

**NEXT FINANCIAL GROUP, INC. SANCTIONED BY THE SEC FOR
VIOLATING REGULATION S-P**

On June 18, 2008, in an Initial Decision (“Decision”), a Securities and Exchange Commission (“SEC”) administrative law judge ordered Next Financial Group, Inc. (“NEXT”) to pay a \$125,000 penalty for violating several sections of SEC Regulation S-P (“Reg S-P”), the SEC’s privacy regulation, and to cease and desist from any violations or future violations of the applicable sections of Reg S-P (Rules 4, 6, 10, 30).

NEXT is a broker-dealer registered with the SEC and currently has approximately 850 registered representatives nationwide. The following is a summary of the findings of fact from the administrative law judge and an overview of the Decision.

Reg S-P applies to SEC registered broker-dealers, SEC registered investment advisors, and SEC registered investment companies (“Covered Institutions”).

Findings of Fact Regarding NEXT’s Recruitment Practices

NEXT has an aggressive recruiting policy in which it recruits registered representatives from other brokerage firms and encourages these recruits to bring their customer accounts to NEXT. Between 2001 and 2006, NEXT’s recruiters and its transition team assisted potential recruits by using customer information provided to NEXT by the recruits *before* they left their current brokerage firms to become affiliated with NEXT. Not all recruits actually became affiliated with NEXT. The information provided by these recruits included “personally identifiable financial information” covered by Reg S-P. NEXT did not establish whether the recruits’ customers consented to the disclosure of this information to NEXT. The customers were not told that recruits disclosed this information to NEXT, nor were they given a reasonable opportunity to opt out of such disclosure. In addition, NEXT did not seek to obtain or review copies of privacy policies from the recruits’ current brokerage firms and thus could not conclude whether the privacy policies of such firms disclosed that recruits could take customer information to a new firm. NEXT did not find out whether the customer information it collected from recruits was publicly available information. Additionally, until 2006, NEXT’s policies and procedures did not prohibit NEXT’s transition team from using the recruits’ passwords and user identifications at their old firms to access customer information at such firms, and did not address the purging of the nonpublic personal information provided by recruits after NEXT had completed its preparation of client account transfer documents.

Findings of Fact Regarding NEXT’s Departing Representative Practices

While NEXT was pursuing new recruits between 2001 and 2006, numerous representatives were also leaving NEXT, some of them joining other broker-dealers. When a registered representative left NEXT to join another broker or dealer, NEXT permitted the representative to retain copies of customer files and documents (including customer names, addresses, Social Security numbers,

birth dates, account numbers, and banking information) and provide that information to his or her newly affiliated broker-dealer. Before February 9, 2006, NEXT's privacy policy notices did not disclose to customers that their nonpublic personal information could leave NEXT if the registered representative servicing their account left and affiliated with a new broker-dealer. In addition, NEXT did not disclose to customers that they could opt out of this information sharing with successor broker-dealer firms.

The Administrative Law Judge's Decision

NEXT was found to have violated Rules 4, 6, 10 and 30 of Reg S-P. Rule 4 requires a Covered Institution such as NEXT to provide its customers with a clear and conspicuous notice that accurately reflects its privacy policies and practices. NEXT was found to have willfully violated Rule 4 since its privacy policy notices did not inform customers that it allowed its departing registered representatives to disclose customer nonpublic personal information to nonaffiliated third parties.

NEXT was also found to have willfully violated Rule 6, which requires a Covered Institution's initial and annual privacy notices to identify the categories of nonpublic personal information that it discloses. NEXT's privacy policy notices did not, until later changed, inform customers that NEXT allowed its departing registered representatives to disclose all of the categories of customer nonpublic personal information to the nonaffiliated third parties with which they intended to associate.

It was also found that NEXT willfully violated Rule 10, which provides that, unless otherwise authorized by another provision of Reg S-P, a Covered Institution may not disclose a consumer's nonpublic personal information to nonaffiliated third parties without proper notice and a reasonable opportunity to opt out. NEXT did not provide its customers with proper notice and a reasonable opportunity to object to (by providing an opt-out clause) the practice that allowed NEXT's departing representatives to take with them and disclose the customer's nonpublic personal information to the representative's new nonaffiliated third-party firm.

Rule 30 requires Covered Institutions to adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information. The Administrative Law Judge found that NEXT did not alter its policies, practices, or procedures with respect to departing representatives, and that it was a reasonably foreseeable risk that departing representatives would disclose customer nonpublic personal information to successor brokerage firms without safeguarding policies and procedures in place; because outbound representatives actually took customer nonpublic personal information with them and disclosed it to other nonaffiliated broker-dealer firms, a willful violation of Rule 30 was found.

Lastly, NEXT was found to have aided and abetted the violation of Rule 10 of Reg S-P with respect to its recruits. The violation of Rule 10 resulted from the recruits' disclosure of nonpublic personal information to NEXT before joining it, without the requisite disclosure in the privacy notice of the recruits' prior broker-dealer, or the reasonable opportunity for the customer

to opt-out. The Administrative Law Judge also stated that the fact that some of the recruits actually made these disclosures prior to leaving their prior firm and joining NEXT was the strongest evidence of misconduct. NEXT was liable for aiding and abetting this violation because it was found to be generally aware of the violation being committed, and substantially assisted in the committing of the violation. While NEXT argued that the violation was cured because the affected customers could have later declined to transfer their accounts to NEXT, the Administrative Law Judge found that the customers ability to decline would not have remedied this violation since Rule 10 affords consumers the opportunity to opt out *before* nonpublic personal information is disclosed.

As the 21-day period for NEXT to petition to review the Decision has expired, the SEC will presumably issue a Finality Order soon, declaring the orders in the Decision effective. As a result, it is important for all Covered Institutions to review their privacy notices, as well as their policies and procedures, to guard against the various violations of Reg S-P for which the SEC has sanctioned NEXT.

The decision can be found at www.sec.gov/litigation/aljdec/2008/id349jtk.pdf.

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If you have any questions regarding this memorandum, please contact, Martin R. Miller (212-728-8690, mmiller@willkie.com), Marc J. Lederer (212-728-8624, mlederer@willkie.com), or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, DC telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at www.willkie.com.

July 15, 2008

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