

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

COMPLAINANT,

v.

MORGAN KEEGAN & COMPANY, INC.
(CRD No. 4161),

RESPONDENT.

DISCIPLINARY PROCEEDING
No. 2007011164501

Hearing Officer:

Note for Electronic Transmission of This Complaint:
The issuance of a disciplinary complaint represents the initiation of a formal proceeding by FINRA in which findings as to the allegations in the complaint have not been made and does not represent a decision as to any of the allegations contained in the complaint. Because this complaint is unadjudicated, interested persons may wish to contact the respondent before drawing any conclusions regarding the allegations in the complaint.

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. During the period January 1, 2006 through December 31, 2007 (the relevant period), member firm Morgan Keegan & Company, Inc. marketed and sold seven affiliated bond funds (the Bond Funds) to retail investors using false and misleading sales materials.¹ All of these funds invested heavily in structured products which caused them serious financial difficulties beginning in early 2007 and led to their collapse later that year, costing investors well over a billion dollars. The sales materials, combined with the firm's misleading internal guidance and inadequate training, misled its own Financial Advisors (FAs). The firm's

¹ These seven funds were: (i) Regions Morgan Keegan Select Intermediate Bond Fund (the Intermediate Fund); (ii) Regions Morgan Keegan Select High Income Fund (the Select High Income Fund); (iii) Regions Morgan Keegan Select Short Term Bond Fund (the Short Term Fund); (iv) RMK High Income Fund; (v) RMK Strategic Income Fund (the Strategic Fund); (vi) RMK Advantage Income Fund (the Advantage Fund); and, (vii) RMK Multi-Sector High Income Fund (the Multi-Sector Fund). Three of the funds (the Intermediate Fund, the Short Term Fund and the Select High Income Fund) were open-end mutual funds. The other four (the RMK High Income Fund, the Strategic Fund, the Advantage Fund and the Multi-Sector Fund) were closed-end registered investment companies that traded on the New York Stock Exchange (NYSE). The first two funds (the Intermediate Fund and the Select High Income Fund) were initially offered in March 1999; the Short Term Fund was initially offered in February 2005; and, the four closed-end funds were initially offered approximately one each year beginning in June 2003 with the last fund (the Multi-Sector Fund) initially offered in January 2006.

supervision of the preparation and review of fund sales materials, and its internal guidance and training, were not reasonably designed to achieve compliance with NASD rules.

2. These failures were particularly acute with respect to the Intermediate Fund. The Intermediate Fund was marketed as a relatively safe and conservative fixed income mutual fund investment. In fact, it suffered risks far different from the risks investors expected in a conservative fixed income bond fund, such as the risks associated with the fund's investments in asset-backed and mortgage-backed securities (including the risks of investing in inferior tranches of structured products) and the risks associated with the portfolio manager's strategy. Those investments later led to the disastrous collapse of the fund. But the risks were never reflected in any of the sales materials at issue in this complaint or Morgan Keegan's internal guidance and training. And Morgan Keegan failed to take reasonable steps to ensure that its sales force was aware of and disclosed material risks of the Intermediate Fund to investors.

3. Certain sales materials for the Intermediate Fund, as well as the Short Term Fund, also omitted or misrepresented the funds' objectives, diversification, and other material information regarding the funds. Morgan Keegan made false and misleading statements, and omitted material facts, by using these materials with Morgan Keegan customers.

4. All of the Bond Funds invested heavily in structured products, particularly inferior (subordinated) tranches of structured securities (including sub-prime products), to achieve greater returns. Beginning in early 2007, serious turmoil in the mortgage-backed securities market, most notably in the sub-prime home equity arena, particularly impacted the Bond Funds due to the investment style and philosophy of the portfolio manager, JK, and the portfolio holdings. Nevertheless, Morgan Keegan failed, in any 2007 sales materials related to

any of the Bond Funds, to disclose these difficulties to customers or that a substantial portion of the Bond Funds' portfolios were acutely affected by then-current economic conditions.

5. Morgan Keegan violated just and equitable principles of trade and failed to adhere to high standards of commercial honor by selling investments using false and materially misleading sales materials (NASD Rule 2110). By using sales materials containing material omissions, false and misleading statements, and exaggerations, which caused the sales materials to not be fair and balanced and to fail to provide a sound basis for evaluating the investments, Morgan Keegan violated NASD Rule 2210 (Communications with the Public). By failing to establish, maintain and enforce a system, including written supervisory procedures, reasonably designed to achieve compliance with NASD's advertising rules, Morgan Keegan violated NASD Rules 3010 (Supervision) and 2110.

6. In addition to the customer-use sales materials, Morgan Keegan undertook to perform due diligence and provide research, investment advice, and performance updates to FAs regarding the Intermediate Fund. Even though the firm was aware of the risks, this internal guidance and information failed to disclose the material characteristics of, and risks of investing in, the fund; misstated the appropriate use of the fund; and otherwise portrayed the fund as a safer investment than it was. Moreover, the firm failed to train FAs regarding the features, risks and suitability of the fund. By misleading its own sales force, Morgan Keegan violated NASD Rule 2110. By failing to establish, maintain and enforce a system, including written supervisory procedures, reasonably designed to ensure that its internal guidance and training to FAs adequately described the nature, holdings and material risks of investing in the Intermediate Fund, or that the risks were otherwise disclosed to customers, Morgan Keegan also violated NASD Rules 3010 and 2110.

RESPONDENT AND JURISDICTION

7. Morgan Keegan and Company, Inc., with principal offices in Memphis, Tennessee is a regional broker-dealer that has been registered with FINRA and the Securities and Exchange Commission since 1969. Morgan Keegan is a wholly owned subsidiary of Regions Financial Corporation, a financial holding company headquartered in Birmingham, Alabama. With over 2,800 registered representatives and 320 branch offices in 20 states, primarily in the Southeast United States, Morgan Keegan offers products and services including mutual funds, securities brokerage, asset management, financial planning, securities underwriting, and sales and trading.

8. Morgan Keegan has a history of disciplinary action related to three of the Bond Funds. In January 2009, Morgan Keegan agreed to pay \$50,000 to the Illinois Securities Investors' Education Fund, \$30,000 to the Illinois Securities Audit and Enforcement Fund, and \$1,600 in restitution and to make other certain remedial measures to settle allegations by the Illinois Securities Department that between 2000 and 2005, the firm engaged in fraudulent or deceptive practices in the sale of securities. Specifically, the Illinois Securities Department alleged that Morgan Keegan failed to disclose to investors material information about the limited transferability of the firm's proprietary funds, including the Intermediate Fund, the Short Term Fund and the Select High Income Fund, and that Morgan Keegan failed to adequately train and supervise its registered representatives and failed to implement adequate compliance and marketing procedures to ensure that accurate information about the funds was communicated to investors.

FACTS

I. The Bond Funds Held Risky, Out-of-Favor Investments

9. Morgan Keegan sold to retail investors seven Bond Funds, each advised by Morgan Asset Management (MAM), an investment adviser affiliate of Morgan Keegan. MAM's senior portfolio manager, JK, selected the investments for the various Bond Funds' portfolios. In 2006 and 2007, Morgan Keegan sold over \$2 billion of the funds to investors.

10. As a portfolio manager who created "unique" products, JK primarily invested in risky, out-of-favor bonds that he believed were undervalued and would generate high yields. From the outset, the Bond Funds were intended to be of low correlation to conventional indices — that is, to behave differently than broad-based fixed income indices — and provide a steady stream of above-market income to investors. Because the Bond Funds were designed to be comprised of non-correlated assets, the Bond Funds did not have a "peer" group of funds. Although the Bond Fund portfolios invested in some conventional corporate debt instruments or equity products, 65–70 percent of each Bond Fund portfolio was invested in asset-backed securities or structured products (that is, securities backed by specific collateral, such as mortgages).

11. The mortgage-backed securities market began to experience serious turmoil in early 2007, most notably in the sub-prime home equity arena, which disproportionately affected JK's bond funds due to his investment style and portfolio holdings. During 2007, the Bond Funds lost value as follows:

NET ASSET VALUES (\$ PER SHARE)					
Bond Fund	Dec. 29, 2006	Mar. 30, 2007	June 29, 2007	Sept. 28, 2007	Dec. 31, 2007
Intermediate (RIBIX)	9.93	9.85	9.46	7.41	4.50
Short Term (MSBIX)	10.08	10.10	9.99	9.27	8.43
Select High Income (MKHIX)	10.13	9.81	9.21	5.94	3.44
RMK High Income (RMH)	13.67	13.85	12.63	7.65	4.88
Strategic (RSF)	13.26	13.04	12.06	7.48	4.69
Advantage (RMA)	13.66	13.29	12.68	7.66	5.01
Multi-Sector (RHY)	14.60	14.10	13.45	7.63	4.59

CLOSED-END FUNDS MARKET VALUES (\$ PER SHARE)					
Bond Fund	Dec. 29, 2006	Mar. 30, 2007	June 29, 2007	Sept. 28, 2007	Dec. 31, 2007
RMK High Income (RMH)	15.69	15.20	13.99	8.88	4.60
Strategic (RSF)	15.35	14.81	13.75	8.36	4.29
Advantage (RMA)	15.90	15.30	13.99	8.70	4.51
Multi-Sector (RHY)	16.50	15.71	14.72	9.29	4.59

II. Morgan Keegan’s Intermediate Fund Sales Materials Misleadingly Portrayed the Fund as Relatively Low Risk and Conservative, and Failed to Disclose Material Risks

A. The Intermediate Fund Was a Risky, Contrarian Fund

12. From the outset, the Intermediate Fund sought “a high level of income” and “capital growth as a secondary objective when consistent with the Fund’s primary objective.” It outperformed almost all other intermediate bond funds by pursuing a “contrarian” and “unique” strategy of investing heavily in asset- and mortgage-backed securities — with a focus upon the

inferior or subordinate tranches of structured deals — and little in government securities. As a result, it was a low correlation fund vis-à-vis its benchmark, the Lehman Brothers Intermediate U.S. Aggregate Index. As a Morningstar analyst observed, the Intermediate Fund held nearly 60% of assets rated in the three lowest investment grade categories, “about three times the [intermediate-term bond] category average.”

13. However, as Morgan Keegan’s due diligence analyst observed in 2007 in a never-issued report, the fund’s “specialization in less traditional sectors” put the fund “at risk of periodic underperformance when these areas are out of favor.” As the Director of the Investments Department, GS, understood, and explained in an internal May 15, 2007 e-mail, the magnitude of that potential underperformance was “comparatively large” and investors could not be expected to understand these risks:

The [Intermediate Fund] has a huge underweight in Govt bonds, a large overweight in asset-backed securities and an overweight in Corp bonds. Again, these differences result in lower correlation, higher tracking error and *most importantly, far different risks than the broad market and than what most investors would expect from their fixed income portfolio. . . .* As a result of the non-traditional exposures, [the fund] *simply does not act like a traditional bond fund. . . .* Clearly [the fund] acts differently than the market, but the *magnitude of that difference is comparatively large.* Again, this is all a result of the holdings within the fund. . . . [T]here are some risk exposures with this fund that are just different than more traditional bond funds. In addition, this fund has a fair amount of liquidity risk

(Emphasis added).

14. The Intermediate Fund, which could only be purchased or held in a Morgan Keegan account, invested significantly in risky securities.

- a. The Intermediate Fund invested heavily in complex asset-backed securities (including certificate-backed obligations (CBOs) and collateralized debt obligations (CDOs)) and mortgage-backed securities (including collateralized

mortgage obligations (CMOs)). At the beginning of the relevant period, over 58 percent of fund assets were invested in asset-backed and mortgage-backed securities. In March 2007, when Morgan Keegan knew adverse market conditions were affecting the fund, over 54 percent of the portfolio was invested in asset-backed and mortgage-backed securities.

- b. The fund significantly invested in the lower (that is, subordinated) tranches of structured securities. The lower tranches of structured products, such as CBOs, CDOs and CMOs, represent lower degrees of credit quality and pay higher interest rates to compensate for the attendant risks. However, the return on the lower tranches is especially sensitive to the rate of defaults in the collateral pool. The market for such securities may be less liquid than is the case for traditional fixed-income securities and senior mortgage- or asset-backed securities. As of June 30, 2007, 51 percent of the fund's assets lacked readily ascertainable market values.
- c. The Intermediate Fund invested in subprime products, that is, securities backed by mortgage loans to borrowers with poor credit. In March 2007, when Morgan Keegan knew market conditions were affecting the fund, 13.5 percent of the Intermediate Fund portfolio's assets were invested in subprime products.
- d. By October 2007, over 66 percent of the Intermediate Fund's investments were illiquid.

B. Morgan Keegan Sold the Intermediate Fund Using Sales Materials That Misleadingly Portrayed the Fund as Low Risk and Conservative and Failed to Disclose Material Risks

15. To sell the Intermediate Fund, Morgan Keegan widely distributed written materials to investors that conveyed that the fund was low risk and conservative, failed to disclose material risks, and were otherwise misleading. The firm prepared and distributed its own materials (*e.g.*, Preferred Fund Profiles) in addition to distributing materials prepared by MAM (*e.g.*, advertising slicks).

16. All of the Intermediate Fund slicks and profiles issued and in effect during the relevant period failed to disclose the following information, which was material in light of Morgan Keegan's overall portrayal of the fund as safe and conservative:

- a. the risks associated with investing in structured products;
- b. that the Intermediate Fund was substantially invested in the subordinated tranches of various structured products;
- c. the risks associated with investing in subordinated tranches of structured products;
- d. that the Intermediate Fund was substantially invested in subprime products; and
- e. that the Intermediate Fund's strategy relied heavily upon structured products to obtain returns exceeding its benchmark.

17. Morgan Keegan was aware that it had provided inadequate disclosure to both customers and its own sales force. In a May 15, 2007 private e-mail from GS, the Director of Investments, to a Morgan Keegan broker, GS acknowledged the firm's failure:

What worries me about this bond fund is the tracking error and the potential risks associated with all that asset-backed exposure. *Mr. & Mrs. Jones don't expect*

that kind of risk from their bond funds. The bond exposure is not supposed to be where you take risks. I'd bet that most of the people who hold that fund have no idea what's [sic] it's actually invested in. I'm just as sure that most of our FAs have no idea what's in that fund either.

If people are using [the Intermediate Fund] as their core, or only bond fund, I think it's only a matter of time before we have some very unhappy investors.

(Emphasis added.)

18. On numerous occasions, Morgan Keegan sold the Intermediate Fund to investors as their only bond fund, and the collapse of the Intermediate Fund led hundreds of investors to file arbitrations against the firm.

i. Advertising Slicks Misrepresented the Intermediate Fund's Objectives, Diversification and Risks

19. During the relevant period, Morgan Keegan regularly distributed to retail customers misleading sales material regarding the Intermediate Fund internally referred to as advertising "slicks." The slicks were provided in hard copy to FAs to distribute to customers and publicly available on MAM's website, mkfunds.com.

20. The slicks distributed during the relevant period were prepared quarterly and delineated by consecutive "volume" numbers. Volumes 20 (data as of December 31, 2005) through 26 (data as of June 30, 2007) were substantially identical except for current financial information (collectively, the "advertising slicks").

21. The advertising slicks misleadingly conveyed that the fund was a safe, diversified investment appropriate for investors primarily seeking to preserve capital and failed to provide material information or adequately disclose material risks.

22. First, the advertising slicks were misleading to investors regarding the investment objective of the Intermediate Fund. The Intermediate Fund prospectuses stated that the fund's "primary objective" is "a high level income" with a secondary goal of "capital growth" only

“when consistent with the fund’s primary objective.” By contrast, the advertising slicks listed a different objective, “capital preservation” first:

If Your
Objective is:

Capital
Preservation
&
Income

This Fund Provides:

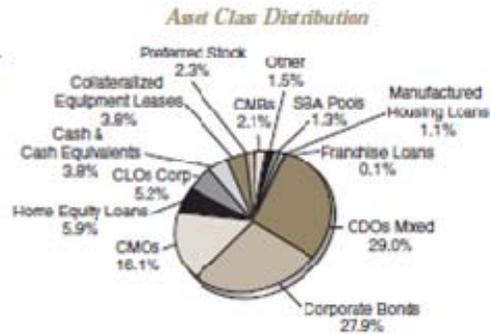
- A higher level of current income than typical money market investments
- A greater stability in principal value than that of long-term bonds
- A diversified portfolio of investment-grade debt instruments

(March 31, 2007). “Capital preservation” involves a significantly less aggressive strategy than “capital growth.” By comparing the Intermediate Fund to money market investments and representing that the fund was appropriate for investors whose objectives were “capital preservation and income” when the actual objectives were primarily a “high level of income” with a secondary objective of “capital growth,” the advertising slicks were misleading regarding the objectives of the fund. Some Morgan Keegan FAs likewise mistakenly believed that a “stated objective” of the Intermediate Fund was “principal preservation,” and some investors believed that the fund was safe and conservative.

23. Second, all of the advertising slicks (including a revised slick, Volume 27, issued as of September 30, 2007) used during the relevant period falsely implied that the Intermediate Fund was less risky and more diversified than it was, by highlighting the benefits of diversification and stating that the risks associated with the fund were reduced because it maintained a diversified portfolio:

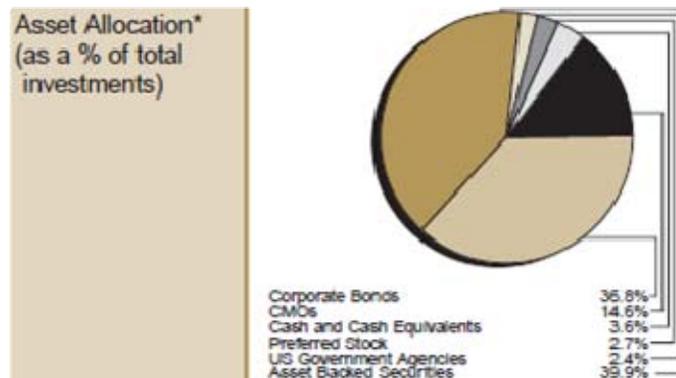
Minimize Risk

The single best way to reduce the risk of any portfolio is through adequate diversification. The Intermediate portfolio is diversified not only with regard to issuer, but also industry, security type and maturity. Furthermore, the Select Intermediate Bond Fund does not invest in speculative derivatives.



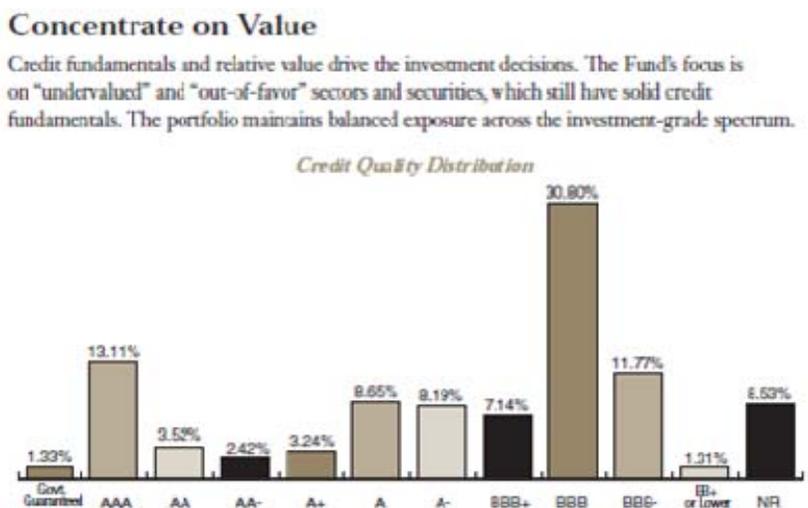
(March 31, 2007). All of the advertising slicks Morgan Keegan used during the review period contained pie charts depicting investments in 10–13 different asset classes, including CMOs, CDOs, CLOs, and variants thereof.

24. The fund was not as diversified as the slicks misleadingly portrayed. Contemporaneous fund materials, such as quarterly updates prepared by the fund manager, depicted the Intermediate Fund as having only 5–6 asset classes with the majority of exposure to two categories that shared many of the same risks: Asset Backed Securities and CMOs:



(March 31, 2007). Had the slicks adequately disclosed the Intermediate Fund’s overconcentration in two closely related asset classes, they would have alerted investors that the fund was not diversified and would suffer outsized decline under certain economic conditions. In a June 13, 2007 internal e-mail commenting on the reasons for the Intermediate Fund’s dramatic failure in mid 2007, the Due Diligence Analyst in Morgan Keegan’s Wealth Management Services Department (WMS) observed that “This is the risk you run when holding any fund that specializes in only a few sectors.”

25. Third, all of the advertising slicks (including the revised slick) failed to provide adequate information regarding investments in junk bonds. According to its prospectus, the Intermediate Fund could invest up to 35% of its assets in securities rated below investment grade. The slicks, however, tout that “This Fund Provides: . . . A diversified portfolio of investment-grade debt instruments” but failed to include its ability to invest in below investment grade securities. A “Credit Quality Distribution” chart in all of the advertising slicks, appearing directly beneath the misleading claim that “The portfolio maintains balanced exposure across the investment-grade spectrum,” indicates the percentage of investments in each credit rating category, without indicating that two of the categories are not rated investment grade:



(March 31, 2007). Had the slicks properly identified the categories, they would have alerted investors that a significant percentage of assets were junk or unrated, and that a third to over half of the assets were rated in the two lowest investment grade categories (BBB and BBB-).

ii. The Preferred Fund Profiles Failed to Disclose the Risks of the Fund and Mischaracterized the Fund

26. During the relevant period, WMS prepared and distributed to FAs quarterly “Preferred Fund Profiles” describing the Intermediate Fund and providing financial information as of the end of the previous quarter.

27. Morgan Keegan approved the profiles for use with customers and they were widely used to sell the Intermediate Fund. Morgan Keegan touted them as “Compliance Approved profiles [that] are excellent overviews to accompany proposals or to provide educational information on all funds on the Best Ideas List.” Regardless of internal approval, none of the relevant profiles for the Intermediate Fund were submitted to NASD’s Advertising Regulation Department for review, as required by NASD Rule 2210(c)(2).

28. At the top of the first page, directly beneath the name of the fund and in large type, each profile included a subheading providing a short characterization of fund.

29. Each profile also provided a narrative section titled “Investment Philosophy,” which purported to describe the investment philosophy of the Intermediate Fund.

a. The 2006 Profiles

30. Profiles issued quarterly through calendar year 2006 were misleading and failed to disclose material facts and risks. These profiles described the Intermediate Fund in a subheading simply as “Taxable Fixed Income” and otherwise failed to provide adequate risk disclosure about the nature of the fund.

31. For example, none of these profiles revealed that the Intermediate Fund invested in inferior tranches of structured deals or that such investments can suffer from a lack of demand and liquidity.

32. The Investment Philosophy section of these profiles recommended that the Intermediate Fund “is best used as a core plus in a diversified fixed income portfolio.” The term “core plus” is nowhere defined or otherwise explained in the profile.

33. Material facts that were omitted from the 2006 profiles were finally included in one profile amended in the fourth quarter of 2006 (performance data as of September 30, 2006). Although only in use for part of the fourth quarter, this profile disclosed information omitted from both previous and subsequent profiles:

- a. The subheading of the profile characterized the Intermediate Fund as “Enhanced Low Correlation Fixed Income” rather than simply “Taxable Fixed Income.”
- b. The Investment Philosophy section revealed that “Issues included in the portfolio are generally the inferior tranches in structured deals.” As a consequence, “They trade at large discounts due to a lack of demand and liquidity.”
- c. The Investment Philosophy section recommended that “Due to the fund’s investment style and its similarities to non-traditional fixed income strategies it is best used as a low correlation fund.”

The revised fourth quarter 2006 profile was the only profile that characterized the Intermediate Fund as either “non-traditional” or “low correlation.” Nevertheless, neither term was defined in the profile.

b. The 2007 Profiles

34. In 2007, Morgan Keegan continued to issue profiles related to the Intermediate Fund in the first, second, and third quarters of 2007 (WMS dropped coverage of the fund prior to the fourth quarter of 2007). The format and some of the types of information contained in previous profiles were changed, and the additional disclosures contained in the amended fourth quarter 2006 profile were removed.

35. Morgan Keegan changed the prominent subheading describing the Intermediate Fund from “Enhanced Low Correlation Fixed Income” to the false characterization “Intermediate Gov’t/Corp. Bond.” At the time the change was made, less than four percent of the Intermediate Fund’s investments were in government bonds or agency bonds, whereas the fund’s benchmark index (Lehman Brothers Intermediate U.S. Aggregate Index) was weighted at least 33 percent toward U.S. Government obligations.

36. The entire Investment Philosophy section reverted to language that appeared in the earlier versions of 2006 profiles and no longer revealed that the Intermediate Fund invested in inferior tranches of structured deals or that such investments suffer from a lack of demand and liquidity.

37. The 2007 profiles also reverted to the investment recommendation contained in the earlier versions of the 2006 profiles: “The strategy is best used as a core plus in a diversified fixed income portfolio.” Again, the 2007 profiles nowhere defined or explained the term “core plus,” and nowhere suggested that the Intermediate Fund was a non-traditional or low correlation fund.

III. Morgan Keegan's Advertising Slicks Misrepresented the Short Term Fund's Objectives, Diversification and Risks

38. During the relevant period, Morgan Keegan repeatedly distributed to retail customers misleading sales material regarding the Short Term Fund prepared by MAM, internally referred to as advertising "slicks." The slicks, which were similar in format to the slicks issued for the Intermediate Fund, were provided in hard copy to FAs to distribute to customers and publicly available on MAM's website, mkfunds.com.

39. The slicks distributed during the relevant period were prepared quarterly and delineated by consecutive "volume" numbers. Volumes 4 (data as of December 31, 2005) through 10 (data as of June 30, 2007) were substantially identical except for current financial information (collectively, the "Short Term advertising slicks").

40. The Short Term advertising slicks misleadingly communicated that the fund was a safe, diversified investment appropriate for investors primarily seeking stable net asset value and failed to provide material information or adequately disclose material risks.

41. First, these slicks were misleading to investors regarding the investment objective of the Short Term Fund. The fund's prospectuses stated that the "fund seeks a high level of current income consistent with preservation of capital." By contrast, the advertising slicks listed a different objective, "stable net asset value," first:

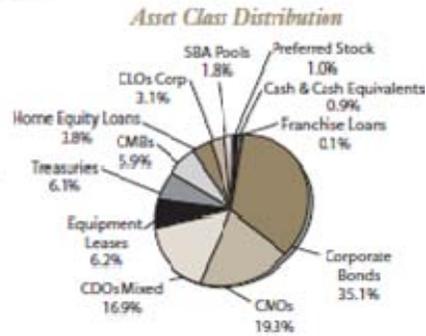


(March 31, 2007). “Stable net asset value” is an investment objective typical of money market funds that manage the portfolio to achieve the same NAV from day to day, whereas a “preservation of capital” goal permits NAV fluctuation. By comparing the Short Term Fund to “typical CDs, savings accounts, or money market instruments” and representing that the fund was appropriate for investors whose objectives were “Stable Net Asset Value & Competitive Short Term Income” when the actual objectives were a “high level of current income consistent with preservation of capital,” the advertising slicks were misleading regarding the objectives of the fund.

42. Second, all of the Short Term advertising slicks (including a revised slick, Volume 11, issued as of September 30, 2007) used during the relevant period falsely implied that the Short Term Fund was less risky and more diversified than it was, by highlighting the benefits of diversification and stating that the risks associated with the fund were reduced because it maintained a diversified portfolio:

Maintain a Fully Invested Portfolio

The single best way to reduce the risk of any portfolio is through adequate diversification. The Select Short Term Bond Fund is diversified not only with regard to issuer, but also industry, security type and maturity. The Select Short Term Bond Fund will utilize corporate bonds, asset backed securities, and mortgage backed securities, maintaining a fully invested position under most market conditions. The Fund will use floating rate securities to mitigate price volatility.



(March 31, 2007). All of the Short Term advertising slicks used during the review period contained pie charts depicting investments in 9–12 different asset classes, including CMOs, CDOs, CMBS, and variants thereof.

43. The fund was not as diversified as the slicks portrayed. Contemporaneous fund materials, such as quarterly updates prepared by the fund manager, depicted the Short Term Fund as having only five asset classes with the majority of exposure to two categories that shared many of the same risks: Asset Backed Securities and Mortgage Backed Securities.



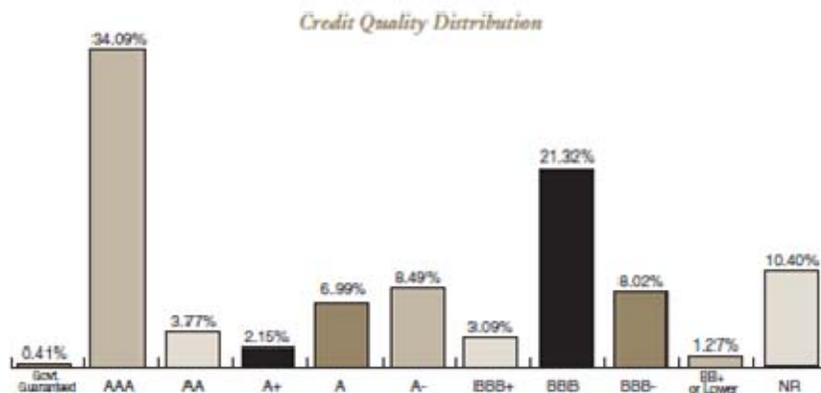
(March 31, 2007). Had the slicks adequately disclosed the Short Term Fund's overconcentration in two closely related asset classes, they would have alerted investors that the fund was not diversified and would suffer outsized decline under certain economic conditions.

44. Third, the Short Term advertising slicks failed to provide adequate information regarding the fund's investments in junk bonds. According to its prospectus, the Short Term

Fund could invest up to 10% of its assets in securities rated below investment grade. The advertising slicks, however, tout that the fund has a “diversified portfolio of short-term investment-grade debt securities” but do not mention its ability to invest in below investment grade securities. A “Credit Quality Distribution” chart in all of the Short Term advertising slicks (including the revised slick), appearing beneath the misleading claim that the fund “maintain[s] a portfolio of investment-grade debt securities,” indicates the percentage of investments in each credit rating category, without indicating that two of the categories are not rated investment grade:

Concentrate on Value

The Fund seeks to provide current income and capital preservation by maintaining a portfolio of investment-grade debt securities. The Fund will attempt to utilize a wide variety of assets, all with solid credit fundamentals, to maximize short-term income. The portfolio invests primarily in issues rated in one of the four highest credit rating categories by a nationally recognized statistical rating organization.



(March 31, 2007). Had the slicks properly identified the categories, they would have alerted investors that a significant percentage of assets were junk or unrated, and that a significant percentage of the assets were rated in the two lowest investment grade categories (BBB and BBB-).

45. All of the Short Term advertising slicks (including the revised slick) issued and in effect during the relevant period failed to disclose the following information, which was material in light of Morgan Keegan’s portrayal of the fund as safe and conservative:

- a. the risks associated with investing in structured products;
- b. that the Short Term Fund was substantially invested in the subordinated tranches of various structured products;
- c. the risks associated with investing in subordinated tranches of structured products;
- d. that the Short Term Fund was substantially invested in subprime products; and
- e. that the Short Term Fund's strategy relied heavily upon structured products to obtain excess returns.

IV. Morgan Keegan's Advertising and Sales Literature Failed to Disclose the Impact of Market Conditions on Any of the Bond Funds in 2007

46. Beginning in early 2007, there was serious turmoil in the mortgage-backed securities market, most notably in the sub-prime home equity arena, which particularly impacted the Bond Funds due to JK's investment style and portfolio holdings. Over the following months, portfolio values plummeted as the turmoil spread to other types of mortgage-related securities, including all structured finance products, and finally to corporate debt, causing investors in the Bond Funds to lose well over a billion dollars by the end of 2007. Ultimately, the open-end funds (Intermediate, Short Term and Select High Income funds) were liquidated.

47. Morgan Keegan was aware in early 2007 that the Bond Funds were experiencing severe difficulties related to the holdings in the funds. In firm-wide conference calls in February and March 2007, JK told some Morgan Keegan brokers that the Bond Funds had invested in the subprime market and that net asset values were probably going to be hurt. By early April 2007, JK reported that stress in the market had spread to other areas, and that he was "concern[ed] and alarm[ed]" about the Bond Funds' net asset values. In mid-July 2007, he acknowledged that "it has been a rough couple of months here with the funds," and warned that "anything that is in

structured finance region is now in a real credit vacuum.” Compounding these difficulties, the majority of the Bond Funds’ assets had no readily ascertainable market value, portending significant liquidity issues.

48. Although JK’s conference calls acknowledged some of the difficulties the Bond Funds were facing, he and other MAM personnel downplayed the risk to the funds of prevailing economic conditions. Beginning in early June 2007, they also stonewalled WMS’s Due Diligence Analyst for the Intermediate Fund when she sought further information to both answer inquiries from FAs and to prepare WMS’s annual due diligence report and recommendation on the Intermediate Fund and Select High Income Fund. Morgan Keegan dropped coverage of the two open-end funds on July 30, 2007, and the annual reports were never issued. Although WMS repeatedly reassured FAs and investors that it was conducting substantial ongoing due diligence and performance monitoring on the Bond Funds, highlighting its timely access to senior fund managers, FAs were never informed that MAM was unresponsive to its affiliate’s due diligence inquiries.

49. Morgan Keegan forwarded customer inquiries on its website regarding the Bond Funds directly to MAM’s Director of Marketing. Beginning in at least March 2007, MAM provided misleading individual responses to both customer and broker inquiries, which downplayed the risks and effect of market conditions on the Bond Funds. For example, MAM’s Director of Marketing responded to inquiries regarding the Bond Funds with the following reassurances:

- a. After expressing confidence in the Strategic Income Fund and optimism going forward, the Director concludes, “In [JK’s] and my own opinion, this is an excellent buying opportunity” (March 16, 2007);

- b. “Nothing specific going on with the portfolio or the income that it produces that would dictate such a sell off. Purely, supply and demand.” (June 14, 2007; regarding all of the funds);
- c. In response to an FA’s question “I assume we are to stay the course with our clients,” the Director responds “I think so. A long term objective should not be forgotten, over a 10 or 15 year period clients will have more in the way of total return in our fund than others because of the high level of income generated.” (July 3, 2007);
- d. In response to an FA’s question “What [sic] up with the closed end funds,” the Director responds, “[JK] thinks we may be close to the end of re-pricing, but who knows about the bottom for the market prices. I think the market is driving the price in anticipation of a dividend cut, that at this time we don’t feel is necessary . . . so I think this is a buying opportunity. We are posting a Q&A with [JK] on the website, hopefully by tomorrow . . . I think this will do a good job of calming the fears.” (July 16, 2007);

During the period MAM offered these reassurances, its portfolio manager JK was voicing concerns — in broker conference calls — about the effects of market conditions on the funds.

Morgan Keegan forwarded its customer inquiries to the fund manager but failed to monitor MAM’s responses or take steps to ensure that MAM provided accurate information and advice.

50. Morgan Keegan became so concerned about the effect the market was having on the Bond Funds that in July 2007 it reduced (and soon after completely eliminated) the Intermediate Fund holdings in its proprietary Preferred Funds Discretionary Program model accounts. The positions were sold because the Intermediate Fund — like the other bond funds

— was “expos[ed] to less liquid structured and sub-prime related fixed income investments,” and Morgan Keegan “believ[ed] there will be more trouble to come in this area.” By early August 2007, the market for bonds held by the Bond Funds — other than the relatively minimal government bond holdings — ground to a virtual halt and Bond Funds’ values plummeted even further. The firm contemporaneously injected \$30 million into the Intermediate Fund and \$55.2 million into the High Income Fund to provide liquidity for redemptions, a paltry amount compared to the \$330 million and \$374 million, respectively, redeemed by investors during the same July–August period.

51. The firm failed to disclose to retail investors these effects in its advertising and sales literature for any of the Bond Funds, including:

- a. The quarterly profiles from March 31, 2007 onward regarding the Intermediate Fund and the Select High Income Fund; and
- b. All of the quarterly advertising slicks from March 2007 onward regarding each of the seven Bond Funds.

V. Morgan Keegan Provided Confusing and Misleading Internal Guidance Regarding the Intermediate Fund

52. In addition to the sales materials provided to the sales force for distribution to customers, Morgan Keegan provided incomplete, confusing, and misleading internal guidance and information to the FAs regarding the Intermediate Fund. Morgan Keegan’s failure to inform its FAs of the risks of the Intermediate Fund increased the likelihood that FAs would make material misrepresentations in their sales of the fund to customers and make unsuitable recommendations.

53. Morgan Keegan had an entire department, the WMS Investments Department, dedicated to assisting the firm’s brokers in selecting investments for clients, setting asset

allocation guidelines, and constructing portfolio models. WMS was uniquely positioned within Morgan Keegan to assist the FAs with understanding the Intermediate Fund and making appropriate representations to customers. Although WMS viewed the FAs as its clients and did not sell securities directly to customers, it created the preferred fund profiles for use with customers and was responsible for assisting clients with investment planning, asset allocation, and traditional and alternative investment recommendations, as well as ongoing performance monitoring.

54. WMS' Investments Department was responsible for providing research and performing due diligence on traditional and alternative mutual funds and managers, and maintaining a list of select mutual funds and alternative investment products. It touted itself as providing "due diligence alerts to ensure that [the FA] is providing [the investor] with the most up to date, sound investment advice." Morgan Keegan's website further assured investors that the firm subjected recommended mutual funds to "one of the most detailed, thorough and exhaustive due diligence processes in the industry," which "goes beyond [analysis of past performance data] to look deep inside not only the funds, but the fund companies and managers who offer them." WMS recommended the Intermediate Fund through its Select List of Investments through mid-2007, during which time it covered the fund.

55. Notwithstanding its pledge to conduct rigorous due diligence and provide fulsome and timely disclosure regarding funds it covered, the WMS Investments Department repeatedly distributed information and recommendations to FAs that failed to disclose material risks of investing in the Intermediate Fund or the effect of market conditions on the fund in 2007.

A. Morgan Keegan's Infrastructure for Describing and Promoting Funds to FAs

56. WMS provided various planning tools, advice, and information sources on numerous investments to FAs, primarily through its WealthWeb intranet website. WealthWeb was Morgan Keegan's centralized resource for:

- a. WMS's marketing materials, including preferred fund profiles (such as the Intermediate Fund profiles).
- b. Fund recommendations through WMS's Select List of Investments, which included the Intermediate Fund.
- c. Regular and irregular notifications from WMS regarding the mutual funds it covered.
- d. Asset allocation models used to generate individual customer portfolios based upon investor goals and five levels of risk tolerance, such as:
 - i. Models for investors with \$10,000 minimum, which included the Intermediate Fund in all of the model allocations.
 - ii. Models for investors with \$50,000 minimum (Preferred Funds Discretionary and Preferred Funds Non-Discretionary programs), which included the Intermediate Fund in the two most conservative model allocations.
 - iii. Models for investors with \$500,000 or \$1,000,000 minimum, which included the Intermediate Fund in the two most conservative model allocations.
- e. Goal Track, a mutual fund management program that allowed FAs to devise a portfolio based upon customer objectives and risk tolerance, and then chart

quarter-by-quarter whether the portfolio was progressing toward those goals; the Intermediate Fund was among nine fixed income investments available to construct Goal Track portfolios.

57. Notwithstanding this infrastructure and these resources, as described below, WealthWeb and its materials did little to accurately disclose the nature and risks of the Intermediate Fund, and in some instances provided information that was misleading.

B. The Investment Department's Classification of the Intermediate Fund on Recommended Lists Failed to Convey the Fund's Unique Investment Style and Risks

58. Morgan Keegan issued quarterly Recommended Lists of investments (renamed "Select Lists of Investments" in mid-2006). The lists were divided into several sections, including Mutual Funds and Alternative Investments, and further categorized by type of investment. To be accepted on the Select List, a fund had to be rated a "buy."

59. Since mid-2004, WMS classified the Intermediate Fund as "Core Plus" on the Recommended List. Although the Select Lists' "Guide to Investment Descriptions" defined "Core" investments, Morgan Keegan did not define "Core Plus" for the FAs in the Select Lists or elsewhere. By contrast, a WMS internal manual defined "Core Plus Portfolios" in part as a "More risky investment than a core portfolio," and designated "core plus mutual fund portfolios" as appropriate for "aggressive clients" along with "speculative" fixed income products and "high yield bonds."

60. In early 2006, Morgan Keegan decided to classify the Intermediate Fund in both the Core Plus category in the Mutual Funds section and in the Non-Traditional Mutual Funds category of the Alternative Investments section. The Intermediate Fund was the only investment on the Select List that was ever classified in more than one category.

61. On or about January 17, 2007, WMS notified FAs that the Intermediate Fund had been removed from the “Core Plus” category and classified it solely as a “Non-Traditional Mutual Fund” in the Alternative Investments section.

62. The January 2007 reclassification was not due to any change in the holdings of the fund, and WMS stated that the reason for the change was merely that “the type of bonds, investment process, and the liquidity of the holdings has [sic] vast similarities to that of a Non-Traditional fixed income product.” The firm provided no further clarification on the meaning of “non-traditional” in the context of fixed income products or otherwise.

63. WMS also claimed that “The Investments Department has suggested for some time that the fund be used in lower allocations as a supplement around the Core Bond Fund holding to help reduce volatility.” However, this limitation on the fund’s appropriate use is nowhere found in the profiles, the advertising slicks, or any other materials distributed to customers. Nor is it found in any materials distributed to the FAs before January 17, 2007.

64. Classifying the Intermediate Fund as a “Non-Traditional Mutual Fund” in the “Alternative Investment” category provided little if any clarification regarding the holdings and risks of the fund. These terms encompassed widely varying investment styles and products both in the financial industry and within Morgan Keegan.

65. The reclassification of the Intermediate Fund solely as an alternative investment caused confusion among numerous Morgan Keegan FAs who had viewed the fund as a more traditional intermediate bond fund. In response, in May 2007, the Manager of the WMS Alternative Investments Group observed, “The [JK] situation in the Morgan Keegan system will always be a source of confusion no matter what we label it” and “there is no question that we have to do a much better job of communicating our message and educating the sales force”

66. He also opined that “the primary problem with having a [JK] fund fall under the Alternative Investment heading has more to do with how much has been sold in the MK system, how it was sold and the hit he has taken in the last few months.” This sentiment was echoed by one of Morgan Keegan’s top-producing brokers who cited the firm’s “widespread, internal and external MARKETING effort that this is a BOND FUND!”

C. WMS Announcements Reassured, Rather than Warned, FAs About the Risks of the Fund

67. In early 2006, Morgan Keegan undertook to alert its brokers through internal Quarterly Alert Summaries when any mutual funds “have underperformed, performed in an uncharacteristic manner, or experienced significant internal changes (*e.g.*, personnel, ownership, portfolio attributes) during the past calendar quarter.”

68. In addition to the regular quarterly alerts, WMS also sent internal Due Diligence Alerts to the FAs that apprised them of Select List additions, removals, watch notices, and other significant developments. The determination to remove the Intermediate Fund from the “Core Plus” category and classify it solely as a “Non-Traditional Mutual Fund” in the Alternative Investments section was announced to the sales force through a Quarterly Alert Summary posted to the firm’s intranet and later attached to a Due Diligence Alert e-mailed to all FAs.

69. On March 22, 2007, after the Intermediate Fund began to suffer disproportionately negative effects from unfavorable economic conditions, WMS issued a Due Diligence Alert with an attachment advising FAs that the Intermediate Fund recently began to lag its benchmark by 59 points “due to widening spreads in the credit markets.” WMS noted that Intermediate Fund had an “overweight relative to the index in the Corporate and Asset Backed Securities” that would be “expected to lag the broader index” during weak credit markets.

70. The bulk of the announcement then reassured FAs that the fund's difficulties were due to "concerns of a global economic slowdown" (causing credit spreads to widen) and "recent panic and news surrounding subprime loan defaults [which] led to further widening on ABS with subprime collateral." WMS went on to disingenuously reassure FAs that, notwithstanding the "fund currently holds 9 percent of ABS backed by subprime loans" (in actuality it held 13.5%), "many tranches within a deal will not have to absorb defaults as the cash flows are redirected," that certain tranches "hold up better in the case of a default," and that the portfolio's holdings "have stronger collateral characteristics." These statements created the false impression that the Intermediate Fund was invested in the stronger, not inferior, tranches of ABS deals.

71. The March 22, 2007 announcement concluded with the assurance that WMS "remains confident in the product and continues to recommend the fund on the Select List." A contemporaneous WMS announcement regarding first quarter performance repeated this assurance.

72. In mid-July 2007, while announcing a reduction of exposure to the Intermediate Fund in certain WMS portfolio models due to its subprime exposure, WMS continued to recommend the fund. On July 19, 2007, the head of the WMS Investments Department, GS, advised FAs that the WMS Investment Strategy Committee ("ISC") had "reduced exposure to the RMK Select Intermediate Fund due to its exposure to less liquid structured and sub-prime related fixed income investments." He reassured FAs, however, "that this decision to reduce [the Intermediate Fund] is not a reflection of the ISC's confidence in the fund or how it is managed." Rather, the Intermediate Fund's difficulties were attributable to "the market's broad reaction to the subprime loan story" and "the problems that the structured product space is having today are temporary."

73. As discussed above, at the time of GS's July 19, 2007 e-mail to FAs, MAM was stonewalling WMS's Due Diligence Analyst's repeated requests for information necessary to provide ongoing due diligence and prepare WMS's annual research report on the Intermediate Fund. However, WMS's recent difficulties arranging a meeting with MAM personnel or obtaining basic due diligence information were not disclosed to the FAs.

74. On July 26, 2007, after NAV declines, GS sent an e-mail to the head of WMS, BF, which advocated "dropping coverage" of the Intermediate Fund and no longer recommending it to FAs. The following morning, July 27, 2007, BF agreed but suggested taking the interim step of placing the Intermediate Fund on "watch first." According to WMS's Policies and Procedures Manual, a watch rating was appropriate when a fund experienced a "material negative change."

75. That same day, notwithstanding top management's avowed lack of confidence in the Intermediate Fund, WMS sent an e-mail to all brokers announcing further reduced exposure to the Intermediate Fund in certain other portfolio models but also reiterating all of the reassurances regarding the fund contained in GS's July 19, 2007 e-mail. Notably, the July 27, 2007 e-mail repeats the earlier assurance "that this decision to reduce exposure to [the Intermediate Fund] is not a reflection of the ISC's confidence in the fund or how it is managed."

76. On July 30, 2007, the TIG met and decided to drop coverage of the Intermediate Fund, citing an unspecified conflict of interest. In mid-August, the Intermediate Fund was sold out of all of Morgan Keegan's proprietary Preferred Funds Discretionary portfolios.

D. Morgan Keegan's Recommended Asset Allocation Models Weighted the Intermediate Fund Higher in Conservative Portfolios Than Aggressive Portfolios

77. During the relevant period, Morgan Keegan had a number of proprietary asset allocation models to serve clients with various investment objectives and risk tolerances. Each of these programs had five recommended portfolios, which identified specific investments for allocation within the model portfolio.

78. Morgan Keegan weighted the Intermediate Fund more heavily in conservative model recommendations, which conveyed the misimpression that the Intermediate Fund was better suited to conservative investors.

VI. Morgan Keegan Failed to Establish, Maintain and Enforce Supervisory Systems Reasonably Designed to Prevent Misrepresentations in the Sale of the Intermediate Fund or Unsuitable Recommendations

79. The Intermediate Fund could only be purchased through Morgan Keegan, and the firm sold over \$675 million in 2006 and 2007 alone. The Intermediate Fund was substantially invested in structured and other products with material, special risks that made them unsuitable for many retail investors and that should have been clearly disclosed to investors. Morgan Keegan had a duty to take appropriate steps to ensure that their associated persons understood and informed their customers about the distinct characteristics and risks of the Intermediate Fund.

80. However, notwithstanding the likelihood that FAs and their customers would misunderstand the nature, holdings and material risks of the Intermediate Fund, Morgan Keegan did not implement and adequately enforce systems or written procedures reasonably designed to ensure that its advertising materials or its internal guidance and training were accurate and complete, or that FAs fully informed customers about the nature, holdings, and material risks of

the Intermediate Fund. These failures increased the likelihood that Morgan Keegan FAs would make material misrepresentations and omissions in their sales of the Intermediate Fund and make unsuitable recommendations.

A. Morgan Keegan Failed to Provide Adequate Training to FAs

81. FINRA has repeatedly advised member firms that their supervisory responsibility to provide adequate training on investments is particularly acute with respect to bond funds containing structured products and similar complex investments. And in September 2005, just prior to the relevant period, FINRA reminded member firms that education of FAs on structured products was “crucial”:

Training for all persons should emphasize that, due to the unique nature of these products, many investors, especially retail investors, may not understand the features of the product, and may not fully appreciate the associated risks of investing in them. Moreover, in light of the fact that investors may be turning to these products as an alternative to traditional equity and fixed income investments, it is crucial for registered persons to have a full and balanced understanding regarding both the risks and the rewards of these products.

Nevertheless, Morgan Keegan did not provide initial or ongoing training to FAs regarding the distinct characteristics and risks of the Intermediate Fund.

B. Morgan Keegan Touted WMS’s Research and Guidance Capability, But Failed to Take Reasonable Steps to Ensure WMS Disseminated Accurate Information to FAs

82. As described above, Morgan Keegan encouraged FAs to take advantage of WMS’s substantial research, promotional, and recommendation infrastructure when selling securities to investors. In addition, Morgan Keegan provided promotional material to investors touting its internal fund research arm, WMS, and assuring them that recommended investments were subjected to rigorous due diligence and ongoing monitoring. The Intermediate Fund

remained on WMS' Select List of Investments through mid-2007, was covered by a WMS analyst, and was promoted by preferred fund profiles issued by WMS.

83. In mid-2004, WMS's bond fund analyst advised other WMS personnel that the fund's strategy was specialized and did not reflect the intermediate bond category as a whole. As the head of the Investments Department recognized, compared with other intermediate bond funds, the Intermediate Fund suffered from "lower correlation, higher tracking error and most importantly, far different risks than the broad market and than what most investors would expect from their fixed income portfolio." As a result, WMS understood that the Intermediate Fund should be used as a satellite fund around more traditional "core" intermediate bond fund holdings.

84. As described above, however, Morgan Keegan failed to adequately communicate these concerns and limitations to the sales force, and issued confusing and misleading internal guidance and provided misleading sales materials for use with customers. WMS prepared some of the misleading materials, such as the profiles, and issued other guidance, such as the Select Lists, that only added to the FAs' confusion. Morgan Keegan was aware that some brokers misunderstood the characteristics and material risks of the Intermediate Fund.

85. After holding out WMS to both FAs and investors as a valuable resource for information and analysis of recommended securities, Morgan Keegan should have taken steps to ensure that WMS accurately and effectively communicated material risks of which it was aware to FAs. Because of this failure, many FAs were unaware of the nature and significant risks of the Intermediate Fund, and were thus more likely to make (1) material misrepresentations and omissions in sales to customers and (2) unsuitable recommendations to customers.

C. Advertising

86. As discussed above, Morgan Keegan distributed false and misleading Preferred Fund Profiles for the Intermediate Fund and advertising slicks for the Intermediate and Short Term Funds.

87. Morgan Keegan touted the Preferred Fund Profiles as “Compliance Approved,” updated them quarterly, and continuously made them available to FAs for use with retail investors. The firm substantially revised the “Investment Philosophy” section of the profiles in late 2006 and again in early 2007 in connection with a wholesale format change. However, the firm conducted no supervisory or compliance review or approval of any of the profiles during the relevant period for compliance with FINRA’s advertising rules.

88. The advertising slicks were subjected to little, if any, firm review. Morgan Keegan ceded responsibility for review of the slicks to MAM’s compliance officer. Her review of the advertising slicks consisted of nothing more than ensuring the narrative text remained unchanged from version to version and that data and charts had been updated by other personnel. In fall 2007, after the Intermediate Fund had suffered substantial losses, she corrected the slicks’ representation of the fund’s objectives, but not the other deficiencies noted above. This mechanical, non-substantive review of the advertising slicks amounted to virtually no review at all.

89. As a consequence of this failure to supervise, Morgan Keegan provided FAs and retail investors with marketing materials that, for nearly a two-year period, misleadingly conveyed that the Intermediate and Short Term funds were safer than they were and failed to disclose the risks described in the complaint. Further, beginning in March 2007, none of the materials disclosed the effect market conditions were having on any of the Bond Funds.

VII. Morgan Keegan Failed to Take Steps Reasonably Designed to Inform FAs and Investors of the Impact of Market Conditions in 2007 on Any of the Bond Funds

90. As alleged above, Morgan Keegan was aware that all of the Bond Funds relied upon a specialized strategy that depended upon continued health of the market for mortgage-related securities. Beginning in early 2007, when the particular risks associated with JK's bond fund strategy began to negatively impact the holdings in the funds, the firm failed to take steps reasonably designed to inform all of the FAs of the effect of market conditions or the risks of investing in the funds under then-current market conditions.

91. Beginning in February 2007, Morgan Keegan became aware, through conference calls hosted by JK and by other means, of the adverse market effects on the Bond Funds. Morgan Keegan lacked effective systems, policies and procedures reasonably designed to timely warn FAs that the market was disproportionately affecting the performance of securities widely sold by Morgan Keegan FAs.

92. As a result, some FAs were unaware that market conditions were disproportionately affecting the performance of the Bond Funds, and FAs sold the funds without disclosing the market effects. In fact, throughout 2007, the head of Morgan Keegan's retail sales force repeatedly advised FAs and his own customers to "hold on buy more" of the Bond Funds. For example, on August 17, 2007, in response to a customer seeking "reassurance" regarding the Bond Funds, the head of Morgan Keegan's sales force stated:

All is well with [JK] and the funds that he manages. The liquidity crises in the bond market caused by the sub prime lending phenomena bled over into bonds of all types, including those owned in the RMK funds. It is temporary and the bonds are still paying and the default rates are still at low levels.

It may take a few months for these prices on bonds to run their course but in the mean time we are still investing the dividends monthly and just building up more shares at even lower prices.

Three days before e-mail was sent, WMS liquidated all Intermediate Fund positions in its Preferred Discretionary Funds portfolios.

FIRST CAUSE OF ACTION
(Failure to Adhere to High Standards of Commercial Honor and Just and
Equitable Principles of Trade — Intermediate Fund)
(Violation of NASD Conduct Rule 2110)

93. The Department realleges and incorporates by reference paragraphs 1 – 92 above.

Misleading Customers Regarding Nature and Material Risks of the Intermediate Fund

94. Morgan Keegan used written promotional materials, including Preferred Fund Profiles and advertising slicks, to sell the Intermediate Fund. These documents contained materially misleading information regarding the fund and omitted material information and material risks of investing in the fund.

95. Morgan Keegan’s material misrepresentations and omissions in the sale of the Intermediate Fund did not comport with high standards of commercial honor or just and equitable principles of trade in violation of NASD Conduct Rule 2110.

Failure to Inform FAs Regarding Nature and Material Risks of the Intermediate Fund

96. Morgan Keegan and its FAs had a duty to understand — and disclose to investors — the nature and material risks of products it recommended to investors. Morgan Keegan assured its FAs and customers that it would provide thorough due diligence, investment advice, and timely performance updates on the Intermediate Fund.

97. WMS was aware that the Intermediate Fund was substantially invested in mortgage-related securities with material, special risks that made the fund unsuitable for many retail investors and that should have been clearly disclosed to investors. Morgan Keegan failed to adequately disclose this information to FAs through its internal guidance, training, the

Preferred Fund Profiles it prepared for use with customers, the advertising slicks it distributed, or otherwise.

98. Morgan Keegan's failure to disclose material information to FAs regarding the Intermediate Fund did not comport with high standards of commercial honor or just and equitable principles of trade in violation of NASD Conduct Rule 2110.

SECOND CAUSE OF ACTION

(Materially False and Misleading Statements, Misleading Omissions of Material Information, Misleading and Exaggerated Claims — Intermediate Fund and Short Term Fund Advertising Slicks) (Violations of NASD Conduct Rules 2110 and 2210(d))

99. The Department realleges and incorporates by reference paragraphs 1 – 98 above.

100. Morgan Keegan distributed advertising slicks regarding the Intermediate Fund and the Short Term Fund that contained materially misleading information regarding the funds and failed to provide material information or disclose all material risks of investing in the funds.

101. The advertising slicks falsely claimed that the Intermediate Fund's primary investment objective was capital preservation. The Short Term advertising slicks falsely claimed that the Short Term Fund's primary investment objective was stable net asset value.

102. All of the advertising slicks misleadingly exaggerated the funds' diversification.

103. All of the advertising slicks failed to disclose material information regarding the risks of investing in asset-backed and mortgage-backed securities, including the risks of investing in subordinated tranches of structured products, and the risks associated with the portfolio manager's strategy.

104. All of the advertising slicks failed to disclose material information regarding the funds' investments in securities related below investment grade or the risks of those investments.

105. Each advertising slick was generally distributed or available to Morgan Keegan customers and otherwise met the definition of “sales literature” in NASD Rule 2210(a)(2).

106. By distributing sales literature that contained material misrepresentations and exaggerated claims, and omitted material information, Morgan Keegan violated NASD Conduct Rules 2110 and 2210.

THIRD CAUSE OF ACTION

(Materially False and Misleading Statements and Misleading Omissions of Material Information — Intermediate Fund Profiles) (Violations of NASD Conduct Rules 2110 and 2210)

107. The Department realleges and incorporates by reference paragraphs 1 – 106 above.

108. Morgan Keegan distributed profiles regarding the Intermediate Fund that contained materially misleading information regarding the Intermediate Fund and failed to provide material information or disclose all material risks of investing in the fund.

109. All of the profiles failed to disclose material information regarding the risks of investing in asset-backed and mortgage-backed securities, including the risks of investing in subordinated tranches of structured products, and the risks associated with the portfolio manager’s strategy.

110. Each of the profiles was generally distributed or available to Morgan Keegan customers and otherwise met the definition of “sales literature” in NASD Rule 2210(a)(2).

111. By distributing communications with the public that contained material misrepresentations and omitted material information, Morgan Keegan violated NASD Conduct Rules 2110 and 2210.

FOURTH CAUSE OF ACTION
(Misleading Omissions of Material Information — Advertising Slicks and Profiles Regarding All of the Bond Funds)
(Violations of NASD Conduct Rules 2110 and 2210)

112. The Department realleges and incorporates by reference paragraphs 1 – 111 above.

113. Morgan Keegan distributed advertising slicks regarding all of the Bond Funds during the relevant period.

114. Morgan Keegan distributed profiles regarding the Intermediate Fund and the Select High Income Fund during the relevant period.

115. Beginning in February 2007, Morgan Keegan became aware that market conditions were having a disproportionately negative effect on the performance of the Bond Funds.

116. From March 2007 through December 2007, all of the advertising slicks and profiles related to the seven Bond Funds failed to disclose material facts concerning the effect of market conditions on the funds.

117. By distributing communications with the public that omitted material information, Morgan Keegan violated NASD Conduct Rules 2110 and 2210.

FIFTH CAUSE OF ACTION
(Failure to File Profiles with NASD’s Advertising Regulation Department)
(Violations of NASD Conduct Rules 2110 and 2210(c))

118. The Department realleges and incorporates by reference paragraphs 1 – 117 above.

119. During the review period, Morgan Keegan prepared quarterly Preferred Fund Profiles for both the Intermediate Fund and the Select High Income Fund.

120. Morgan Keegan never submitted the profiles used during the relevant period to NASD's Advertising Regulation Department for review.

121. Each of the profiles was generally distributed or available to Morgan Keegan customers and otherwise met the definition of "sales literature" in NASD Rule 2210(a)(2).

122. By distributing communications with the public without filing such materials with NASD, Morgan Keegan violated NASD Conduct Rules 2110 and 2210(c).

SIXTH CAUSE OF ACTION

(Failure to Establish, Maintain, and Enforce an Adequate Supervisory System, Including Written Supervisory Procedures, Reasonably Designed to Achieve Compliance with NASD Rules) (Violation of NASD Conduct Rules 3010(a), 3010(b), and 2110)

123. The Department realleges and incorporates by reference paragraphs 1 – 122 above.

Advertising, Guidance and Training Regarding the Intermediate Fund

124. Morgan Keegan recommended the Intermediate Fund through its Select List of Investments and undertook to provide thorough due diligence, investment advice, and timely performance updates on the fund. The Intermediate Fund was substantially invested in mortgage-related securities with material, special risks that made them unsuitable for many retail investors and that should have been clearly disclosed to investors. The department charged with researching and recommending mutual funds to FAs, WMS, was aware of the characteristics and material risks associated with the holdings in the Intermediate Fund.

125. Morgan Keegan's supervisory system and written procedures were not reasonably designed to ensure that the firm provided FAs with thorough and accurate information, risk disclosures, and training regarding the Intermediate Fund.

126. Morgan Keegan's supervisory system and written procedures were not reasonably designed to ensure that the profiles, or the advertising slicks prepared by the fund manager and distributed by Morgan Keegan, were complete, were accurate, disclosed all material risks, were not misleading, and did not contain exaggerated claims. In both its internal guidance and external marketing material, Morgan Keegan failed to adequately describe the nature, holdings and material risks of the Intermediate Fund in its communications with FAs.

127. As a result of the inadequate internal guidance and training, and misleading marketing materials, many FAs were misled and failed to understand the characteristics and risks of the Intermediate Fund, which, in turn, increased the likelihood that FAs would fail to disclose the nature, holdings, and material risks of the Intermediate Fund to customers or recommend unsuitable investments.

128. By failing to adequately supervise FA training, the firm's dissemination of information to the FAs and investors, and its review and dissemination of advertising material, Morgan Keegan failed to establish, maintain, and enforce an adequate supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with NASD rules in the sale of the Intermediate Fund in violation of NASD Conduct Rules 3010(a), 3010(b), and 2110.

The Effect of Market Conditions in 2007 on All of the Bond Funds

129. Morgan Keegan was aware that all of the Bond Funds relied upon a specialized strategy that depended upon continued health of the market for mortgage-related securities. Beginning in early 2007, when the particular risks associated with JK's bond fund strategy began to negatively impact the holdings in the funds, the firm failed to take steps reasonably designed

to revise its advertising materials to inform FAs and their customers of the effect of market conditions or the risks of investing in the funds under current market conditions.

130. Beginning in February 2007, Morgan Keegan became aware, through conference calls hosted by JK and by other means, that the market began to impact the Bond Funds. Morgan Keegan lacked effective systems, policies and procedures reasonably designed to timely revise advertising materials to warn investors that the market was disproportionately affecting the performance of securities widely sold by Morgan Keegan FAs.

131. Morgan Keegan failed to revise its advertising materials to reflect the impact of market conditions beginning in February 2007 on all of the Bond Funds. Accordingly, Morgan Keegan failed to establish, maintain, and enforce an adequate supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with the advertising rules in the sale of the Bond Funds in violation of NASD Conduct Rules 3010(a), 3010(b), and 2110.

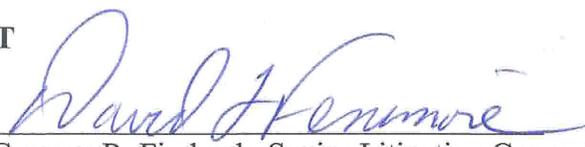
RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed, including that the Respondent be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest and/or offer rescission to Bond Fund purchasers.
- B. order that the Respondent bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.

FINRA DEPARTMENT OF ENFORCEMENT

Date: April 7, 2010


Gregory R. Firehock, Senior Litigation Counsel
Gino F. Ercolino, Senior Counsel
David L. Fenimore, Senior Counsel
Linda S. Riefberg, V. P. and Chief Counsel

FINRA Department of Enforcement
1801 K Street N.W.
Suite 800
Washington, D.C.
20006-1334

Phone: 202.974.2828
Fax: 202.721.8315
e-mail: gregory.firehock@finra.org