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

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, **Plaintiff,** **v.** **STEPHEN M. FOLAN,** **Defendant.**	:	**CASE NO. 1:11-cv-8905**

COMPLAINT

Plaintiff, the United States Securities and Exchange Commission (the "SEC"), for its Complaint, alleges as follows:

SUMMARY

1. Over year-end 2006 and the beginning of 2007, Defendant Stephen M. Folan ("Folan") aided and abetted the issuance of materially misleading financial statements and other materially false statements by Sentinel Management Group, Inc. ("Sentinel"), formerly a Northbrook, Illinois investment adviser registered with the SEC. Sentinel is now in bankruptcy.

2. Folan is a former employee of FTN Financial Securities Corp. ("FTN"), a registered broker-dealer headquartered in Tennessee.

3. Sentinel managed overnight cash primarily for institutional clients. Sentinel told its clients that it invested their assets in very safe and highly liquid investments that it maintained

in segregated custodial accounts. Instead, Sentinel engaged in a massive fraud in which it invested a significant portion of client assets in risky, illiquid investments.

4. Sentinel employed a risky, undisclosed leveraging strategy that left it unable to meet its clients' liquidity needs. As part of its undisclosed leveraging strategy, Sentinel borrowed money from a bank (the "bank loan"). Sentinel reported the bank loan balance in its year-end financial statements, which Sentinel purported to prepare in accordance with Generally Accepted Accounting Principles ("GAAP"). Sentinel provided these financial statements to some current and prospective clients and to counterparties to repurchase transactions which Sentinel engaged in as part of its leveraging strategy.

5. Over year-end 2006 and the beginning of 2007, FTN engaged in a five-day repurchase transaction (the "Repo Transaction") with Sentinel, in which FTN purchased and then resold to Sentinel approximately $35 million in securities known as collateralized debt obligations ("CDOs"). The Repo Transaction provided Sentinel with $25 million that it used to reduce its bank loan balance temporarily as of December 31, 2006. The Repo Transaction substantially assisted Sentinel in reporting in its year-end 2006 financial statements an outstanding bank loan balance that was materially below the typical amount of Sentinel's bank loan balance. Sentinel reported a temporarily reduced bank loan balance without booking a liability for the Repo Transaction or disclosing that the non-recurring, atypical Repo Transaction helped cause the reduced bank loan balance. This was part of Sentinel's broader fraudulent scheme to mislead its clients and counterparties with respect to its substantial use of leverage in contradiction of its stated investment policies.

6. Folan, a registered representative at the time with FTN's Chicago office who had responsibility for the Sentinel account, knowingly or recklessly provided substantial assistance to

Sentinel's fraud. He did so by acting as the primary advocate for the Repo Transaction within FTN and serving as the primary conduit between Sentinel and FTN's management.

7. Folan was Sentinel's primary contact at FTN, and he was close friends with Sentinel's portfolio manager, Charles Mosley ("Mosley"). In October 2006, Mosley, one of the architects of Sentinel's fraud, requested that FTN purchase millions of dollars worth of a certain type of CDO, known as "PreTSL Income Notes," hold them in the FTN's inventory over year-end 2006, and then resell them to Sentinel. The PreTSL Income Notes were the most risky and least liquid class of PreTSL securities.

8. Over the course of the following two months, Folan acted as the primary advocate for the Repo Transaction within FTN and repeatedly stressed to his superiors at FTN how important it was to accommodate Sentinel, which was Folan's best customer. Although Folan had information indicating that Sentinel would use the Repo Transaction for an improper purpose, he did not share this information with his superiors at FTN.

9. At the end of December 2006, FTN, based in substantial part on Folan's advocacy for the Repo Transaction and his failure to share information about Sentinel's purpose for engaging in the transaction, agreed to the Repo Transaction with Sentinel. Instead of Sentinel using the Repo Transaction to provide temporary year-end liquidity to clients, as it had claimed, it used the Repo Transaction to mislead its clients by temporarily reducing the outstanding bank loan balance in its year-end 2006 financial statements by approximately 10% without disclosing that the source of the reduction was an atypical, non-recurring event and by understating its liabilities by failing to record any liability associated with the Repo Transaction.

JURISDICTION AND VENUE

10. This Court has jurisdiction over this action pursuant to Section 209(d) of the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. § 80b-9(d)]. The defendant has, directly or indirectly, made use of the means and instrumentalities of interstate commerce, or the mails, or of the facilities of a national securities exchange in connection with the acts, practices and courses of business alleged in this complaint.

11. This is an appropriate venue under Section 214 of the Advisers Act [15 U.S.C. § 80b-14]. The transactions, acts, practices and courses of business constituting the violations alleged herein occurred within the Northern District of Illinois and elsewhere. In addition, the Defendant is a resident of this District, and the SEC's Chicago Regional Office, which has been responsible for investigating and prosecuting this action, is located within this District.

THE DEFENDANT

12. Stephen M . Folan, age 48, is a resident of Plainfield, Illinois. He was employed as a salesperson and registered representative of FTN's Chicago office from January 2005 through March 2011.

OTHER INTERESTED PARTIES

13. **Sentinel** was an Illinois corporation that during all relevant times had its principal place of business in Northbrook, Illinois. At all relevant times, Sentinel was registered with the SEC as an investment adviser and with the Commodity Futures Trading Commission ("CFTC") as a Futures Commission Merchant. On August 17, 2007, Sentinel filed for Chapter 11 bankruptcy. At around the time of Sentinel's bankruptcy, Sentinel managed accounts for around 70 clients and purported to have approximately $1.4 billion in assets under management. Sentinel is now under the control of a liquidation trustee.

FACTS

PreTSL Securities

14. In approximately 2000, FTN helped start a securities pooling program called PreTSL. PreTSLs are CDOs created by pooling and securitizing trust preferred securities issued by community and regional banks and thrifts, insurance companies, and/or real estate investment trusts. FTN helped create a new PreTSL every quarter and was one of only a few brokers who made a market in them. PreTSL securities were sold in tranches, each with its own risk and liquidity profile, ranging from AAA rated senior notes to the unrated Income Notes. The PreTSL Income Notes were the most risky and least liquid class of PreTSL securities.

15. Sentinel was one of the biggest purchasers of PreTSLs from FTN. Sentinel was by far Folan's most important customer, accounting for up to 75% of his commissions.

Sentinel's Fraud

16. Sentinel defrauded its clients by telling them it invested their assets in safe, highly liquid cash management products, when in fact, it exposed clients to undisclosed risks by, among other things, employing substantial leverage through undisclosed reverse repurchase transactions, commonly known as "repos," and through the bank loan.

17. In a repo 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.

18. Repos are commonly used to provide short-term liquidity in a cash management investment strategy. Instead of using repos merely as a periodic short-term liquidity tool, however, Sentinel used the repos as part of a consistent leveraging strategy.

19. Sentinel's website - which was consistent with Sentinel's other representations to clients - promised clients that "your funds [will] be accessible when you need them," and that "Sentinel is prudent in its placement of funds, in order to provide a minimum of risk while maintaining maximum liquidity. All client funds are placed in readily marketable government and corporate securities, a large portion of which are in overnight investments, allowing us to meet client withdrawal needs while maintaining the integrity of our portfolios."

20. Contrary to these representations, Sentinel engaged in an undisclosed strategy of using leverage and repos to fund its purchases of risky, illiquid securities such as PreTSLs. Then Sentinel commingled the interest from these risky securities to pay interest to clients (that Sentinel misled clients into thinking was only generated by the safe, liquid securities listed on client statements). Contrary to its representations that it used the bank loan for short-term liquidity, Sentinel used it primarily to finance its use of leverage and repos, and it used securities purchased for its clients as collateral for the bank loan.

21. Sentinel reported the amount of the bank loan in its year-end financial statements, which it purported to prepare in accordance with GAAP and provided to trading counterparties and clients that requested them. As detailed below, Sentinel issued materially misleading year-end 2006 financial statements because it failed to record a liability associated with the Repo Transaction. Sentinel also failed to disclose that it lowered the bank loan balance by, among other things, engaging in a non-recurring, temporary Repo Transaction.

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

22. By mid-March 2006, Sentinel had purchased nearly $85 million in PreTSL securities from FTN. In March 2006 emails, Mosley and Sentinel's CEO, Eric Bloom ("Bloom"), discussed the need to reduce the size of the bank loan temporarily at 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."

23. In a recorded telephone conversation that same month, Mosley approached his primary contact at FTN, Folan, 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. 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. In response, Folan asked why Sentinel needed to divest itself of particular PreTSL securities at month-end, adding quickly, "You 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."

24. In a second recorded telephone conversation that same day, Mosley told Folan 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: "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." Folan did not provide his superiors at FTN with this information, and instead helped accommodate Sentinel's request.

Sentinel's and FTN's End of 2006/Beginning of 2007 Repo Transaction

25. Like it had done at the end of the first quarter, at the end of 2006, Sentinel attempted to reduce the size of the bank loan over year-end. Prior to year-end 2006, Sentinel's

CEO Bloom had repeatedly told Mosley to lower the loan balance near year-end, once stating that, "No matter what we have to get [the loan] down or we will lose about 700 million dollars from our current customers" and another time remarking that, "Hopefully, the bigger loan won't induce panic."

26. As part of Sentinel's year-end efforts, in early October 2006, Mosley advised Folan that Sentinel needed to temporarily reduce its position in PreTSL Income Notes by $60 million (the entire amount of PreTSL Income Notes that FTN had sold to Sentinel at this point) at year-end 2006. Mosley stated that Sentinel would be willing to repurchase $40 million of the PreTSL Income Notes in early 2007. Mosley then told Folan's superiors at FTN that Sentinel needed to reduce temporarily its position in PreTSL Income Notes primarily because Sentinel's clients needed liquidity at year-end. Mosley explained to Folan's superiors that while Sentinel was able to generate some year-end cash by engaging in repos with other counterparties, these counterparties would not accept PreTSL Income Notes as collateral, rendering them unusable in repos. Because Sentinel's clients' needs for year-end liquidity exceeded Sentinel's ability to generate year-end liquidity through ordinary course repos, Mosley explained, Sentinel needed to dispose of its PreTSL Income Notes temporarily to generate additional liquidity.

27. In a recorded conversation in October 2006, Folan referred to Sentinel's situation as the "liquidation thing" and then told Mosley that they needed to talk privately about the situation because "nobody else need know the conversation" because it was a "conversation we don't want to have in front of the whole crew." The following month, Folan remarked during a recorded call with Mosley that the Repo Transaction was "a hugely, very important thing for you," to which Mosley replied, "that's an understatement." Folan then stated that it was also "a very important thing for me because you're my best customer."

28. In a late December 2006 recorded telephone conversation, Folan asked Mosley whether it would "screw you badly" that the repo ended up leaving Sentinel $10 million short of its claimed year-end need. After a lengthy pause, Mosley started to respond, then stopped, and asked Folan whether his phones were recorded. Folan replied that though he did not think so, "we can talk on our cell phones about that." But Mosley continued anyway, "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 ..." Folan: "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 sh-t' you know." Folan acknowledged this information by saying "hmm" repeatedly as Mosley was speaking. When Mosley was finished speaking, Folan immediately changed topics and continued with the conversation. Folan did not tell his superiors at FTN about Mosley's comments regarding the Repo Transaction's possible impact on Sentinel's regulatory requirements.

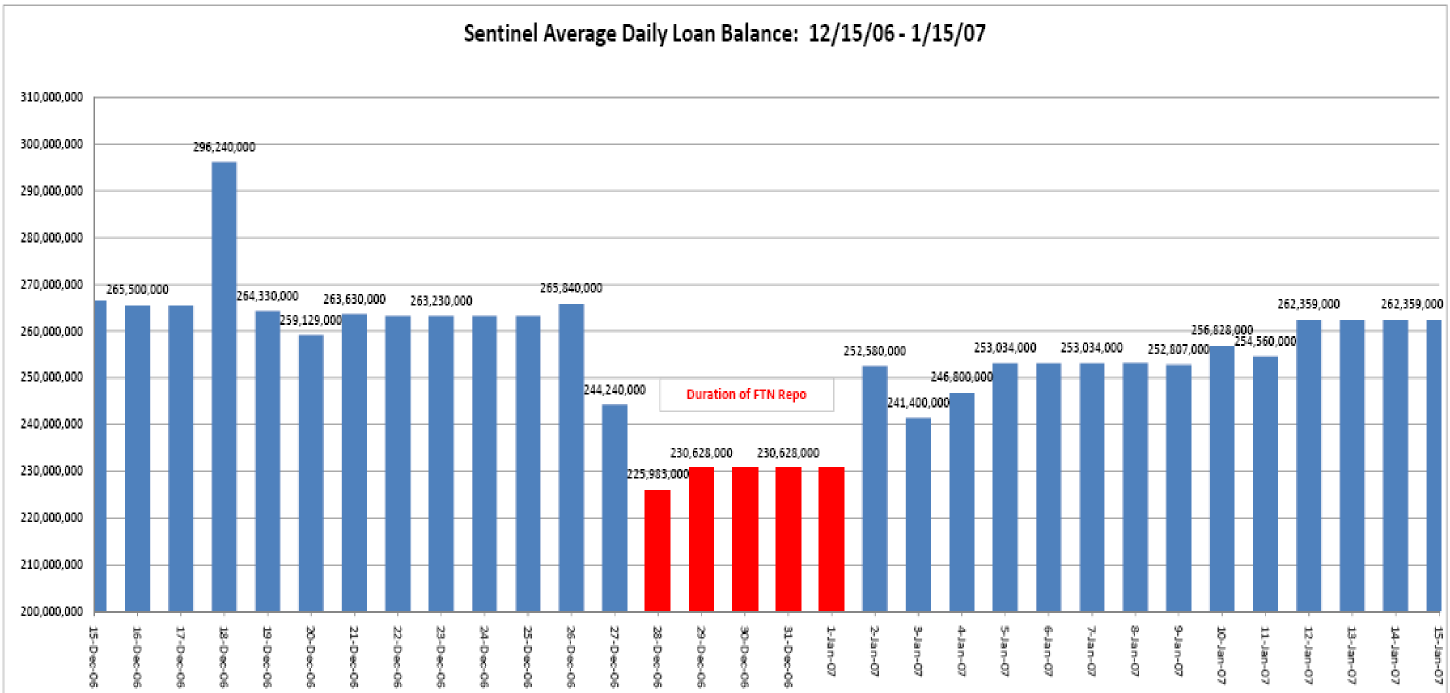
29. In December 2006, relying in substantial part on Folan's advocacy, FTN engaged in the Repo Transaction in which FTN purchased approximately $35 million par value in Income Notes from Sentinel for approximately $25 million.

30. The Repo Transaction provided Sentinel with $25 million in cash to reduce temporarily the bank loan balance to a level below its typical average balance.

31. In its 2006 financial statements, Sentinel, using the proceeds from the Repo Transaction, reported a bank loan balance of approximately $230 million as of December 31, 2006, which was the lowest balance of the loan at any point in 2006 or 2007. Sentinel did not disclose that a material part of this reduction in the bank loan balance was temporary and caused by a non-recurring event. 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.

32. The chart below reflects Sentinel's temporary lowering of the bank loan balance at the end of 2006:



Several Months After Engaging in the Repo Transaction, Sentinel Collapses, and Its Fraud is Revealed

33. In mid-2007, several months after engaging in the Repo Transaction, Sentinel suffered a liquidity crisis and ultimately collapsed under the weight of its leveraging strategy.

34. In approximately June 2007, a repo counterparty with which Sentinel had over $1 billion in outstanding repos began closing out its repos with Sentinel, mostly based on the decline in market value of CDOs, such as PreTSLs, and other securities that Sentinel had sold to these counterparties in repo transactions.

35. In July 2007, another counterparty, with which Sentinel had over $600 million in outstanding repos, also began closing out its repos with Sentinel.

36. Sentinel drew heavily on the bank loan in a desperate effort to pay counterparties and stave off collapse, with the bank loan ballooning to over $500 million.

37. In early-August 2007, Sentinel tapped out its sources of funds, including the bank loans, and ran out of cash to meet client redemptions.

38. Later in August 2007, Sentinel filed for bankruptcy, and it is now under the control of a liquidation trustee. Its collapse has caused hundreds of millions of dollars in client losses.

COUNT I

Aiding and Abetting Violations of Section 206(2) of the Advisers Act [15 U.S.C. § 80b-6(2)]

39. The SEC realleges and incorporates by reference the allegations set forth in paragraphs 1 through 38 above.

40. By engaging in the conduct alleged above, Sentinel committed primary violations of Section 206(2) of the Advisers Act by, directly or indirectly, knowingly or recklessly, by use of the mails or any means or instrumentality of interstate commerce, while acting as an investment adviser within the meaning of Section 202(11) of the Advisers Act [15 U.S.C. § 80b-2(11)], having engaged in transactions, practices, or courses of business which operated as a fraud or deceit upon a client or prospective client.

41. By engaging in the conduct alleged above, and pursuant to Section 209(d) of the Advisers Act [15 U.S.C. § 80b-9(d)], Folan aided and abetted, and is therefore liable for, the primary violations committed by Sentinel of Section 206(2) of the Advisers Act [15 U.S.C. § 80b-6(2)], because Folan knowingly or recklessly provided substantial assistance to Sentinel's

violations of this provision. Unless enjoined, Folan likely will again aid and abet violations of Sections 206(2) of the Advisers Act [15 U.S.C. § 80b-6(2)].

RELIEF REQUESTED

WHEREFORE, the SEC respectfully requests that the Court:

I.
(Findings of Fact and Conclusions of Law)

Issue findings of fact and conclusions of law that Folan committed the violations charged and alleged herein and enter judgment against him.

II.
(Injunctive Relief)

Grant an Order of Permanent Injunction, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently restraining and enjoining Folan, his agents, servants, employees, attorneys and those persons in active concert or participation with them who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Section 206(2) of the Advisers Act [15 U.S.C. § 80b-6(2)].

III.
(Civil Penalties)

Issue an Order imposing appropriate civil penalties upon Folan pursuant to Section 209(e) of the Advisers Act [15 U.S.C. § 80b-9(e)].

IV.
(Retention of Equitable Jurisdiction)

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

V.
(Other Relief)

Grant such orders for further relief the Court deems appropriate.

Dated: December 15, 2011

Respectfully submitted,

/s/***Daniel S. Ryan***_____________________

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