

# BusinessWeek

NEWS August 7, 2008, 5:00PM EST

## Selling Toxic Debt to Seniors

Memphis broker Morgan Keegan is under fire for allegedly failing to disclose the subprime risks of seven funds

The subprime securities that created carnage on Wall Street are bringing new pain to Main Street. Regulators in five states are investigating whether Memphis brokerage Morgan Keegan failed to disclose the risks of seven mutual funds stuffed with toxic debt and whether it inappropriately sold them to seniors and other small investors. Six lawsuits and dozens of arbitration cases claim it did.

Three years ago Katherine and Lester Poer needed a safe place to tuck away \$250,000, part of a windfall from a land sale. With no investing experience, the retired couple from Gulf Shores, Ala., sought advice from Morgan Keegan, which manages \$80 billion in assets. Lester Poer, 81, says he told the adviser "not to take any chances." The recommendation: an in-house fund, RMK Select Intermediate Bond.

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But that portfolio was loaded with risky securities, including some backed by subprime mortgages. Collateralized debt obligations, the same investments that have wiped out billions on Wall Street, made up a quarter of the holdings. RMK Intermediate has lost 86% in the past year, making it the worst-performing fund in its category, according to research firm Morningstar ([MORN](#)). When the Poers sold the fund earlier this year, the account had \$37,000 left. "We've got elderly clients in a fund that's based on speculative investments," alleges Pensacola (Fla.) attorney Peter Mougey, who says he plans to file 200 arbitration claims on behalf of the Poers and others. A Morgan Keegan spokeswoman declined to comment.

The investigations, lawsuits, and arbitration cases focus on bond funds formerly run by Keegan's James C. Kelsoe, once a star manager. Unlike many peers, Kelsoe sidestepped the problems in the bond market when WorldCom imploded in 2002. His RMK Select High Income ranked in the top 1% of its category every year but one between 2000 and 2005, according to Morningstar.

Morgan Keegan promoted Kelsoe's funds as a stable source of income. Sales materials for the High Income fund noted its "relative conservative credit posture" without "excessive credit risk." "[Our broker] knew we were conservative," says Arlene Berman, a retired nurse in Gulf Breeze, Fla., who lost much of the \$100,000 she invested in a Morgan Keegan fund.

One lawsuit, filed in Tennessee federal court on July 11, alleges investors didn't know about the portfolios' underlying risks. The suit claims some of the funds kept as much as 50% of their assets in "exotic, complex, thinly traded, market-untested" securities such as CDOs, which violated rules in the prospectuses limiting such illiquid securities to 15%. Some of those investments have deteriorated rapidly. As of March, the RMK Multi-Sector fund owned part of a mortgage pool created by the now defunct lender First Franklin Financial valued at \$310, down from \$3.1 million. Says Atlanta attorney Brian N. Smiley, who represents former Morgan Keegan investors: "What you have here are investments that carried huge risks."

10/3/2008

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Over the past year, the seven funds under Kelsoe's purview have lost 51% to 86%. On July 29 shareholders voted to replace Morgan Keegan and hire New York's Hyperion Brookfield Asset Management ([BAM](#)) to run the funds. "Getting a new set of eyes on the portfolio is not a bad thing," says Morningstar senior fund analyst Lawrence Jones. "But that by no means suggests investors should have hope."

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