

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3316 / November 17, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14632

In the Matter of

**FTN FINANCIAL SECURITIES
CORP.**

Respondent.

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**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTION 203(k) OF THE
INVESTMENT ADVISERS ACT OF
1940, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST
ORDER.**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), against FTN Financial Securities Corp. (“FTN” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. This case concerns a transaction between FTN and Sentinel Management Group, Inc. (“Sentinel”) through which FTN was a cause of Sentinel’s failure to maintain true, accurate and current books and records relating to its securities transaction liabilities in its year-end 2006 financial statements, which were used by Sentinel as part of its fraud against its advisory clients. Sentinel was a Northbrook, Illinois registered investment adviser that, prior to its bankruptcy, primarily managed investments of short-term cash for advisory clients, including futures commission merchants, hedge funds, financial institutions, pension funds, and individuals. Sentinel purported to invest its clients’ assets primarily in highly liquid cash management products, when in fact, Sentinel employed leverage to invest in a substantial amount of illiquid securities, using client assets to collateralize a bank loan (the “Bank Loan”) used to finance the trading.

2. Sentinel drew on the Bank Loan to finance a portion of its undisclosed leveraging strategy. Sentinel reported the amount of the Bank Loan in its year-end financial statements, which Sentinel provided to its trading counterparties and clients. Sentinel represented that its financial statements were prepared in conformity with generally accepted accounting principles (“GAAP”).

3. Over year-end 2006 and beginning of year 2007, Sentinel engaged in a five-day reverse repurchase transaction (“Repo Transaction”) with FTN, a broker-dealer headquartered in Memphis, Tennessee. Sentinel used the proceeds from the Repo Transaction to temporarily pay down a portion of its Bank Loan balance before year-end 2006 in order to reduce the amount reported in its year-end financial statements. Sentinel’s 2006 financial statements failed to record a liability associated with Sentinel’s obligation to repurchase the securities when the Repo Transaction was unwound.

4. Earlier in March 2006, before engaging in the Repo Transaction, FTN had engaged in a transaction with Sentinel to purchase securities from Sentinel at quarter-end, a transaction that Sentinel told FTN employees it needed to “make our loan look lower.” In addition, towards the end of 2006, before engaging in the Repo Transaction, a Sentinel employee made statements to one of those same FTN employees suggesting that Sentinel intended to use the Repo Transaction to circumvent a regulatory requirement.

5. During its consideration of the year-end Repo Transaction, FTN’s management became concerned that some of the securities that it believed Sentinel had purchased from FTN on behalf of certain of its clients and wished to include in the Repo Transaction did not meet those clients’ year-end liquidity needs. Although FTN management restricted certain of Sentinel’s future purchases, it approved the Repo Transaction. Based upon these concerns and the earlier March 2006 transaction, FTN should have known that Sentinel would use the Repo Transaction for an improper purpose.

6. As a result of this conduct, FTN was a cause of Sentinel’s violations of Section 204(a) of the Advisers Act and Rule 204-2(a)(6) thereunder.

Respondent

7. FTN Financial Securities Corp., a Tennessee corporation headquartered in Tennessee, is a registered broker-dealer and a wholly owned subsidiary of First Tennessee Bank National Association, which is the principal subsidiary of First Horizon National Corporation, a registered bank holding company.

Related Party

Sentinel

8. Sentinel Management Group, Inc., formerly an Illinois corporation headquartered in Illinois, was registered with the Commission as an investment adviser since 1980. On August 17, 2007, Sentinel filed for Chapter 11 bankruptcy. At the time of its bankruptcy, it managed approximately 178 accounts for around 100 clients and had approximately \$1.4 billion in assets under management. Sentinel is now under the control of a liquidation trustee.

Facts

PreTSL Securities

9. In or around 2000, FTN developed, with another unrelated broker-dealer, a type of security referred to as a Preferred Term Securities Ltd. (“PreTSL”). PreTSLs are collateralized debt obligations created by pooling and securitizing trust preferred securities issued by community and regional banks and thrifts, insurance companies and/or real estate investment trusts. PreTSL securities were sold in tranches, each with its own risk and liquidity profile, ranging from AAA rated senior notes to unrated residual interests known as “Income Notes.” The PreTSL Income Notes were the highest yielding, most risky, and least liquid class of PreTSL securities. The offering memoranda for PreTSLs warned that “a purchaser must be prepared to hold the [securities] for an indefinite period of time or until the maturity thereof.” PreTSL securities, including Income Notes, had a stated legal final maturity of 30 years.

Sentinel’s Fraud

10. Sentinel fraudulently and deceptively told clients that it invested their assets in safe, highly-liquid cash management products in which the clients had a *pro rata* ownership interest, when in fact, it exposed clients to undisclosed risks by, among other things, employing substantial leverage through reverse repurchase transactions² (“repos”) and use of the Bank Loan. Sentinel used this undisclosed leverage to fund purchases of high-yield, risky, and often illiquid securities such as PreTSL Income Notes and then used the yield from these securities to pay a higher rate of interest to its clients than its competitors and to enrich its owners and top executives.

² In a reverse repurchase transaction, one party sells a security to a counterparty with an agreement to repurchase the securities at a higher price on a later date. Absent default, the income received on the coupon from the underlying securities over the term of the borrowing still belongs to the borrower.

11. Partly as the result of Sentinel's use of this undisclosed leveraging strategy, Sentinel was unable to meet client redemption requests and collapsed in August 2007. On August 17, 2007, Sentinel filed for Chapter 11 bankruptcy protection.

12. Sentinel reported the amount of the Bank Loan as of December 31 in its annual financial statements, which it was required to accurately keep and maintain under the Advisers Act and rules thereunder. Towards the end of 2005 and 2006, Sentinel's management became concerned about reporting the large amount of the Bank Loan in its financial statements, and Sentinel employed various means to temporarily reduce the size of the Bank Loan for December 31, without disclosing the temporary means to its clients or counterparties. For example, in a December 29, 2005 email from a Sentinel employee to Sentinel's head portfolio manager, Charles Mosley, the employee reported that Sentinel's CEO, Eric Bloom, "said no matter what we have to get [the loan] down or we will lose about 700 million dollars from our current customers." The next day, Mosley reported to Bloom that he was unable to get the loan down to the \$100 million level that Bloom desired. Bloom replied: "Hopefully, the bigger loan won't induce panic."

Sentinel's Suspicious End-of-Quarter Transaction in Early 2006

13. By mid-March 2006, Sentinel had purchased nearly \$85 million in PreTSL securities from FTN.

14. In March 2006 emails between Mosley and Bloom, they discussed the need to reduce the size of the Bank Loan temporarily for quarter-end. In one email, Mosley told Bloom that he thought they needed to make the size of the Bank Loan look lower at quarter-end "so we can tell our clients" that the size of the Bank Loan at the prior "year-end was an aberration." In a follow-up email later that month, Bloom told Mosley that Sentinel needed to reduce the size of the Bank Loan for month-end even further because "I don't want to get anyone nervous."

15. In a telephone conversation that same month, Sentinel, through Mosley, approached FTN with a request for a "favor" that FTN engage in a transaction in which it would repurchase \$8 million in PreTSL securities that it had previously sold to Sentinel and then sell them back to Sentinel after the end of the first quarter of 2006, or the end of March 2006. Mosley explained that Sentinel was having "balance sheet" issues and needed to get the securities "off" Sentinel's books for the end of the month.

16. In that same conversation, an FTN employee ("Employee A") asked Mosley why Sentinel needed to divest itself of particular PreTSL securities at month-end, adding that "[y]ou don't have to tell me if you don't want to." Mosley responded: "This is not to repeat to anybody else. They are sitting at our bank so they give us a loan so it blows us up...and it inflates what we have."

17. In a second telephone conversation that same day between Mosley, Employee A, and another FTN employee, Mosley told the FTN employees that the PreTSL securities Sentinel sought to get out of temporarily over quarter-end were "basically like sitting at our bank. The bank loans us money but it blows up." Mosley added: "If I could lend them out, I would keep

‘em. So now it’s just, at this time, we want to make our loan look lower, so literally, I mean I just have to have it off by the end of the month. I mean I could buy it back the next day.”

18. Although FTN did not engage in the sell-buyback transaction requested by Mosley, FTN did assist Sentinel by entering into a swap transaction in which it purchased the \$8 million in PreTSLs from Sentinel in exchange for Sentinel’s purchase of approximately \$6 million in PreTSL Income Notes from FTN, with settlement on the Income Note purchase to be delayed until the following month.

19. For quarter-end of the first quarter of 2006, Sentinel used the proceeds from its end of March sale of PreTSLs to FTN to temporarily reduce the size of the Bank Loan.

Sentinel and FTN Engage in the 2006 Year-end Repo Transaction

20. By October 2006, Sentinel had purchased nearly \$210 million in PreTSL securities from FTN, including over \$60 million in Income Notes.

21. As part of Sentinel’s effort to reduce the size of the Bank Loan for December 31, 2006, Sentinel, through Mosley, contacted FTN in October 2006 about a year-end transaction. Sentinel proposed that before the end of 2006, FTN repurchase nearly all of the PreTSL Income Notes it had previously sold Sentinel and then resell those securities back to Sentinel at the beginning of 2007.

22. An FTN compliance team reviewed Sentinel’s proposed end-of-year transaction. FTN’s compliance team was concerned that a transaction being proposed by Sentinel (in which Sentinel’s obligation to repurchase the securities was unclear) might be viewed as illegal “parking” of securities. The FTN compliance team ultimately concluded that a transaction structured as a reverse repurchase transaction would not constitute parking.

23. After FTN’s compliance team reviewed the proposed end-of-year transaction, FTN’s management became involved in evaluating the transaction. Initially, FTN’s management rejected the proposed transaction, but discussions with Sentinel regarding its need for a year-end transaction continued.

24. In a phone call on November 28, 2006, Mosley explained to FTN’s management that the reason Sentinel needed to engage in a year-end transaction was to raise cash so that Sentinel could meet certain clients’ year-end liquidity needs. Mosley explained further that Sentinel was unable to meet those liquidity needs in part due to Sentinel’s inability to “lend out” (i.e. repo) the PreTSL Income Notes that it held for its clients.

25. FTN’s management became concerned that Sentinel had bought from FTN Income Notes that did not meet certain Sentinel clients’ year-end liquidity needs. Certain members of FTN’s management, as well as other FTN employees, looked at Sentinel’s website, in which Sentinel represented that it would provide clients with immediate liquidity. An FTN manager who was aware of Sentinel’s request believed Sentinel might have been lying about its reason for wanting the transaction – to meet client liquidity needs – and that Sentinel actually intended to use the Repo proceeds for different purposes.

26. On December 20, 2007, during a telephone conversation between Mosley and Employee A, Mosley made statements that suggested that Sentinel intended to use the Repo Transaction for an improper purpose. In that recorded call, the Employee A asked Mosley whether it would “screw you badly” if the Repo Transaction ended up leaving Sentinel short of its liquidity needs. After a lengthy pause, Mosley started to respond, then stopped, and asked Employee A whether his phones were recorded. Employee A replied that though he did not think so, “we can talk on our cell phones about that.” But Mosley continued, “It is just a regulatory thing so if....It will be close and then if they miss it we’re fine. But we have a new um” Employee A: “Regulator?” Mosley: “Well the person, same regulator, new person this year. So the old one we were comfortable with, but the new one is like oh [expletive].”

27. In late December 2006, despite the lingering concerns described above, FTN’s management approved the Repo Transaction. On December 28, 2006, FTN purchased approximately \$35 million par value of Income Notes from Sentinel for approximately \$25 million. On January 2, 2007, FTN resold the Income Notes back to Sentinel to complete the transaction.

28. At the time of the Repo Transaction, FTN’s general practice was to accept highly rated, liquid securities such as treasury and agency securities in repo transactions. FTN had never before engaged in a repo transaction in which PreTSL income notes were used as collateral. FTN also had a practice of not engaging in repo transactions with its brokerage customers. FTN’s decision to engage in the Repo Transaction with Sentinel deviated from this practice.

29. The FTN compliance team that had initially reviewed the transaction was not involved in the ultimate decision of FTN’s management to approve the transaction in late December.

Sentinel’s Misleading Financial Statements

30. As a registered investment adviser, Sentinel was required to maintain true, accurate, and current books and records relating to its investment advisory business, including trial balances and financial statements.

31. Sentinel provided its year-end 2006 financial statements to various trading counterparties and prospective clients.

32. Sentinel purported to prepare its financial statements in accordance with GAAP. GAAP required Sentinel to account for its repos as secured borrowings with corresponding pledges of collateral, and to continue to report the securities used as collateral for the repos as assets.³

33. The Repo Transaction provided Sentinel with \$25 million that it used to temporarily reduce its Bank Loan balance as of December 31, 2006. In its 2006 financial

³ See FASB Statement of Financial Accounting Standards No. 140, “*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*”

statements, Sentinel, using the proceeds from the Repo Transaction and other temporary measures, reported a loan balance of approximately \$230 million, which was the lowest balance of the loan at any point in 2006 or 2007. Sentinel's average daily 2006 loan balance was approximately \$282 million, and its average daily 2007 loan balance (before Sentinel's August 2007 collapse) was approximately \$300 million. The \$230 million year-end loan balance that Sentinel reported in its year-end 2006 financial statements was approximately 19% lower than its average daily 2006 loan balance and approximately 24% lower than its average daily 2007 loan balance. On the day Sentinel entered into the Repo Transaction, the Bank Loan balance declined more than 7%.

34. Sentinel's financial statements failed to include as a liability Sentinel's obligation from the Repo Transaction to repurchase the Income Notes from FTN. As a result, Sentinel's financial statements were not prepared in accordance with GAAP and understated Sentinel's liabilities by nearly 11%.

35. Sentinel did not disclose that the Bank Loan balance reported in its 2006 financial statements reflected proceeds from the non-recurring, short-term Repo Transaction, among other short-term transactions, which Sentinel engaged in solely to temporarily reduce the Bank Loan balance.

36. Based upon FTN's unresolved concerns and the earlier March 2006 transaction, FTN should have known that Sentinel would use the Repo Transaction for an improper purpose.

Legal Discussion

37. Sentinel recorded the Repo Transaction in an inaccurate manner in its internal books and records and failed to record liabilities associated with its securities repurchase obligations as described above. As a result, Sentinel violated Section 204(a) of the Advisers Act and Rule 204-2(a)(6) promulgated thereunder, which require every investment adviser registered under Section 203 of the Advisers Act to make and keep true, accurate and current books and records relating to its investment advisory business, including trial balances and financial statements.

38. Based on the facts discussed above, FTN should have known that by engaging in the Repo Transaction, it would be a cause of Sentinel's violations of Section 204(a) of the Advisers Act and Rule 204-2(a)(6) promulgated thereunder. Section 203(k) of the Advisers Act provides that the Commission may issue a cease-and-desist order against a person who is "a cause of [another person's] violation, due to an act or omission the person knew or should have known would contribute to such violation"

Undertakings

Respondent undertakes to:

39. Cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, Respondent shall:

A. Produce, without service of a notice or subpoena, any and all non-privileged documents and other information requested by the Commission staff subject to any restrictions under the law of any foreign jurisdiction;

B. Use its best efforts to cause its officers, employees, and directors to be interviewed by the Commission staff at such time as the staff reasonably may direct;

C. Use its best efforts to cause its officers, employees, and directors to appear and testify without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission staff; and

D. In connection with any testimony of Respondent's officers, employees, and directors to be conducted at deposition, hearing, or trial pursuant to a notice or subpoena, Respondent:

1. Agrees that any such notice or subpoena for Respondent's officers', employees', and directors' appearance and testimony may be served by regular or electronic mail on: Harry J. Weiss, Esq., Wilmer, Cutler, Pickering, Hale and Dorr, 1875 Pennsylvania Avenue, N.W., Washington, DC 20006; harry.weiss@wilmerhale.com.

2. Agrees that any such notice or subpoena for Respondent's officers', employees', and directors' appearance and testimony in any action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(k) of the Advisers Act, Respondent FTN Financial Securities Corp. shall cease and desist from committing or causing any violations and any future violations of Section 204(a) of the Advisers Act and Rule 204-2(a)(6) promulgated thereunder;

B. Respondent FTN Financial Securities Corp. shall, within 10 days of the entry of this Order, pay disgorgement of \$1,495,878.00 and prejudgment interest of \$377,758.73. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to Frederick J. Grede, the Liquidation Trustee for the Sentinel Liquidation Trust created in *In re Sentinel Management Group, Inc.* Case No. 07-14987 (Bankr. N.D. Ill.) for immediate distribution on a pro rata basis solely to certain harmed Sentinel clients that invested in Sentinel's investment portfolios; and (C) submitted under cover letter that identifies FTN Financial Securities Corp. as a Respondent in

these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, money order or check shall be sent to Robert Burson, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604.

By the Commission.

Elizabeth M. Murphy
Secretary