

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

FILED: NOVEMBER 17, 2008
08CV6587

FREDERICK J. GREDE, as Chapter 11 Trustee
for Sentinel Management Group, Inc.,

Plaintiff,

v.

STEPHEN M. FOLAN,
JACQUES DE SAINT PHALLE, and
FTN FINANCIAL SECURITIES
CORPORATION,

Defendants.

) JUDGE DOW
) MAGISTRATE JUDGE VALDEZ
) CH
)

Case No. _____
JURY TRIAL DEMANDED

COMPLAINT

Plaintiff Frederick J. Grede, not individually but as Chapter 11 Trustee for Sentinel Management Group, Inc. (“the Trustee”), hereby states for his Complaint as follows:

NATURE OF THE ACTION

1. This is a complaint by the Trustee against securities brokers Stephen M. Folan, Jacques de Saint Phalle, and FTN Financial Securities Corp. (“FTN”) for aiding and abetting a breach of fiduciary duty, commercial bribery, securities fraud, violation of the Illinois Blue-Sky law, violation of the Illinois Consumer Fraud Act, negligence and unjust enrichment. In addition, the Trustee seeks avoidance of transfers of cash and securities to defendant FTN worth hundreds of millions of dollars made with the actual intent to hinder, delay and defraud Sentinel’s creditors.

2. Sentinel was a cash manager for various customers, including futures commission merchants, hedge funds, and individuals. As each of the defendants well knew, Sentinel was

required to invest its customers' funds exclusively in safe, highly liquid securities, such as government securities and certain investment-grade corporate bonds.

3. Nevertheless, defendants recommended and sold to Sentinel, through Sentinel's head trader, Charles Mosley, hundreds of millions of dollars worth of structured finance products, most of them known as "PreTSLs." These securities were wholly unsuitable for Sentinel. They were unsuitable for Sentinel's customer portfolios because they were risky, illiquid securities with 30-year maturities, characteristics completely inconsistent with Sentinel's duty to invest customer funds in only safe, high-grade securities. And they were unsuitable for Sentinel's own small proprietary portfolio because Sentinel did not have anywhere close to sufficient assets to purchase that volume of securities. Defendants knew, or should have known, that these securities were unsuitable for Sentinel and sold them to Sentinel anyway.

4. Defendants Folan, de Saint Phalle and FTN sold PreTSLs and similar securities to Sentinel utilizing two corrupt and deceptive methods. First, defendants compromised, co-opted, duped and bribed Mosley by improperly providing him with lavish meals, wine, entertainment, lodging, travel, tickets to sporting events, and other benefits and things of value. Second, having compromised Mosley's independent judgment, one or more of the defendants furthered their deceptive scheme by providing Sentinel with false and misleading information about the liquidity of the securities, particularly FTN's ability and willingness to make a market in these securities, the ratings of the securities, and whether the securities were exposed to risk arising from non-prime lending.

5. Defendants participated in this conduct in order to earn huge income, commissions, compensation and profits associated with the sale of these securities. To magnify this unlawful income, defendants traded in and out of various PreTSL positions when there was

no legitimate reason for Sentinel to engage in such transactions. When the credit market tightened in mid-2007, defendants then compounded the harm by urging Mosley to hold rather than sell the PreTSL securities. Defendants did this in order to protect FTN's own position in PreTSLs.

6. In August of 2007, Sentinel collapsed under the weight of the illiquid and risky securities it had purchased, including the PreTSLs purchased from FTN, and the huge debt it had incurred to finance the purchase of such securities. The PreTSLs Sentinel was left holding turned out to be worth only a fraction of their face value, and some were worth nothing at all.

JURISDICTION AND VENUE

7. This Court has jurisdiction pursuant to 28 U.S.C. § 1334(b) because this proceeding is related to and arises under the Chapter 11 case, *In Re Sentinel Management Group, Inc.*, pending in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division, as Case No. 07 B 14987. In addition, this Court has jurisdiction pursuant to 28 U.S.C. § 1331 in that certain of the claims arise under the laws of the United States, specifically, 15 U.S.C. § 78j(b) and Rule 10(b)-5 and 11 U.S.C. §§ 548(a)(1)(A) and 550(a). The Court also has supplemental jurisdiction over counts arising under State law pursuant to 28 U.S.C. § 1367. This matter is being filed in the District Court in order to permit the Trustee to obtain a trial by jury.

8. Venue is proper under 28 U.S.C. § 1409(a) because the matter relates to and arises under a bankruptcy proceeding in this District and under 28 U.S.C. § 1391(b) in that a substantial part of the events giving rise to the claim occurred in this District.

THE PARTIES AND RELATED ENTITIES

9. Plaintiff Frederick J. Grede is the chapter 11 trustee for Debtor Sentinel Management Group, Inc., duly appointed under Section 1104 of the Bankruptcy Code by Orders of this Court dated August 23 and 29, 2007.

10. Sentinel is an Illinois corporation which was at relevant times headquartered in Northbrook, Illinois. Sentinel was registered with the Securities and Exchange Commission (“SEC”) as an investment adviser and with the Commodity Futures Trading Commission (“CFTC”) as a futures commission merchant (“FCM”).

11. Defendant Steven M. Folan (“Folan”) is, on information and belief, a resident of Plainfield, Illinois. Folan also owned homes in Lake Geneva, Wisconsin and in Chicago, Illinois. Folan is employed as a broker by defendant FTN Financial Securities Corp. in its Chicago, Illinois office.

12. Defendant Jacques de Saint Phalle (“de St. Phalle”) is, on information and belief, a resident of Greenwich, Connecticut. De St. Phalle also owns a home in Coral Gables, Florida. Between February 2006 and July 2007, De St. Phalle was employed as a managing director in the Structured Finance Group of defendant FTN Financial Securities Corp., in its office in New York, New York. De St. Phalle was one of the people who created the PreTSL instruments.

13. Defendant FTN Financial Securities Corp. (“FTN”) is a corporation organized under the laws of the State of Tennessee, with its principal place of business in Memphis, Tennessee and other offices throughout the country. FTN is a subsidiary of First Tennessee National Bank and Trust Association (“First Tennessee”). FTN is registered with the SEC and the Financial Industry Regulatory Authority (“FINRA”) as a broker-dealer. FTN conducted various businesses, including acting as a broker-dealer of equity and debt securities, underwriting

securities, trading securities for its own account, and creating and marketing complex structured finance products.

FACTUAL BACKGROUND

SENTINEL'S CASH MANAGEMENT BUSINESS

14. Sentinel primarily managed investments of short-term cash for various clients, including other FCMs, hedge funds, financial institutions, pension funds, and individuals.

15. Sentinel solicited clients by offering them the opportunity to participate in several safe investment programs, each of which purportedly had its own investment policy designed to meet the requirements and risk profiles of different types of clients. Each of these programs was supposed to provide safety of principal and same-day liquidity. Depending on the source of the funds being invested, Sentinel assigned client assets into one of three account pools referred to within Sentinel as SEG 1, SEG 2 and SEG 3. Assets in each of the accounts were supposed to be segregated and used solely for the benefit of clients in that segregated account.

16. SEG 1 was supposed to contain customer funds and property of registered FCMs. The investment of FCM customers' funds is subject to the provisions of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 1 et seq., and the rules and regulations promulgated thereunder by the CFTC, 17 C.F.R. § 1.1 - 190.10, including the strict investment standards embodied in CFTC Rule 1.25, 17 C.F.R. § 1.25, and generally is supposed to consist of only the highest grade securities and similar highly liquid investments.

17. SEG 2 was supposed to contain the funds and property of FCM customers that are engaged in trading at foreign exchanges, invested in accordance with CFTC Rule 30.7, 17 C.F.R. § 30.7. Rule 30.7 imposes restrictions on the investment of customer funds similar to those in Rule 1.25.

18. SEG 3 was supposed to contain assets of all other types of clients, including FCMs' own (*i.e.*, non-customer) funds, hedge funds, trust accounts, endowments and individuals. About 75% in amount of the SEG 3 investments were supposed to be invested in Rule 1.25 compliant securities. Even Sentinel's highest-return "Prime" portfolio (which represented a portion of the SEG 3 pool) was, according to Sentinel's website, invested in only short-term commercial paper rated A1/P1 or investment grade corporate bonds.

19. In addition to the supposed SEG 1, SEG 2, and SEG 3 customer pools, Sentinel managed a much smaller "House" or "Street" portfolio, which was a portfolio of securities traded by Sentinel for the ultimate benefit of certain insiders, including Philip Bloom, Eric Bloom, and Charles Mosley.

20. Sentinel was required under federal law and its agreements with its customers to segregate the assets of each of the customer SEGs from Sentinel's own funds and those of other customer groups.

THE "PRETSL" SECURITIES RECOMMENDED AND SOLD BY DEFENDANTS

21. Defendants recommended and sold to Sentinel, through Mosley, a large number of collateralized debt obligations ("CDOs"), securities that were wholly unsuitable for Sentinel, most of them known as "PreTSLs."

22. "PreTSL" is the acronym for Preferred Term Securities Limited, a structured investment product that was originally created by FTN and Keefe Bruyette & Woods, Inc. ("KBW"). In approximately 2000, FTN and KBW began the PreTSL program and approached a variety of regional banks and savings and loans to assist them in raising capital, primarily by issuing trust preferred securities. Trust preferred securities are an attractive means for banks to raise capital because, while they pay interest like debt securities, they are treated as capital for

regulatory purposes. FTN and KBW created various PreTSL trust vehicles which issued multiple classes of notes to investors. The note proceeds were used to purchase trust preferred securities issued by various depository institutions. In that way, the PreTSL notes are backed or collateralized by the underlying trust preferred securities issued by the depository institutions. (In more recently issued PreTSLs, the collateral pool was expanded to include issuers of trust preferred securities in the mortgage REIT and insurance industries.)

23. The typical PreTSL capital structure consists of multiple series of notes, each series of which has a specified interest rate and a different priority position as to distributions of income and principal. The different series of notes are referred to as tranches. The senior note tranche generally has first priority on payment and the lowest stated interest rate. The stated interest rates for each tranche increase as the payment priority level decreases. The lowest payment priority level is the “income note” which has no stated interest rate but receives all funds available for distribution after payments on the higher priority notes. In the aggregate, FTN and KBW created twenty-eight PreTSL trust structures, which issued collateralized debt obligations, or CDOs, secured by between 50 to 100 different underlying obligors, with a face amount typically ranging from \$600 million to \$1.6 billion per offering.

24. PreTSL notes did not mature for 30 years, and the secondary market for these instruments was limited. Many of the PreTSLs were physical (i.e., paper) securities which were not registered in the national or international book entry trading systems.

25. Many of the PreTSLs, particularly the lower tranches, did not qualify as investment grade securities. Income notes, for example, were not rated by any NRCRA -- nationally recognized credit rating agencies -- as would be required to be considered investment grade. Such notes provided “targeted” yields of 15 to 20%, but carried corresponding high risk

because they were generally last in line for the distribution of income and principal. The inherent risk of being the lowest priority noteholder was further exacerbated by the terms of the underlying Trust Preferred Securities pursuant to which the depository institutions that issued the Trust Preferred Securities could defer making any payments on the notes for up to five years if the depository institution could not meet its internal targeted cash flows.

26. Moreover, even those PreTSL tranches that were rated by NRCRAs often had qualifications attached to those ratings that in sum and substance meant that those ratings did not correspond to the comparable ratings of corporate bonds and that those tranches were not “investment grade” as that term is commonly used in the investment community. Defendants nonetheless falsely represented to Sentinel that these “rated” notes were investment grade, when certain of them were not.

SENTINEL’S FINANCING OF PRETSLS

27. Certain insiders at Sentinel treated the funds of all customers and those of Sentinel itself as a single, commingled pool. Head trader Charles Mosley purchased PreTSLs and other highly illiquid, unsuitable and risky securities with funds from this pool, employing a massive leveraging scheme that was concealed from Sentinel’s customers and regulators. The leveraging scheme involved the misuse of what were supposed to be customer assets to secure a loan to Sentinel from the Bank of New York. That loan, in turn, financed the purchase of the risky securities.

28. The purchase of these securities was financed in two ways. One was simply to draw the entire purchase price from Sentinel’s loan with the Bank of New York, which was unlawfully secured by what were supposed to be segregated customer assets. In many other instances, the purchase of securities was financed by the use of repurchase agreements under

which Sentinel transferred the security purchased to a repo counterparty, such as Fimat or Cantor Fitzgerald, which loaned Sentinel a percentage of the price of the security (e.g., 90%) and took the security as collateral for the amount loaned. The remainder of the purchase price was financed using Sentinel's loan with the Bank of New York. Using repo agreements and the Bank of New York loan, Mosley and other insiders were thus able to control billions of dollars of securities.

**DEFENDANTS' KNOWLEDGE OF THE UNSUITABILITY
OF PRETSLS FOR SENTINEL**

29. FTN was at all relevant times a broker-dealer registered with the SEC and a member of the FINRA. At all relevant times, Folan was an associated person of FTN, and at certain relevant times de St. Phalle was an associated person of FTN.

30. In those capacities, each of the defendants had an obligation pursuant to FINRA Rule 2310 to "know [their] customer" and to recommend only suitable securities to a customer based on the facts disclosed by the customer, including the customer's other securities holdings, financial situation and needs. Both FINRA and the SEC have interpreted that rule to require, with respect to institutional customers, that a broker-dealer consider the customer's ability to evaluate the investment risk independently and the extent to which the customer is exercising independent judgment.

31. Based on materials on Sentinel's website, defendants' conversations with Mosley, Sentinel's financial statements, and publicly available materials, defendants knew, or should have known, about the segregated account structure and that Sentinel's guiding investment objective for customer portfolios was supposed to be "preservation of capital and liquidity in even the most turbulent of market conditions." Defendants knew, or should have known, that Sentinel represented that its clients' assets were invested in U.S. Treasury obligations or other

high quality, marketable securities issued by U.S. agencies, corporations and banks. Sentinel's website explained that it invested client cash mostly in the overnight market, that it ensured that client cash was safe and liquid, and that Sentinel bought only the "highest quality and most liquid securities" unless specifically directed by a client to seek higher yield in somewhat lower quality issues. However, Sentinel explicitly promised that it would not use derivatives, options or "any other 'financial engineering' techniques to enhance the yield on its portfolios. Sentinel's objective [was] to achieve the highest yield consistent with preservation of principal and daily liquidity."

32. At all relevant times prior to recommending the purchase of PreTSLs, defendants knew or should have known that PreTSLs did not fit the investment profile for Sentinel's customers and were far too risky and illiquid for any of Sentinel's customer portfolios. Indeed, a managing director at de St. Phalle's previous employer had warned de St. Phalle of that fact before he joined FTN. That warning could hardly have come as a surprise to any of the defendants, especially de St. Phalle, who had helped create PreTSLs in the first place and knew their risks better than anyone.

33. Defendants also knew or should have known that Sentinel's customers treated the money they placed with Sentinel as cash and had been promised daily liquidity. Holding substantial amounts of illiquid securities for such customers is necessarily inconsistent with that investment profile.

34. Defendants Folan, de St. Phalle and FTN therefore knew or should have known that PreTSLs, and especially the lower tiers of PreTSL issues, such as income notes, were unsuitable investments for any of Sentinel's customer portfolios.

35. In addition, defendants knew or should have known that the volume of these securities that they recommended and sold to Sentinel were unsuitable for Sentinel's proprietary portfolio because Sentinel had few or no assets with which to purchase these instruments. Indeed, defendants also knew or should have known that Sentinel was actually purchasing PreTSLs and similar securities with what were supposed to be customer funds.

36. In particular, defendants regularly received information on all securities held in Sentinel's overall portfolio, including the volume of PreTSLs and other illiquid collateralized debt obligations (CDOs) held by Sentinel. Defendants further had an obligation under FINRA know-your-customer rules to know Sentinel's financial resources. By March 1, 2006, Sentinel's non-customer accounts had total stated balances of \$13 million. On the same date, Sentinel controlled more than \$185 million (face value) in CDOs. By January 2, 2007, the non-customer accounts had stated balances of about \$15 million, but Sentinel controlled \$318 million in CDOs. Defendants therefore knew or should have known that the huge volume of PreTSLs they sold to Sentinel could only have been purchased with funds belonging to Sentinel customers, which were supposed to be invested in accordance with the investment objectives of safety of principal and liquidity as described above.

37. In fact, defendants Folan and FTN knew, because Mosley explicitly told Folan, that Sentinel's purchases of PreTSL income notes were being financed with a loan from the Bank of New York, which was illegally secured by securities that were supposed to belong to and to be segregated for Sentinel's customers.

38. In addition, defendants knew or should have known that Mosley was incapable of independently evaluating the risk of these extremely complex investments and that he did not in fact exercise independent judgment in purchasing the PreTSLs they recommended to him.

Indeed, the very point of offering and providing Mosley with things of value was to ensure that he did not exercise independent judgment. Accordingly, defendants were not engaged in arms-length transactions with Mosley, and Mosley's conduct cannot be imputed to Sentinel.

**DEFENDANTS' SCHEME TO SELL PRETSLS TO SENTINEL
THROUGH MISREPRESENTATIONS AND SUBORNING MOSLEY**

39. Despite its knowledge that PreTSLs were unsuitable for Sentinel, FTN recommended and sold to Sentinel PreTSLs and similar unsuitable securities, which had a total face value of almost \$400 million, some of which were later sold by Sentinel or swapped for other similar securities. Defendants did so in order to generate huge income, profits and sales commissions.

40. Mosley participated in this scheme and breached his duties to Sentinel for two primary reasons. First, Mosley's compensation was based on trading profits he generated for the House account. "Profits," which were generally imaginary, on trades in illiquid, high-risk securities were attributed to the House and thus increased his bonus.

41. Second, Mosley was motivated in large part to engage in the scheme, and in particular to trade in unsuitable, illiquid and high-risk securities, because he was suborned and compromised by defendants. The defendants unlawfully showered Mosley with vacations, tickets to sporting events, expensive meals, all-night drinking excursions, limousine rides, plane tickets, golf outings, and the use of condominiums and houses belonging to the brokers, as is further explained in detail below. Defendants provided this improper compensation to Mosley in blatant violation of FINRA Rule 3060, which prohibited them from giving him anything of value in excess of \$100 per year in relation to either FTN's or Sentinel's business.

42. Thus, part of defendants' scheme to sell these unsuitable instruments to Sentinel was to compromise and suborn Mosley so that Mosley was unable to and in fact did not exercise

disinterested judgment in accepting their recommendations that Sentinel purchase the PreTSLs and other similar securities offered to him by defendants. These inducements went far beyond typical or acceptable levels of client entertainment measured by the value of the gifts and favors offered, the frequency of the offers, the proximity of the offers to sales, the implicit quid pro quo nature of this entertainment, and the extent of the debauchery involved in many of the events. On information and belief, defendants provided Mosley with things of value worth thousands of dollars annually.

43. For example, Folan regularly took Mosley to expensive restaurants and bars in the Chicago area, spending large sums of cash entertaining Mosley, expeditions that sometimes began at lunch or in the afternoon and lasted until the late hours of the evening or early the following morning. Folan paid for these dinners, which typically included \$100 bottles of wine.

44. In addition, for many of these excursions, Folan paid for door-to-door limousine service for Mosley. A car would pick Mosley up and take him downtown, where he would join Folan at restaurants and bars. When the evening was over, the limousine would return Mosley to his home in the northern suburbs.

45. It was further part of defendants' scheme that they recommend and sold securities to Sentinel and failed to disclose to Sentinel that the securities they were recommending were unsuitable for any of Sentinel's portfolios.

46. It was also part of defendants' scheme that they recommended and sold these PreTSLs to Sentinel by falsely representing to Mosley that FTN would and could provide liquidity for these securities and that FTN would always make a market in these instruments should Mosley wish to sell.

47. These representations were made by defendants knowing that they were false. Because the secondary market for these instruments was very limited, Sentinel's ability to extricate itself from these risky positions depended on FTN's willingness to buy them back and to make a market in these securities. Because FTN had limited capital and resources, defendants knew that FTN had no way to repurchase all the instruments it sold Sentinel and defendants had no basis for believing it could re-market all those PreTSLs to third parties, particularly within a time frame that could match Sentinel's liquidity promise to its customers.

48. Folan, de St. Phalle and FTN also recommended and sold PreTSLs to Sentinel by providing Mosley with ratings information on the securities that they knew was misleading. At various times in the course of selling PreTSLs to Sentinel, Folan advised Mosley that the rating established for a PreTSL instrument corresponded to the same rating for an ordinary corporate security, indicating, for example that a PreTSL note rated "A" carried the same risk as a corporate bond rated "A." In fact, as defendants knew or should have known, the ratings on many PreTSLs were not comparable to those for corporate bonds because, among other things, these ratings were qualified. Thus, defendants misled Mosley to believe that many of the securities he purchased were "investment grade" or a particular investment grade (such as "BBB") when they were not.

SALE OF PRETSLS 2005

49. Folan and FTN sold their first PreTSL security, an \$8 million (face value) class D note to Mosley and Sentinel on March 9, 2005.

50. In approximately mid-April 2005, about a month later, Folan offered Mosley a trip to Memphis, Tennessee, where FTN had its headquarters, and stated that he would try to get tickets for an NBA basketball game.

51. On August 10, 2005, Folan offered Mosley tickets to Chicago Bears football games.

52. On August 15, 2005, Folan offered Mosley and his assistant the opportunity to stay at Folan's vacation home at the Geneva National Golf Club in Lake Geneva, Wisconsin for lunch, dinner, entertainment and golf. This was one of at least three trips Mosley took to stay at Folan's Lake Geneva home for parties and golf.

53. On September 12, 2005, Folan offered to pay for a trip for Mosley to New York in early November 2005. In October, Folan in fact purchased plane tickets and paid for hotel accommodations for himself and Mosley for the trip.

54. On or about November 9, 2005, Folan paid for Mosley's ticket to a Chicago Bulls basketball game.

55. Between October 13 and December 15, 2005, Folan and FTN sold Sentinel \$44.8 million face value in PreTSL instruments, generating substantial income for Folan and FTN. About \$13 million worth of these securities were combination notes--a security that included both a "rated" portion and an unrated income note portion. Another \$7 million were class D notes.

**2006: DE ST. PHALLE JOINS FTN AND
SALES OF PRETSLS TO MOSLEY INCREASE**

56. In February 2006, Jacques de St. Phalle abruptly left his position at KBW, where he had helped to create and market PreTSLs, and moved to FTN. Even before he joined FTN, de St. Phalle had sold Mosley a huge volume of PreTSLs. By the end of 2005, de St. Phalle and his colleagues at KBW had sold Mosley well in excess of \$100 million in PreTSLs, including almost \$30 million during December 2005 alone.

57. While he was at KBW, de St. Phalle employed the same strategy pursued by Folan--coopting Mosley and compromising his judgment with offers of valuable personal benefits. Indeed, in January 2006, a few weeks before he joined FTN, de St. Phalle and/or KBW entertained Mosley at the Orange Bowl football game in Miami, paying for his ticket and all his expenses while he was in Florida. In addition, de St. Phalle had Mosley stay as a guest at his vacation home in the exclusive Deering Bay gated waterfront golf and marina community in Coral Gables, Florida.

58. At the end of de St. Phalle's employment at KBW, in late 2005, a KBW managing director learned that KBW had been selling large quantities of these illiquid instruments to Sentinel and informed the KBW employees involved that these sales were unsuitable and inappropriate for Sentinel's customer portfolios. The KBW manager advised de St. Phalle and others that there were no portfolios at Sentinel which were appropriate for the large quantity of high-yield, high-risk investments being sold to Sentinel. Shortly thereafter, de St. Phalle, who had generated enormous income on the sales to Mosley, left KBW and moved to FTN.

59. Because of de St. Phalle's preexisting relationship with Mosley, FTN decided that commissions or income earned on the sale of PreTSLs would be divided between de St. Phalle and Folan.

60. On February 17, 2006, shortly after de St. Phalle joined FTN, Folan and FTN sold Sentinel \$16 million in face value of PreTSL 21 class C and D notes, for settlement on March 1, generating substantial income for Folan, de St. Phalle and FTN.

61. On February 23, 2006, Folan and Mosley had a telephone conversation in which they discussed the purchase and sale of PreTSL securities. Folan advised Mosley that he had never "done an income note" before and did not know how to price it. During that conversation,

they also discussed Folan or FTN arranging for Mosley to attend the Big East Conference basketball tournament in March. The also, discussed, alternatively, having a “real wild party” in Chicago which would include de St. Phalle.

62. Part of defendants’ plan for selling more PreTSLs to Sentinel was to buy back PreTSLs, including income notes, that Mosley had previously purchased from KBW, which would free up funds for Sentinel to buy new PreTSLs from FTN. In order to induce Mosley to participate, defendants had to come up with a way to create a profit for Mosley on FTN’s purchase of the securities from Sentinel, even if such a profit did not exist.

63. In a later conversation on February 23, Folan explained that de St. Phalle had not been able to take his records with him when he left KBW and that Folan and de St. Phalle were trying to figure out at what price Mosley had bought the notes. Folan explained that he needed that information “to try to come up with a level that gets you out of them at where it makes sense,” in other words, in order to allow Mosley to book a profit on the sale, whether or not the notes had actually appreciated in value.

64. Such a conversation would never take place in an arms’ length relationship with a broker. But Mosley’s relationship with defendants was not arms’ length because he was co-opted and compromised by favors and by the prospect of enhancing his own bonus.

65. In a discussion the next day, February 24, Mosley indicated that at the price suggested by FTN, Sentinel would sustain a loss because of the cost at which Sentinel carried these PreTSLs on its books. Folan explained that FTN knew that Mosley had to get rid of some of the PreTSLs KBW had sold him (to buy new ones) and that doing so would “work great for everybody.” Folan then asked Mosley whether “going forward, it is a difficult thing for you to

do to change how you account for this stuff or no?” Mosley indicated that they might be able to “tweak” it.

66. During another call later the same day, Folan advised Mosley that “Jacques [de St. Phalle] would really like to come in and have dinner with you sooner rather than later. . . . Because we’re going to be probably doing quite a few of these things.” Folan then related that de St. Phalle said that most purchasers of income notes booked them at a lower rate of interest than the rate actually estimated as part of the sale, and that when the estimated interest was received the excess would reduce the cost basis of the securities and thus give Mosley “flexibility” and “room” to play with to re-sell them at a profit.

67. In yet another call the same day, Folan and Mosley further discussed the purchase of some of Sentinel’s income notes. Folan then suggested a dinner meeting for Wednesday, March 1, for Mosley, Folan, de St. Phalle and another FTN official at a friend’s restaurant “where we can just be alone with nobody around us and we can just chat. What they want to do basically is to talk to you about regarding how these things are on your books,” because at the price Mosley was carrying those securities, it would be impossible for FTN to re-sell them. Folan said that de St. Phalle had told him that in the past Mosley and de St. Phalle had worked a deal in which Mosley artificially reduced his carrying price “which gave [Mosley] wiggle room and gave [KBW] wiggle room. You know, that way you didn’t have to book - you know - book a loss. . . .”

68. These discussions reflect the truly conspiratorial nature of the relationship between Mosley and the defendants. A legitimate broker would never need to discuss how an investor carried the investment on its books or how the investor could book a profit.

69. The planned dinner meeting between Folan, de St. Phalle and Mosley took place on March 1, 2006, at Entourage, a restaurant owned by a friend of Folan in Schaumburg, Illinois. At about 3:00 p.m., Folan had a limousine pick Mosley up at his office in Northbrook and drive him downtown, where he met Folan at a bar in the Rush Street area for drinks. Then, Folan hired a limousine to take them to Entourage with de St. Phalle and others. After dinner, a limousine transported Mosley and the others back to downtown Chicago for a drinking binge that lasted until about 5:00 the following morning. And finally, Folan hired a limousine to take Mosley home to Vernon Hills.

70. During the dinner meeting in Schaumburg, the parties discussed future purchases of PreTSLs by Mosley. De St. Phalle specifically advised Mosley to artificially reduce his cost basis by booking the notes at a lower interest rate than they were actually estimated to return and later characterizing the difference between the actual interest paid and the estimated rate as a return of principal on Sentinel's books. Following de St. Phalle's advice would lower Mosley's cost basis and thereby give him flexibility to be able to re-sell those instruments at a "profit" even if the value of the instruments had not increased.

71. Two days later, on March 3, 2006, Folan offered Mosley free tickets to the Big East basketball tournament.

72. On March 7, 2006, Folan had another conversation with Mosley about how to account for PreTSLs during which Folan told Mosley that de St. Phalle had suggested that Mosley "back up what you pay out just a little bit to maybe improve your cost basis on these;" in other words, to hold on to some of the interest and treat it as a return of principal.

73. On March 9, 2006, Folan, de St. Phalle, another FTN employee and Mosley had a phone conversation about a PreTSL transaction.

74. On March 13, 2006, Folan and FTN sold Sentinel PreTSL 21 income notes for just under \$15 million, which settled on April 3, 2006, generating substantial income for Folan, de St. Phalle and FTN. These income notes were the lowest tier of the PreTSL structure. They were unrated, physical securities with the last priority for payment.

75. The following day, de St. Phalle and Folan had a conversation about PreTSL notes. During the conversation, de St. Phalle repeatedly advised Mosley that when he received the next payment on one of his notes “keep as much as you can for yourself, ‘cause then that gives us room to really work.” In essence, de St. Phalle was again advising Mosley to characterize a portion of the interest received on the note as principal, which would then allow him to artificially lower his cost basis in PreTSLs to facilitate their later re-sale while still booking a profit. Following these conversations with de St. Phalle and Folan, Mosley in fact began to artificially reduce his cost basis by characterizing a portion of the interest payments he received as return of principal.

76. On March 24, 2006, Folan invited Mosley to a Chicago Bulls basketball game.

77. On March 30, 2006, Folan and FTN sold Sentinel a \$6 million (face value) PreTSL 19 class A1 note, which settled on April 13, 2006, generating substantial income for Folan, de St. Phalle and FTN.

78. On or about April 28, 2006, Folan and FTN sold Sentinel a class B1 PreTSL security with a \$3.2 million face value, which settled on May 3, generating substantial income for Folan, de St. Phalle and FTN.

79. On or about May 5, 2006, Folan and FTN sold Sentinel an unsuitable Prime Holdings Trust Preferred Security (“TRUP”), with a \$15 million face value, which settled on May 9, generating substantial income for Folan and FTN.

80. Three days later, on May 8, 2006, Folan had telephone conversations with Mosley in which: (a) Folan provided Mosley with Folan's credit card number so that Mosley could change a flight he was taking to Memphis; (b) Folan proposed a trip to Las Vegas to take place in November; and (c) Folan proposed that Mosley consider purchasing securities in the next PreTSL deal.

81. On May 9, 2006, Folan advised Mosley that there was a lot of interest in the BBB-rated and income note tranches of the new PreTSL issue.

82. On May 16, 2006, Folan again urged Mosley to get his order in for the PreTSL issue and again indicated that there was good interest in the BBB "rated" tranche, falsely implying that this was an investment grade security.

83. On or about May 30, 2006, Folan and FTN sold Sentinel class B1 PreTSL securities with a \$6 million face value, which settled on June 2, generating substantial income for Folan, de St. Phalle and FTN.

84. On or about June 8, 2006, Folan and FTN sold Sentinel PreTSL 22 notes, classes B, C, and D, with a total face value of \$29.8 million, which settled on June 15, generating substantial income for Folan, de St. Phalle and FTN.

85. On or about June 20, 2006, Folan and FTN sold Sentinel PreTSL 21 income notes with a face value of \$10 million, which settled June 26, generating substantial income for Folan, de St. Phalle and FTN.

86. On or about July 5, 2006, Folan and FTN sold Sentinel PreTSL 17 income notes with a face value of \$5 million, which settled July 18, generating substantial income for Folan, de St. Phalle and FTN.

87. On August 17, 2006, Folan and FTN sold Sentinel \$6.7 million face value in PreTSL 22 income notes, for settlement August 24, generating substantial income for Folan, de St. Phalle and FTN.

88. On August 23, 2006, Folan and FTN sold Sentinel PreTSL 9 income notes with a total face value of \$3.9 million, for settlement on September 15, generating substantial income for Folan, de St. Phalle and FTN.

89. On August 24, 2006, Folan and FTN sold Sentinel PreTSL series 16-19 income notes with a total face value of \$9.5 million, generating substantial income for Folan, de St. Phalle and FTN.

90. On information and belief, Folan continued offering and providing Mosley substantial personal benefits as part of his campaign to sell PreTSLs to Mosley during the summer of 2006.

91. On September 11, 2006, Folan and de St. Phalle had a conversation with Mosley in which de St. Phalle offered to sell Mosley PreTSL income notes and combination notes. De St. Phalle told Mosley that the combination note had “good liquidity” to it. De St. Phalle also falsely represented to Mosley that by purchasing a combo note composed of bonds rated “A” with unrated income notes, Mosley would be getting an “investment grade” security.

92. On September 14, 2006, Folan and FTN sold Sentinel a \$10 million face value PreTSL 23 income note and a \$17 million face value PreTSL 23 combination note, for settlement September 21, generating substantial income for Folan, de St. Phalle and FTN.

93. On September 18, 2006, Folan proposed to Mosley a four or five day golf trip for Folan, de St. Phalle and Mosley for the following spring.

94. Also on September 18, 2006, Folan and Mosley had a lengthy telephone conversation about a highly publicized case in which a broker had been indicted for bribing a government employee in connection with the sale of securities. During the course of the conversation, Folan indicated his belief that the broker had not done anything that everyone else does not do, that he couldn't "see what the hell he did that was that wrong," and that the broker did not do "anything that hasn't been done 150-[expletive deleted]-thousand times before."

95. Folan indicated, for example, that he believed that charges against the broker concerning his supplying a client with dinners that included \$100 bottles of wine were inappropriate because "Try buying a bottle of wine that is less than \$100 right now." During the course of that conversation, Mosley discussed having used defendant de St. Phalle's Florida home. Folan explained that he didn't "see the big deal of it, but probably the feds do." In addition, Folan explained that he felt sorry for the broker because "we all do it."

96. Folan then proceeded to discuss FTN's new client entertainment guidelines. Folan expressed his view that "You're going to tell me how to spend my own [expletive deleted] money, too? I don't [expletive deleted] think so." Folan opined that the charges against the broker resulted from the fact that "you get politicians, you get all these [expletive deleted] pencil pushers, they get out there and they get these things and they're making [expletive deleted] 30

grand a year and they're like, 'how can these guys be out spending \$100 on a bottle of wine? I have to go to Sizzler for dinner.'”

97. Two days after that conversation Folan offered Mosley luxury box tickets to see the Chicago Bulls play an exhibition basketball game in October in Memphis.

98. The day after that, on September 21, 2006, Folan and FTN sold Mosley PreTSL 22 class C notes, with a face value of \$1 million, for settlement on September 26, generating substantial income for Folan, des St. Phalle and FTN.

99. A few days later, on September 27, 2006, Folan discussed with Mosley problems he was having locating the airline reservations he had made for himself and Mosley to go to the 2007 Super Bowl in Miami. Mosley asked Folan if he had made the reservations through FTN's travel department. Folan responded that he had not because “it creates all kinds of questions that I don't particularly want asked.”

100. On October 4, 2006, in another conversation about PreTSLs, Folan advised Mosley that FTN would always provide liquidity for the PreTSLs he bought through them because “we sold you the [expletive deleted] bond, we're going to bid it. You know, it's as simple as that There's no chance in the world that we would not bid those bonds.”

**DEFENDANTS' PARKING OF SECURITIES AND
DISCUSSIONS REFLECTING THE UNSUITABILITY OF THESE
SECURITIES FOR SENTINEL**

101. The PreTSL income notes that FTN had sold to Sentinel were not only not investment grade, but completely unrated, which meant that Sentinel could not finance these securities through repo counterparties. In the latter part of 2006, defendants Folan, de St. Phalle and FTN aided, abetted and participated in a scheme to “park” these notes with FTN over the year end.

102. This scheme commenced by at least October 10, 2006, when Folan explained to Mosley that if Sentinel had \$40 million in PreTSL income notes at year-end, FTN would not be able to “take them down” (that is, buy back) as much as Mosley wanted to sell. Folan suggested that Mosley “put something on and then take it off again right after the new year.” Folan also suggested that they discuss the matter with de St. Phalle.

103. At around the same time, Folan also suggested that Sentinel obtain a line of credit from First Tennessee National Bank, FTN’s parent company, which would allow Mosley to borrow money and use PreTSL income notes--which were unrated, and so illiquid and esoteric that legitimate repo counterparties would not accept them in repo transactions--as collateral for the loan. Folan thus arranged a \$20 million line of credit with First Tennessee.

104. On October 23, 2006, during a conversation with an official from First Tennessee, Mosley said that about 40% of the PreTSL securities that Sentinel was holding were held for the benefit of customers, not for Sentinel’s House portfolio.

105. Also on October 23, 2006, Folan and Mosley further discussed the securities that Mosley wanted to get off his books. Folan specifically referred to other risky collateralized debt obligations, known as Tabernas and Kleros, that Mosley had purchased from other brokers. Folan told Mosley that de St. Phalle had asked “what is he doing with that shit?” Folan went on to explain that Folan could not understand why Sentinel would purchase such securities since “looking at Bloomberg that’s all that’s out there is the ones you own.” Folan and de St. Phalle’s comments thus reflected their understanding that Sentinel should not be purchasing illiquid securities--securities of the same type as PreTSLs.

106. On November 6, 2006, Folan reported that FTN, including its compliance department, was trying to figure out a way to get these PreTSL income notes off Sentinel’s

books for the end of the year. Folan explained that they had to figure out “how we can basically take them off yours, onto ours, and sell it back to you, but not have it look like we parked bonds over the end of the year. . . . it looks like we’re parking bonds....” Folan said that they would have to do it as close as possible to year end and then sell them back in early January.

107. On November 10, 2006, Folan reported to Mosley that the proposal to temporarily take back the PreTSL income notes had “gone all the way up the company tree,” including to the CEO of FTN, because it was a pretty big compliance issue. Folan again explained that the problem was since FTN was “going to sell them back to you. . . how to structure it where it doesn’t look like (a) we’re parking bonds, or that you’re parking bonds, or that we’re helping you park bonds.”

108. Folan and Mosley had another similar discussion later on November 10.

109. On November 12, Folan, de St. Phalle and Mosley attended a New York Giants football game together in New York. De St. Phalle provided the tickets. On information and belief, the trip was funded, at least in part, by Folan and/or FTN.

110. On November 28, Folan reported to Mosley that he had just spoken to Frank Gusmus, the president of FTN. Folan explained that he had told Gusmus how Sentinel’s accounts “treat [their accounts at Sentinel] as basically cash,” that Sentinel managed money for futures exchanges, and that Sentinel needed cash for year-end. Folan had further explained to Gusmus that the unrated PreTSL income notes could not be used for repurchase agreements. Folan also told Mosley that he had told Gusmus that FTN would only need to hold these securities for four to five days over year end and that Mosley had previously done the same thing with de St. Phalle at de St. Phalle’s prior employer.

111. Later the same day, Frank Gusmus, the president of FTN, and Rod Turner, another FTN official, contacted Mosley to discuss the situation. Mosley explained that Sentinel had managed money for a lot of futures commission merchants at commodity exchanges. Sentinel's clients looked at Sentinel as overnight liquidity. He also claimed that the customers needed the cash over year-end and that if Mosley could just get rid of the illiquid securities for two days over year-end, that would be sufficient. Turner asked whether structuring a transaction as a repo would work for Mosley, and Mosley said it would. Gusmus indicated that Folan had already shared with Mosley some of the "constraints" that FTN had. However, Gusmus indicated that "What we're trying to do is trying to meet your needs as a firm because you've been an excellent customer." Gusmus then confirmed his understanding that Sentinel managed short-term money. Mosley indicated that they had just under \$2 billion under management. Turner asked why Mosley would pick income notes. Mosley responded that it related to the way the portfolios were set up and that if clients took money out of that portfolio, they would not have any facility to repo out the income notes. As Mosley explained, "it would almost be like... now we're borrowing from another client to take care of this and that wouldn't" Turner responded: "Gotcha. Certain clients would be in a segregated portfolio?" Mosley indicated that that was correct.

112. This conversation with Gusmus made crystal clear that FTNs top management knew that: (a) Sentinel was a cash manager of short-term money; (b) that Sentinel had purchased a huge volume of securities from FTN and was an important customer; (c) that the illiquid PreTSLs that FTN had sold Sentinel, and particularly the unrated, highly risky income notes, were completely unsuitable for Sentinel's customers; (d) Sentinel's public customers were exposed to these securities, that is, Sentinel's need for cash to pay customers could not be met

unless these securities were converted to cash; (e) the customers included futures commission merchants on futures exchanges who were subject to segregation requirements (and thus also strict investment standard requirements imposed by the Commodity Exchange Act); and (f) that Sentinel itself did not have resources to pay for these securities. Despite its clear knowledge of these facts, FTN continued scheming with Mosley to park these illiquid securities over year end 2006 and sell PreTSLs to Sentinel through the middle of 2007.

113. Initially, FTN, Gusmus and Folan attempted to arrange for Fimat, a Sentinel repo counterparty, to take the PreTSL income notes over year end.

114. When that plan fell through because Fimat was unwilling to take unrated, unpriceable, non-DTC registered securities under a repo agreement, FTN, Folan, de St. Phalle and other FTN employees arranged for FTN itself to briefly hold these securities over year-end under a one-time repo transaction.

115. Once Mosley and the defendants had determined that a repo transaction was the only way to push the PreTSLs over year end, Mosley and the defendants turned to the specifics of the scheme. Mosley wanted to generate \$35 million in cash by repo-ing \$51.7 million in PreTSL income notes to FTN. But Folan told Mosley that FTN was “full to the gills” on income notes and could not lend more than \$25 million against those securities.

116. On December 20, 2006, Folan advised Mosley that de St. Phalle had reiterated that FTN could only provide Sentinel with \$25 million under the repurchase transaction. Folan then confirmed that FTN’s purchase of the securities would settle December 28 and the sale back to Sentinel would settle January 2. When Mosley and Folan then discussed whether they would need a formal repurchase agreement for the transaction, Folan stated, “I honestly don’t know a [expletive deleted] thing about it . . . because we don’t really do, we don’t do repo.”

117. On December 28, 2006, FTN in fact acquired, pursuant to a repurchase agreement, various PreTSL income notes, many of which Folan and FTN had sold to Sentinel between late June and late September 2006. FTN held those securities until January 2, 2007, when it returned them. This was a round-trip transaction which had no economic purpose to either Sentinel or FTN. Thus, defendants only participated in this unlawful transaction in order to accommodate Mosley and thereby to permit themselves to continue selling to Sentinel securities that they knew were unsuitable.

118. To further assist Mosley in generating cash for year-end, on December 21, 2006, Folan and FTN engaged in a swap transaction involving a \$10 million (face value) income note. FTN purchased the income note from Mosley. In exchange, defendants sold Sentinel a PreTSL note with a supposed value of \$10 million. Because the note Mosley bought was “rated,” Mosley could then use it to generate cash by immediately delivering it to a repo counterparty.

2007: SWAPPING OF INCOME NOTES FOR COMBO NOTES

119. As of year-end 2006, Sentinel had a \$230 million loan with the Bank of New York that was collateralized by securities that should have been segregated for customers. A substantial portion of that loan related to the purchase of PreTSL income notes, which were financed almost entirely with the loan because such notes were not accepted under legitimate repo agreements. Mosley was under pressure to reduce the loan, which meant disposing of the income notes. However, Mosley did not want to sell the income notes because doing so could have required Sentinel to incur some losses and that in turn would impact Mosley’s bonus.

120. Notwithstanding the problems that Mosley was already having with PreTSL income notes, and that defendants knew that he was having, on January 8, 2007, defendants sold

Mosley a PreTSL 20 income note, with a face value of \$5.95 million, for settlement on January 12, 2007, which generated substantial income for Folan, de St. Phalle and FTN.

121. Also in January 2007, defendants de St. Phalle, Folan and FTN came up with a plan to “help” Mosley with the income note problem while also creating substantial income for themselves by allowing them to sell even more securities to Mosley. Defendants offered to “buy” income notes from Sentinel, combine them with other PreTSL products to create combination or “combo” notes, and then sell the combo notes (including the same income note component) back to Sentinel.

122. Combo notes were unsuitable for Sentinel for the same reasons the income notes were unsuitable – they were risky securities that did not provide for safety of principal or liquidity. While a rating could be obtained for these combo notes, the ratings were misleading in that they suggested that the notes were investment grade when in fact they were not. Even though Mosley could (for a time) repo out the combo notes he purchased from defendants, defendants knew that the combo notes were not liquid. Indeed, the combo notes were comprised in part of the very income notes that Mosley held.

123. De St. Phalle and FTN arranged for a ratings agency to provide an “investment grade” rating for these combo notes. Obtaining the rating cost Sentinel tens of thousands of dollars for the first transaction in which Sentinel swapped income notes for combo notes.

124. On February 1, 2007, defendants Folan, de St. Phalle and FTN concluded a \$24 million transaction with Sentinel pursuant to this scheme. Sentinel “sold” FTN \$12 million in PreTSL income notes. FTN took the income notes, combined them with other PreTSL securities, created a new CUSIP number, and then resold the packaged combo product, including

the income note portion, to Sentinel for about \$24 million. The transaction settled on February 15, generating substantial income for the defendants.

125. As this February 1 deal was made, Mosley was literally on his way out the door for a trip to the National Football League's February 4 Super Bowl game in Miami, Florida. Folan paid for Mosley's airplane ticket to Florida. Mosley again stayed at de St. Phalle's home in the Deering Bay waterfront community while in Florida, and attended the game with Folan and de St. Phalle. Defendants paid for Mosley's expenses for the long weekend of partying in Florida. (Mosley, who had four tickets to the game, sold Folan and de St. Phalle their tickets.)

126. After the Super Bowl, defendants paid for Mosley to travel to New York to discuss further purchases of PreTSL combination notes. Prior to leaving Chicago for Miami, Mosley and Folan had discussed Mosley's hotel arrangements for the New York trip. During that call, when asked where he wanted to stay, Mosley advised Folan "I'm not paying for it."

127. Mosley returned to his office on or about February 12, 2007. The following day, February 13, Folan and FTN sold Sentinel a class B1 PreTSL 14 security for approximately \$6.7 million, generating substantial income for Folan, de St. Phalle and FTN.

128. On February 14, 2007, Folan and FTN sold Sentinel a PreTSL 12 class B1 note at a price of over \$15 million, generating substantial income for himself and FTN. Defendants persuaded Mosley to buy this security, which FTN had repurchased from another customer, by telling him that new PreTSL paper was going to be oversubscribed and it would be difficult for Mosley to obtain an allocation on that offering.

129. On March 8, 2007, Folan and Mosley had a series of telephone conversations involving: (a) yet another sale of PreTSL notes to Sentinel and (b) tickets that Folan had purchased for himself and Mosley for the Big Ten basketball tournament that evening. Folan

and FTN sold Sentinel a PreTSL 21 combination note for just over \$25 million, generating substantial income for himself and FTN. As part of the deal, FTN bought a PreTSL 23 note held by Sentinel in the amount of \$5 million, which Mosley was not able to repo. As part of his sales pitch, Folan advised Mosley that the \$10 million income note portion of the PreTSL 21 was “principal guaranteed.” Because Folan had purchased a \$5 million income note from Mosley but sold him a \$10 million income note, this transaction increased Sentinel’s exposure to income notes.

130. Folan and Mosley then attended the basketball tournament.

131. Between March 14 and 16, 2007, Folan and FTN sold Sentinel newly issued PreTSL 25 securities at a price of \$13.5 million, including a \$10 million combo note, generating substantial income for Folan, de St. Phalle and FTN.

132. Beginning on March 27 and continuing through approximately May 11, 2007, de St. Phalle, Folan, and FTN engaged in an effort, ultimately successful, to persuade Mosley to purchase another completely unsuitable security for Sentinel, this one a trust preferred instrument issued by a mortgage lender known as HomeBanc. At the time, HomeBanc was already experiencing severe financial problems as a result of the mortgage crisis, and FTN was anxious to unload the \$7 million HomeBanc security that it owned.

133. Folan and de St. Phalle advised Mosley that HomeBanc was a good buy and that it did not have much exposure to sub-prime mortgage loans and claimed that it was “all prime mortgages, except for I believe like 1%.” That statement was false. Defendants knew that in fact HomeBanc did not have “all prime mortgages except...1%,” and that in truth more than half of HomeBanc’s mortgages were in fact higher risk, non-prime loans, known as “Alt-A” loans. De

St. Phalle assured Mosley that FTN “know[s] the company real well,” that FTN formerly owned HomeBanc, and that there could be a short-term profit opportunity.

134. Also on March 27, Folan, de St. Phalle and others at FTN spoke with Mosley to discuss FTN creating PreTSL combination notes for Sentinel with respect to PreTSL issues 20 and 23. FTN personnel told Mosley that “you don’t have subprime exposure” and that “this is not subprime lending.” This statement was misleading because, as the defendants (but not Mosley) well knew, PreTSL 23 included trust preferred securities issued by HomeBanc.

135. On March 29, 2007, Folan, de St. Phalle, and FTN offered Mosley a trip to St. Louis for the NCAA hockey tournament semi-finals, which Mosley accepted.

136. The following day, March 30, de St. Phalle called Mosley with respect to Mosley’s purchase of General Electric bonds, asking “What the hell you buying that shit for?” Mosley replied: “I’ve got to buy something safe; you put me in all this other stuff.” De St. Phalle then turned the conversation to HomeBanc. Dan Collins, who was FTN’s chief credit officer, then told Mosley that HomeBanc was a solid company in which they had lots of faith and which had little subprime exposure. FTN also advised that HomeBanc would be able to pay its trust preferred obligations even if it hit rough times. Defendants knew or should have known that these statements were false and misleading.

137. On April 3, 2007, Folan attempted to persuade Mosley to buy the HomeBanc securities by telling him that they had another potential buyer to whom they were making a presentation on the bonds.

138. Also on April 3, Folan offered Mosley tickets to a cigar smoking, dining and drinking event called the Big Smoke to be held in Chicago on April 10.

139. On the same day, Folan proposed to Mosley a transaction in which Mosley would trade certain PreTSL notes to FTN in exchange for PreTSL combination notes.

140. On approximately April 4, 2007, Folan and FTN engaged in a substantial swap transaction with Sentinel that settled April 5. The substance of the transaction was that Sentinel would “sell” about \$30 million in PreTSL income notes plus about \$30 million in PreTSL mezzanine notes to FTN, which would then use them to create a \$60 million PreTSL combo note, which it would then “sell” back to Sentinel.

141. Folan and FTN induced Mosley to enter into this transaction, in part, by offering to let Mosley set any price he wished for the securities that Sentinel would sell to FTN, thus permitting Mosley to generate non-existent profits. Folan advised Mosley: “I need you to come up with the dollar prices that you want to basically sell them to us, because you’ll be basically for all intents and purposes selling everything to us. Here’s what we’ll be doing...you’ll be selling us your pieces. We’ll be putting the combos together [less fees]. . . and come back with a blended price to sell to you. So what I need from you is the dollar prices you want to use on your sell side. However you want to work that, with your books and everything else.”

142. No legitimate broker participating in an arms-length transaction would ever make such a statement or offer to buy securities at whatever price the seller specified.

143. Because Folan and FTN allowed Mosley to set his price unilaterally, Mosley sold the \$30 million (face value) in PreTSL income notes to FTN at an inflated price, and Sentinel booked a phony gain of \$1.6 million on that transaction. Based on Mosley’s bonus structure at Sentinel, Mosley had created a bonus for himself of \$160,000 for participating in that single transaction.

144. On the other side of the transaction, defendants Folan and FTN “sold” Sentinel PreTSL 20, 22, and 23 combo notes for more than \$60 million. Defendants knew at the time that the risky HomeBanc trust preferred securities were part of the collateral for PreTSLs 22 and 23, but did not disclose that fact to Mosley. They also knew that the securities were not worth \$60 million.

145. The April 4 swap transaction was a round-trip transaction which had no economic substance. Sentinel sold securities it held for \$60,478,763.79 and repurchased the same securities, re-packaged and with a new set of CUSIP identifiers, for \$60,586,768.89--the price difference reflecting fees to create the combo structure.

146. The transaction, as defendants well knew, had no legitimate business purpose. Besides improperly generating bonuses for Mosley, the only purpose for the transaction was for Sentinel to exchange income notes that could not be used for repurchase agreements for combination notes that could be so used. In essence, defendants’ sale of the combo notes to Mosley allowed him to borrow against them under repurchase agreements, ultimately providing him with additional funds to buy even more unsuitable securities from defendants, all while generating a bonus for himself.

147. On April 9 and 11, 2007, Folan offered Mosley tickets to various Chicago Cubs baseball games.

148. On April 17, 2007, Folan and FTN sold Mosley PreTSL 14 class B1 note for approximately \$4 million, generating substantial income for themselves.

149. On or about May 10, 2007, de St. Phalle, Folan and FTN sold Mosley the \$7 million HomeBanc security that they had been pushing since March 27, which transaction settled

May 15, generating substantial income for them and also ridding FTN of a security which defendants knew was distressed and wanted to remove from FTN's portfolio.

150. Sometime prior to June 6, 2007, Folan secured Mosley's agreement to purchase a \$10 million combo note from the new PreTSL 26 issue. However, on June 6, Mosley and Folan learned that there was a question whether Sentinel's repo counterparty, Fimat, would continue to finance existing combo notes because the interest portion of the note was unrated. Folan knew that Mosley could only purchase securities which could be repo'd. Folan, de St. Phalle and FTN then persuaded Fimat that the combo notes currently on repo to Fimat should not be returned to Sentinel. Having done that, Folan secured Mosley's agreement to go through with the purchase of the combo note.

151. On June 7, 2007, Folan offered Mosley the use of his vacation home in Lake Geneva for a week.

152. On or about June 13, 2007, Folan and FTN sold Mosley two PreTSL securities with a total face value of \$14 million, including a newly issued PreTSL 26 combo note with a face value of \$10 million, for settlement on June 21, which generated substantial income for defendants.

153. On June 19, Mosley told Folan he couldn't use the Lake Geneva home and Folan offered him the use of Folan's condo in downtown Chicago instead.

THE REPO COUNTERPARTIES' RETURN OF PRETSL NOTES TO SENTINEL

154. The PreTSL combination notes and other "rated" securities which FTN had sold to Sentinel were, in turn, delivered to counterparties like Fimat under a repo agreement. Fimat and other counterparties provided funds to Sentinel against the securities, but under overnight

agreements that allowed them to refuse to continue the financing and return the securities to Sentinel at any time.

155. During the last week in June 2007, Fimat refused to continue financing approximately \$147 million (face value) in PreTSLs transferred to Fimat under the repo agreements, and returned those securities to Sentinel. The return of those securities obliged Sentinel to come up with cash to repurchase them, which it was only able to do by drawing further on its loan with the Bank of New York.

156. Mosley then desperately tried to sell some of the PreTSLs back to FTN. Mosley made clear during his phone calls with FTN that the situation was serious and that Sentinel needed to get rid of the PreTSLs.

157. FTN responded that it would not be able to buy back that quantity of PreTSLs, and indicated that it would try to purchase \$20 million in PreTSLs from Mosley. In addition, FTN and Folan agreed to unwind the sale of a \$10 million PreTSL 26 security that they had sold to Mosley on June 13 and which had settled on June 21.

158. In fact, in an effort to keep Sentinel afloat, and to keep Mosley from attempting to sell the rest of his PreTSL combination notes in the market, FTN did buy back the \$24 million PreTSL it had sold to Sentinel on February 1, 2007.

159. Defendants knew that if Mosley were to dispose of the rest of his PreTSLs in the open market, it would cause the value of PreTSLs that FTN itself held to drop dramatically. Thus, for FTN's benefit and to protect themselves from exposure, defendants Folan and de St. Phalle urged Mosley not to sell the remaining PreTSLs.

160. For example, on June 26, Folan told Mosley that "We just want to make sure that we're all on the same page and that we're all kind of singing to the same tune" and that "we need

to kind of protect each other.” Another high-ranking FTN employee explained to Mosley that “we benefit each other remarkably well.” However, that employee explained, if Mosley were to try to liquidate his combination notes in the market it would send a shockwave through the market that would affect both Sentinel’s positions and “the positions that I own.”

161. The following day, de St. Phalle told Mosley that Mosley should not go to the market because “that would [expletive deleted] everybody, you, us” and would “spook” the market. De St. Phalle told Mosley, as an incentive for Mosley not to sell, that he had “new buyers” waiting in the wings. De St. Phalle reiterated that Mosley should hold as many of the securities as possible.

162. Defendants attempted to help prop up the Sentinel house of cards that they and Mosley had created by assisting in an effort to persuade Fimat to continuing accepting PreTSLs for repos.

163. One of the reasons that Fimat had refused to continue engaging in repo transactions of the PreTSLs was that there were no publicly available prices to value those instruments. In response to Mosley’s attempt to convince Fimat to change its decision, Fimat asked Sentinel and FTN for a copy of FTN’s written pricing guidelines and procedures. However, FTN revealed to Mosley that there never had been any such procedures or guidelines for pricing PreTSLs. As Folan put it in a call with Mosley on June 26, 2007, “We don’t have anything like that, to be honest with you.”

164. Despite the fact that FTN had no pricing policy, defendants de St. Phalle, FTN and Folan then proceeded to gin up a document outlining pricing procedures and transmitted it to Fimat. Fimat rejected the document as meaningless.

165. When Fimat rejected that document, Folan, de St. Phalle and FTN sent a second purported FTN pricing guideline to Fimat, which in fact was based on a document prepared by another brokerage firm, and presented it as FTN's purported pricing policy. Despite these efforts, Fimat refused to continue holding the PreTSL combo notes and returned them to Sentinel.

SENTINEL'S COLLAPSE

166. Sentinel's problems continued throughout July 2007, as repo counterparties continued to return illiquid securities sold to Mosley by brokers, including defendants, which in turn required Sentinel to borrow more money from Bank of New York to fund the repurchases. This left Sentinel in a liquidity crisis and led to Sentinel's collapse.

167. In July 2007, defendant de St. Phalle left FTN and joined a new firm. On July 25, knowing that Sentinel was in the midst of a liquidity crisis caused in large part by Mosley's purchase of unsuitable securities from him, de St. Phalle nonetheless called from his new firm and tried to sell Mosley even more unsuitable securities.

168. Also on July 25, defendant Folan sold Sentinel trust preferred securities issued by the Bank of America and Wachovia Bank, knowing that Sentinel had no need for such securities, that Sentinel had no funds available to buy such securities, and that Mosley had been instructed by Eric Bloom not to buy any more securities.

169. On Friday, August 10, 2007, Folan called Mosley to inform him that HomeBanc, the issuer of \$7 million security that Folan, de St. Phalle and FTN had sold to Sentinel in May 2007, had just filed for bankruptcy. Folan explained that HomeBanc was also involved in both PreTSL 22 and 23, exacerbating the injury to Sentinel. As Folan put it, "It's a [expletive deleted] disaster....[but] it's a worse thing for you than it is for me."

170. The next business day, Monday, August 13, 2007, in the face of customer attempts to redeem that Sentinel was unable to honor, Sentinel unilaterally halted customer redemptions.

171. On August 16, 2007, a transaction in which Sentinel provided to FTN \$36 million (face value) in PreTSL 23 combo notes and received back \$36 million (face value) in PreTSL 23 income and mezzanine notes, which had been agreed to weeks before, finally settled.

172. On Friday, August 17, 2007, Sentinel filed for bankruptcy.

HARM TO SENTINEL

173. Defendants' recommendation and sale of unsuitable securities to Sentinel harmed Sentinel. Sentinel owned these positions: they were not reported on Sentinel's customer account statements and Sentinel bore the entire risk on these positions. Sentinel's losses on these securities occurred because of the very facts which rendered them unsuitable in the first place and which were not disclosed to Sentinel.

174. These positions did not benefit Sentinel at all; to the contrary, purchasing these securities immediately compromised Sentinel's ability to meet its obligations to creditors. The only beneficiaries of the scheme were defendants and others who aided and abetted the scheme, Mosley, and certain other Sentinel insiders who reaped false profits from the scheme by using what were supposed to be customer assets to generate returns for themselves personally.

175. As of the date it collapsed, Sentinel was holding or had repo'd to counterparties PreTSL and HomeBanc securities with a face value of approximately \$175 million, at a cost basis of approximately \$164.2 million. None of the approximately \$47 million (face value) in PreTSL income notes and HomeBanc securities could be sold by the Trustee at any price, and Sentinel suffered a 100% loss on those securities. The PreTSL class C notes held by Sentinel and used to create combo notes were sold at less than 10% of their face value. Most of the rest

of the notes sold for a fraction of their face value. In total, Sentinel sustained a loss on the PreTSL and HomeBanc securities sold by defendants to Sentinel of approximately \$125.9 million.

COUNT ONE

Aiding and Abetting/Knowing Participation in Mosley's Breach of Fiduciary Duty (All Defendants)

176. Plaintiff restates and realleges paragraphs 1 through 175 of this Complaint as though fully set forth herein.

177. At all relevant times, Charles Mosley was an officer and director of Sentinel.

178. As an officer and director, Mosley owed Sentinel a fiduciary duty of loyalty and a fiduciary duty to act with due care and to deal honestly and fairly with Sentinel. Mosley's primary duty to Sentinel was to ensure that Sentinel was investing funds consistent with its obligations to customers.

179. Defendants Folan, de St. Phalle and FTN knew of Mosley's fiduciary duties to Sentinel.

180. Mosley breached his fiduciary duties to Sentinel by, among other things: (a) purchasing securities for Sentinel from defendants that were unsuitable for Sentinel and which put Sentinel at undue risk; (b) purchasing risky and illiquid securities from defendants that were inconsistent with Sentinel's requirements and representations concerning the types of securities in which it would invest customer funds; (c) purchasing securities from defendants for the improper purpose of generating income and profits for defendants when there was no legitimate business purpose or benefit to Sentinel from doing so; (d) purchasing securities from defendants for the purpose of improperly generating inflated bonuses for Mosley; (e) engaging in round-trip transactions which had no economic purpose; (f) participating in a massive leveraging scheme

which, among other things, misused what were supposed to be customer assets to collateralize a loan to Sentinel; (g) accepting valuable gifts, travel, sports tickets, vacations, and other benefits and things of value from defendants in connection with his purchase of securities from defendants; and (h) subordinating his duties to Sentinel to his inappropriate personal relationship with defendant Folan and his perceived obligations to defendants based on the benefits he received from them.

181. Defendants Folan, de St. Phalle and FTN knew of Mosley's breaches of fiduciary duty and knowingly induced, aided, abetted, participated in and benefited from those breaches. In particular, defendants knowingly: (a) recommended and sold unsuitable securities to Sentinel to generate improper and inflated income and profits to themselves; (b) traded excessively with Sentinel to generate improper and inflated income and profits for themselves; (c) sold securities to Mosley knowing that the purchase of those securities was funded by misusing assets that were supposed to belong to customers; (d) engaged in round-trip transactions that had no economic purpose; (e) parked bonds they had previously sold Mosley; (f) provided misleading assurances to Mosley that they would protect him from the risks of his improper purchases of securities, including assurances as to the liquidity of and FTN's commitment to make a market in those securities, in order to sell those securities to Sentinel or to induce Sentinel to hold them; (g) suborned and corrupted Mosley and improperly influenced his decision-making by offering and providing him with valuable gifts, travel, sports tickets, vacations and other benefits and things of value; (h) cultivated an inappropriate personal relationship with Mosley; (i) advised Mosley to mischaracterize interest payments as returns of principal in order to justify more excessive and inappropriate trades; and (j) induced Mosley to participate in swaps by allowing him to charge an

artificially high price for the securities Sentinel was selling to FTN as part of such swap transactions, in order to create false profits and unjustified bonuses to Mosley.

182. Sentinel has been damaged as a result of defendants' participation in Mosley's breaches of fiduciary duty.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan, de St. Phalle and FTN for compensatory damages, plus punitive damages in an amount to be determined by the Court, interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT TWO

Commercial Bribery (All Defendants)

183. Plaintiff restates and realleges paragraphs 1 through 182 of this Complaint as though fully set forth herein.

184. Between 2005 and June 2007, defendants Folan, de St. Phalle and FTN sold Sentinel hundreds of millions of dollars in securities.

185. Mosley was an employee, officer, agent and fiduciary of Sentinel, and as head trader was entrusted with the duty of purchasing securities for Sentinel and with ensuring that the securities he purchased satisfied Sentinel's obligations to its investors.

186. Defendants conferred and offered to confer extensive benefits upon Charles Mosley, as described in detail above.

187. Sentinel did not consent to and did not know of the benefits being offered to or conferred on Mosley, particularly their extent, nature and frequency.

188. Defendants offered and conferred these benefits with intent to influence Mosley in the performance of his job, namely, to influence Mosley to buy securities from them on behalf of Sentinel.

189. Offering and conferring these benefits on Mosley was part of a device, scheme and artifice to defraud Sentinel. The practice of offering and conferring the benefits on Mosley operated to deceive Sentinel, which relied on Mosley's undivided loyalty and judgment in purchasing securities from defendants. Mosley was in fact suborned and unduly influenced by the benefits provided by defendants and thereby failed to faithfully execute his duties to Sentinel in connection with the purchase of securities.

190. Sentinel was damaged as a result of its purchase of securities from defendants and defendants were unjustly enriched by the sale of those securities to Sentinel.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan, de St. Phalle and FTN for rescission, disgorgement of the value of the bribes, disgorgement of all income, profits, commissions and compensation received by defendants on transactions with Sentinel, and compensatory damages, plus punitive damages in an amount to be determined by the Court, interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT THREE

Securities Fraud in Violation of 15 U.S.C. § 78j(b) and Rule 10(b)-5(a)-(c) (All Defendants)

191. Plaintiff restates and realleges paragraphs 1 through 190 of this Complaint as though fully set forth herein.

192. Between 2005 and June 2007, defendants Folan, de St. Phalle and FTN sold Sentinel hundreds of millions of dollars in PreTSL and similar unsuitable securities.

193. These sales of securities were part of an unlawful scheme to defraud Sentinel, and this course of business operated as a fraud upon Sentinel.

194. It was part of the scheme that defendants bribed and co-opted Mosley by conveying benefits to him, as set out in detail above, without the knowledge or consent of Sentinel.

195. Defendants acted with scienter in knowingly bribing and coopting Mosley and in failing to disclose these benefits to Sentinel. Defendants acquired undue influence over Mosley as a result of the bribery.

196. Defendants had a duty to disclose these benefits to Sentinel by virtue of paying the benefits and by virtue of the fact that they recommended the purchase of the securities to Mosley.

197. Sentinel relied on Mosley's undivided loyalty and independent judgment in purchasing securities from defendants.

198. It was further part of the scheme that defendants recommended and sold to Sentinel PreTSLs and other securities by means of various misrepresentations.

199. Defendants acted with scienter by misrepresenting to Sentinel various facts, including whether the securities were investment grade, the ratings of these securities, their liquidity, and defendants' willingness and ability to make a market in those securities and other facts, intending that Sentinel rely on those misrepresentations.

200. The facts misrepresented were material to the transactions.

201. Sentinel was deceived by these misrepresentations and justifiably relied on defendants' recommendations in purchasing the above-described securities.

202. It was further part of the scheme that defendants recommended and sold to Sentinel securities that they knew were unsuitable for Sentinel.

203. Despite knowledge of their unsuitability, defendants Folan, de St. Phalle and FTN recommended the unsuitable PreTSL securities to Sentinel, intending that Sentinel rely on their recommendations.

204. Defendants Folan, de St. Phalle and FTN had a duty to disclose to Sentinel that the PreTSL and other similar securities they sold to Sentinel were unsuitable. Such a duty arose by virtue of the FINRA know-your-customer rules and by virtue of the facts that defendants made recommendations to Sentinel to purchase PreTSL securities, defendants had bribed and co-opted Mosley, and defendants knew that Mosley was not exercising independent judgment in purchasing these securities but that Sentinel was relying on Mosley to exercise that independent judgment.

205. Defendants Folan, de St. Phalle and FTN breached their duty to disclose by failing to disclose to Sentinel that the PreTSL securities they sold were unsuitable for Sentinel.

206. The suitability of the PreTSL securities for Sentinel was material to the transactions.

207. Sentinel relied on the facts known to it in purchasing the securities.

208. Sentinel would not have purchased the securities had it known of the bribery of Mosley, the unsuitability of the securities, or the true facts concerning the securities.

209. Sentinel was damaged as a result of defendants' scheme to defraud, misrepresentations and failures to disclose. Sentinel purchased hundreds of millions of dollars in unsuitable securities in reliance on this misconduct. Sentinel's losses were caused when the

value of these securities declined because of the very facts which were misrepresented, omitted or which rendered these securities unsuitable.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan, de St. Phalle and FTN for compensatory damages, plus punitive damages in an amount to be determined by the Court, interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT FOUR

Violation of the Illinois Blue Sky Law 815 ILCS 5/12 (Defendants Folan, de St. Phalle and FTN)

210. Plaintiff restates and realleges paragraphs 1 through 209 of this Complaint as though fully set forth herein.

211. Defendants Folan, de St. Phalle and FTN failed to disclose to Sentinel material facts in connection with their sale of the following PreTSL securities to Sentinel between March 1, 2006 and August 10, 2007:

<u>Settlement Date</u>	<u>Par Amount</u>	<u>Description</u>	<u>Identifier</u>
12/15/2005	5,000,000	PRETSL FLOAT	741382AJ4
03/01/2006	7,450,000	PRETSL FLOAT	74042JAE3
06/02/2006	1,000,000	PRETSL FLOAT	44984RAE8
06/02/2006	5,000,000	PRETSL FLOAT	44984RAE8
02/16/2007	6,500,000	PRETSL FLOAT/PRETSL	74041UAE9
02/20/2007	15,000,000	PRETSL FLOAT	74041NAE5
03/13/2007	25,000,000	PRETSL FLOAT	741378AA1
03/22/2007	10,000,000	.PXXV COMBO	74139LAA0/PP3H0ASK2
03/28/2007	6,000,000	PRETSL FLOAT	741382AL9
04/05/2007	11,900,000	PRETSL FLOAT	741382AL9
04/05/2007	30,700,000	PXXII FLOAT	74139NAA6/PP3H0AS17
04/20/2007	4,000,000	PRETSL FLOAT/PRETSL	74041UAE9
05/29/2007	500,000	PRETSL 5.3	74041WAE5
06/27/2007	500,000	PRETSL FLOAT	74042HAB3
08/16/2007	18,000,000	PRETSL FLOAT	74043AAQ4

08/16/2007	18,000,000	.PXXIII FLOAT	74043BAA7
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212. Defendants Folan and FTN's material omissions were made in connection with the sale of PreTSL securities listed in Paragraph 211 above and tended to work a fraud or deceit upon Sentinel.

213. Defendants Folan and FTN's material omissions regarding the PreTSL transactions listed in Paragraph 211 above allowed FTN to obtain money and/or property from Sentinel through the fraudulent sale of PreTSL securities.

214. Defendants Folan and FTN's material omissions regarding the PreTSL transactions listed in Paragraph 211 above were part of a device, scheme or artifice to defraud Sentinel in connection with the sale of PreTSL securities.

215. Sentinel reasonably relied on defendants false and misleading statements and omissions in purchasing these securities.

216. Sentinel would not have purchased the securities absent defendants' false and misleading statements and omissions.

217. Sentinel's losses were caused when the value of these securities declined because of the very facts which were misrepresented and omitted.

218. The Trustee gave notice of its election to void and rescind the purchase of securities within six months after obtaining knowledge that the sale of the securities to Sentinel was voidable.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendant FTN for rescission and for the full amount paid for the PreTSL securities transactions listed in Paragraph 211 above, together with interest from the date of

payment less any income or other amounts received by Sentinel on the securities and the amount received by Sentinel for or on account of the disposition of the securities.

COUNT FIVE

**Securities Fraud in Violation of 15 U.S.C. § 78j(b) and Rule 10(b)-5
(All Defendants)**

219. Plaintiff restates and realleges paragraphs 1 through 218 of this Complaint as though fully set forth herein.

220. On May 11, 2007, defendant FTN sold Sentinel a \$7 million HomeBanc security.

221. In connection with the purchase of that security, defendants Folan, de St. Phalle, and FTN made material misrepresentations of fact. On March 27, 2007, defendants Folan and de St. Phalle told Mosley that HomeBanc was “all prime mortgages, except for I believe like 1%” and did not have much exposure to sub-prime mortgage loans.

222. On March 30, 2007, another FTN employee, Dan Collins, told Mosley that HomeBanc had little sub-prime exposure and would pay its trust preferreds even if it hit rough times and had to be liquidated. In particular, Collins stated, “These guys [HomeBanc] are clearly prime; not sub-prime. There’s little to no sub-prime exposure.”

223. The March 27 and March 30 statements regarding the HomeBanc securities were materially false and misleading. HomeBanc in fact had extensive exposure to high risk, non-prime loans, known as “Alt-A” loans.

224. Defendants Folan, de St. Phalle, and FTN acted with scienter because they knew that their statements regarding the HomeBanc security were materially false and misleading in that HomeBanc’s loans were not all prime, and defendants intended that Sentinel rely on their misrepresentations.

225. Sentinel relied on the representations that Home Banc was not exposed to non-prime loans in purchasing this security.

226. Sentinel would not have purchased the HomeBanc security if it had known about HomeBanc's exposure to non-prime loans.

227. Sentinel has been damaged by defendants' false and misleading statements regarding the HomeBanc security. In August 2007, HomeBanc filed for bankruptcy because of its exposure to non-prime loans. At the time Sentinel filed for bankruptcy on August 17, 2007, it still held the HomeBanc securities it purchased from FTN in May 2007. The securities became worthless after HomeBanc filed for bankruptcy. Sentinel has sustained a loss of millions of dollars associated with the HomeBanc securities FTN sold it. These losses were caused by the facts misrepresented about HomeBanc's exposure to non-prime loans.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan, de St. Phalle and FTN for compensatory damages, plus punitive damages in an amount to be determined by the Court, interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT SIX

Violation of the Illinois Blue Sky Law

815 ILCS 5/12

(Defendant FTN)

228. Plaintiff restates and realleges paragraphs 1 through 227 of this Complaint as though fully set forth herein.

229. On March 27 and 30, 2007, defendants Folan, de St. Phalle and FTN made statements of material fact regarding the HomeBanc security that FTN subsequently sold to

Sentinel that were false and misleading and/or omitted to state material facts necessary in order to make the statements not misleading.

230. Defendants Folan, de St. Phalle and FTN's false and misleading statements and/or omissions regarding HomeBanc were made in connection with the sale of the HomeBanc security that FTN sold to Sentinel, and tended to work a fraud or deceit upon Sentinel.

231. Defendants Folan, de St. Phalle and FTN's false and misleading statements and/or omissions regarding HomeBanc allowed FTN to obtain money and/or property from Sentinel through the fraudulent sale of the HomeBanc security.

232. Defendants Folan, de St. Phalle and FTN's false and misleading statements and/or omissions regarding HomeBanc were part of a device, scheme or artifice to defraud Sentinel in connection with the sale of the HomeBanc security.

233. Sentinel reasonably relied on defendants' false and misleading statements and omissions in purchasing the HomeBanc security.

234. Sentinel's losses were caused when the value of these securities declined because of the very facts which were misrepresented and omitted.

235. The Trustee gave notice of its election to void and rescind the purchase of the security within six months after obtaining knowledge that the sale of the security to Sentinel was voidable.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendant FTN for rescission and for the full amount paid for the HomeBanc security purchased on May 10, 2007, together with interest from the date of payment less any income or other amounts received by Sentinel on the security and the amount received by Sentinel for or on account of the disposition of the security.

COUNT SEVEN

**Negligent Misrepresentation
(All Defendants)**

236. Plaintiff restates and realleges paragraphs 1 through 235 of this Complaint as though fully set forth herein.

237. On May 11, 2007, defendant FTN sold Sentinel a \$7 million HomeBanc security.

238. In connection with the purchase of that security, defendants Folan, de St. Phalle, and FTN made material misrepresentations of fact. On March 27, 2007, defendants Folan and de St. Phalle told Mosley that HomeBanc was “all prime mortgages, except for I believe like 1%” and did not have much exposure to sub-prime mortgage loans.

239. On March 30, 2007, another FTN employee, Dan Collins, told Mosley that HomeBanc had little sub-prime exposure and would pay its trust preferreds even if it hit rough times and had to be liquidated. In particular, Collins stated, “These guys [HomeBanc] are clearly prime; not sub-prime. There’s little to no sub-prime exposure.”

240. The March 27 and March 30 statements regarding the HomeBanc securities were materially false and misleading. HomeBanc in fact had extensive exposure to high risk, non-prime loans, known as “Alt-A” loans.

241. Defendants had a duty to communicate accurate information by virtue of their having recommended the security to Mosley and by virtue of their claim to have special knowledge about HomeBanc as a company that FTN effectively “owned.”

242. Defendants Folan, de St. Phalle, and FTN were (at least) negligent in ascertaining the truth of whether HomeBanc’s portfolio consisted of all prime mortgages.

243. Defendants made the misrepresentations to Sentinel intending that Sentinel act on them and purchase the security.

244. Sentinel in fact acted in reliance on the truth of the statements and purchased the security.

245. Sentinel would not have purchased the HomeBanc security if it had known about HomeBanc's exposure to non-prime loans.

246. Sentinel has been damaged by defendants' false and misleading statements regarding the HomeBanc security. In August 2007, HomeBanc filed for bankruptcy because of its exposure to non-prime loans. At the time Sentinel filed for bankruptcy on August 17, 2007, it still held the HomeBanc security it purchased from FTN in May 2007. The security became worthless after HomeBanc filed for bankruptcy. Sentinel has sustained a loss of millions of dollars associated with the HomeBanc security FTN sold it. These losses were caused by the misrepresentation about HomeBanc's exposure to non-prime loans, which were the reason Sentinel incurred losses with respect to that security.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan, de St. Phalle and FTN for compensatory damages, plus interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT EIGHT

Securities Fraud in Violation of 15 U.S.C. § 78j(b) and Rule 10(b)-5(a)-(c) (Defendants Folan and FTN)

247. Plaintiff restates and realleges paragraphs 1 through 246 of this Complaint as though fully set forth herein.

248. On April 4, 2007, defendant FTN recommended to and engaged in a transaction with Sentinel in which Sentinel “sold” certain PreTSL mezzanine and income notes to FTN, and FTN then “sold” those securities back to Sentinel as combination notes.

249. The April 4, 2007 transaction was not an economic transaction made at arms’ length, but rather was made to generate false profits and bonuses for Sentinel and Mosley.

250. Defendants Folan and FTN induced Mosley to enter the transaction by offering to let him set any price he wished for the securities that Sentinel would sell to FTN. In particular, Folan advised Mosley: “I need you to come up with the dollar prices that you want to basically sell them to us, because you’ll be basically for all intents and purposes selling everything to us. Here’s what we’ll be doing...you’ll be selling us your pieces. We’ll be putting the combos together [less fees] . . . and come back with a blended price to sell back to you. So what I need from you is the dollar prices you want to use on your sell side. However you want to work that, with your books and everything else.”

251. On April 4, 2007, Sentinel sold PreTSLs to FTN for \$60.5 million and then immediately paid FTN \$60.6 million to buy back PreTSL combo notes consisting of the same pieces it had sold to FTN.

252. Because Mosley and defendants Folan and FTN manipulated the prices at which Sentinel sold FTN the PreTSLs, Mosley was able to book a \$1.6 million “gain” on the transaction. However, there was no economic basis for booking a “gain.” The only economic benefit to the transaction was that defendants Folan and FTN helped Mosley generate a \$160,000 bonus for himself based on the paper “gain” he booked for Sentinel. In actuality, Sentinel did not generate a real gain from the transaction, but still incurred an obligation to pay Mosley.

253. Defendants Folan and FTN also acted with scienter by intentionally recommending and engaging in this transaction (a) knowing that it was part of a scheme to defraud and operated as a fraud on Sentinel, and (b) knowing that they had failed to disclose material facts to Sentinel concerning the transaction.

254. Defendants Folan and FTN acted with scienter by failing to disclose that they had engaged in a transaction that had no legitimate economic rationale and that was adverse to Sentinel's interests. Such a duty arose under the common law, because they had bribed and co-opted Mosley, and by virtue of the fact that defendants Folan and FTN recommended the structure of the April 4, 2007 transaction.

255. Defendants Folan and FTN breached their duty to disclose by failing to disclose to Sentinel that the April 4, 2007 transaction only benefited Mosley, did not benefit Sentinel, and was not negotiated in arms' length but was merely made for the purpose of generating false profits for Sentinel and a higher bonus payment for Mosley.

256. The facts that the April 4, 2007 transaction only benefited Mosley, did not benefit Sentinel, and was not negotiated in arms' length but was merely made for the purpose of generating false profits for Sentinel and a higher bonus payment for Mosley were facts material to the transaction.

257. Sentinel relied on the implicit representation that this was a legitimate transaction and on the non-existence of the facts which defendants failed to disclose. Sentinel would not have entered into this transaction except for defendants' fraud and deceit.

258. Sentinel was damaged as a result of defendants Folan and FTN's conduct. Specifically, Sentinel was damaged in the amount of the costs it was charged by defendants in connection with the purchase and sale. Those losses were caused by Defendants Folan and

FTN's scheme to defraud and their failure to disclose to Sentinel that the April 4, 2007 transaction only benefited Mosley, did not benefit Sentinel, and was not negotiated at arms' length but was merely made for the purpose of generating false profits for Sentinel and a higher bonus payment for Mosley.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan and FTN for compensatory damages, plus punitive damages in an amount to be determined by the Court, interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT NINE

**Violation of the Illinois Consumer Fraud Act
815 ILCS § 505/1
(All Defendants)**

259. Plaintiff restates and realleges paragraphs 1 through 258 of this Complaint as though fully set forth herein.

260. Defendants engaged in deceptive acts or practices in connection with the sale of PreTSLs and similar securities to Sentinel. Those deceptive acts or practices included the misrepresentations, omissions, and bribery described above.

261. Sentinel was a consumer, as that term is defined in 815 ILCS §505/2(e), in connection with the purchase of securities from defendants.

262. Defendants intended that Sentinel rely on their deceptive acts and practices.

263. Defendants' deceptive conduct occurred in the course of its conduct involving trade and commerce, namely, the sale of securities.

264. Defendants' deceptive conduct was material to the transactions with Sentinel.

265. Sentinel suffered harm proximately caused by defendants' deceptive conduct. Specifically, Sentinel purchased hundreds of millions of dollars in unsuitable securities. Sentinel's losses were caused when the value of these securities declined because of the very facts which were misrepresented, omitted or which rendered these securities unsuitable. Sentinel would not have suffered these losses if the facts were as Sentinel believed them to be.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan, de St. Phalle and FTN for compensatory damages, plus punitive damages in an amount to be determined by the Court, interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT TEN

Negligence (All Defendants)

266. Plaintiff restates and realleges paragraphs 1 through 265 of this Complaint as though fully set forth herein.

267. Defendants' business involved providing recommendations and other information about securities to prospective purchasers, including recommending the purchase of securities based on the characteristics of those securities and the prospective purchasers' investment objectives and financial circumstances.

268. Defendants owed a duty to Sentinel, arising under the common law and under FINRA Rule 2310 and similar suitability rules, to recommend only suitable securities to Sentinel.

269. Defendants breached that duty by negligently recommending that Sentinel purchase securities, including PreTSLs and similar instruments that were unsuitable for Sentinel.

270. Relying on those recommendations, Sentinel purchased unsuitable securities.

271. Sentinel has been damaged as a result of defendants negligently recommending the purchase of unsuitable securities.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against defendants Folan, de St. Phalle and FTN for compensatory damages, interest, costs, and attorneys' fees, and grant such other relief as may be appropriate.

COUNT ELEVEN

**Unjust Enrichment
(All Defendants)**

272. Plaintiff restates and realleges paragraphs 1 through 271 of this Complaint as though fully set forth herein.

273. As a result of the conduct alleged in this Complaint defendants wrongfully received direct and indirect benefits from Sentinel which should have inured to the benefit of Sentinel.

274. Defendants Folan, de St. Phalle and FTN have been unjustly enriched, and equity requires that they disgorge and pay the amount by which they have been unjustly enriched.

WHEREFORE, Plaintiff respectfully requests that the Court enter judgment in favor of Plaintiff and against all defendants, jointly and severally, order disgorgement of all profits, fees, commissions and income received by defendants in connection with the sale of PreTSLs and similar securities to Sentinel (plus interest, costs and attorneys' fees), and grant such other equitable relief as may be just and appropriate.

COUNT TWELVE

**Avoidance and Recovery of Fraudulent Transfers Pursuant to
§§ 548(a)(1)(A) and 550(a) of the Bankruptcy Code
(Defendant FTN)**

275. Plaintiff restates and realleges paragraphs 1 through 274 of this Complaint as though fully set forth herein.

276. Mosley and certain other insiders engaged in a fraud scheme to misuse what were supposed to be customer assets for their own benefit.

277. These insiders improperly pledged securities that should have been segregated for customers as collateral for Sentinel's bank loan, which in turn financed repo borrowing. The money generated by this leveraging scheme was used by Mosley to fund speculative and risky trading in instruments like PreTSLs for the benefit of certain Sentinel insiders.

278. The insiders perpetrated and concealed the fraud by, among other things, sending the customers fictitious account statements which did not reflect the leverage and which falsely represented that securities were being held in segregation for their benefit when in fact they were not in segregation but were pledged for the bank loan.

279. Defendant knew that PreTSLs owned by Sentinel had been purchased with a bank loan which was collateralized by securities that were supposed to be segregated for Sentinel's customers.

280. From December 15, 2005 to August 17, 2007, Sentinel purchased the following securities from FTN:

<u>Settlement Date</u>	<u>Par Amount</u>	<u>Description</u>	<u>Identifier</u>
12/15/2005	5,000,000	PRETSL FLOAT	741382AJ4
03/01/2006	50,000	PRETSL FLOAT	74042JAE3
03/01/2006	7,450,000	PRETSL FLOAT	74042JAE3

03/01/2006	8,500,000	PRETSL FLOAT	74042JAG8
04/03/2006	5,000,000	.PXXI FLOAT/PRETSL XXI	74042KAA8
04/03/2006	10,000,000	.PXXI FLOAT/PRETSL XXI	74042KAA8
04/13/2006	6,000,000	PRETSL FLOAT	74042HAA5
05/03/2006	3,200,000	PRETSL FLOAT	44984RAE8
05/09/2006	5,000,000	PRIME HOLDINGS TRUP	74161LAA1
05/09/2006	10,000,000	PRIME HOLDINGS TRUP	74161LAA1
06/02/2006	1,000,000	PRETSL FLOAT	44984RAE8
06/02/2006	5,000,000	PRETSL FLOAT	44984RAE8
06/15/2006	5,000,000	PRETSL FLOAT	74042MAE6
06/15/2006	4,000,000	PRETSL FLOAT	74042MAJ5
06/15/2006	5,000,000	PRETSL FLOAT	74042MAJ5
06/15/2006	6,000,000	PRETSL FLOAT	74042MAJ5
06/15/2006	4,800,000	PRETSL FLOAT	74042MAN6
06/15/2006	5,000,000	PRETSL FLOAT	74042MAN6
06/26/2006	10,000,000	.PXXII FLOAT	74042LAA6
07/18/2006	5,000,000	.PXVII FLOAT	74042VAA4
08/24/2006	6,700,000	.PXXII FLOAT	74042LAA6
08/31/2006	1,000,000	.PXVI FLOAT	74042GAA7
08/31/2006	2,500,000	.PXIX FLOAT	74042HAJ6
08/31/2006	1,500,000	.PXVII FLOAT	74042VAA4
08/31/2006	4,500,000	.PXIIX FLOAT	74042XAA0
09/15/2006	3,910,157	.PIX FLOAT	74040UAA8
09/21/2006	10,000,000	.PXXIII FLOAT	74043BAA7
09/21/2006	12,000,000	.PXXII/.PXXIII FLOAT	74138RAA8/PP3H0ASH9
09/21/2006	5,000,000	.PXXIII FLOAT	74138WAA7
09/26/2006	1,000,000	PRETSL FLOAT	74042MAJ5
12/27/2006	10,000,000	PRETSL FLOAT	74043AAC5
01/12/2007	5,950,000	.PXX Inc. Nt	74042BAA8
02/15/2007	24,100,000	.PXXI COMBO	74139MAA8
02/16/2007	6,500,000	PRETSL FLOAT/PRETSL	74041UAE9
02/20/2007	15,000,000	PRETSL FLOAT	74041NAE5
03/13/2007	25,000,000	PRETSL FLOAT	741378AA1
03/14/2007	1,000,000	PRETSL FLOAT	74042HAE7
03/22/2007	1,000,000	PRETSL FLOAT	74042FAC5
03/22/2007	2,500,000	PRETSL FLOAT	74042FAG6
03/22/2007	10,000,000	.PXXV COMBO	74139LAA0/PP3H0ASK2
03/28/2007	6,000,000	PRETSL FLOAT	741382AL9
03/28/2007	4,000,000	.PXXIII/.PXXIII	74138RAA8/PP3H0ASH9

		FLOAT	
04/05/2007	11,900,000	PRETSL FLOAT	741382AL9
04/05/2007	20,000,000	.PXXIII/.PXXIII FLOAT	74138RAA8/PP3H0ASH9
04/05/2007	30,700,000	PXXII FLOAT	74139NAA6/PP3H0AS17
04/20/2007	4,000,000	PRETSL FLOAT/PRETSL	74041UAE9
5/15/2007	7,000,000	HOMEBA NC TRUP	40422XAA1
05/29/2007	500,000	PRETSL 5.3	74041WAE5
06/21/2007	4,000,000	PRETSL FLOAT	74042QAG2
06/21/2007	10,000,000	.PXXVI FLOAT	74139TAA3
06/27/2007	500,000	PRETSL FLOAT	74042HAB3
08/16/2007	18,000,000	PRETSL FLOAT	74043AAQ4
08/16/2007	18,000,000	.PXXIII FLOAT	74043BAA7

281. In connection with each of the foregoing purchases of securities, Mosley caused Sentinel to transfer cash and/or securities to FTN (the “FTN Transfers”).

282. Each of the FTN Transfers was made in furtherance of the insiders’ fraud scheme and was made with the actual intent to hinder, delay, or defraud Sentinel’s creditors.

283. Each of the FTN Transfers was made, mediately or immediately, to or for the benefit of FTN.

284. Each of the FTN Transfers constituted transfers of interests in Sentinel’s property. In particular, the transfers of funds and securities were made from Sentinel’s unsegregated accounts at the Bank of New York. Those assets transferred to FTN constitute property of Sentinel by virtue of, among other things, Sentinel’s failure to separately account for assets supposed to belong to customers, the commingling of assets, Sentinel’s treatment of the assets, and the other facts and circumstances of the case.

285. The Trustee may avoid all FTN Transfers pursuant to section 548(a)(1)(A) of the Bankruptcy Code.

286. The Trustee may recover, for the benefit of the estate, the FTN Transfers or their value from the defendants as either the initial transferee of the FTN Transfers or the entity for whose benefit the FTN Transfers were made pursuant to section 550(a) of the Bankruptcy Code.

WHEREFORE, Plaintiff respectfully requests that the Court enter an Order: avoiding each of the FTN Transfers pursuant to section 548(a)(1)(A) of the Bankruptcy Code; ordering the return and recovery of the FTN Transfers, or entering judgment against each defendant pursuant to section 550(a) of the Bankruptcy Code in the amount of the FTN Transfers made to or for the benefit of each such defendant; awarding the Trustee punitive damages in an amount to be determined by the Court, pre- and post-judgment interest, costs and attorneys' fees and expenses; and granting such other equitable relief as may be just and proper.

Dated: November 17, 2008

Respectfully submitted,

FREDERICK J. GREDE, not individually but
as Chapter 11 Trustee of Sentinel Management
Group, Inc.

By: /s/ Chris Gair
One of his attorneys

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