

COMMONWEALTH OF KENTUCKY  
PUBLIC PROTECTION CABINET  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
AGENCY CASE NO. 2008-AH- 239

SEP - 9 2008

11494

DEPARTMENT OF FINANCIAL INSTITUTIONS

PETITIONER

V.

NEXT FINANCIAL GROUP, INC.

RESPONDENT

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**SETTLEMENT AGREEMENT AND ORDER**

**BACKGROUND AND FACTUAL FINDINGS**

1. The Department of Financial Institutions (“DFI”) is the agency of Kentucky state government charged with enforcement of the provisions of KRS Chapter 292 (the “Kentucky Securities Act”) and the rules and regulations enacted thereunder.

2. NEXT Financial Group, Inc. (“NEXT”) is a registered Broker/Dealer, which is also registered as such in Kentucky with the DFI. NEXT maintains its principal offices at 2500 Wilcrest, Suite 620, Houston, Texas 77042-2757. NEXT is doing business in the Commonwealth of Kentucky through its agents and representatives.

3. On April 21 through 23, 2008, pursuant to the authority granted by KRS 292.330(12), the DFI, Division of Securities (the “Division”), conducted a routine examination of a branch office of NEXT (Examination No. BD-961), located at 25 Eury Lane, Somerset, Kentucky 42501.

4. On May 12, 2008, the Division issued a written report of its examination, which contained a Statement of Findings (“Statement of Findings”) indicating areas of concern regarding the aforementioned branch office of NEXT and the principal office’s supervision over suitability matters.

5. In paragraph 1 of the Statement of Findings (“Equity Indexed Annuities”), the Division noted that on five occasions, Registered Representative Ken Prevett sold equity indexed annuities that were not reported or recorded through NEXT as required by firm policy. In addition, the equity indexed annuity transaction for a client involved the redemption of a variable annuity and there is not evidence that a switch form was completed. In response to the Statement of Findings, NEXT represented that Ken Prevett has been told and verbally acknowledges that all equity indexed annuities must be processed through NEXT. In addition, NEXT represents that it does not have an equity indexed annuity disclosure form but relies on forms and applications required by the Kentucky Department of Insurance for adequate disclosures and suitability requirements. On October 30, 2007, NEXT performed a field office examination or inspection (the “inspection”) of its Somerset, Kentucky branch office. The Field Office Exam Interview form completed by NEXT’s internal inspector asked if Prevett recommended equity indexed annuities products to his clients, and if so, whether that had been reported on an Outside Business Activity Form. However, the internal inspector failed to fill in the answers to those questions on the form, and they were left blank.

6. In paragraphs 2 through 5 of the Statement of Findings (“Switching”), the Division addressed concerns related to switching transactions and disclosures. In

paragraph 2 of the Statement of, the Division noted that the Division considers switching transactions to include mutual fund to mutual fund, mutual fund to variable annuity, variable annuity to variable annuity and the sale of a security to purchase an indexed annuity. NEXT could not generate a switch report for review by the Division during the examination, and the Somerset, Kentucky office does not maintain a switch file as all switch documents are filed in the client file. In response to the Statement of Findings, NEXT represented that it captures switch transactions by a principal of the firm reviewing a copy of the Mutual Fund Disclosure form and a Variable Annuity Disclosure Form which require the source of funds to be indentified. In addition, the weekly sales blotters and monthly CDSC reports are tools used to identify switching.

7. In paragraph 3 of the Statement of Findings, the Division noted that two clients did transact variable annuity switches but copies of the NEXT Liquidation Disclosure Form and Variable Annuity Disclosure Form were not found. In response to the Statement of Findings, NEXT represents that the NEXT Liquidation Disclosure Form is only needed if a product valued at greater than \$10,000 is sold and would not have been required for these transactions. The Variable Annuity Disclosure Forms could not be located for these transactions and NEXT has directed Ken Prevett to obtain new disclosure forms for these transactions.

8. In paragraph 4 of the Statement of Findings, the Division noted that it had concerns regarding the switch forms used by the firm relating to adequate disclosures. In response to the Statement of Findings, NEXT represented that the majority of the

suggested statements included in the Division's Disclosure in Switching Transaction document were already contained in NEXT's disclosure forms.

9. In paragraph 5 of the Statement of Findings, the Division noted that several items of correspondence did not contain evidence of supervisory review and/or approval. Some of this correspondence was received or was sent from this branch prior to NEXT's October 30, 2007 internal inspection. In response to the Statement of Findings, NEXT represented that the correspondence in question appeared to be administrative in nature, and therefore did not require prior approval by a principal. On October 30, 2007, NEXT performed a field office examination or audit of its Somerset, Kentucky branch office. This correspondence reportedly was reviewed by NEXT's internal inspector and no deficiency was noted, but there was no evidence of review.

10. In paragraph 6 of the Statement of Findings, the Division noted that Sales Logs provide for incoming correspondence to be attached and a block is to be checked to indicate whether or not correspondence is attached. Most of the Sales Logs for the period of January 2007 through April 2008 did not have the block checked. In response to the Statement of Findings, NEXT represents that Ken Prevett informed them that it was an administrative error on his part and has been informed that this process needs to be corrected. There was no evidence that correspondence was reviewed during the inspection on October 30, 2007.

11. In paragraph 7 of the Statement of Findings, the Division noted that five checks were not recorded on the Sales Logs. In response to the Statement of Findings, NEXT represents that Ken Prevett indicated that it was an administrative oversight on

the part of his office assistant and that he has reviewed this policy with his assistant. The inspection failed to note this deficiency.

14. In paragraphs 8 and 9 of the Statement of Findings (“Advertising Materials”), the Division noted that the fax cover sheet does not contain required disclosures pertaining to Ken Prevett’s association with NEXT, and there is no evidence that NEXT has reviewed and approved Ken Prevett’s business card and letterhead. In response to the Statement of Findings, NEXT represents the fax cover sheet was not acceptable and has required changes to be made, and represents that the business card and letterhead had not been approved and has subsequently reviewed. The inspection failed to note this deficiency.

15. NEXT’s internal inspector only looked at a very small number (less than five) of client files during his inspection, and failed to note deficiencies present in one of the files he did review.

16. KRS 292.330(12)(d) provides that the Commissioner of DFI (the “Commissioner”) may make periodic examinations of each broker-dealer registered in Kentucky at such times and in such scope as he determines, and the expense reasonably attributable to any such examination shall be paid by the broker-dealer whose business is examined but the expense so payable may not exceed an amount which the Executive Director by rule prescribes.

17. 808 KAR 10:400, Section 2 provides that the fee for a routine examination of a broker-dealer shall be thirty five (35) dollars per working hour with the total fee not to exceed \$1,000. The total fees associated with this examination are \$577.50.

18. KRS 292.500(3) authorizes the Commissioner to promulgate administrative regulations necessary to carry out the provisions of the Kentucky Securities Act.

19. KRS 292.330(12)(f) authorizes the Commissioner to promulgate administrative regulations regulating the conduct of business by broker-dealers which he finds appropriate in the public interest and for the protection of investors.

20. Pursuant to 808 KAR 10:030, Section 2(1) each agent shall be subject to the supervision of a supervisor designated by the broker-dealer employing the agent. The responsibilities of a designated supervisor with respect to each agent under his supervision shall include, among other things, the prompt review and written approval of the opening of each new customer account by the agent, each securities transaction by the agent. Under this Section, supervision also requires periodic review of customer accounts of the agent and the regular inspection of the records of the agent at the agent's place of business.

21. Pursuant to 808 KAR, Section 3 each broker-dealer shall establish, maintain and enforce written procedures that are reasonably designed to detect and prevent violations of the Kentucky Securities Act, 808 KAR Chapter 10, orders issued under that chapter, rules promulgated by the Securities and Exchange Commission pursuant to 15 U.S.C. 78w, and the rules of any self-regulatory organization (such as FINRA) of which the broker-dealer is a member.

22. Internal examinations or reviews must be reasonably designed to assist the broker/dealer in detecting and preventing violations of the securities laws and should include, among other things, a review of any on-site customer account documentation

and other books and records, meetings with individual registered representatives to discuss the products they are selling and their sales methods, and an examination of correspondence and sales literature.

23. In order to resolve this matter without further litigation or adversary proceedings, NEXT has agreed to compromise and settle all claims arising from the above referenced examination by the Division in accordance with the terms set forth herein.

### **AGREEMENT AND ORDER**

The Department of Financial Institutions and NEXT Financial Group, Inc., in the interest of economically and efficiently resolving the issues raised in the foregoing Background and Factual Findings, agree as follows:

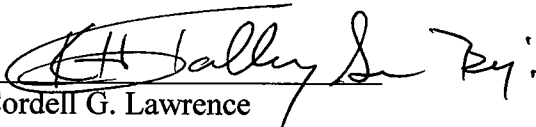
1. NEXT Financial Group, Inc. agrees to pay a fine in the amount of One Thousand Dollars (\$1,000) for failure to adequately supervise or perform an adequate internal examination of the activities of its registered representatives in its Louisville, Kentucky branch office as more fully set forth above. This fine shall be made payable to the "Kentucky State Treasurer" and mailed to the Department of Financial Institutions, Attn: William B. Owsley, 1025 Capital Center Drive, Suite 200, Frankfort, Kentucky 40601, on or before the date of execution of this Settlement Agreement and Order.
2. NEXT Financial Group, Inc. further agrees to pay examination fees in the amount of five hundred and seventy seven dollars and fifty cents (\$577.50), payable to the "Kentucky State Treasurer" and mailed to the

Department of Financial Institutions, Attn: William B. Owsley, 1025  
Capital Center Drive, Suite 200, Frankfort, Kentucky 40601, on or before  
the date of execution of this Settlement Agreement and Order.

3. NEXT Financial Group, Inc further agrees to promptly implement (within sixty days following entry of this Order), to the extent it has not done so already, such system changes as will address those issues raised in the Statement of Findings relating to the detection of switching transactions, development of a switch form for indexed annuities, review and approval of all correspondence, including electronic mail, and conduct a review of its internal inspection system to address deficiencies with respect to the number of accounts reviewed and to evidence review of compliance files to ensure that its system is reasonably designed to detect and prevent violations of the securities laws.
4. In regard to this matter, NEXT Financial Group, Inc waives its right to demand a hearing, at which it would be entitled to legal representation, to confront and cross examine witnesses for the Department of Financial Institutions, and to present evidence on its own behalf. Further, NEXT Financial Group, Inc consents to and acknowledges the jurisdiction of the Department of Financial Institutions over this matter and that this Agreement is a matter of public record and may be disseminated as such.
5. This Settlement Agreement shall constitute the Final Order in this matter.

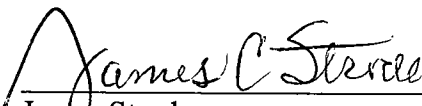


IT IS SO ORDERED on this the 9<sup>th</sup> day of ~~July~~<sup>September</sup>, 2008.

  
Cordell G. Lawrence  
Commissioner  
Department of Financial Institutions  
Consented To:

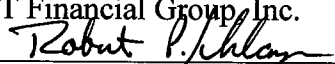
This 9<sup>th</sup> day of Sept., 2008

HAVE SEEN AND AGREED TO:

  
James Strode  
Director  
Division of Securities  
Kentucky Department of Financial Institutions

AND

This 29 day of August, 2008

NEXT Financial Group, Inc.  
BY:   
ITS: Chief Compliance Officer

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