UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of

JOHN P. FLANNERY AND
JAMES D. HOPKINS,

Respondents.

Administrative Proceeding
File No. 3-14081

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DIVISION OF ENFORCEMENT'S BRIEF IN SUPPORT OF ITS PETITION FOR REVIEW

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I. INTRODUCTION

This matter involves two former employees of State Street Bank and Trust Company ("State Street") who, through a series of misleading statements and a fraudulent course of conduct, lulled some of the investors in State Street's commingled trust funds to remain invested in those funds by misleading them about the funds' exposure to subprime residential mortgage-backed securities ("subprime RMBS"). Those investors were invested in State Street's Limited Duration Bond Fund ("LDBF") and other State Street funds that were themselves invested in LDBF (the "Related Funds"). Hopkins marketed LDBF as a relatively low-risk, enhanced cash investment, but LDBF's strategy was anything but low-risk. LDBF was concentrated in subprime RMBS and used extensive leverage to make other subprime investments. As long as the subprime investments performed, LDBF would modestly outperform other low-risk fixed income funds invested in a diverse portfolio of short-term, low-risk fixed income investments. In 2007, turmoil in the subprime RMBS market decimated LDBF's value as a result of its undisclosed exposure to leveraged subprime investments. Many LDBF investors lost a significant portion of their investments, with the exception of clients of State Street's internal advisory groups -- who received a targeted warning before calamity struck. The Respondents committed securities fraud because they misled LDBF's investors about their exposure to subprime investments and the funds' resulting risk in an attempt to avoid a run on the fund beyond the inside investors' redemptions.

II. PROCEDURAL HISTORY

On September 30, 2010, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment

Company Act of 1940 ("Investment Company Act") against James D. Hopkins and John P. ("Sean") Flannery (the "OIP"). Securities Act Rel. No. 9147. The Division alleged that during the subprime mortgage crisis in 2007, State Street, Hopkins and Flannery engaged in a course of business and made material misrepresentations and omissions that misled investors about the extent of subprime RMBS held in certain unregistered funds managed by State Street Global Advisors ("SSgA"), including LDBF and the Related Funds. SSgA, which is not itself a legal entity, is a division of State Street, which is itself a wholly-owned subsidiary of publicly traded State Street Corporation. ID at 3.[1] The Division also alleged that this course of business and these misrepresentations misled many investors to continue to purchase or continue to hold their investments in these funds, resulting in hundreds of millions of dollars of investor losses during the subprime market meltdown in mid-2007. For their roles in this course of business and these misrepresentations, the Division alleged that Hopkins and Flannery violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. On October 25, 2010, Hopkins and Flannery each filed an Answer, responding to the allegations in the OIP and asserting certain affirmative defenses.

Evidence against Hopkins and Flannery was presented in an eleven-day hearing in Boston on February 28 through March 16, 2011. The law judge issued an Initial Decision on October 28, 2011, dismissing the charges against Hopkins and Flannery. On November 21, 2011, the Division filed a petition for review with the Commission, which was granted on March 30, 2012. On December 9, 2011, and December 12, 2011, Flannery and Hopkins each sought

[1] "ID" means the Initial Decision dated October 28, 2011. "DFF" means the Division's Proposed Findings of Fact. References to "Tr." indicate the transcript of the Hearing and the page number and line of the transcript. References to "DX," "HX" and "FX" indicate the Division's Exhibits, Respondent Hopkins' Exhibits and Respondent Flannery's Exhibits, respectively, that are part of the record. *See* Exhibit List Pursuant to Commission Rule of Practice 351, dated September 13, 2011.

summary affirmance by the Commission of the Initial Decision. The Division opposed those motions on December 16, 2011, and the Commission denied the motions for summary affirmance on March 30, 2012.

III. STANDARD OF REVIEW

The Commission reviews both the findings of fact and the conclusions of law of initial decisions *de novo*. *See Gary M. Kornman*, Exchange Act. Rel. No. 59403, 2009 WL 367635, *9 n.44 (Feb. 13, 2009), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010); *In re Herbert Moskowitz*, Exchange Act Rel. No. 45609, 2002 WL 434524, *1 (Mar. 21, 2002) (reversing initial decision after noting that "[w]e base our findings on an independent review of the record, except with respect to those findings not challenged on appeal"). Rule 411(a) of the Commission's Rules of Practice provides that "the Commission may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. §201.411(a). In reviewing an initial decision, each Commissioner may make his or her own factual determinations *de novo*. *Graham v. SEC*, 222 F.3d 994, 1006 n.22 (D.C. Cir. 2000). This broad authority independently to review the law judge's findings and conclusions extends even to credibility determinations where, as in the present case, the record contains substantial evidence to do so. "[T]here are circumstances where, in the exercise of our review function, we must disregard explicit determinations of credibility." *In re Kenneth R. Ward*, Exchange Act Rel. No. 47535, 2003 WL 1447865, *10 (Mar. 19, 2003), *aff'd*, 75 Fed. Appx. 320 (5th Cir. 2003) (rejecting witness testimony found credible by law judge where other evidence in the record supported a contrary finding that witness's testimony "was vague and self-serving"); *In the Matter of the Application of Warren R. Schreiber*, Exchange Act Rel. No 40629, 1998 WL

761850, *1 (Nov. 3, 1998) (in *de novo* review, the Commission does not accept the law judge's credibility determinations "blindly").[2]

IV. STATEMENT OF FACTS

A. The Course of Business That Misled Investors in LDBF And The Related Funds

LDBF was made up of two funds – one for ERISA investors and one for non-ERISA investors. DFF 43-44. Both funds were offered only to institutional investors (*id.*), but they resembled mutual funds because they were managed to a stated investment goal and offered daily liquidity based on their daily net asset value. DFF 48-49. Many of LDBF's investors were Related Funds managed by SSgA that invested in LDBF either as a source of "enhanced cash" or as a source of excess return. In the "enhanced cash" category was the Enhanced Dow Jones AIG Commodities Fund ("Commodities Fund"), a commodities futures fund that invested in derivatives to meet its benchmark and in LDBF to beat its benchmark. DFF 56, 58, 437. Because it was a futures fund, over 90% of the Commodities Fund's assets were its cash collateral, which was invested in LDBF. *Id.* The Related Funds also included other SSgA fixed income funds that used LDBF as a portable alpha source to generate excess return. ID at 5. Because of its prevalent use by the Related Funds, LDBF was one of SSgA's hallmark actively managed fixed income products and had assets under management of almost $2.9 billion as of June 30, 2007. *Id.* at 6. Investors in LDBF and the Related Funds included pension funds, endowments, and foundations, and some of these investors were also clients of SSgA's internal

[2] The Initial Decision relied on the testimony of character witnesses, many of whom were State Street employees enmeshed in the same culture that permitted Respondents' deceptive course of business, to find that Respondents were honest and were concerned about clients. ID at 3. This finding, which should be examined closely on *de novo* review, improperly influenced the Initial Decision's finding that Respondents could not have acted with scienter. The evidence supports a contrary finding: Respondents were concerned about some clients at the expense of other clients, and Respondents believed it was acceptable to mislead investors about the risks of their investments to buy time for the market to recover. Their motives may have been paternalistic, but the result was fraud.

groups, such as SSgA's Office of the Fiduciary Advisor (OFA) that advised State Street Corporation's pension plan to invest in a Related Fund. *Id.* at 5.

Hopkins and Flannery bear unique responsibility for deceiving investors in LDBF and the Related Funds from 2006 through the summer of 2007 about the nature and the extent of subprime RMBS held in those funds and the risks taken on by those funds in reaction to the crisis in the subprime RMBS market. Their deceptive course of business began with Hopkins' misrepresentations concerning LDBF's exposure to subprime RMBS as investors were evaluating their exposure in 2006 and early 2007, and culminated with Flannery's decision to mislead investors about the actions SSgA was taking to reduce the risks of LDBF and the Related Funds at the height of the subprime crisis in mid-2007.

B. Hopkins' Numerous Misrepresentations to LDBF's Investors Concerning Its Subprime Exposure and Leverage in the First Half of 2007

As LDBF's product engineer in 2006 and 2007, Hopkins was responsible for drafting and updating a number of communications routinely sent to current and prospective investors about the Fund and Related Funds. He failed in these duties, and made misleading statements to a series of investors.

1. Hopkins Was Responsible for Misleading Statements in the Quarterly Fact Sheets.

Part of Hopkins' job was to review the fund's quarterly fact sheets, to ensure the accuracy of the "description" section of those fact sheets, and to update them as necessary. DFF 139-41. Hopkins knew that the fact sheets were marketing tools provided to prospective and current investors. DFF 140-42. Hopkins acknowledged his responsibility for correcting inaccuracies in these fact sheets, ID at 19, but he failed in this regard, leaving these fact sheets misleading in several ways. First, the fact sheet falsely represented that LDBF was sector diversified during a period that Hopkins knew the fund was virtually all subprime RMBS. ID 11, 19; DFF 150-51.

Second, the fact sheets described LDBF's significant exposure to asset backed securities ("ABS"), a term that encompasses a broad range of securities, including securities backed by credit cards, airplane leases, auto loans, student loans and residential mortgages, but omitted that all of this exposure was subprime RMBS. DFF 66, 149, 151. Finally, the fact sheets misleadingly concealed the risk of LDBF by omitting LDBF's significant use of leveraged subprime RMBS investments, both in the description of investments and in LDBF's sector exposure. For example, the fact sheets only provided LDBF's sector weights by market value, even though the fund's actual exposure to these sectors was as much as 3.5 times the market value. ID 12.

2. Hopkins Was Aware that the Quarterly Fact Sheets Were Causing Investor Confusion.

By the spring of 2007, Hopkins knew that the fact sheets had caused actual confusion for a consultant who was considering whether its client should invest in LDBF. DFF 153-54. The consultant questioned how the fact sheets could state that the Fund had "better sector diversification" than a money market fund and yet be invested 100% in ABS, and questioned the breadth of the definitions used in the fact sheet. DFF 153. Instead of clarifying the fact sheet, or explaining to the consultant that LDBF was actually 100% invested in subprime RMBS, Hopkins responded by emphasizing LDBF's lower-rated ABX exposure (a subprime RMBS investment), which was about 3% of the Fund's assets. DFF 154. Despite knowing that the quarterly fact sheets caused actual confusion, Hopkins *never* changed them to correct their misleading statements even though he was responsible for their accuracy. DFF 141, 143, 194.

3. Hopkins' Failure to Correct the "Typical Slide" in Standard Investor Presentations Propagated Misleading Information About LDBF's Portfolio Composition.

In 2006 and 2007, a standard presentation about LDBF was used by relationship managers when presenting information about LDBF or the Related Funds to their clients or prospects. DFF 160-61, 177. During this time, Hopkins was responsible for reviewing the standard presentation slides on a quarterly basis and was obligated to correct any inaccuracies. DFF 160.

The standard presentation contained a slide describing the Fund's "typical" sector breakdown in a way that concealed LDBF's exposure to subprime investments, and also indicated a greater level of sector diversification than actually existed at the time (the "Typical Slide"). DFF 166. Hopkins personally presented the Typical Slide to clients on at least five occasions during 2006 and 2007. DFF 28, 162-64, 170-73, 241. The slide stated:

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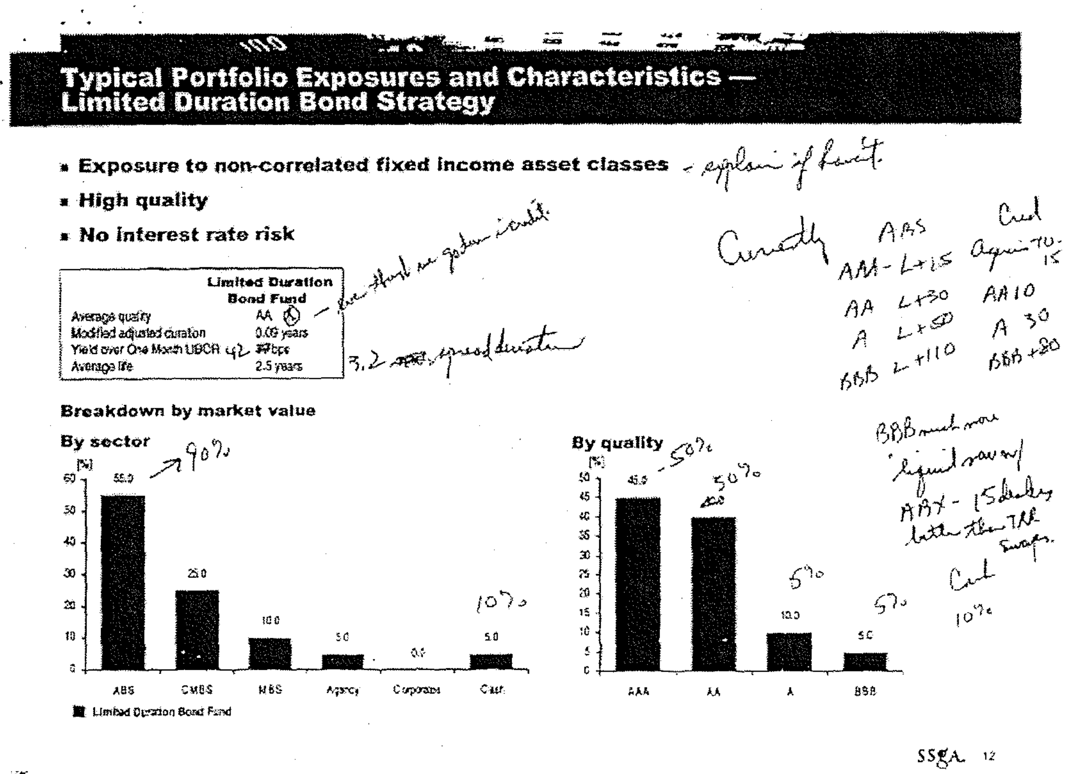

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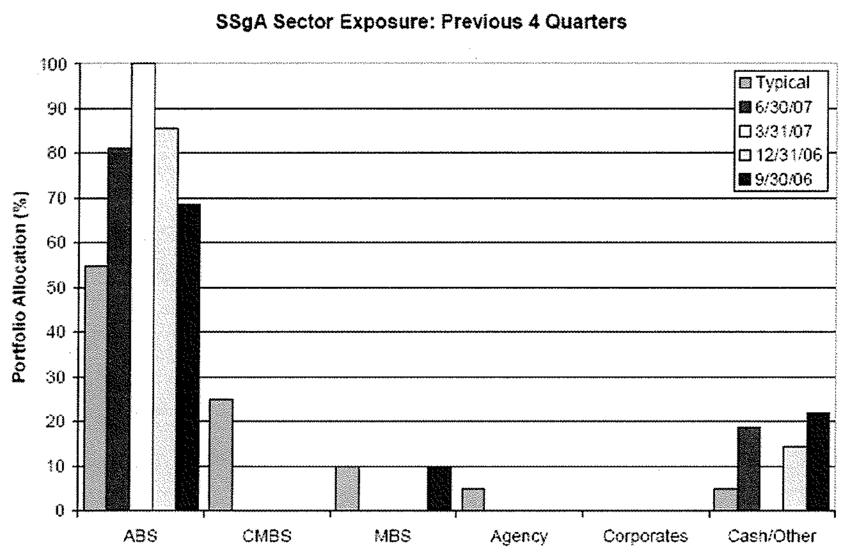
DFF 166-68. Although the presentation stated that LDBF's "typical" ABS exposure was 55%, Hopkins knew the fund's actual investments during this time were almost all ABS, and specifically almost all subprime RMBS. ID 21; DFF 117-19, 178, 269-70, 318-20. As demonstrated by his handwritten notes on his copies of the slides, Hopkins knew that the "typical" sector breakdown shown in the clients' copies of the presentations was not "typical." DFF 170-72. This chart tracks the inaccuracy of the Typical Slide during the third quarter of 2006 through the second quarter of 2007:



DFF 269 (comparing percentages represented in the Typical Slide to actual sector allocation at quarter end). As with the fact sheets, the Typical Slide omitted LDBF's significant use of leverage and falsely conveyed the fund's actual exposure to subprime RMBS through both securities and derivatives. DFF 71-73, 182, 195-96. Hopkins had several opportunities to correct the Typical Slide's misleading statements and failed to do so. DFF 180-85.

4. Hopkins Made Misrepresentations to Clients Concerning LDBF's ABX Investments.

In January and February 2007, LDBF underperformed its benchmark by 12 and 51 basis points, respectively. ID 10. After these performance problems, Hopkins wrote a letter for distribution to clients to explain how the faltering ABX index (an index based on the price of credit default swaps on the index's constituent subprime RMBS securities) had caused negative performance in LDBF and the Related Funds. ID 23-24; DFF 198-99, 204. Some clients received that letter in March 2007 (the "March 2007 letter"). DFF 207. In that letter, Hopkins characterized the exposure of SSgA's active strategies to the subprime home equity market as "modest," even though he knew that LDBF was virtually all subprime RMBS. DFF 119, 206. As a result, SSgA's client-facing personnel and fund investors were misled into thinking that LDBF's BBB-rated ABX investment was its sole exposure to subprime RMBS. DFF 320, 338.

To compound his omission, Hopkins then lied about LDBF's BBB-rated ABX investment. Following the February price drop of the BBB-rated ABX index, LDBF sold about one-third of its BBB ABX holdings, reducing them to about 1.5 percent of its portfolio. DFF 213, 216. After the BBB ABX index gradually recovered in March and April, however, LDBF re-doubled its position -- increasing it back to about 3 percent of the portfolio. DFF 89, 216. On April 25, 2007, Hopkins learned about this ABX re-doubling in a one-on-one recorded telephone call with LDBF's portfolio manager. However, he then used PowerPoint presentations with LDBF investors later that day, and again on May 10, 2007, that continued to state that LDBF had reduced its BBB ABX investment while omitting that it had actually re-doubled the investment. ID 23; DFF 210-17, 248-50.

5. Hopkins Made Misrepresentations to A Consultant For Several Clients.

During the spring of 2007, Hopkins made a series of misrepresentations to David Hammerstein, a consultant at Yanni Partners ("Yanni"), who advised National Jewish Medical Center and several other clients invested in the Commodities Fund, which invested in LDBF. DFF 223, 58, 243. Based on what SSgA told Yanni during Yanni's due diligence process on the Commodities Fund, Hammerstein believed that LDBF was a very conservative fund that was invested across many different fixed income sectors. DFF 224-28. Hammerstein was not told that LDBF was concentrated in subprime RMBS or used leverage. DFF 229.

Hopkins spoke to Hammerstein and others on April 9, 2007 to discuss how LDBF caused the Commodities Fund's underperformance. DFF 233. Hopkins told Hammerstein that LDBF underperformed because of its investment in the BBB-rated tranche of the ABX index. DFF 235. Hopkins then misrepresented LDBF's total subprime RMBS exposure as 2% -- rather than 80% plus. DFF 75, 119, 237.[3] Because of Hopkins' misrepresentation, Hammerstein continued to believe, and advised his clients, that the Commodities Fund was still a sound investment with well-diversified and modest risk, in which his clients should continue to invest. DFF 239-40.

On May 10, 2007, Hopkins met in-person with Hammerstein and National Jewish Medical Center representatives. DFF 241. Hopkins did most of the talking at this meeting. DFF 246. Hopkins' presentation discussed both the Typical Slide and the slide representing that LDBF had reduced its BBB-rated ABX investment (that he previously used with a client on April 25). *Supra* IV.B.3. Hammerstein testified that he was misled by these slides and Hopkins' discussion of them. First, Hopkins used the Typical Slide to misrepresent that LDBF had a well-diversified portfolio and to conceal LDBF's subprime RMBS concentration. These issues – the nature of LDBF's investments and SSgA's risk control – were very significant for Hammerstein. DFF 252-54. Second, Hammerstein believed Hopkins' misrepresentation that LDBF's BBB-rated ABX exposure had been reduced. DFF 250. Hopkins did not reveal that the ABX investment had been increased back to its original size. *Id.*

Hopkins and Hammerstein had another call in late July after the performance of the

[3] The Initial Decision cited Hopkins' lawyers' argument, not his testimony, to support its finding that "Hopkins denies that he told Hammerstein in April 2007 that the LDBF's exposure to subprime was only 2%." ID at 28, 48. Hopkins actually testified that he did not recall whether he disclosed LDBF's total subprime RMBS exposure during his April 2007 call with Hammerstein. Tr. 255:21-256:1. In contrast, Hammerstein testified that Hopkins specifically told him during this call that LDBF's total exposure to subprime issues was 2%. Tr. 2450:20-2451:11. The Initial Decision's finding cannot stand on *de novo* review.

Commodities Fund had fallen further. DFF 259. During that call, Hopkins told Hammerstein -- for the first time -- that LDBF employed leverage and was concentrated in subprime RMBS. DFF 260-61. Hammerstein was surprised and dismayed, because LDBF's use of leverage made the fund far riskier than Hopkins had represented it to be, and its concentration directly contradicted Hopkins' prior statement that LDBF was only 2% subprime. DFF 260-62. Following the call, Hammerstein recommended that Yanni's clients exit the Commodities Fund because, through LDBF, it was much riskier than they had been led to believe and SSgA had not adequately disclosed the funds' risks. DFF 265, 267.

C. The Course of Business Continued Through Client Letters that Misled Investors by Understating the Risk of LDBF After July 25.

In June 2007, the price of LDBF's subprime investments plunged, negatively impacting the performance of LDBF and the Related Funds. ID 13-14; DFF 321-25. The two component LDBF funds performed 41 basis points and 82 basis points under their LIBOR benchmark during the month of June. DFF 61. For a fund seeking an annual return of 50 to 75 basis points over its benchmark, this negative performance was substantial. DFF 40. Other Related Funds – such as the Short Term Bond Fund, the Intermediate Bond Fund and the Bond Market Fund – performed 49, 52 and 55 basis points, respectively, under their benchmarks during June. DFF 61.

The performance situation got even worse in July for LDBF and the Related Funds. Through July, spreads widened and prices decreased on subprime bonds in all credit rating categories as liquidity nearly vanished for these securities. DFF 289. Spreads on AAA and AA-rated subprime RMBS bonds approached historical widths and daily volatility was extremely high. DFF 289, 310. By at least July 23, 2007, both component LDBF funds had exceeded their annual risk budgets, and the performance of LDBF and the Related Funds was suffering. DFF 61, 86.

By July 20, Hopkins had had numerous conversations with clients who indicated they would be pulling out of LDBF and the Related Funds. DFF 276. Hopkins told Flannery about these conversations on July 23, and also told him that LDBF and the Related Funds would be losing assets. *Id.* Flannery was startled and distressed by this information. *Id.* Flannery conceded that on July 24, he knew that SSgA's Investment Committee would be meeting to decide what to do to raise money to meet anticipated redemptions from LDBF. DFF 275. There were meetings on July 23 and 24 between the investment management team and the relationship management team to discuss the volume of anticipated redemptions. DFF 277, 280. These discussions resulted in the recommendation that LDBF raise approximately 40% liquidity. DFF 280.

1. On July 26, SSgA Sold LDBF's Highest Rated and Most Liquid Assets to Meet Investor Redemptions.

At 8:30 am on July 25, Flannery chaired a meeting of SSgA's Investment Committee to determine LDBF's fate given the recent crisis in the subprime market and the need to raise cash to fund investor redemptions. DFF 278-79. At the meeting, Flannery announced that: (1) SSgA Relationship Management estimated that LDBF would experience 25-50% redemptions, (2) he was uncomfortable only reacting to client redemption requests, and therefore (3) his educated guess was that SSgA would have to sell about 40% of LDBF's assets to satisfy redeeming clients' demands for liquidity. DFF 280. As to which assets SSgA should sell to raise cash for redemptions, Flannery told the Committee that if SSgA decided to sell only LDBF's most liquid assets "we will be stuck with just illiquid and so the situation could get much worse. . . If we don't sell a slice across the portfolio then we end up with a less liquid portfolio – valued less." DFF 287. However, because LDBF would be forced to realize large losses if it sold its more illiquid, lower-rated assets to raise cash for redemptions, LDBF's portfolio manager told the

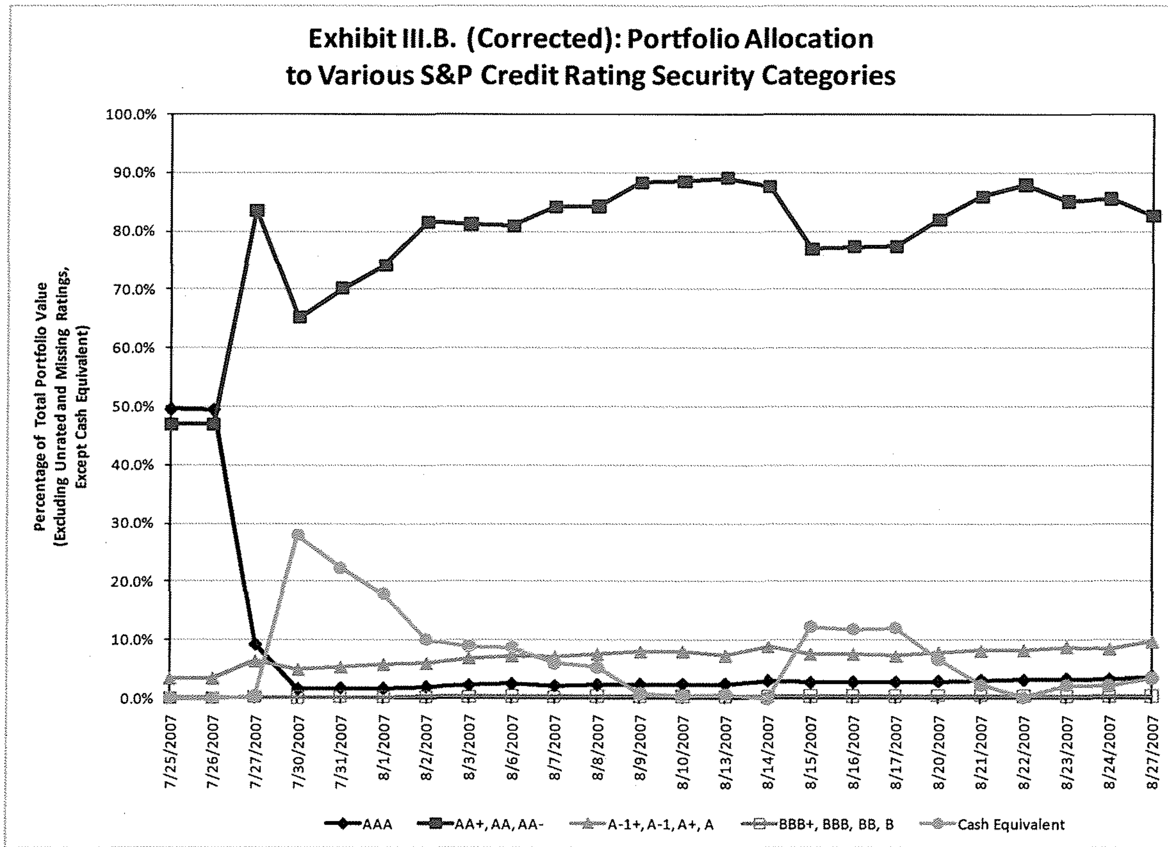
Committee that SSgA "should raise cash through selling the AAA" (i.e., the more liquid assets). DFF 285. Flannery cautioned that this sale "will change [LDBF's] risk profile." *Id.* Fully informed about the dilemma between avoiding immediate losses and changing the risk profile of LDBF, the Committee voted unanimously to direct LDBF's portfolio manager to sell the fund's highest rated and more liquid assets (AAA subprime bonds) to meet anticipated investor redemptions of 25-50% by month end. DFF 288.

As soon as LDF's portfolio manager left the Investment Committee meeting, he began working to implement the Investment Committee's instruction to sell LDBF's AAA bonds. DFF 292-94. The AAA bond sale was completed on the afternoon of July 26, 2007, and LDBF raised a net of $431,932,795 from the sale after repaying outstanding reverse repurchase commitments. DFF 291. Flannery was informed about the AAA bond sale shortly after it was complete on the afternoon of July 26. DFF 302-10.

After the AAA bond sale, LDBF's portfolio was very different. Its saleable assets had gone from roughly equal proportions of AAA and AA subprime bonds to almost exclusively AA subprime bonds, and the AA bonds left in LDBF after July 26 were far more illiquid than the AAA bonds that had been sold. DFF 301. The AA bonds left in LDBF thus carried greater liquidity and price risk if the subprime market drop of July 2007 proved to be more than a short-term crisis. DFF 289-90. The AA bonds were also inherently riskier because they were structurally designed to be less protected from default than AAA bonds. ID at 36.

2. *As Flannery Expected, the Cash From the July 26 AAA Bond Sale Was Used Almost Immediately to Meet Insiders' Redemption Demands.*

Had the cash generated by the AAA bond sale stayed in the portfolio, LDBF's risk profile may have been reduced by the sale for the common sense reason that holding cash is less risky than holding securities of any type. Unfortunately for LDBF's investors, LDBF's risk profile increased as a result of the July 26 AAA bond sale because the cash raised from the sale was used up almost immediately to meet cash redemptions. The following chart demonstrates the dramatic deterioration in LDBF's portfolio after July 26:



Id. This chart shows that, from July 26 to August 27:

- LDBF changed from a fund evenly balanced between AA and AAA-rated subprime bonds to a fund that held substantially all illiquid AA-rated subprime bonds[4] (DX 167 at SS 463124, 463144);

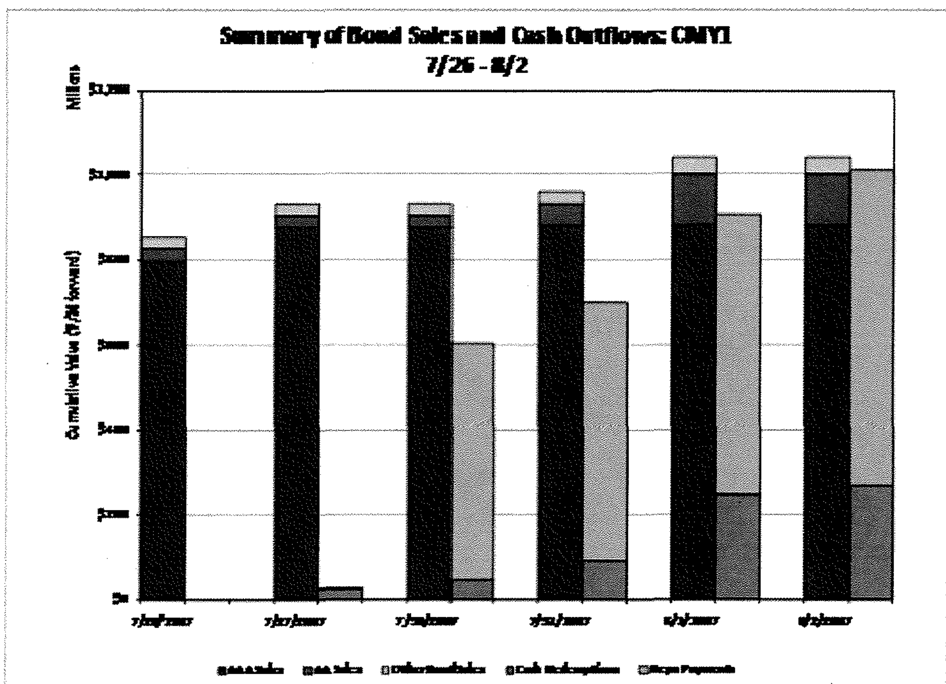
- the cash raised from the July 26 AAA bond sale was rapidly drawn down to re-pay the repurchase commitments on the AAA bonds and to meet redemptions by clients of SSgA's internal advisory groups and other SSgA funds invested in LDBF (DX 217, 218, 229 (pp. 58-61), 230, 231 (pp. 26-30)); and

[4] LDBF's other holdings were derivatives, with no or negative market value, that could not be sold to satisfy investors' redemptions. DFF 74, 366, 369.

- SSgA used the cash from the July 26 AAA bond sale instead of selling a pro rata share of LDBF's more illiquid bonds to re-pay reverse repurchase agreements and satisfy cash redemptions. *Id.*

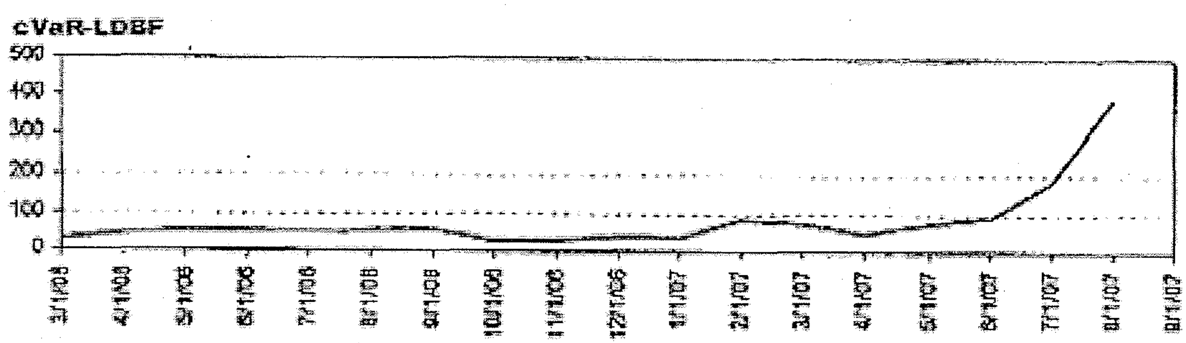
Though LDBF's ERISA and non-ERISA component funds sold their highest-rated bonds and then bled cash at slightly different rates, the evidence clearly demonstrates that the vast majority of the bonds sold by LDBF from July 26 to August 2 were the safest, highest-rated AAA bonds. DX 217, 218, 229 (pp. 58-61), 230, 231 (pp. 26-30).

The evidence is also clear that early redeemers received the cash proceeds of the July 26 sale, leaving later redeemers to satisfy their claims from illiquid, lower valued assets. For example, from July 26 to August 2, LDBF ERISA sold $1,041,121,722 in bonds, including $797,522,192 in AAA bonds on July 26. DX 217. Over this same period, LDBF ERISA repaid $739,361,000 in repurchase commitments and satisfied $270,289,398 of cash redemptions. DX 218, 229 (pp. 58-60), 231 (pp. 26-30). LDBF ERISA had only *one penny* in cash on August 2. DX 230. LDBF ERISA's bond sales and cash outflows from July 26 to August 2 are summarized below:



3. Selling LDBF's AAA Bonds and Then Using the Cash to Meet Redemptions Caused a Significant Shift in LDBF's Risk Profile.

At the July 25 Investment Committee meeting discussed above, Flannery said, in substance, that if SSgA did not sell LDBF's liquid and illiquid assets evenly then the fund would be stuck with only illiquid assets and the situation could get worse. DFF 287. This statement captures the essence of the tradeoff SSgA faced at the end of July 2007. If SSgA sold a pro rata share of LDBF's assets to satisfy early redeemers, LDBF would have to realize significant losses on lower rated subprime bonds -- but all investors (both investors who chose to redeem and investors who chose to hold) would share those losses pro rata. Conversely, if SSgA sold LDBF's most liquid assets (AAA subprime bonds) to satisfy immediate redemption needs, the fund would not need to incur significant realized losses in the short term, but investors who chose not to redeem at the end of July would bear all the risk of future volatility in the subprime market. Flannery and the SSgA Investment Committee chose the second alternative and, as they expected during the Committee meeting, LDBF's risk increased in July and August 2007 as a result of their decision. As Flannery and other SSgA executives told the State Street Corporation Board on October 18, 2007, LDBF's risk (as measured by cVaR, which was SSgA's method of measuring a fund's risk) increased from around 100 on June 1, 2007 to around 400 on August 1, 2007:



DFF 391.[5]

4. *The Decision to Sell LDBF's AAA Bonds on July 26 Caused Investors Who Remained in LDBF After July to Realize a Disproportionate Share of Losses.*

SSgA's decision to hold most of LDBF's lower rated and more illiquid bonds until after July 26 harmed investors far more than if assets had been sold pro rata across investment grades. Spreads on the AA and lower-rated bonds continued to rise, and their prices continued to decline, after July 26, and SSgA was forced to sell these bonds to fund redemptions that occurred after the early redeemers received the proceeds of the July 26 sale. *Infra* IV.C.2. In a presentation to State Street Corporation's Board, Flannery and others at SSgA described the cost of "forced liquidation" on LDBF. In their presentation, they told the Board that the July 26 AAA bond sale cost the fund 3%, whereas the sale of LDBF's AA-rated bonds one month later cost the fund an additional 10%. DFF 398. That means that investors who were not among the early redeemers bore a 10% loss that the early redeemers avoided. For investors in a fund with LDBF's purportedly conservative investment goals, such a loss was staggering.

[5] The Initial Decision erroneously relied on Flannery's expert witness, Ezra Zask, who provided a hypothetical opinion that LDBF's risk had decreased at the time of the July and August 2007 investor letters. ID at 53. Zask's hypothetical opinion was based on assumed facts that were never intended to occur and never did occur—specifically that LDBF would continue to hold all the cash it raised from its AAA bond sale on July 26. The reliance on hypothetical facts as if they were true formed the basis of the Initial Decision's mistaken findings that the investor letters were not misleading. ID at 13. Zask measured LDBF's risk according to the fund's conditional value at risk (CVaR), which was essentially a worst case scenario premised on how all of LDBF's assets had performed historically. *Id.*; Tr. 1718:12 – 1720:7. Zask used LDBF's CVaR risk budget model to calculate a hypothetical CVaR for LDBF after the July 26 AAA bond sale but made two key errors. First, in a gross distortion of reality, Zask pretended that the cash raised from the AAA bond sale would stay in the fund, thus freezing his analysis at the moment the AAA bonds were sold and ignoring the fact that the cash raised from that sale was – as intended – quickly spent. DFF 402-05. Second, Zask used a stale CVaR number for LDBF's AA-rated subprime bonds that was between *7-15 times* too low. DX 252-253; FX 218 at SS 4832874. Zask's hypothetical LDBF with a CVaR of 100 thus looked nothing like the real LDBF -- which had a CVaR of about 400. *Compare* FX 299 at Ex. 6 (low, hypothetical CVaR) and DFF 391 (actual CVaR of 400 by August 1, 2007).

5. *The Message of the July 26, August 2, and August 14 Letters Is Belied By LDBF's Actual Increased Risk.*

As described above, on July 25, 2007, Flannery and the SSgA Investment Committee decided to reposition LDBF -- by selling only the fund's highest rated assets -- to meet immediate redemption demands. This decision was fair to *all* of LDBF's investors only if the fund's remaining investors chose not to redeem before the subprime market recovered. Unable to control what happened in the market, Flannery commenced a deceptive course of business in an attempt to control the second factor. He attempted to quell investors' desire to redeem by providing false information about the steps he claimed SSgA had taken to protect investors. This course of business included his editing and approval of three letters that provided deceptive information to investors:

- SSgA's July 26 letter to investors: "We have been seeking to reduce risk in those portfolios where we believe it is appropriate by taking advantage of liquidity in the market when it exists, and will continue to do so, while seeking to avoid putting undue pressure on asset valuations." DFF 357.

- SSgA's August 2 letter to investors: "To date, in [LDBF], we have reduced a significant portion of our BBB-rated securities and we have sold a significant amount of our AAA-rated cash positions. Additionally, AAA-rated exposure has been reduced as some total return swaps rolled off at month end. Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics. The actions we have taken to date in the Limited Duration Bond Strategy simultaneously reduced risk in other SSgA active fixed income and active derivative-based strategies." DFF 374.

- Flannery's August 14 letter: "While we will continue to liquidate assets for our clients when they demand it, we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come." DFF 166.

These statements were deceptive because they led most investors to believe that SSgA had taken steps to reduce LDBF's risk attributable to the subprime market. Of course, some investors already knew the truth about LDBF and had decided to redeem, but these letters were targeted at investors who had not yet decided to redeem.[6] Although SSgA had decided to sell LDBF's most liquid assets to satisfy immediate investor redemptions, including the internal advisory groups' redemptions, Flannery oversaw a course of communications that conveyed the opposite message to investors. In some sense, he had left himself with no other choice. Having pillaged the fund for early-redeeming investors, LDBF would not survive even a short-term liquidity crisis if all of the fund's investors had known the truth about what was left in the fund.

Flannery had a significant role in the fraudulent course of business that continued with the July and August 2007 letters to LDBF's investors. Flannery was the main gatekeeper of the letters' accuracy for their statements relating to investment facts. DFF 313, 331-35, 342-45, 349-56, 362-68, 371-82, 406-19. The letters were primarily deceptive because of their mischaracterization of the investment facts about LDBF. Flannery even drafted and signed the third of the letters because he knew that his own reputation was on the line if investors began to defect from the funds *en masse*. DFF 438-43.

V. FLANNERY AND HOPKINS VIOLATED SECTION 17(A) OF THE SECURITIES ACT AND SECTION 10(B) OF THE EXCHANGE ACT.

Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit fraud in connection with securities transactions. 15 U.S.C. §77q(a); 15 U.S.C. §78j(b); 17 C.F.R. §240.10b-5. The Commission need not prove any investors actually relied on the misrepresentations or that any investors were harmed. *SEC v. Tambone*, 597 F.3d

[6] SSgA's internal advisory group OFA had a representative who attended the entire July 25 Investment Committee meeting. DFF 420-21, 433. After the Investment Committee meeting, OFA decided to recommend that its investors, including the State Street Corporation Retirement Plan, redeem from LDBF and the funds invested in LDBF. DFF 420, 423. Flannery was informed about OFA's decision to recommend LDBF's termination on July 27. DFF 424. Flannery was well aware that the internal SSgA investors who knew the truth about LDBF (OFA, another SSgA internal group called GAA, and SSgA's other funds invested in LDBF) had decided to redeem and would therefore receive the cash from the July 26 AAA bond sale. DFF 420-37.

436, 447 n.9 (1st Cir. 2010). Violations of Section 17(a)(1), Section 10(b) and Rule 10b-5 require a showing of scienter; violations of Sections 17(a)(2) and 17(a)(3) do not. *Aaron v. SEC*, 446 U.S. 680, 685-86 n.5, 695-97 (1980); *SEC v. Fife*, 311 F.3d 1, 9 (1st Cir. 2002).

The evidence demonstrates that Flannery and Hopkins violated Section 17(a) and Section 10(b) in several ways:

- Hopkins made actionable misrepresentations and omitted material facts in documents he and others at SSgA provided to clients, and in his personal statements to SSgA's clients, in violation of Section 17(a)(2) and Rule 10b-5(b).

- Hopkins engaged in a scheme to defraud, and a course of business which operated as a fraud, in violation of Section 17(a)(1) and (3), and Rule 10b-5(a) and (c), through his drafting of misleading market updates that were sent to clients, his direct misrepresentations to clients, his misleading edits to the July 26 client letter, and his failure to correct and update numerous marketing and offering documents for LDBF during 2006 and 2007 that he knew were used to market LDBF.

- Flannery made actionable misrepresentations and omitted material facts in letters sent to SSgA's clients on August 2 and August 14, in violation of Section 17(a)(2).

- Flannery engaged in a scheme to defraud, and a course of business which operated as a fraud, in violation of Section 17(a)(1) and (3) and Rule 10b-5(a) and (c), through his involvement in, editing of, and approval of, the July 26 and August 2 client letters. Flannery further engaged in a course of business which operated as a fraud in violation of Section 17(a)(3) and Rule 10b-5(c) through his involvement in the July 26, August 2 and August 14 client letters.

A. Hopkins "Made" Misrepresentations Under Section 10(b) and Rule 10b-5(b) Thereunder.

It is a violation of Rule 10b-5(b) to "make" a material misstatement or to "omit to state" a material fact whose omission makes a statement misleading. In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2301 (2011), the Supreme Court defined what it means "to make" an untrue statement under Rule 10b-5(b). The Court held that "to make" a misstatement, the "maker" must have ultimate control over the content and format of the statement. *Id.* at 2302. The Court explained that, in the ordinary case, "attribution within a statement" is strong evidence that a statement was "made" by the party to whom it is attributed. *Id.*

After *Janus,* courts have held that individuals who make oral misstatements directly to investors are primarily liable for those misstatements under Rule 10b-5(b). *See In re Textron, Inc.,* 2011 WL 4079085, *6 (D.R.I. Sept. 13, 2011) (CEO primarily liable for oral statements made during investor conference calls); *SEC v. Daifotis*, 2011 WL 3295139, *3 (N.D. Cal. Aug. 1, 2011) (individual "maker" of oral statement made during conference call). As for written misstatements, courts interpreting *Janus* have found that individuals are makers of any statements attributed to them by name, including written statements attributed to them in larger documents such as company press releases, offering documents, news articles and advertisements. *See City of St. Clair Shores General Employees' Retirement Sys. v. Lender Processing Servs., Inc.,* 2012 WL 1080953, *3 (M.D. Fla. Mar. 30, 2012) (corporate officers were "makers" of statements attributed to them in company press releases and news articles); *Lopes v. Viera,* 2012 WL 691665, *6 (E.D. Cal. Mar. 2, 2012) (organizer of company was "maker" of statements about financial information in offering document where document said he provided the financial information to the company); *Textron,* 2011 WL 4079085, *6 (CEO was "maker" of statements that were attributed to him in company press releases); *In re Merck & Co., Inc. Secs., Derivative & ERISA Litig.*, 2011 WL 3444199, *25 (D.N.J. Aug. 8, 2011) (EVP of company was "maker" of statements attributed to him in news articles and company press releases); *Daifotis*, 2011 WL 3295139, *3 (individual liable for advertising material attributed to him). More than one individual can be the maker of a misstatement. *City of Roseville Employees' Retirement Sys. v. EnergySolutions, Inc.*, 814 F.Supp.2d 395, 417 n.9 ((S.D.N.Y. 2011).

Here, Hopkins "made" misstatements as to three sets of communications: 1) the misrepresentations he spoke directly to Hammerstein during their conference call and in-person meeting; 2) the Typical Slide contained within PowerPoint presentations attributed to him; and 3) the ABX slides contained within PowerPoint presentations attributed to him. As to direct oral representations to Hammerstein, the law is clear that Hopkins "made" those misrepresentations. The PowerPoint presentations containing the Typical Slide and the ABX slide were attributed to Hopkins by name on the front cover, and he used them when making presentations at client meetings. DX 23 34, 43, 85, 221; HX 57, 135; DFF 214-16, 248-50; *see supra* IV.B.3-5.

B. Hopkins and Flannery Obtained Money and Property By Means Of Misstatements In Violation of Section 17(a)(2).

Section 17(a)(2) renders it unlawful to, in the offer or sale of a security, "obtain money or property by means of any untrue statement . . . or any omission." The conduct of Flannery and Hopkins violated this provision.

1. Flannery and Hopkins "Obtained Money" By Means Of False Statements.

As Section 17(a)(2) requires, both Hopkins and Flannery "obtain[ed] money or property by means of" misrepresentations to investors in LDBF and the Related Funds. Respondents' misrepresentations were made in the offer or sale of securities to SSgA's investors because they were made to obtain investments in LDBF and the Related Funds. *U.S. v. Naftalin*, 441 U.S. 768, 773, 777-78 (1979) (applying Section 17(a) to a defrauded broker and finding that "[t]he statutory terms ['in,' 'offer,' and 'sale'] Congress expressly intended to define broadly, are expansive enough to encompass the entire selling process…"). Respondents obtained money for SSgA as a result of their misconduct. DFF 384 (independent investors made purchases in LDBF in July-August 2007 and afterwards). This alone is sufficient to satisfy the statutory requirement where, as here, Respondents used the misstatements in the course of their employment by SSgA and with the purpose of benefitting their employer. *See SEC v. Delphi Corp.*, 2008 WL 4539519, *9, 20 (E.D. Mich. Oct. 8, 2008) ("Section 17(a)(2) does not require that the person alleged to have made the false or misleading statement in an offering document obtain money or property for themself. Rather, it is sufficient that the complaint alleges that [defendant] made false statements to investors in connection with [his employer's] efforts to raise money through its public offerings."). Further, both Respondents earned significant salaries and bonuses from SSgA during the period of time that they were using misstatements to mislead investors in LDBF and the Related Funds, and those misstatements permitted them to keep earning those salaries and bonuses. DFF 23, 35, 29 (Hopkins understood job entailed offering securities and that he received salary for those services). *See SEC v. Wolfson*, 539 F.3d 1249, 1264 (10th Cir. 2008) (consultants obtained money or property under §17(a)(2) when they were paid for their services in preparing misleading public filings); *In the Matter of Weiss*, Admin. Proc. File No. 3-11462, 2005 WL 3273381, *12 (Dec. 2, 2005) (lawyer violated §17(a)(2) when he was paid to issue an opinion about the tax exempt nature of a bond issuance and the opinion was negligent), *rev. denied*, 468 F.3d 849 (D.C. Cir. 2006).

2. *Flannery and Hopkins Obtained Money "By Means Of" False Statements.*

Flannery and Hopkins obtained money "by means of" their false statements. Unlike Rule 10b-5(b), Section 17(a)(2) makes no reference to "making" a false statement. Accordingly, the Supreme Court has held that Section 17(a) is "expansive enough to encompass the entire selling process." *Naftalin*, 441 U.S. at 773. Accordingly, the "by means of" language of Section 17(a)(2) applies to any "use" of a false statement regardless of whether one was its maker, *SEC v.*

Tambone, 550 F.3d 106, 127 (1st Cir. 2008), as well as to the preparation of documents used to solicit investors, *see Wolfson*, 539 F.3d at 1261, 1264.[7]

Both Flannery and Hopkins violated Section 17(a)(2) by using misstatements to obtain money or property. In addition to the misstatements that Hopkins "made," and therefore "used" *see supra* V.A., Hopkins obtained money by means of misrepresentations in the quarterly fact sheets and the March 2007 letter. Hopkins was responsible for reviewing fact sheets each quarter and revising them for inaccuracies. DFF 139-142. Hopkins knew that the primary use of the fact sheets was to provide information to prospects and consultants when soliciting their investments in LDBF. *Id.* Employees in the marketing group frequently provided fact sheets to their prospects, and asked Hopkins for updated versions for that purpose. DX 8. Likewise, the March 2007 letter that Hopkins authored was designed to be sent to investors and to assuage their concerns about poor performance in LDBF and the Related Funds. DFF 202-09. Hopkins knew it would be used in this way. *Supra* IV.B.3.

Flannery edited the August 2 letter and added the key additional deceptive language to it. DFF 364-405. He was one of the final approvers of the letter as the senior reviewing member of the investment team. DFF 365-373, 375, 377. The purpose of the August 2 letter was to encourage investors to stay in LDBF and the Related Funds by leading them to believe that SSgA had taken proper steps to reduce the funds' risk. *Supra* IV.C.5. The letter was sent to clients who still held their investments. DFF 374. Flannery knew it would be used that way. DFF 364-65, DX 159 (Flannery copied on final version to be circulated to clients).

Flannery signed the August 14 letter and was intimately involved in its drafting and editing. He weighed in on every decision as to how and when it would be sent to investors.

[7] The First Circuit initially vacated, but later reinstated, the portions of *Tambone* interpreting Section 17(a)(2). *SEC v. Tambone,* 597 F.3d 436, 450 (1st Cir. 2010) (*en banc*).

DFF 406-10, 413, 415. Flannery's motivation behind both letters was to keep investors in LDBF and the Related Funds. DFF 438-43. Flannery hoped to keep the investors in those funds long enough to improve performance. DFF 440.

Nevertheless, the ALJ erroneously rejected the Section 17(a)(2) claims on the theory that the *Janus* court's interpretation of the word "make" in Rule 10b-5(b) applies to claims under Section 17(a)(2) despite the fact that Section 17(a)(2) does not even use the word "make." Numerous district courts have recognized this distinction post-*Janus* and have declined to apply *Janus* to a Section 17(a)(2) claim. *See SEC v. Sentinel Mgmt., Inc.*, 2012 WL 1079961, *14-15 (N.D. Ill. Mar. 30, 2012); *SEC v. Pentagon Cap. Mgmt. PLC,* 2012 WL 479576, *42 (S.D.N.Y. Feb. 14, 2012); *SEC v. Mercury Interactive,* 2011 WL 5871020, *3 (N.D. Cal. Nov. 22, 2011); *SEC v. Geswein*, 2011 WL 4565861, *2 (N.D. Ohio Sept. 29, 2011); *Daifotis*, 2011 WL 3295139, *5-6; *see also SEC v. Radius Cap. Corp.,* 2012 WL 6955668, *7 (M.D. Fla. Mar. 1, 2012) (recognizes language difference between Section 17(a)(2) and Rule 10b-5(b) and allows claim to go forward pursuant to Section 17(a) for statement in prospectus that defendant used but did not "make").

The sole exception to this line of federal court decisions is the decision in *SEC v. Kelly*, 2011 WL 4431161, *5 (S.D.N.Y. Sept. 22, 2011). The *Kelly* court, however, failed to address the textual differences between Rule 10b-5(b) and Section 17(a)(2). Nor did *Kelly* consider that the policy consideration underlying *Janus* – the availability of a private right of action under Section 10(b) – is absent from claims under Section 17(a)(2). *See Sentinel,* 2012 WL 1079961, *15. Accordingly, *Kelly* is not a persuasive authority and no other court has accepted its rationale.

C. The Respondents' Misrepresentations Were Material.

The facts misrepresented or omitted by Hopkins and Flannery in their communications with investors and potential investors were material. *See supra* IV.B-C. A fact is material if a *reasonable* investor would view its disclosure as significantly altering the "total mix" of information in evaluating the merits of the investment. *See Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318 (2011); *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). A fact is material if it "may affect the desire of investors to buy, sell, or hold the company's securities," or if it "in reasonable and objective contemplation might affect the value of the corporation's stock or securities." *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968).

The information that Hopkins and Flannery provided in a misleading way, or failed to provide, touched upon key attributes affecting the risk, performance, composition and liquidity of the investments held by institutional investors, who analyzed all of this information in determining whether to purchase and hold their investments in LDBF and the Related Funds. The materiality of this information is demonstrated by the fact that, once SSgA made the truth available to many of these institutional investors, they immediately decided to liquidate their holdings in LDBF and the Related Funds. *See, e.g., SEC v. Mayhew*, 121 F.3d 44, 52 (2d Cir. 1997) ("a major factor in determining whether information was material is the importance attached to it by those who knew about it"); DFF 61 (showing that, adjusted for market value decline, more than half of clients in active pooled funds with subprime exposure exited from those funds in summer of 2007); DFF 278-88, 307-08, 420-36 (internal clients who got information first, like SSgA's internal advisory groups and the portfolio managers of the Related Funds, got their investors out first).

1. Misrepresentations Concerning LDBF's Subprime Exposure and Its Use of Leverage Were Material.

The quarterly LDBF fact sheets and the Typical Slide that Hopkins used in investor presentations on LDBF were inaccurate during late 2006 and the first half of 2007 because they conveyed that LDBF was sector diversified and low risk while omitting that LDBF was virtually all subprime RMBS, and used extensive leverage that was also linked to the performance of subprime RMBS. Similarly, Hopkins' March 2007 letter and his continuing presentations about LDBF's ABX exposure in the spring of 2007 led investors to believe that LDBF's subprime exposure was "modest," and had been reduced in response to the February performance problems in the lower-rated ABX index. Further, Hopkins directly misrepresented both of these key facts – LDBF's subprime exposure and its use of leverage – to Hammerstein. These misleading statements about LDBF's sector diversification and the portion of LDBF's investments that were subprime RMBS, as well as the repeated failure to disclose LDBF's leveraged subprime RMBS exposures, were material in late 2006 and 2007, particularly because the misrepresentations concerned exposure to subprime RMBS during the subprime market crisis. *See Freudenberg v. E*Trade Fin. Corp.*, 712 F.Supp.2d 171, 182-83 (S.D.N.Y. 2010) (misrepresentations about nature of defendant's exposure to subprime and mortgage risk were material); *Fundamental Portfolio Advisors, Inc.* ("*FPA*"), 80 S.E.C. Docket 1851, 2003 WL 21658248, *11-12 (July 15, 2003) (misrepresentations about the nature of a portfolio's investments are material).

For example, the Typical Slide represented that LDBF held a 55% investment in the ABS sector, when LDBF's actual portfolio composition was closer to 90% ABS in 2006-07. ID at 46-47. During the sixteen months Hopkins used the slide with clients and prospective clients the Typical Slide did not reflect LDBF's actual portfolio. ID at 21-22. Thus it was never remotely typical during those sixteen months. When presented to Hammerstein and his client during a May 10, 2007 in-person meeting, the Typical Slide was materially misleading. *Supra* IV.B.5. Hammerstein later learned about LDBF's actual sector allocations, and he testified that he was misled by the Typical Slide, which suggested a fund that was sector diversified and less risky that the fund actually was, both key attributes that he valued as part of his decision-making on behalf of his clients. DFF 252-54. Additionally Hammerstein testified that on April 9, 2007, during a telephone conference, Hopkins told him that LDBF was only 2% exposed to subprime even though the fund held more than 80% subprime at the time. *Id.* Based on what Hopkins told him, Hammerstein recommended to his clients that they remain invested in the Commodities Fund – a fund almost 100% invested in LDBF. ID at 28; DFF 239-40.

2. *The Misrepresentations In the July and August Client Letters Were Material.*

The misrepresentations in the July 26, August 2, and August 14 letters primarily concerned the risk of LDBF, and by virtue of their LDBF investments, the Related Funds. Each of those letters emphasized that LDBF's risk had been reduced when it had actually increased. Misrepresentations about risk are material. *See In re Bear Stearns Cos., Inc. Sec. Litig.*, 2011 WL 223540, *50, 59-60 (S.D.N.Y. Jan. 19, 2011) (statements about risk and VaR in connection with subprime investments were material). The letters also variously omitted basic facts about LDBF's subprime concentration, its use of leverage, its inconsistent credit quality, SSgA's views about whether smart investors should stay invested in LDBF, and the sale of its highest-rated and most liquid investments to fund the redemptions of those clients who got information before others.

The amount of time that SSgA invested in preparing and reviewing these letters demonstrates their materiality. Each of the letters was circulated to numerous client service, legal, and investment team members. Multiple meetings were held to discuss each of the letters.

This investment of time would have been unwarranted had SSgA not known that these letters would receive significant scrutiny from clients and from the marketplace when they were sent. Because these letters addressed LDBF and the Related Funds' exposure to subprime RMBS during the market crisis, reasonable investors in the funds would have taken the letters into account when making investment decisions. *Freudenberg,* 712 F.Supp.2d at 182-84 ("reasonable investors would have taken into account" defendants' repeated public statements about its exposure to subprime RMBS "when making investment decision[s]" where subprime RMBS was an important segment of the business). During this time period, SSgA was slow to provide its outside clients with other detailed information about their investments in LDBF and the Related Funds, so these investors necessarily considered the letters in evaluating whether to hold or sell their investments. DFF 197. Flannery even conceded that investors would find a letter signed by SSgA's CIO significant, particularly in the midst of a market crisis. DFF 408. That's in part why he decided to write the August 14th letter. *Id.*

3. *Investor Sophistication Is Not Part of the Materiality Analysis.*

To conclude that the numerous misrepresentations alleged were not material, the Initial Decision relied heavily on "investor sophistication." ID at 39-40, 43-44, 45-46, 51-52. This was clear error both factually and legally. The Initial Decision found that "LDBF's investors were sophisticated, institutional investors, most of whom engaged investment consultants to provide investment assistance." ID at 40. Yet the evidence cited for this finding was spotty at best, relying on the opinion of experts or off-handed statements by Flannery or a client relations person. ID at 3, 33-44. The actual evidence indicated that investors were not always sophisticated as to fixed income. DFF 98, 107. Respondents' expert admitted that sophistication of the investors in LDBF varied. DFF 98. Moreover, Hopkins admitted that otherwise sophisticated investors might not know a lot about fixed income investing—the core of this action. DFF 107. Hopkins also admitted that the experience of consultants in dealing with fixed income varied. *Id.* In the face of this evidence, the Initial Decision erroneously assumed extreme sophistication across the board when it analyzed whether certain misstatements were material. ID at 45 (considering materiality of omissions in fact sheet); ID at 46 (considering the Typical Slide).

To support its conclusion that investor sophistication influenced the standard of materiality, the Initial Decision erroneously cited private actions holding that investor sophistication was relevant for reliance or scienter, not materiality. ID at 40. The Initial Decision failed to cite a single government enforcement case supporting its findings linking investor sophistication to materiality. In Commission cases, what matters is not what a "sophisticated" investor would find material, but what a "reasonable" investor would find material. *See Basic*, 485 U.S. at 231-32. The Initial Decision's findings, and its unwarranted conclusion that Respondents should get a free pass for their fraudulent conduct, were infected by this error.

D. Respondents Engaged In a Fraudulent Course of Business in Violation of Section 17(a)(1), (3) and Rule 10b-5(a), (c).

Rule 10b-5 makes it unlawful to, in connection with the purchase or sale of securities, "employ any device, scheme, or artifice to defraud" or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. §240.10b-5(a), (c). Section 17(a)(1) and (3) prohibit the same conduct in the offer or sale of securities. 15 U.S.C. §77q(a). The courts have interpreted these provisions to create "scheme liability." *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 111-12 (2d Cir. 1998); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1471-72 (2d Cir. 1996); *SEC v. Lee*, 720 F.Supp.2d 305, 334 (S.D.N.Y.

2010); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F.Supp.2d 319, 336-37 (S.D.N.Y. 2004); *In re AOL Time Warner, Inc. Sec. & ERISA Litig.*, 381 F.Supp.2d 192, 217, 229 (S.D.N.Y. 2004). Hopkins and Flannery also engaged in schemes to defraud and courses of business which operated as a fraud, in violation of Section 17(a)(1) and (3) and Rule 10b-5(a) and (c).

The "scheme or artifice to defraud" concept has a long legal history. Decades before the phrase was used in Rule 10b-5 and Section 17(a), the phrase "scheme or artifice to defraud" appeared in other federal fraud statutes. *See* 18 U.S.C. §§1341 (mail fraud), 1343 (wire fraud). Indeed, the "scheme or artifice to defraud" language in the mail fraud statute served as the basis for the same language in Section 17(a) of the Securities Act, and Rule 10b-5 was in turn modeled on Section 17(a). Staples, *Legislation: The Securities Act of 1933*, 20 Va. L. Rev. 451, 462 (1934) (Section 17(a) is "couched almost verbatim in the language of the mail fraud statute"); Robert A. Prentice, *Scheme Liability: Does It Have a Future After Stoneridge?*, 2009 Wisc. L. Rev. 351, 365 n.77 (2009) ("Rule 10b-5's scheme to defraud language was copied from section 17(a) of the 1933 Act. . . . Congress derived that language, in turn, from the mail-fraud statute, which is currently codified at 18 U.S.C. § 1341 (2006).").

The judicial construction of the phrase "scheme or artifice to defraud" as used in the mail and wire fraud statutes is appropriately applied to that same phrase in the federal securities laws. Courts have frequently recognized that "fraud statutes that use the same relevant language should be analyzed in the same way." *U.S. v. Slevin*, 106 F.3d 1086, 1088 (2d Cir. 1996); *see also Northcross v. Bd. of Ed. of Memphis City Schs.*, 412 U.S. 427, 428 (1976) (per curiam) ("The similarity of language [in two statutes] is, of course, a strong indication that the two statutes should be interpreted pari passu."). A consistent interpretation of the "scheme to defraud" language in both the mail and wire fraud statutes and the securities laws is all the more compelling given that the language of the securities laws is not only identical to that in the mail and wire fraud statutes, but also was intentionally patterned on those provisions. *See U.S. v. Johnson*, 14 F.3d 766, 770 (2d Cir. 1994) ("The fact that Congress chose to adopt . . . substantially identical language in enacting §879, which addresses a concern parallel to that engaged by §871, bespeaks an intention to import the established general intent interpretation of §871 into the new statute."); *U.S. v. Bonanno Organized Crime Family*, 879 F.2d 20, 25 (2d Cir. 1989) (judicial interpretations of RICO Act are relevant to interpretation of Clayton Act because it "contain[s], in certain respects, identical language"). Additionally, both Rule 10b-5(a) and Section 17(a)(1) prohibit "any" scheme to defraud, *see* 17 C.F.R. §240.10b-5(a); 15 U.S.C. §77q(a)(1), which, at that time those provisions were enacted, included schemes to defraud as defined in the mail and wire fraud statutes. *See Bragdon v. Abbott*, 524 U.S. 624, 645 (1998) ("When administrative and judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its administrative and judicial interpretations as well."); *U.S v. Wells*, 519 U.S. 482, 495 (1997) (presumed "Congress expects its statutes to be read in conformity with th[e] Court's precedents" with regard to "the relevant language of the statute"). For all these reasons, Section 17(a) and Rule 10b-5 are properly interpreted to include a "scheme to defraud" as that phrase has been interpreted in the mail and wire fraud context.

Cases interpreting the mail and wire fraud statutes have long held that a "scheme to defraud" exists when there is both a false statement *and* wronging another in his property rights. *See McNally v. U.S.*, 483 U.S. 350, 358 (1987) ("to defraud" in the mail fraud statute "commonly refer[s] 'to wronging one in his property rights by dishonest methods or schemes'") (quotation omitted); *Carpenter v. U.S.*, 484 U.S. 19, 25 (1987) (same). What defines a "scheme to defraud" is not the presence of deceptive conduct distinct from a misrepresentation, but rather the presence of a purpose of wronging another in his property rights. Indeed, for more than a century it has been understood that misrepresentation cases are at the core of the "scheme to defraud" outlawed by the mail fraud statute. *See Durland v. U.S.*, 161 U.S. 306, 314-15 (1896) (a scheme to defraud "includes everything designed to defraud by representations as to the past or present"). And as the Second Circuit more recently said, "the phrase 'scheme or artifice to defraud' ***requires*** 'material misrepresentations.'" *U.S. v. Rybicki*, 354 F.3d 124, 146 n.20 (2d Cir. 2003) (citation omitted) (emphasis added); *see also U.S. v. Doherty*, 969 F.2d 425, 429 (7th Cir. 1992) ("As its ordinary meaning suggests, the term 'scheme to defraud' describes a broad range of conduct, some of which involve false statements or misrepresentations of fact and others which do not.") (internal citations omitted).

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972), supports the application of this interpretation of the "scheme or artifice to defraud" language to the federal securities laws. In *Affiliated Ute*, the Supreme Court held that liability under Rule 10b-5(a) and (c) was established even though the case was one "involving primarily a failure to disclose" to investors. *Id.* at 153. In that case, defendants made misleading statements and omissions to entice investors to sell their securities. *Id.* at 152-53. No "distinct" deceptive conduct was present apart from the misstatements and omissions. Yet the Court concluded that this conduct fell squarely within the scope of scheme liability under subsections (a) and (c) of Rule 10b-5. *See id.* at 153. Similarly, in *Stoneridge*, the Supreme Court emphasized that the defendants' "course of conduct included both oral and written statements, such as the backdated contracts," and described such conduct as involving "deceptive acts." 552 U.S. at 158. Thus, the Supreme Court recognized that "deceptive acts" can include misrepresentations. Accordingly, the "scheme or artifice to defraud" language in Rule 10b-5(a), like the identical language in the mail and wire fraud statutes, is rightly interpreted to include schemes to defraud based solely on misleading statements or omissions designed to wrong another in his property rights, and this is so regardless of the absence of additional or distinct deceptive conduct.

The courts have further held that a person who "substantially participates" in a fraudulent scheme may be held liable under subsections (a) and (c) of Rule 10b-5:

> Section 10(b) and Rule 10b-5 impose primary liability on any person who *substantially participates* in a manipulative or deceptive scheme by directly or indirectly employing a manipulative or deceptive device (such as the creation or financing of a sham entity) intended to mislead investors, even if a material misstatement by another person creates the nexus between the scheme and the securities market.

Lee, 720 F.Supp.2d at 334 (emphasis in original); *see also U.S. Envtl.*, 155 F.3d at 111 (explaining that "a primary violator is one who participated in the fraudulent scheme") (internal quotation marks omitted); *First Jersey Sec.*, 101 F.3d at 1471 (scheme liability extends to those "who had knowledge of the fraud and assisted in its perpetration"). In sum, a defendant is subject to scheme liability under Rule 10b-5(a) and (c) and Section 17(a)(1) and (3) if he substantially participates in a scheme to wrong another in his property rights by means of false or misleading statements or omissions.

The evidence demonstrates that both Hopkins and Flannery substantially participated in a series of misstatements and other deceptive actions that were part of a larger scheme to defraud investors in LDBF and the Related Funds. Hopkins' misconduct lasted over a year, during which he routinely misrepresented to clients the nature of LDBF's subprime RMBS exposures and the way in which leverage increased the risk of those exposures. His conduct included failing to update fact sheets and PowerPoint presentations and allowing others to solicit business with them. *Supra* IV.B.2-3. His conduct was repeated and was committed in derogation of his responsibility as a product engineer to ensure the flow of accurate and current information about LDBF from the investment managers to the relationship managers and directly on to clients. DFF 139-142, 160. In July 2006, Hopkins was involved in drafting the July 26, 2007 letter aimed at keeping investors in the fund. In particular he suggested the core misleading language that SSgA had taken steps to "reduce risk" in the fund, which went out in the final letter to investors. DFF 345-46, 357. The goal of this scheme was to encourage investors to invest in LDBF and the Related Funds and to keep them from leaving.

When LDBF's subprime exposure – and through LDBF, the subprime exposure of many SSgA active fixed income funds – became a crisis in July 2007, Flannery affirmatively inserted himself into the process of crafting client communications, played a critical role in pushing them along, was the senior member of the investment team responsible for their accuracy, and finally approved their factual content. DFF 313, 331-35, 342-45, 349-56, 362-68, 371-81, 406-19. He took these steps because, as CIO, he was the leader of the investment team presiding over those funds' impending failure, and the crisis was of sufficient magnitude that he knew it had the potential to affect his own future, and the active funds' prospects to remain viable competitors beyond the summer of 2007. Flannery's involvement in client communications, as well as his role in implementing the July 25th Investment Committee's decision to sell LDBF's highest-rated and most liquid assets to fund the cash redemption requests of internally-advised investors, were part of his deceptive scheme and course of business. To buy time for the subprime market to recover, Flannery tried to convince investors to hold their investments by misleading them about the risks of continuing to invest in LDBF.

E. Flannery and Hopkins Violated Section 17(a)(1) and Section 10(b) By Acting With Scienter.

1. Scienter May be Established by Indirect Evidence of Extreme Recklessness.

The Division has shown that Hopkins and Flannery acted with scienter in violation of Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act. *See Aaron,* 446 U.S. at 697. Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter may be established by indirect evidence, and "may extend to a form of extreme recklessness[.]" *In re Cabletron Sys., Inc.*, 311 F.3d 11, 38 (1st Cir. 2002). Reckless conduct is that "which is highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Rolf v. Blyth, Eastman Dillon & Co., Inc.,* 570 F.2d 38, 47 (2d Cir. 1978).

Hopkins made a series of misrepresentations to investors, and failed to fulfill his obligations to update and correct other misleading documents that he knew were provided to investors. *Supra* IV.B. At the time he made each of these misrepresentations or omissions, he knew the information that was being misrepresented or concealed. *See id.* He was thus, at a minimum, extremely reckless in failing to correct these statements and omissions. Hopkins' scienter is further illuminated by the direct misrepresentations he made to Hammerstein. Hammerstein recalled specific lies that Hopkins told at a time when Hopkins indisputably knew that his statements were wrong. *Supra* IV.B.4. Hopkins continued to make misleading statements about LDBF's subprime RMBS concentration, use of leverage, and exposure to the ABX index, even after he knew that some investors had inaccurate information and were confused about the fund's risks and exposures. DFF 150-54, 193-94, 318-25, 358-63.

Flannery was at least extremely reckless in connection with the scheme to keep investors in LDBF. He edited the August 2, 2007 letter to describe specific steps SSgA had already taken to sell certain assets and left in place the letter's misleading assertion that these actions reduced risk when he knew that LDBF's highest rated bonds had been sold to finance ongoing investor redemptions. DFF 302-07, 309-10, 366-68, 371-72. As CIO, Flannery certainly knew that investors deciding whether to hold their investments or make additional purchases would attach significance to whether SSgA had reduced the funds' risk, and his efforts to misrepresent the facts concerning whether SSgA had reduced risk for those who remained in the funds demonstrates his scienter. *See SEC v. Nacchio*, 438 F.Supp.2d 1266, 1282 (D. Col. 2006) (complaint alleged scienter by stating that CFO knew investors cared about categorization of revenue and knew that revenue was miscategorized in public statements). Flannery's conduct was motivated by his desire to buy time for LDBF and the Related Funds to weather the subprime crisis. DFF 387, 438, 440-42. In the face of an increasingly illiquid market for subprime investments, the only way for him to preserve the funds' assets and protect their performance records was to discourage further redemptions. DFF 440-42. The evidence is compelling that Flannery understood his reputation and his career were on the line, and he acted in accordance with his own self-interest. DFF 36, 439, 443.

2. *Respondents May Not Rely on Counsel's Involvement in the July 26 or August 2 Letter to Negate Their Scienter.*

The involvement of counsel in reviewing the July 26 and August 2 letters does not negate Respondents' scienter as to those letters. Reliance on the advice of counsel is relevant to a lack of scienter only where a defendant can show that he: 1) made a complete disclosure to counsel; 2) sought advice of counsel as to the legality of his conduct; 3) received advice from counsel that his conduct was legal; and 4) relied on the counsel's advice in good faith. *See Markowski v. SEC*, 34 F.3d 99, 104-05 (2d Cir. 1994); *United States v. Wenger*, 427 F.3d 840, 854 (10th Cir. 2005) (defense fails when appellant did not establish that he disclosed all relevant facts to his attorneys); *SEC v. Savoy Ind., Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981); *Charles F. Kirby*, Rel. No. ID-177, 2000 WL 1787908, *19 (Dec. 7, 2000); *WHX Corp.*, ID-173, 2000 WL 1482921, *20, n.20 (Oct. 6, 2000); *William H. Gerhauser, Sr.*, Rel. No. 34-40639, 1998 WL 767092, *6 n.25 (Nov. 4, 1998).

Any claim by Respondents that their reliance on counsel's advice negates their scienter falters on the first prong of the test. Neither Hopkins nor Flannery made complete disclosures to counsel about the material facts they knew were misrepresented in, or omitted from, the July 26 and August 2 letters. Because they did not make complete disclosures to counsel, they could not seek advice about whether the letters were misleading in light of that information.

In particular, Hopkins did not tell counsel reviewing the July 26 letter that:

- LDBF's concentration in higher rated subprime investments was causing its underperformance and its greatest risks;
- his suggested risk reduction language related to LDBF's sale of its investment in the BBB-rated ABX index, which was only three percent of LDBF's assets;
- LDBF was concentrated in subprime RMBS and was further exposed to that market through leverage, and clients were confused about those facts.

DFF 352.

Flannery did not tell counsel reviewing the August 2 letter that:

- LDBF's most liquid and highest-rated assets (AAA bonds) had been sold to fund client redemptions;
- once the funds generated by the AAA bond sale had left the fund (as they had by August 2), LDBF was a riskier investment;
- LDBF's average credit quality was necessarily affected by the AAA bond sale.

DFF 332-33, 355, 378, 381-82. Faced with this evidence, Hopkins and Flannery will likely argue that counsel knew or should have known many of these facts. Such an argument is legally insufficient, and does not negate their scienter. *See C.E. Carlson, Inc.*, 36 S.E.C. Docket 591, 1986 WL 72650, *3, n.16 (Sept. 11, 1986) ("respondents were not entitled to assume that [counsel's] advice was based on anything except the facts they specifically presented to him").

F. Hopkins And Flannery Were Negligent In Violation of Section 17(a)(2) and (a)(3).

To prevail on its claims under Section 17(a)(2) and (3), the Division need only establish that the Respondents were negligent in their actions. *See, e.g., SEC v. Scott*, 565 F.Supp. 1513, 1525-26 (S.D.N.Y. 1983), *aff'd*, 734 F.2d 118 (2d Cir. 1984).

The Division submits that the evidence discussed above shows that almost all of the Respondents' actions and inactions that form the basis for the Section 17(a)(2) and (3) charges were committed with scienter, in addition to being negligent. The only new allegation, brought solely under Sections 17(a)(2) and (3), involves Flannery's drafting, editing and approval of the August 14 letter.

Flannery was negligent in signing the August 14 letter and authorizing its transmission to clients because he should have known that it contained misrepresentations and material omissions. The August 14 letter was misleading because it omitted:

- that all of LDBF's shareholders controlled by SSgA had terminated their investments in LDBF while purporting to convey SSgA's view that "many judicious investors will hold their positions";
- why judicious investors might want to hold onto their LDBF shares by August 14 – the only assets left in LDBF were illiquid and any future redeemers would receive fire sale prices.

Supra IV.C.4-5. Flannery knew the information that was omitted from the August 14 letter. Specifically, he knew that SSgA's internal advisory groups, OFA and GAA, had recommended that their clients redeem from LDBF and the Related Funds, and he knew that their clients had followed that advice. DFF 424, 432-36. Flannery also knew that the Related Funds had redeemed from LDBF. DFF 384, 419, 437. Flannery also knew that LDBF's most liquid investments, its AAA bonds, had already been sold and that the cash generated by those sales had been used to satisfy the redemption requests of the early redeemers. *Supra* IV.C.1-2. He knew that any investors wishing to redeem after August 14 would receive fire sale prices for their shares because the only saleable assets left in LDBF were illiquid and were trading at historically low prices. DFF 280-310.

Flannery will likely claim that he cannot be found negligent because he acted reasonably in seeking an attorney's input on his letter. His claim is not supported by the evidence. Nothing in the record suggests that Flannery ever told the attorney all of the facts he knew that made the August 14 letter misleading. DFF 411, 414, 418. Even if the attorney knew one of the omitted facts, there is no evidence that Flannery ever checked with the attorney to ensure he knew it or understood its import. DFF 411. There is no evidence that the attorney understood how risk had increased in LDBF as a result of the AAA bond sale. DFF 418. Without such affirmative disclosures by Flannery, the attorney's participation in reviewing and editing the letter does not undo Flannery's negligence. The lawyers reviewing the August 14 letter relied on the investment professionals like Flannery to get the investment facts, and the investment implications of those facts, correct. DFF 357. Flannery failed to do so and was thus negligent.

VI. RELIEF REQUESTED

A. Cease-and-Desist Orders Should Be Issued.

Section 8A of the Securities Act and Section 21C(a) of the Exchange Act authorize the Commission to impose a cease and desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Securities Act or the Exchange Act or the rules and regulations thereunder. In determining whether a cease and desist order is appropriate, the Commission considers: the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his conduct, the respondent's opportunity to commit future violations, the degree of harm to investors, the extent to which the respondent was unjustly enriched, and the remedial function to be served by the cease-and-desist order in the context of other sanctions being sought. *KPMG v. SEC*, 289 F.3d 109, 124-25 (D.C. Cir. 2002). "[A] single past violation ordinarily suffices to raise a sufficient risk of future violations" to support a cease and desist order. *Rodney R. Schoemann*, S.E.C. Rel. No. 9076, 2009 WL 3413043, *12-13 (Oct. 23, 2009), *aff'd*, 2010 WL 4366036 (D.C. Cir. Oct. 13, 2010). The Commission should also "consider the function that a cease-and-desist order will serve in alerting the public that a respondent has violated the securities laws." *FPA.*, 2003 WL 21658248, *18.

Hopkins and Flannery committed egregious securities violations when they knowingly or recklessly defrauded investors in LDBF and the Related Funds. The Respondents have failed to provide any assurances against future violations, and have even refused to acknowledge that a violation has occurred. Investors in LDBF and the Related Funds lost hundreds of millions of dollars because of Respondents' conduct. If Respondents seek and obtain future employment in the investment industry, they will again be placed in circumstances where they can violate the securities laws.

A cease-and-desist order also alerts the public that Respondents have violated the securities laws. Providing a meaningful remedy in this case will send a message that highly-compensated investment professionals working for large investment managers cannot hide behind the hierarchy of their employers to evade responsibility for their own misconduct.

B. Each Respondent Should Be Ordered to Pay a Civil Penalty.

Under Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203(i) of the Advisers Act and Section 9(d) of the Investment Company Act, the Commission may impose a civil monetary penalty if a respondent has willfully violated any provision of the Exchange Act, the Securities Act, or the rules and regulations thereunder and if it is in the public interest. The following six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) need for deterrence; and (6) such other matters as justice may require, are relevant to determining whether a penalty is in the public interest. *See* Exchange Act, §21B(c); Advisers Act, §203(i)(3); Investment Co. Act, §9(d)(3). Because Respondents' violations involved fraud and resulted in substantial losses to investors, a third tier penalty of $130,000 for each violation is appropriate. 17 C.F.R. §201.1003 (applicable to conduct occurring after February 15, 2005 and before March 3, 2009). Although Respondents did not take money directly from the investors they harmed to line their own pockets, their misstatements and omissions were made in furtherance of keeping their lucrative jobs. Substantial civil penalties are appropriate given Respondents' positions at SSgA and the impact that their conduct had on investors. *Cf. FPA*, 2003 WL 21658248, *18 (imposing civil penalty of $250,000 on associated person); *Don Warner Reinhard*, Rel. No. IA-3139, 2011 WL 121451, *2 (Jan. 14, 2011) (noting imposition of third tier penalties on investment adviser president who made misrepresentations and omissions about the safety of investments offered to his clients).

C. The Commission Should Impose Appropriate Bars on Respondents.

To protect investors, Section 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act authorize the Commission to order appropriate remedial action for willful violations of the Securities Act or the Exchange Act. At the time they misrepresented facts concerning LDBF and the Related Funds, Hopkins and Flannery were associated with SSgA FM, a registered investment adviser. In other administrative proceedings, bars have been issued for violations similar to Respondents'. *Seghers v. SEC*, 548 F.3d 129 (D.C. Cir. 2008) (upheld Commission order barring investment adviser to hedge funds from association with any investment adviser based on violation of antifraud provisions when adviser overstated value of funds to investors); *Reinhard*, 2011 WL 121451 (bar entered based on violations of the antifraud provision involving misrepresentations as to financial health of hedge fund).

CONCLUSION

For the reasons stated above, the Division requests that the Commission reverse the Initial Decision and:

(a) make findings that Hopkins and Flannery willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and

(b) based on such findings, issue an order: (i) requiring Hopkins and Flannery to cease and desist from committing or causing any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, or Rule 10b-5 under the Exchange Act, (ii) requiring Hopkins and Flannery to pay an appropriate civil penalty, (iii) ordering appropriate remedial action pursuant to Section 203(f) of the Advisers Act and 9(b) of the Investment Company Act, and (iv) imposing such other remedial relief as it deems appropriate.

Respectfully submitted,

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