolidated Customer Account Statements**

With respect to consolidated customer account statements ("CCAS"), LFS has undertaken the following corrective actions or enhancements.

- a. Promptly upon learning that certain CCAS could not be reproduced by the software program provided by the third-party vendor, LFS took steps to preserve and retain all CCAS that were distributed to customers. Specifically, LFS instituted a policy requiring that copies of all CCAS provided to customers be sent to LFS's Home Office for retention and review. LFS also required that representatives send to the Home Office a completed manual asset authorization form and documentation to verify manual entries above certain thresholds.
- b. LFS then implemented an additional CCAS reporting system feature which automatically creates a PDF of all CCAS that are intended to be shared with customers and stores the PDF in the firm's document management system for retention and review. To date, LFS is unaware of any harm to customers stemming from the issues relating to CCAS described in the AWC, and LFS continues to be diligent in monitoring the situation.
- c. LFS adopted a written supervisory procedure for manually entered assets to, among other things, verify that only approved assets are contained in the CCAS reporting system, verify that the completed manual asset authorization form is on file, and verify that representatives have submitted the appropriate documentation to verify manually entered assets meeting certain thresholds.

- d. LFS updated its compliance manual with respect to the use of the CCAS reporting system and manual entry of approved assets.
- e. LFS issued multiple internal compliance alerts to instruct and remind its registered representatives regarding LFS's policies and the use and retention of CCAS.

Respectfully submitted:

10/21/2016  
Date

Lincoln Financial Securities Corporation

By: Paul T. Chryssikos  
Paul T. Chryssikos  
Vice President and Counsel

Reviewed by:

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