

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT  
NO. 2019063058701**

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

RE: NEXT Financial Group, Inc. (Respondent)  
Member Firm  
CRD No. 46214

Pursuant to FINRA Rule 9216, Respondent NEXT Financial Group, Inc. 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 Respondent alleging violations based on the same factual findings described in this AWC.

**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**

NEXT has been a FINRA member since 1999 and is headquartered in Houston, Texas. The Firm is a general securities broker-dealer and currently has approximately 540 registered persons.

On December 5, 2017, FINRA issued a Letter of Acceptance, Waiver and Consent (No. 2015043319901), in which NEXT was censured, fined \$750,000 and was required to retain an independent consultant for, among other things, systemic supervisory failures relating to excessive trading and variable annuities.<sup>1</sup>

**OVERVIEW**

From January 2012 through February 2019, NEXT failed to establish, maintain, and enforce a supervisory system, including written supervisory procedures (WSPs), reasonably designed to detect and prevent unsuitable short-term trading of mutual funds and municipal bonds in customer accounts and over-concentration of customer accounts in Puerto Rican municipal bonds. As a result of the misconduct, NEXT violated NASD Rules 3010(a) and (b), FINRA Rules 3110(a) and (b), MSRB Rules G-27(b) and (c), and FINRA Rule 2010.

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<sup>1</sup> For more information about the firm, including prior regulatory events, visit BrokerCheck® at [www.finra.org/brokercheck](http://www.finra.org/brokercheck).

In addition, from approximately March 2013 through February 2017, the firm failed to establish a reasonable system of supervisory controls to test and verify that its supervisory procedures were reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules. As a result, the firm violated FINRA Rule 3120, NASD Rule 3012, FINRA Rule 2010, and MSRB Rule G-27(f).

### **FACTS AND VIOLATIVE CONDUCT**

This matter originated from a tip to FINRA, a customer arbitration filed against NEXT, and an examination of the firm.

#### **NEXT Failed to Establish, Maintain and Enforce a Supervisory System Reasonably Designed to Supervise Mutual Funds and Municipal Bonds.**

FINRA Rule 3110(a) and its predecessor, NASD Rule 3010(a),<sup>2</sup> require that FINRA members establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. FINRA Rule 3110(b) and its predecessor, NASD Rule 3010(b), require that FINRA members establish, maintain, and enforce written procedures to supervise the types of business in which they engage and the activities of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. FINRA Rule 2010 provides that “[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.” A violation of FINRA Rule 3110 is a violation of FINRA Rule 2010.

FINRA Rule 2111 and its predecessor, NASD Rule 2310,<sup>3</sup> require member firms or their associated persons to have a reasonable basis to believe that a recommended securities transaction or investment strategy is suitable for a customer, based on information obtained through the reasonable diligence of the firm or associated person to ascertain the customer’s investment profile.

Mutual funds are composed of several classes of shares. Class A Shares usually include an initial or “front-end” sales charge levied upon the purchase of shares, as well as annual, ongoing distribution and service fees that are typically 0.25 percent. The majority of the front-end charge is paid to the selling broker-dealer as a concession.<sup>4</sup> Class A mutual fund shares (Class A Shares) are intended to be held long-term because there are significant up-front costs associated with the purchase of these products. A recommendation that an investor engage in short-term trading in Class A Shares is potentially unsuitable because of these significant up-front costs. Mutual fund switching occurs when a customer sells mutual fund shares and reinvests the proceeds in another mutual fund company, often incurring additional charges and commissions.

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<sup>2</sup> FINRA Rule 3110 superseded NASD Rule 3010 on Dec. 1, 2014.

<sup>3</sup> FINRA Rule 2111 replaced NASD Rule 2310 effective July 9, 2012.

<sup>4</sup> Class B and C Shares typically do not carry a front-end sales charge but have significantly higher distribution and service fees (typically 1.00%) and may be subject to a contingent deferred sales charge (CDSC).

MSRB Rule G-27(b) requires municipal dealers to establish and maintain a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and regulations and MSRB Rules. Rule G-27(c) further requires each municipal dealer to adopt, maintain, and enforce written supervisory procedures that are reasonably designed to ensure that the conduct of municipal securities activities complies with MSRB Rules and the Exchange Act.

MSRB Rule G-17 requires brokers in municipal securities to “deal fairly” with their customers and prohibits “any ... unfair practice.” MSRB Rule G-19 requires that a broker “in recommending to a customer any municipal security transaction . . . shall have reasonable grounds . . . for believing that the recommendation is suitable.”

Like Class A Shares, municipal bonds typically are long-term investments, which, when held until their maturity date or an earlier call date, allow an investor to preserve capital while generating tax-advantaged or tax-free income. Purchase of a municipal bond generally involves costs to the investor in the form of a mark-up. Sales can also involve costs in the form of a mark-down. A recommendation that an investor engage in short-term trading of municipal bonds may be unsuitable due to these costs.

*The firm’s supervisory system was not reasonably designed or enforced to detect and prevent unsuitable mutual fund switching.*

From January 2012 through February 2019, NEXT relied upon an automated surveillance system to identify and flag for review Class A Share switches. This system generated alerts, and firm supervisors were responsible for reviewing the alerts to determine whether flagged transactions were suitable. The surveillance system was not reasonably designed to achieve compliance with applicable FINRA rules because it did not provide critical data to assist the supervisors in evaluating the transactions for suitability.

Review of alerts generated by the system did not provide information regarding holding periods of the Class A Shares sold or costs to the customer associated with the switch transactions. Without this information, the reviewing supervisor could not determine if short-term trading was taking place or the financial benefit or detriment to the customer of the transaction. In addition, when the system flagged a switch transaction prior to 2015, the firm provided supervisors with no guidance through its WSPs to assist in evaluating the suitability of the switch. The WSPs in place during that time also provided no information regarding appropriate holding periods for Class A Shares or other factors to be considered in determining the suitability of a Class A Share switch. Furthermore, after updates to the WSPs in 2015, the criteria to be used by supervisors was vague and did not provide sufficient guidance.

In instances in which a switch alert is missing information that would be significant to making a determination regarding whether a switch is suitable, it is unreasonable for supervisors to clear individual alerts without sufficient investigation. The firm allowed supervisors to clear individual alerts after obtaining an explanation from the registered representative, without any further investigation. This included instances in which red

flags should have put supervisors on notice that the explanations were incomplete or inaccurate.

*The firm's supervisory system was not reasonably designed or enforced to detect and prevent unsuitable short-term trading and over-concentration in municipal bonds.*

From January 2012 through February 2019, NEXT's supervisory system was not reasonably designed or enforced to detect and prevent short-term trading of municipal bonds or over-concentration of these bonds in customer accounts. Additionally, the WSPs did not discuss suitability reviews specific to municipal bonds, address or provide any guidance regarding holding periods for municipal bonds, or address factors to be considered in determining appropriate levels of concentration. The WSPs also did not have any other additional suitability guidance that would be applicable and assist supervisors in analyzing the suitability of municipal bonds.

*The firm failed to reasonably detect and respond to red flags in Broker A's trading.*

As a result of the conduct described above, the firm failed to detect and reasonably respond to red flags in the trading of Broker A prior to customers incurring significant losses.<sup>5</sup> These red flags included short term trading of mutual funds and municipal bonds, as well as over-concentration of Puerto Rican municipal bonds (PR Bonds) in customer accounts.

From 2012 until February 2019, Broker A employed a strategy of short-term trading of Class A Shares in 19 customer accounts, many of which belonged to seniors. This trading strategy resulted in the 19 accounts incurring unnecessary Class A Share sales charges totaling approximately \$925,000.

From approximately June 2013 to November 2016, Broker A engaged in short-term trading of PR Bonds in 16 customer accounts and concentrated five customer accounts in PR Bonds. These bonds carried risks not associated with other municipal bonds because of concerns about the Puerto Rican economy and subsequent restructuring of Puerto Rican debt. The risk of such concentration was compounded by frequent trading in the PR Bonds because of the repeated payment of upfront costs that would decrease any investment returns. Broker A's customers suffered losses of approximately \$4.1 million on investments in PR Bonds.

In late 2016, a trading desk employee raised questions about Broker A's Class A Shares trading. The firm then performed a review of Broker A's switching activity. That review highlighted the fact that Broker A was moving his customers in and out of mutual funds and PR Bonds, causing the customers to incur sales charges that affected the profitability of the accounts. When Broker A was questioned regarding this activity, he gave misleading explanations to justify the activity and no further review of the transactions was conducted. The firm's failure to conduct a further review to verify Broker A's

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<sup>5</sup> Broker A was barred from associating with any FINRA member in a 2020 AWC for refusing to testify before FINRA.

explanations was not reasonable given the inconsistency of those explanations with the multitude of red flags in the customers' account information and in the firm's blotter.

Despite being aware of red flags regarding Broker A's trading through supervisory alerts and a special review of his trading in 2016, NEXT failed to conduct a continued heightened review of Broker A's trading activity. The firm did not address the red flags associated with the transactions again until after arbitrations were filed by customers in June and September 2018 regarding both the Class A Share and PR Bond transactions. As a result, Broker A continued to short-term trade Class A Shares and PR Bonds in customer accounts, causing customers to incur additional unnecessary fees and suffer losses until March 2019.<sup>6</sup>

Therefore, NEXT violated NASD Rule 3010(a) and (b), FINRA Rules 3110(a) and (b) and 2010, and MSRB Rule G-27(b) and (c).

**NEXT failed to establish, maintain and enforce a reasonable system of supervisory control policies and procedures to test and verify its surveillance systems.**

FINRA Rule 3120 and its predecessor, NASD Rule 3012,<sup>7</sup> require that a member firm establish, maintain, and enforce a system of supervisory control policies and procedures to test and verify whether the member's supervisory procedures are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules. A designated firm principal must submit an annual report to senior management that details the system of supervisory controls, the test results, and any amended procedures created in response to the test results. MSRB Rule G-27(f) imposes a similar requirement upon municipal securities dealers.

From March 2013 through February 2017, NEXT failed to have a reasonably designed system of supervisory control policies and procedures to test the firm's surveillance systems relating to mutual funds and municipal bonds. Although the firm performed annual tests of its supervisory procedures for these years and created a report regarding those tests, the tests were not reasonably designed. None of these tests examined whether the system to supervise two active business lines—mutual funds and municipal bonds—was reasonably designed to achieve compliance with FINRA and MSRB suitability rules. As an example, NEXT failed to test the surveillance system with regard to mutual funds and municipal bonds to determine whether it was operating effectively to identify potential unsuitable switching transactions.

Therefore, NEXT violated FINRA Rules 3120, NASD Rule 3012, FINRA Rule 2010 and MSRB Rule G-27(f).

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

- a censure;

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<sup>6</sup> As a result of an action brought by the Texas State Securities Board in February 2020, customer arbitrations, and FINRA's investigation, NEXT has paid restitution to the affected customers of Broker A totaling \$4,277,000.

<sup>7</sup> FINRA Rule 3120 superseded NASD Rule 3012 on Dec. 1, 2014.

- a \$750,000 fine (\$225,000 of which pertains to the violations of MSRB Rule G-27); and
- the following undertaking:
  - Certification Regarding Implementation of Reasonably Designed Procedures. Within no later than 120 days of the date this AWC is accepted, a senior officer and principal of NEXT shall certify in writing to FINRA that the firm has implemented supervisory systems and written supervisory procedures reasonably designed to address unsuitable short-term trading of mutual funds and municipal bonds in customer accounts and over-concentration of customer accounts in Puerto Rican municipal bonds. This certification shall be submitted by letter addressed to Laura Leigh Blackston, Senior Counsel, FINRA Enforcement Department, 1100 Poydras St, Suite 850, New Orleans, Louisiana, 70163 and to [Laura.Blackston@finra.org](mailto:Laura.Blackston@finra.org).

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 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 an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

## 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 its acceptance or rejection.

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 Respondent; and
- C. If accepted:
  - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;
  - 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 its subject matter 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 Respondent's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent 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.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's 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 Respondent has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

July 13, 2021

Date

*Barry G. Knight*

NEXT Financial Group, Inc.  
Respondent

Print Name: Barry G. Knight

Title: President

Reviewed by:

*Jack D. Ballard*

Jack D. Ballard, Esq.  
Counsel for Respondent  
Bressler, Amery & Ross, P.C.  
3700 Buffalo Speedway, Suite 1020  
Houston, TX 77098

Accepted by FINRA:

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

July 13, 2021

Date

*Laura Leigh Blackston*

Laura Leigh Blackston  
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FINRA  
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