

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

RECEIVED

AUG 20 2007

MICHAEL W. DOBBINS
CLERK, U.S. DISTRICT COURT

JUDGE KOCORAS
MAGISTRATE JUDGE MASON

07C 4684
CASE NO.

JURY DEMANDED

UNITED STATES SECURITIES
AND EXCHANGE COMMISSION,

Plaintiff,

v.

SENTINEL MANAGEMENT GROUP, INC.

Defendant.

**DECLARATION OF LOU GRACIA IN SUPPORT OF
PLAINTIFF'S EMERGENCY MOTION FOR A
TEMPORARY RESTRAINING ORDER AND OTHER ANCILLARY RELIEF**

I, Lou Gracia, pursuant to 28 U.S.C. 1746, declare as follows:

1. I am an Assistant Regional Director of the United States Securities and Exchange Commission (the "Commission" or "SEC") in its Chicago Regional Office. One of my duties is to conduct and supervise SEC examinations of investment advisers registered under the Investment Advisers Act of 1940 ("Advisers Act"). In such examinations, the SEC obtains and reviews various kinds of information obtained from investment advisers to monitor compliance with the federal securities laws. Such information includes brokerage account statements, bank statements, custodial account statements, investment advisory customer statements reflecting the securities transactions, assets and liabilities in their accounts, client account reconciliations, and client advisory agreements. I submit this declaration in support of Plaintiff's Emergency Motion for a Temporary Restraining Order and Other Ancillary Relief. The facts set

forth herein are based upon my personal knowledge or upon information contained in the files of the Commission.

2. Sentinel Management Group, Inc. ("Sentinel") is an investment advisor registered with the Commission and a futures commission merchant ("FCM") registered with the Commodities Futures Trading Commission ("CFTC"), located in Northbrook, Illinois. Sentinel's business is to provide investment advisory and discretionary money management services for various advisory clients, including financial institutions, private investment firms, pension funds, and individuals. Sentinel is regulated by the Commission and the CFTC. Sentinel is also a member of the National Futures Association ("NFA"), a self-regulatory organization. As of August 13, 2007, Sentinel claimed to have \$1.2 billion of client interests in assets under management.

3. On August 13, 2007, Sentinel issued a letter to clients announcing that it was requesting authority from the CFTC to cease redemptions ("August 13 letter"). Attached as **Exhibit A** to this declaration is a copy of that letter. Although the CFTC did not grant that authority, Sentinel told clients that they would not be allowed to redeem their investments.

4. On August 14, 2007, Sentinel's refusal to allow redemptions was reported in the press.

5. On August 15, 2007, the Commission began an examination of Sentinel at its Northbrook offices under my supervision. My staff conducted interviews of Eric Bloom, Sentinel's President, Theresa Arana, Sentinel's Chief Financial Officer, and J. Matthew Keel, Sentinel's Chief Compliance Officer, and collected documents from Sentinel.

6. In its August 13 letter, Sentinel told clients that the reason for the redemption freeze was because if clients requested significant redemptions due to the downturn in the credit markets, Sentinel would be forced to sell securities at deep discounts to their fair value; and this could cause losses to clients. This explanation is false and misleading. As described below, the clients' exposure to loss was exacerbated by the undisclosed use of leverage and apparent commingling and misappropriation of clients' securities.

7. At the time the August 13 letter was sent to clients, the securities reported on account statements provided to clients bore no relation to the actual securities held for clients as reflected in their custodial account records.

The Programs

8. According to Sentinel's Form ADV, Part II, Sentinel offered clients the opportunity to participate in a variety of investment programs, each of which had its own investment policy designed to meet the requirements and preferences of different types of clients.

9. Regardless of which investment program a particular client chose, Sentinel pooled the client's assets with those of similar types of clients in one of three segregated accounts, Seg 1, Seg 2 and Seg 3:

- Seg 1 contained assets of FCMs with only domestic customer deposits. FCMs are futures brokers that are members of the NFA and investments are subject to the rules of the CFTC;
- Seg 2 contained assets of FCMs with domestic customer deposits trading in foreign markets; and

