UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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
POST-HEARING BRIEF

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INTRODUCTION

From 2006 through the summer of 2007, investors in a number of unregistered collective trust funds managed by State Street Bank and Trust Company ("State Street") were misled about the nature and characteristics of their investments. In particular, investors in the Limited Duration Bond Fund ("LDBF" or the "Fund"), and in other State Street funds that were themselves invested in LDBF (the "Related Funds"), were deceived about the nature and the extent of subprime residential mortgage-backed securities held in those funds, and the risks taken on by those funds in reaction to the unfolding subprime mortgage crisis. As the subprime market crumbled in mid-2007, these investors lost hundreds of millions of dollars.

Two State Street employees, respondents James D. Hopkins ("Hopkins") and John P. (Sean) Flannery ("Flannery"), bear unique responsibility for the deceptions visited upon these investors.

Hopkins, as a product engineer, was responsible for ensuring that accurate information about LDBF was transmitted from the investment management team to investors either directly or through State Street's internal client-facing personnel. Hopkins failed to fulfill his responsibility to update standard offering and marketing materials that mischaracterized LDBF, drafted misleading investment commentaries that were sent to investors, used deceptive presentation materials with investors, and made direct misrepresentations to investors and their consultants about LDBF's subprime investments. Further, with the knowledge that some investors were confused about LDBF's and the Related Funds' subprime exposures, Hopkins also contributed edits to a letter that State Street sent to investors on July 26. His suggested edits failed to ameliorate investors' confusion and even made that letter more misleading.

Flannery, as the Chief Investment Officer ("CIO") of the Americas, was involved in the communications that were sent to investors in LDBF and the Related Funds on July 26, August 2 and August 14, 2007. He edited and approved the letters sent on July 26 and August 2, and was the author and signatory of the August 14 letter. These letters were misleading and omitted critical information that investors in LDBF and the Related Funds needed to know in order to evaluate whether to hold or sell their investments. Further, under Flannery's supervision and with his direct approval, the managers of LDBF sold the fund's highest rated and most liquid investments to benefit early redeemers from the fund (who included clients advised internally by other State Street groups and the Related Funds controlled by State Street). Rather than disclosing the significant decrease in the credit quality and liquidity of the fund's remaining saleable assets, Flannery revised and approved the letters' misleading characterization of the changes in LDBF's portfolio as risk reduction measures.

As a result of Hopkins and Flannery's actions and omissions, they engaged in a course of business, and made material misrepresentations and omissions, that misled the investors in LDBF and the Related Funds and caused them to continue to purchase or hold their investments in LDBF and the Related Funds. As detailed below, their actions willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act of 1933 ("Securities Act"), which prohibit fraudulent conduct in the offer and sale of securities, and Section 10(b) of the Securities and Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities. The appropriate sanction for Hopkins' and Flannery's violations includes a cease and desist order, a civil penalty, and bars prohibiting them from associating with any investment adviser or registered investment company.

STATEMENT OF FACTS

A. Respondents' Role Within SSgA

State Street is a Massachusetts trust company and a bank that is a member of the Federal Reserve System.[1] FOF 6. State Street Global Advisors ("SSgA"), which is not a legal entity, is the investment management division of State Street Corporation. FOF 8. The employees of SSgA managed both unregistered funds offered to investors by State Street and registered funds advised by SSgA Funds Management, Inc. ("SSgA FM"), a registered adviser for funds registered pursuant to the Investment Company Act. FOF 7-8. SSgA's clients included investors in both these registered and unregistered funds. FOF 10. Both State Street and SSgA FM are subsidiaries of State Street Corporation. FOF 6-7.

SSgA was led by a President and Chief Executive Officer, William Hunt. FOF 9. The business of SSgA was organized under seven groups, each of which reported directly to Hunt. *Id.* Three of those groups are involved in this case: the investment teams led by Flannery, the client-facing or "relationship management" teams led by Marc Brown, the Chief Marketing Officer, and the legal teams led by Mitchell Shames, the Chief Counsel. *Id.*

Hopkins began his employment with SSgA in 1998, and from 2005 to 2007, he was the product engineer for LDBF and several Related Funds. FOF 13-14. In July 2008, State Street promoted Hopkins to head of product engineering for North America. FOF 14. Hopkins' employment with State Street ended when the Commission instituted this action. *Id.* As a product engineer, Hopkins was the member of the State Street fixed income group who acted as

[1] Citations to the Division of Enforcement's Proposed Findings of Fact, which is being filed herewith, appear in the form "FOF __." Citations to trial exhibits that were admitted into evidence appear in the form "Div. Ex. __," "Hop. Ex. __," or "Flan. Ex. __," as they were numbered at trial.

the group's liaison with investors, investors' consultants, and State Street's client service representatives. FOF 25. Hopkins' professional expertise was in fixed income securities. FOF 12, 18-19. He spent more than 15 years selling mortgage-backed securities before working at SSgA, and during his time at SSgA, members of SSgA's relationship management and product engineering groups relied on him as a source of expertise about the fixed income securities held in LDBF and the Related Funds. FOF 12, 16, 25, 209. Further, the LDBF portfolio manager relied on Hopkins to explain LDBF to SSgA's relationship managers and answer any questions they had. FOF 26.

Flannery began working for SSgA in 1996, and in early 2005, Flannery became CIO of the Americas, the position he held until State Street terminated him in November 2007, in part as a result of the failure of LDBF and many of the Related Funds. FOF 31-32, 438. Flannery came up through the ranks at SSgA from the product engineering group, graduating to become head of Product Engineering, then head of the global fixed income group. FOF 31. As CIO, Flannery supervised all of the fixed income investment managers, all of the product engineers, the risk management group, and one of SSgA's advisory groups called Global Asset Allocation ("GAA"). FOF 33. As the supervisor of the fixed income investment team, Flannery was ultimately responsible for the active fixed income funds whose performance were imploding in the summer of 2007 as a result of the subprime mortgage meltdown. *Id.*

In 2007, Flannery was also a member of SSgA's Executive Management Group and SSgA's Investment Committee. FOF 34, 278. The Executive Management Group was SSgA's most senior management group, was responsible for running SSgA's business, and was comprised of the Chairman of SSgA's Investment Committee and all seven of the direct reports to SSgA's Chief Executive Officer. FOF 34. The Investment Committee, whose members included Flannery and the members of SSgA's major investment groups, including GAA and the Office of the Fiduciary Advisor (another internal advisory group) ("OFA"), served a governance and control function for SSgA's funds, including the Fund and the Related Funds, and approved major investment decisions for those funds. FOF 10, 52, 421, 433.

Both Hopkins and Flannery considered their employer to be SSgA. FOF 13-14, 31. During their employment with SSgA, and in particular during 2006 and 2007, however, both Respondents were also associated with SSgA FM, SSgA's affiliated registered investment advisor. FOF 7, 21-22. Flannery had managerial responsibility for SSgA FM's registered funds because SSgA FM's portfolio managers, and their managers, reported through the SSgA hierarchy to him, and SSgA's Investment Committee, of which he was a member, oversaw SSgA FM's registered funds as well as State Street's unregistered funds. FOF 7, 10. Similarly, Hopkins was the product engineer for certain registered funds advised by SSgA FM as well as unregistered State Street funds like LDBF. FOF 21. Product engineers for certain of the registered funds advised by SSgA FM also reported directly to Hopkins. FOF 22.

B. The Limited Duration Bond Fund – From Hallmark Fund to Performance Contagion

The Limited Duration Bond Fund ("LDBF") was made up of two similarly-managed unregistered collective trust funds offered to institutional investors such as pension funds, employee retirement plans, and charities. FOF 42-45. One of the LDBF funds, known within SSgA by its "fund code" of CMY1 ("LDBF ERISA"), was offered to investors qualified as ERISA plans such as defined contribution or defined benefit plans. FOF 43. The other LDBF fund, known as the LDBF Common Trust Fund or CMZ5 ("LDBF CTF"), was offered to institutions other than ERISA investors like charities, colleges, and other non-profits. FOF 44.

The two LDBF funds resembled mutual funds in many ways: they set a daily net asset value that was used to offer daily liquidity to investors, they were managed to a stated investment goal, and they offered investors some of the cost savings of collective management. FOF 48-49. Unlike mutual funds, however, the two LDBF funds did not provide prospectuses to investors, and their governing documents provided little guidance about, or limitation on, the strategy the funds were to employ to meet their stated goal – a return of one-half to three-quarters of one percent per year over the one-month London Inter-Bank Offer Rate (LIBOR), the interest rate that banks charge each other for short-term loans, which was considered a low rate of return. FOF 40, 50, 52.

LDBF was an actively managed fund that SSgA and Hopkins described to investors as an "enhanced cash" fund, or a fund that could serve as an alternative to a registered money market fund for some investors. FOF 39, 188-89. It was also marketed as having better sector diversification than a registered money market fund. FOF 144, 150. When it was established in 2002, LDBF invested in a broad range of fixed income products, including investments secured by credit cards, student loans, automobile leases, and commercial mortgages. FOF 47. In 2005, LDBF failed to earn its targeted return over LIBOR. FOF 62-63. In 2006, apparently in an attempt to improve its performance and despite the fact that LDBF continued to be marketed as sector diversified, Flannery's investment team decided to concentrate LDBF's investments in securities and derivatives dependent on subprime residential mortgage-backed securities ("subprime RMBS"). FOF 62-63, 66, 69, 75-83. All of these subprime investments were in the same sector because they were all subprime RMBS. FOF 124. Further, in 2006 and early 2007, the investment team magnified LDBF's exposure to subprime investments by increasing its use of reverse repurchases, credit default swaps, and total return swaps tied to the performance of subprime investments. FOF 76-83. All of these investments had the effect of increasing LDBF's leverage, and ultimately exposed it to more risk. *Id.* The leverage of LDBF, as measured by the ratio of its notional value to its market value, increased from near 1 at the end of 2006 to about 3.5 by the end of June 2007. FOF 81-83. Nonetheless, SSgA and Hopkins continued to describe the Fund to prospective and current investors as having better sector diversification than a typical money market fund, while failing to disclose the extent of its exposure to subprime investments and their attendant risks. FOF 144, 150-51.

At about the same time that LDBF was becoming a more subprime-dependent and leveraged fund, its influence among many of SSgA's other active funds was spreading. E.g. FOF 61. In part because LDBF had successfully met its return goals during many of the quarters between 2002 and the end of 2006, the investment team permitted many other actively-managed SSgA funds to invest up to 25% of their assets in LDBF, and at least one commodity futures index fund (the Enhanced Dow Jones AIG Commodities Index Strategy) invested more than 90% of its cash in LDBF. FOF 56, 58, 437. This practice of allowing other funds to invest in LDBF was part of the "portable alpha" strategy that SSgA promoted to its clients in 2006 and 2007 as a way to achieve additional return on top of that achieved by replicating an index. FOF 57-61. In 2006 and 2007, Hopkins and others also touted LDBF to SSgA's clients as one of its "hallmark" products in active fixed income. FOF 54.

The consequence of LDBF's influence was a performance crisis across SSgA's active fixed income portfolios when the subprime investments held by LDBF began to plummet in value and liquidity in the summer of 2007. FOF 61. As described in more detail in section F below, spreads on the subprime RMBS held by LDBF increased dramatically in July 2007, which means that their prices had dropped proportionately. FOF 289-90, 337. Not only did the performance of LDBF take a substantial hit, but also the performance of many Related Funds suffered. FOF 61. In mid-June 2007, LDBF had assets of approximately $3 billion. That amount had dropped precipitously – to about $407 million – by mid-August 2007. FOF 53. As a direct consequence of the performance problems in LDBF, 10 SSgA funds invested in LDBF were forced to close by September 30, 2007. FOF 61.

C. Hopkins and Flannery Closely Followed LDBF While It Was Taking On More Risk.

Even before the subprime market crisis in the summer of 2007, both Hopkins and Flannery were closely following developments in LDBF and knew that it was almost exclusively concentrated in subprime RMBS investments.

As a member of the fixed income team with responsibility for LDBF, Hopkins had access to the portfolio analytics spreadsheet by which LDBF's portfolio manager managed the Fund. FOF 71. By the summer of 2006, Hopkins could obtain information for himself from the server where the portfolio analytics spreadsheet was stored. *Id.* Because it was part of Hopkins' role to ensure the flow of accurate information between LDBF's portfolio managers and clients, he was required to keep up to date on developments in the Fund's investments and strategy. FOF 25-27. He knew, in the summer of 2006, that LDBF had begun to invest in total return swaps dependent on the performance of subprime RMBS, and he knew, at the latest, by February of 2007 that LDBF was primarily invested in subprime RMBS securities and derivatives. FOF 116-19. Throughout late 2006 and the first half of 2007, Hopkins also knew that LDBF used leverage which increased the Fund's exposure to the subprime market. FOF 71-73.

Starting in May 2006, Flannery began to ask his investment team to provide him with updates on how news of weakening in the subprime mortgage market could affect the risk of SSgA funds' subprime investments. FOF 91. In response, his team told him that LDBF was concentrated in the subprime market, and he was not surprised by that information. *Id.* Flannery continued to keep tabs on the subprime market throughout 2006 and into early 2007, when problems with lower-rated subprime securities caused LDBF's performance to suffer. FOF 92. He was following those problems closely enough to revise his subordinates' commentary about the subprime market in late February. *Id.* He also provided updates about the subprime investments held in SSgA's funds to the CFO of State Street Corporation in April 2007, and periodically throughout the summer. FOF 93. In May 2007, knowing that LDBF's investments were heavily concentrated in subprime RMBS, Flannery recorded a video for SSgA's public website that discussed the subprime mortgage market. FOF 94. By June 2007, Flannery was monitoring daily emails on the performance of an index of subprime derivatives. FOF 96-97. He told the Investment Committee that although many active fixed income funds with subprime investments (like LDBF) had suffered significant negative performance, he was paying attention to whether those funds were still within their risk budgets. *Id.* During the summer of 2007, Flannery was in nearly daily contact with SSgA's risk management group. FOF 87.

D. LDBF's Performance Stumbled In February 2007.

In February 2007, LDBF held investments in the ABX index, which represented derivatives backed by subprime RMBS issued during a particular period of time. FOF 70, 77, 92. The ABX index was segregated into different tranches based on the credit ratings of the underlying subprime securities, and at various times, LDBF owned the AAA, AA, and BBB rated tranches of that index. FOF 70. In February 2007, LDBF was invested in the BBB-rated tranche of the ABX index, as well as the AA-rated tranche. FOF 70, 77, 404. As a result of emerging negative views on the subprime market and particularly the lower-rated segments of that market, spreads on the ABX BBB index widened significantly (by about 350%), and price declined (by about 20%), in January and February. FOF 192. The impact on LDBF was dramatic – it had 55 basis points of negative performance in February alone. FOF 206.

E. Hopkins Made Numerous Misrepresentations To LDBF's Investors Concerning Its Subprime Exposure and Leverage in The First Half of 2007.

As the LDBF product engineer in 2006 and 2007, Hopkins was responsible for drafting and updating a number of offering documents and other communications about the Fund and Related Funds for current and prospective investors. In particular, Hopkins had both the responsibility and the authority to correct information about LDBF that was made available to investors and potential investors through quarterly fact sheets and standard presentations. FOF 139-42, 160, 180-85. Each of these types of offering documents was deceptive because they contained inaccurate and misleading information about the sector diversification of LDBF and the extent of its subprime exposure, as well as its use of leverage. FOF 147, 149-50, 178, 193-97. Hopkins was also responsible for misleading communications to clients in the spring of 2007 about the nature and extent of LDBF's investment in the ABX index. FOF 206, 217. He also made misrepresentations to David Hammerstein, a consultant for several SSgA clients invested in the Related Funds, about the extent of LDBF's subprime exposure. FOF 237, 240, 244, 248-54, 260-61.

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

Part of Hopkins' job as the LDBF product engineer was to review the fund's quarterly fact sheets, to ensure the accuracy of the "description" section of the fact sheets, and to provide updates to the extent it was necessary. FOF 139-41. As Hopkins knew, the fact sheets were marketing tools provided to prospective and current investors. FOF 140, 142. From the third quarter of 2006 through the second quarter of 2007, the fact sheets stated:

Investment Objective

The Limited Duration Bond Strategy seeks to maximize income while preserving capital by investing in a diversified portfolio of highly rated fixed income securities. The Strategy seeks to match or exceed the returns of the JP Morgan one-month US Dollar LIBOR Index over trailing one-year periods.

Description

The Limited Duration Bond Strategy utilizes an expanded universe of securities that goes beyond typical money markets including: Treasuries, agencies, collateralized mortgage obligations, adjustable rate mortgages, fixed rate mortgages, corporate bonds, asset backed securities, futures, options, and swaps. All securities purchased for the fund have a minimum investment grade rating by either Standard and Poor's or Moody's Investor Service. The fund's maximum effective duration is one year.

Risk Management

When compared to the typical 2 A-7 regulated money market portfolio, the Strategy has better sector diversification, higher average credit quality, and higher expected returns. The tradeoff is this fund purchases issues that are less liquid than money market instruments and these instruments will have more price volatility. This Strategy should not be used for daily liquidity. Returns to the Strategy are more volatile over short horizons than traditional cash alternatives and may not benefit the short-term investor.

FOF 143, 144, 147. The fact sheets also contained information about the "Sector Weights – by Market Value" of the Fund. FOF 148. The quarterly fact sheets from September 30, 2006 to June 30, 2007 stated that LDBF contained a low of 68.5% "asset-backed securities" to a high of 100% "asset-backed securities":

Sector Weights – by Market Value	
ABS	68.50%
Cash	21.90
MBS	9.60

Sector Weights	
US Asset Backed Securities	100.00%

Sector Weights	
ABS	85.70%
Other	14.30

Sector Weights	
ABS	81.30%
Rates	18.70

Id. These fact sheets were misleading in several ways.

First, between 2002 and 2006, the composition of LDBF's portfolio changed significantly, and by 2006 and 2007, LDBF invested in far fewer of the types of securities listed in the fact sheet than it had in 2002. FOF 146-47. Hopkins, however, never updated the list of securities that LDBF "utilized." FOF 143. Further, though Hopkins knew by late 2006 that LDBF was primarily invested in subprime RMBS, he never changed the fact sheet's statements that the fund was "investing in a diversified portfolio" or had "better sector diversification" than a "typical 2A-7 regulated money market portfolio." FOF 150-51. These misleading statements suggested to investors that LDBF was less risky than it actually was.

Second, the sector weight information was misleading to the extent that it concealed LDBF's concentration in subprime RMBS. The "ABS" or "asset backed securities" sector, into which the majority of LDBF's assets were categorized, was never defined in the fact sheet. FOF 149. SSgA apparently used the term "ABS" to encompass many different types of securities, such as securities backed by credit cards, airplane leases, auto loans, student loans and residential mortgages, including subprime RMBS. FOF 128-29. The fact sheets never explained the term ABS however, and never specified whether subprime RMBS was contained in the ABS sector, or in the MBS or "mortgage-backed securities" sector (in which LDBF also invested). FOF 149. As the testimony at the hearing demonstrated, intelligent investment professionals had differing opinions about whether subprime RMBS was, or should have been, categorized in the ABS sector or the MBS sector or in some other sector. FOF 156, 159. In addition, because ABS is such a potentially broad category, it is misleading to inform investors that LDBF contained 100% ABS without also telling investors that 100% of the ABS was subprime RMBS. FOF 66, 151-52, 157. Without such an explanation, the fact sheet's sector breakdown, in combination with its claims to diversification, failed to inform investors that LDBF was concentrated almost exclusively in subprime RMBS.

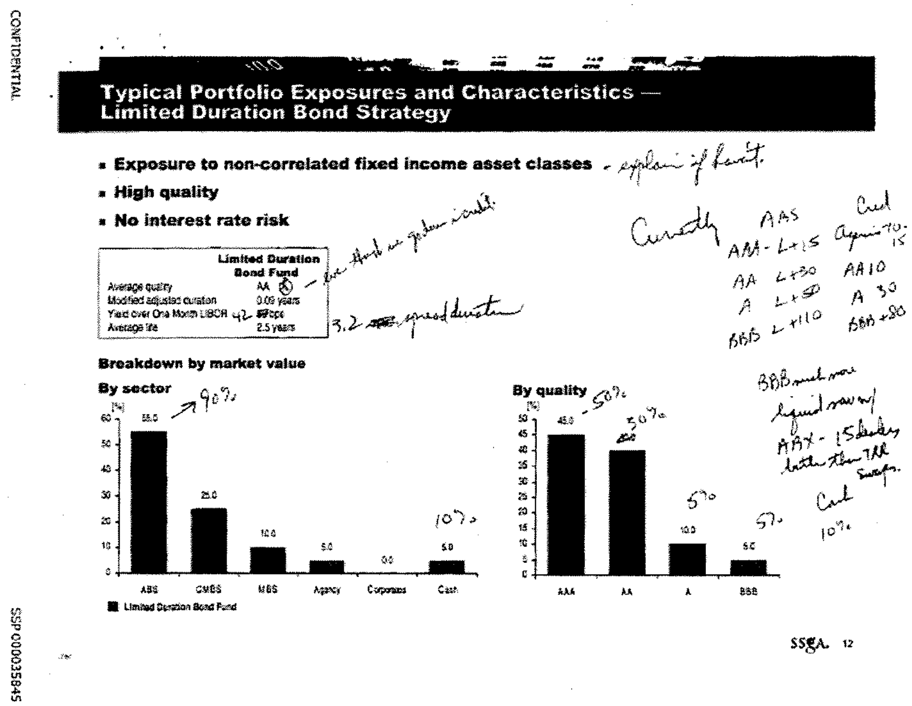
Third, the sector weight information was misleading to the extent it concealed LDBF's use of leverage. During this period, the Fund was leveraged through reverse repurchases, total return swaps on subprime bonds and investments in the ABX index. FOF 76-80. The notional value of these derivative contracts is the total value of the derivative contract's assets, and a small amount invested in such derivative contracts often controls a much larger notional value. FOF 72, 77. Therefore, where a portfolio of assets – like LDBF – includes derivative investments, a description of a portfolio's notional value relative to its market value may be necessary to determine a portfolio's exposure to leverage. FOF 122. The fact sheet provided sector weights by market value and not by notional value. FOF 193. LDBF's fact sheets failed to disclose that LDBF's exposure to subprime RMBS risk greatly exceeded the market value of its assets and thus failed to inform investors that its use of leverage magnified its subprime exposure. *Id.* Hopkins could have edited the descriptive language in the fact sheets to include information about LDBF's leverage but failed to do so, even though he knew that investors cared about leverage. FOF 194.

By the spring of 2007, Hopkins knew that the fact sheet had caused actual confusion for a consultant who was considering a recommendation that its client invest in LDBF. FOF 153-54. The consultant questioned how the fact sheet could state that the Fund had better sector diversification than a money market fund and yet be invested 100% in asset-backed securities, and questioned the breadth of the definitions used in the fact sheet. FOF 153. Instead of making clarifying corrections to 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, which was about 3% of the Fund's assets. FOF 154. Despite knowing that the quarterly fact sheets caused actual confusion, Hopkins *never* changed them to correct their misrepresentations even though he was responsible for their accuracy. FOF 141, 143, 194.

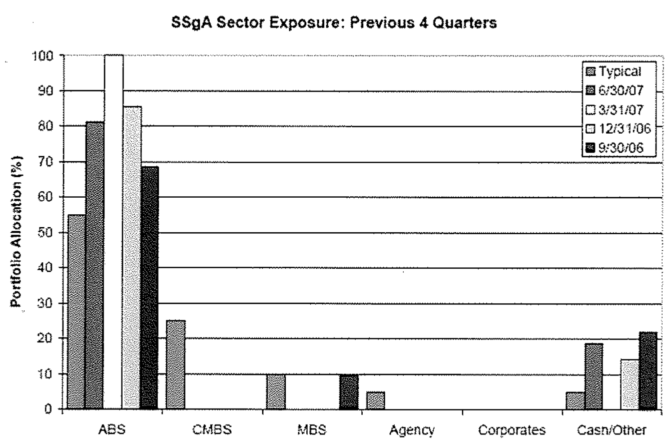
2. Hopkins Failed To Correct The "Typical Slide" in Standard Investor Presentations, Thus Ensuring That Clients Received Misleading Information About The Contents of LDBF's Portfolio.

In 2006 and 2007, there was a standard presentation about LDBF that could be used by relationship managers who were presenting information about LDBF or the Related Funds to their clients or prospects. FOF 160-61, 177. Hopkins himself also frequently presented these LDBF slides to clients when a relationship manager asked him to participate in client meetings. FOF 28, 162-64, 170-73, 241. Part of Hopkins' job responsibilities during 2006 and 2007 was to review the standard presentation slides on a quarterly basis to ensure that they contained accurate information for clients. FOF 160. If the standard presentation slides were inaccurate, Hopkins was obligated to correct or clarify them. *Id.* Hopkins understood that clients received copies of the slides either before or during presentations that he and the SSgA relationship managers made. FOF 161.

The standard presentation contained a slide describing the Fund's "typical" sector breakdown in a way that failed to disclose any exposure to subprime investments, and also indicated a greater level of sector diversification than actually existed at the time (the "Typical Slide"). FOF 166. For example, the slide stated:



FOF 166-68. Although the presentation stated that LDBF's "typical" exposure to ABS was 55%, its actual investments during this time were almost all ABS, and specifically almost all subprime RMBS. FOF 117-19, 178, 269-70, 318-20. Thus, the Fund's typical ABS exposure was never 55% during the time period. This chart clearly demonstrates the inaccuracy of the Typical Slide during the third quarter of 2006 through the second quarter of 2007:



FOF 269 (showing the percentages represented in the Typical Slide as compared to the actual sector allocation at quarter end for the relevant quarters). Hopkins included the Typical Slide in presentations he personally made on at least five occasions during 2006 and 2007. FOF 170-73, 241. During that time, as demonstrated by his handwritten notes on the slides, Hopkins knew that the "typical" sector breakdown shown in his presentations was not "typical." FOF 170-72. He does not recall telling clients during those presentations that the Typical Slide was very different from the portfolio's actual composition. FOF 170-72, 176, 245, 251. Hopkins was given the express opportunity to review and correct the Typical Slide in at least August 2006, October 2006, February 2007, and May 2007. FOF 180-85. He failed to do so. *Id.* By continuing to use the Typical Slide in his presentations to investors and causing others at State Street to use the slide by failing to update the standard slide with accurate information, Hopkins misled investors.

When Hopkins used the Typical Slide in 2007, he also knew it was misleading because he knew that LDBF had significant exposure to subprime derivatives that were not included in the sector breakdown on the slide. FOF 71-73, 195. Because the slide did not indicate the fund's exposures by notional value, it conceals LDBF's exposure through leverage. FOF 195. Hopkins could have changed the bullet points on the Typical Slide to explain LDBF's use of leverage, but he failed to do so. FOF 196. Hopkins also could have changed the bullet points to convey definitional information about the sector breakdown so that clients would have been aware of LDBF's concentration in subprime RMBS. FOF 182, 196. Again, he failed to do so.

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

After LDBF's performance problems in February 2007, as discussed in section D above, Hopkins wrote an internal "Client at Risk Alert" ("CAR Alert") for SSgA's relationship managers concerning the impact of subprime market problems on LDBF. FOF 198-99. Hopkins adapted the internal CAR Alert into a nearly identical letter for SSgA's client-facing personnel to send to their active fixed income clients to explain how the faltering ABX index had caused negative performance in LDBF and the Related Funds. FOF 204. Some clients received that letter in early March 2007. FOF 207. In that letter, Hopkins wrote that SSgA's active strategies have "been taking modest exposure to the investment grad[e] triple B asset-backed securities market, specifically the sub-prime home equity market." FOF 206. At the time, Hopkins was aware that LDBF's investments were virtually all in the subprime RMBS sector. FOF 119. Though the March letter discloses that LDBF and the Related Funds were invested in the BBB-rated tranche of the ABX Index, it fails to disclose that:

- LDBF's BBB-rated ABX exposure was only about 3% of the fund's assets;
- LDBF and the Related Funds were invested in higher rated tranches of the ABX index and in higher rated subprime RMBS bonds and derivatives;
- LDBF was invested almost exclusively in subprime bonds and derivatives.

FOF 119, 206, 216. These omissions mattered. Most of the active funds that were negatively impacted by ABX underperformance had that exposure through their investments in LDBF. FOF 208. Both SSgA relationship managers (who were providing information to clients) and clients themselves were misled into thinking that LDBF's BBB-rated ABX investment was its sole exposure to subprime RMBS. FOF 320, 338.

To compound his omission, Hopkins misrepresented the status of LDBF's BBB-rated ABX investment to clients during the spring of 2007. Following the February price drop of the BBB-rated ABX index, LDBF reduced the size of its BBB ABX holdings by approximately one-third, or down to about 1.5 percent of its portfolio. FOF 213, 216. Following a gradual recovery in the index in March and April, however, LDBF doubled its position in the BBB ABX index by increasing it back to about 3 percent of its portfolio. FOF 89, 216. Hopkins learned about the increase in LDBF's BBB-rated ABX exposure no later than April 25 during a telephone call with LDBF's portfolio manager. FOF 216.

On April 25, shortly after Hopkins spoke to LDBF's portfolio manager about the increase in LDBF's BBB-rated ABX position, Hopkins gave a presentation to SSgA client Catholic Healthcare. FOF 214-16. Hopkins was discussing the ABX trade with clients during this period because it had caused significant underperformance earlier in the year. FOF 210. The written slides he provided to the client and used during the presentation represented that LDBF had reduced its BBB-rated ABX investment. FOF 211, 213. Hopkins cannot recall whether he orally corrected the written slides during his discussions with Catholic Healthcare. FOF 217. Even though he knew the written slide was wrong, Hopkins used it again in a presentation he made to another SSgA client, National Jewish Medical Center, on May 10, 2007. FOF 248-50.

4. Hopkins Made Misrepresentations to A Consultant For Several SSgA Clients.

During the spring and summer of 2007, Hopkins made a series of misrepresentations to David Hammerstein, a consultant working at Yanni Partners ("Yanni") who advised several clients invested in the Enhanced Dow Jones AIG Commodities Fund ("Commodities Fund"). FOF 223. Because the Commodities Fund implemented its commodities strategy through derivatives requiring a limited amount of up-front cash, its cash collateral (over 90% of the fund's assets) was invested in LDBF. FOF 58, 243. Based on information provided to Yanni by SSgA to April 2006 and February 2007, 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. FOF 224-28. Hammerstein and Yanni did not know that LDBF was concentrated in subprime RMBS or used leverage. FOF 229.

Hopkins had a conference call with Hammerstein and others on April 9, 2007 to discuss the Commodities Fund's underperformance because of LDBF. FOF 233. Hopkins told Hammerstein that LDBF underperformed because of its investment in the BBB-rated tranche of the ABX index.

FOF 235. Hopkins misrepresented LDBF's total subprime RMBS exposure – telling Hammerstein that LDBF's total exposure to subprime RMBS was only 2% (rather than 80% plus). FOF 75, 119, 237. 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, and that his clients should continue to hold their investments in it. FOF 239-40.

On May 10, 2007, Hopkins attended an in-person meeting with Hammerstein, his client National Jewish, and others. FOF 241. Hopkins did most of the talking at this meeting. FOF 246. At the meeting, Hopkins discussed both the Typical Slide that he had used with many other clients, and the slide representing that LDBF had reduced its BBB-rated ABX investment that he had used with Catholic Healthcare. *See supra*, pt. E.2-3. Hammerstein was misled by both of these slides and Hopkins' discussion of them. First, Hopkins used the Typical Slide to represent to Hammerstein that LDBF had a well-diversified portfolio. FOF 252-53. Hopkins concealed LDBF's subprime RMBS concentration from Hammerstein and thus misrepresented an issue of significance to him – the nature of LDBF's investments and SSgA's risk control. FOF 254. Second, Hammerstein believed Hopkins' misrepresentation that LDBF's BBB-rated ABX exposure had been reduced. FOF 250. Hammerstein was not told that it had been increased back to its original position. *Id.*

Hopkins, Hammerstein and others had another call in late July after the performance of the Commodities Fund had fallen further. FOF 259. During that call, Hopkins told Hammerstein for the first time that LDBF employed leverage. FOF 260. On the call, Hopkins also disclosed for the first time that LDBF was concentrated in subprime RMBS. FOF 261. Hammerstein was surprised and dismayed, for LDBF's use of leverage made the fund far riskier than he had understood it to be based on Hopkins' prior representations, and its subprime concentration was a direct contradiction of Hopkins' prior statement that LDBF was two percent subprime. FOF 260-62. Following the call, Hammerstein and Yanni recommended that their clients exit the Commodities Fund because the Commodities Fund (through LDBF) was much riskier than they had been led to believe and SSgA had not adequately informed them of the funds' risks. FOF 265, 267.

F. In June and July, LDBF's Performance Tumbled.

In June 2007, news that two hedge funds with significant subprime RMBS investments were having difficulty and may be liquidating caused the price of the BBB-rated ABX index to plunge again. FOF 321, 325. The price drop in the BBB-rated ABX index, and price drops in other subprime investments negatively impacted the performance of many subprime-invested SSgA active funds in June. FOF 323. The two component LDBF funds performed 41 basis points and 82 basis points under their LIBOR benchmark during the month of June. FOF 61. For a fund seeking an annual return of 50 to 75 basis points over its benchmark, this negative performance was substantial. FOF 40. Other Related Funds like 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. FOF 61.

The performance situation got even worse in July for LDBF and the Related Funds. Through July, spreads widened and price decreased on subprime bonds in all credit rating categories as liquidity nearly vanished for these securities. FOF 289. Spreads on AAA and AA-rated subprime RMBS bonds approached historical wides, and daily volatility was extremely high. FOF 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. FOF 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. FOF 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 apparently startled and dismayed by this information. *Id.* Flannery conceded that on July 24, he knew that the Investment Committee would be meeting to decide what to do to meet anticipated redemptions from LDBF. FOF 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. FOF 277, 280. These discussions resulted in the recommendation that LDBF raise approximately 40% liquidity. FOF 280.

G. On July 25, The Investment Committee Decided To Sell A Significant Amount of LDBF's Bonds To Meet Anticipated Client Redemption Requests.

At 8:30 am on July 25, the Investment Committee convened to consider what to do about the dramatic negative performance in LDBF and the Related Funds caused by the subprime crisis. FOF 278. Flannery acted as chair of the meeting and reminded the attendees about the "strict confidentiality" of the discussion they were about to have. FOF 278-79. In response to Flannery's caution, Alistair Lowe, the head of the GAA advisory group that reported to Flannery, left the meeting to avoid learning confidential information about forthcoming LDBF trades that would impair his ability to make decisions about whether the clients his GAA group advised should hold or sell their investments in LDBF and the Related Funds. FOF 279, 433. A representative of the OFA group, which also advised clients invested in LDBF and the Related Funds, chose to remain at the meeting and learned confidential information. FOF 420-21, 433.

The Investment Committee led by Flannery discussed the investment team's significant concerns about the illiquidity of many of the subprime investments held in LDBF, the impacts that such illiquidity had on the accuracy of the pricing for those investments, and the need to sell assets to address the forthcoming client redemptions. FOF 280-89. Flannery knew that client redemptions were coming:

Sean Flannery: Uncomfortable to only reacting to client demand/redemption. The IC needs to make some decisions.

FOF 280. And his educated guess was that LDBF would have to sell about 40 % of its assets to satisfy the redeeming clients' demands for liquidity:

> Sean Flannery: 1) Does anyone not agree that we need to build liquidity in fund and estimates are geared toward 25-50% (per Relationship Management) – so we need to build 30-40% of liquidity by month end? 2) If money comes out we need to sell a pro-rata share to meet client demand for liquidity. (everyone agreeded)

Id. The Committee also discussed how LDBF's assets should be sold and acknowledged that sales of LDBF's highest rated assets combined with significant investor redemption requests could harm investors who remained in LDBF:

> Paul Greff: If we can sell the AAA and as redemptions happen; we will have to sell slices leaving us with the AA piece (illiquid). We can't leave the clients with riskier lower grade in portfolio.
>
> Sean Flannery: We take a fundamental view: we have to sell illiquid & liquid now or else we will be stuck with just illiquid and so the situation could get much worse.
>
> Sean Flannery: what if no one lifts you. We are going in to month end and everyone is hysterical about pricing and the window is going to close quickly. If we don't sell a slice across the portfolio then we end up with a less liquid portfolio – valued less.
>
> Bob Pickett: We should raise cash through selling the AAA, but it will change risk profile.

FOF 284, 287. The debate at the meeting was, in essence, whether to raise liquidity for client redemptions by 1) selling LDBF's more liquid AAA bonds, or 2) selling assets evenly across the credit quality ratings held in the portfolio. *See id.*

At the time, the only assets that LDBF could sell to raise cash to fund investor redemptions were its subprime RMBS bonds. The subprime derivatives that LDBF held either had no market value or a negative market value (in other words, LDBF would have to pay money to its counterparty to terminate its investment). Div. Ex. 167; FOF 74, 301. At the time, LDBF's cash bonds were mostly rated AAA and AA. FOF 301. Though both component LDBF funds held subprime RMBS bonds rated A and BAA, those holdings were less than ten percent of the portfolios' market value. *Id.* Because AAA bonds were more liquid than AA bonds, the spreads on AAA bonds were narrower than the spreads on AA bonds, and AAA bonds were selling at a greater percentage of their par value, selling AAA bonds, rather than a mix of AAA and AA bonds, would minimize the immediate loss that LDBF would experience and improve its approaching month-end performance picture. FOF 287, 289, 380, 398. Selling AAA bonds, rather than a mix of AAA and AA bonds, would, however, increase LDBF's risk profile. FOF 287, 398-405.

The Committee, led by Flannery, voted unanimously to direct the portfolio managers of the Fund to sell assets to meet anticipated investor redemptions of 25-50% by month end:

> Investment Committee past the following motions instructing the portfolio management team:
> 1) to increase the liquidity in the Limited Duration Bond Fund portfolio, per consultation with the Relationship Management team, by the end of the month.
> 2) sell a pro-rata share (across capital structures) to warrant any withdrawals
> 3) reduce the AA exposure, a target of 5%, by the end of the week.

FOF 288. LDBF's portfolio manager, Robert Pickett, attended the July 25 Investment Committee meeting, and its instructions were directed at him. Pickett understood that he was to implement the first of the Investment Committee's instructions by selling "one point something billion" of LDBF's AAA-rated cash bonds, which were the highest-rated assets in the Fund that could be sold to generate cash, "by the end of the week." FOF 292. He understood that he was following the specific direction of Flannery and the rest of the Investment Committee. *Id.*

The Investment Committee's second instruction, selling a "pro-rata share across capital structures" was a second phase to be implemented only after liquidity was raised through the AAA bond sale. FOF 296-97. LDBF's portfolio manager explained that after the AAA bonds were sold, the portfolio was "repositioned." *Id.* The next step was to maintain that repositioning through August. *Id.* As client redemption requests came in, Pickett was instructed to sell LDBF's remaining assets proportionately in order to satisfy those later redemption requests. *Id.*

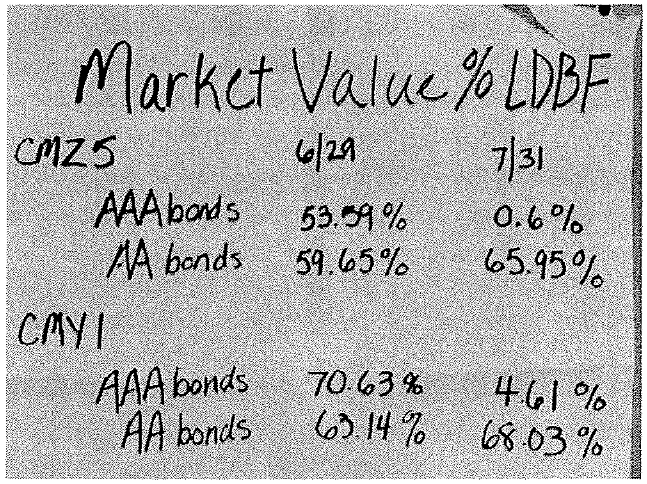
H. LDBF's Portfolio Manager Followed The Investment Committee's Directions By Selling LDBF's Highest-Rated And Most Liquid Saleable Assets.

After leaving the Investment Committee meeting on July 25, Pickett began working to implement the Investment Committee's first instruction – raise liquidity of approximately 40 percent in LDBF by selling AAA bonds. FOF 294. To sell the AAA bonds, Pickett worked with James Kramer and Andrew Tenczar who were both traders on the trading desk. *Id.* The AAA bond sale was the largest Pickett had ever worked on as either the backup or lead portfolio manager of LDBF. *Id.* The AAA bond sale was arranged as a "block sale" in which one buyer, Citigroup, bought all of the bonds that LDBF was selling for a single price. FOF 295. Typically, in block sales like this one, the buyer pays a discounted price in exchange for its willingness to purchase an entire portfolio before its price declines further. *Id.*

The AAA bond sale was completed on the afternoon of July 26, 2007. FOF 306. The two LDBF funds sold $1,592,148,795 in AAA-rated bonds. FOF 291. Those bonds were subject to a total of $1,160,216,000 in outstanding reverse repurchase commitments. *Id.* After repaying the reverse repurchasers and taking a loss on the sale price, LDBF raised $431,932,795 from the sale. *Id.* It received those cash proceeds by July 29. FOF 298.

Flannery was informed about the AAA bond sale shortly after it was complete on the afternoon of July 26. FOF 302-10. Flannery had been following the traders' progress in completing the trade. FOF 306. After the sale was complete, Kramer, the head U.S. fixed income trader, told Flannery that Citigroup had purchased the large block of LDBF's bonds. FOF 307. Kramer also told Michael Wands, a senior member of the investment team, that the AAA bond sale was complete and he was "pleased." FOF 308.

After the AAA bond sale, LDBF's portfolio was very different. Its saleable assets had gone from roughly equal proportions of AAA and AA bonds to almost exclusively AA bonds.

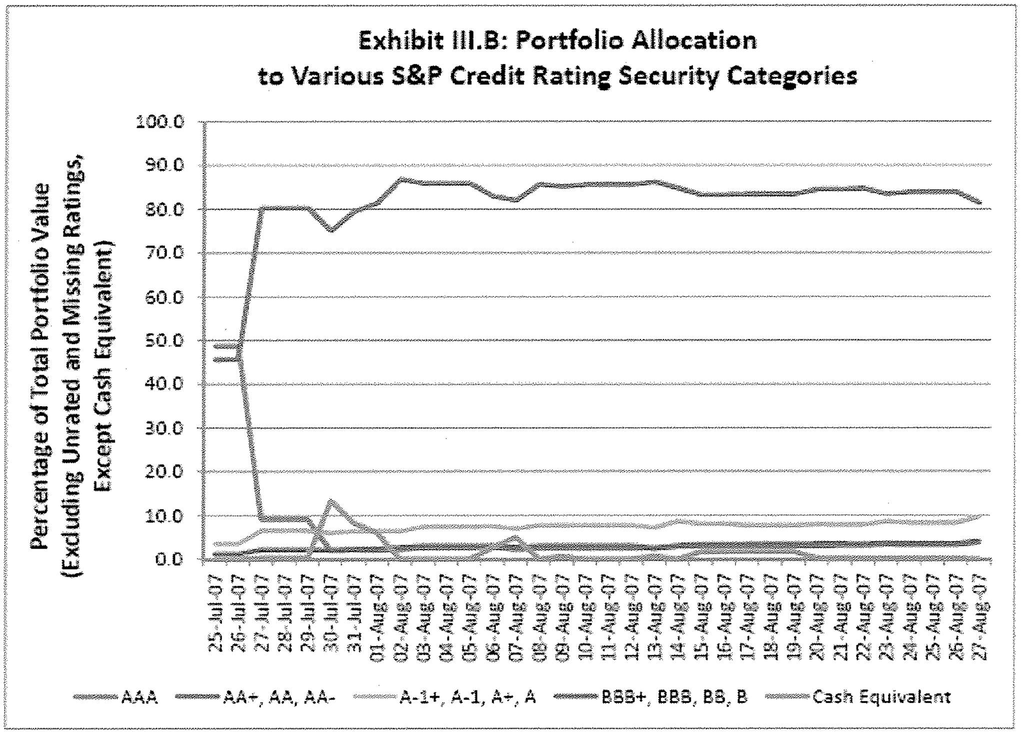


Market Value % LDBF

CMZ5	6/29	7/31
AAA bonds	53.59 %	0.6 %
AA bonds	59.65 %	65.95 %
CMY1		
AAA bonds	70.63 %	4.61 %
AA bonds	63.14 %	68.03 %

FOF 301. The AA bonds left in the LDBF portfolio after July 26 were far more illiquid than the AAA bonds that had been sold and thus carried greater liquidity and price risk. FOF 398-405. The AA bonds were also inherently riskier because they were structurally designed to be less protected from default than AAA bonds. FOF 95.

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. FOF 300, 403. Unfortunately for LDBF's investors, that's not what happened. As the following chart demonstrates, all of the cash raised from the AAA bond sale was gone from the LDBF portfolio within four days.



FOF 298. The cash raised from the AAA bond sale is shown in the light blue "Cash Equivalent" line. It was received by LDBF by July 29, and had been completely spent to fund early client redemption requests by August 2. From July 27 to August 2, there were $486,353,751 in total cash redemptions from LDBF. FOF 386. The LDBF portfolio was thus riskier after the cash from the AAA bond sale was used to meet client redemption requests than it had been before the sale on July 26. FOF 391-405.

This chart also shows how Pickett implemented the Investment Committee's second instruction to sell a pro rata share of the portfolio after the July 26th "repositioning," and the third instruction to sell 5 percent of LDBF's AA exposure by the end of July. FOF 298-99. The 5 percent sale instruction is shown by the dip in the red AA line on July 31. The pro rata sales are shown by the basic consistency of the red AA line thereafter throughout August.

Investors who redeemed from LDBF for cash before August 2 did better than investors who redeemed from LDBF for cash after August 2, when the proceeds of the AAA bond sale were gone. As Flannery and others reported to State Street Corporation's board:

Cost of Liquidation
How Much Did Forced Liquidation Cost LDBF?

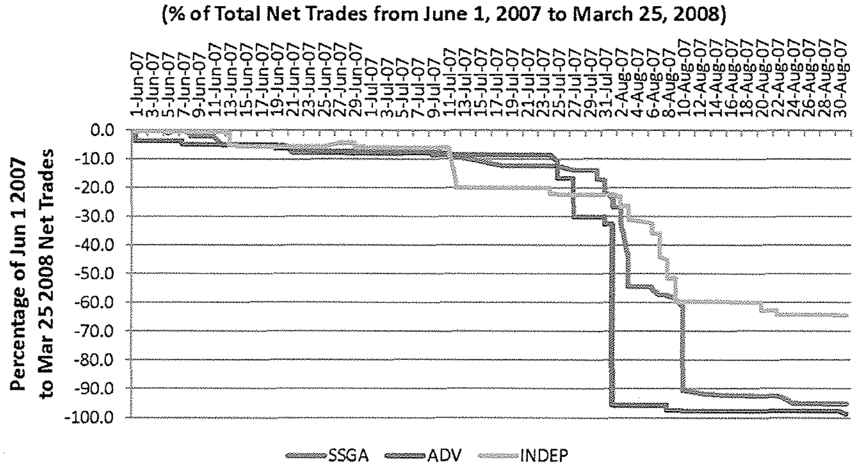
Asset Sold	Period	Approx. Fund Impact
AAA HEL Cash Bonds Approx. 6 point loss	End July	-3%
AAA HEL Swaps Incl price loss and tearup cost	End August	-7
AA HEL Cash Bonds Assume 50% of fund at 20 point loss	End August	-10
Estimated Total Impact on Fund		**-20%**

FOF 398. The most significant losses from LDBF's forced sales were due to the sale of illiquid AA bonds by the end of August 2007, whereas the sale of LDBF's AAA bonds at the end of July 2007 only had a 3% impact on LDBF. *Id.*

I. Almost All of the SSgA-Controlled or SSgA-Advised Shareholders In LDBF Redeemed Their Shares By August 10.

The users of the liquidity generated by the AAA bond sale on July 26 were almost exclusively shareholders controlled by SSgA or shareholders advised by one of SSgA's internal advisory groups, GAA and OFA. As the following chart shows, investors advised by GAA and OFA (the red "ADV" line) largely redeemed from LDBF on July 27 and August 2:

Exhibit II.B.: Cumulative Daily Net Trades, by Investor Type
(% of Total Net Trades from June 1, 2007 to March 25, 2008)



FOF 61. The Related Funds, shown on this chart as the blue "SSGA" line, redeemed about half of their LDBF investments between July 30 and August 3, and another 30-40 percent on August 10. These advisory and SSgA investors had better access to information about LDBF's investments and performance than other independent LDBF shareholders who redeemed later, as the chart's green "Independent" line shows. FOF 420-36. The managers supervising the Related Funds, and the investors advised by OFA, also had the benefit of knowing about the instructions issued by the Investment Committee at its July 25th meeting to sell LDBF's assets to meet anticipated redemptions. FOF 278-88, 307-08, 421. These investors who received privileged information fared better than LDBF's independent investors.

Because the redemptions by the Related Funds and the SSgA-advised investors depleted all of the cash raised by the AAA bond sale on July 26, LDBF's managers were forced to sell the Fund's less liquid assets to fund the redemptions requested by clients after August 2. FOF 298, 386. At the hearing, Respondents' counsel made much of the fact that some of the Related Funds' redemptions from LDBF were "in-kind" redemptions rather than redemptions for cash. There were no in kind redemptions from LDBF CTF until August 10. FOF 386. There were no in kind redemptions from LDBF ERISA until August 3 (when two Related Funds redeemed in kind) and the bulk of LDBF ERISA's in kind redemptions occurred on August 10. *Id.* In addition, because the Related Funds withdrew substantial amounts from LDBF, their withdrawal placed LDBF's continued viability as a fund in jeopardy. FOF 298.

One of the SSgA advisory groups whose clients were invested in LDBF and the Related Funds was OFA. FOF 421. That group provided "outsource[d] CIO solutions to pensions, endowments, and foundations," and made recommendations to those clients about what kinds of investments they should hold. FOF 420. A member of the OFA team, Mr. Qin, attended the confidential Investment Committee meeting on July 25 and thus learned that LDBF was going to be selling a significant portion of its securities to raise liquidity for redemptions. FOF 278-88, 421. On the same day, OFA was trying to make a "decision about watch-listing and potentially terminating the fund or making a recommendation to terminate the fund to our clients." FOF 421. Mr. Qin participated in OFA's decision. *Id.* OFA's official recommendation that its clients redeem from LDBF was made on July 26, 2007. FOF 422. The reason for its decision to recommend termination of LDBF and the Related Funds was the "[s]ignificant underperformance of LDBF due to [its] holdings in securities related to sub-prime mortgage market." *Id.* One of OFA's clients that redeemed was State Street Corporation's Retirement Plan. FOF 423.

Flannery learned about OFA's decision to recommend that its clients redeem from LDBF and the Related Funds on the afternoon of July 27. FOF 424. Martha Donovan, a relationship manager in the OFA group, called Flannery and left him a message stating that OFA was recommending redemption. *Id.* Around 5 or 6 pm on that day, Flannery called Donovan back and they discussed OFA's recommendation. *Id.* Donovan informed Flannery that OFA needed to gather its clients' authorizations to exit from LDBF and she expected that OFA's clients would exit as a group on August 1. *Id.* In response, Flannery told her that there was liquidity in LDBF such that OFA's clients need not wait until August 1 if they wanted to redeem before then. *Id.*

GAA was another SSgA advisory group that provided investment advice to its clients. Some GAA clients invested in LDBF and the Related Funds. FOF 427, 429. Most GAA clients were small entities that relied on GAA to allocate their assets and select which of SSgA's funds they should hold. FOF 427. The head of GAA, Alistair Lowe, reported to Flannery. FOF 428.

Throughout 2007, GAA was kept informed about developments in LDBF, and the group was informed, through meetings with the investment team and their receipt of internal SSgA communications that LDBF was heavily concentrated in subprime investments. FOF 430. GAA's formal decision to recommend termination of LDBF and the Related Funds was made on July 25. FOF 431. When GAA made the decision to terminate LDBF, Lowe: 1) was more negative on subprime than the fixed income team; 2) knew that the subprime market was blowing up; 3) knew that subprime investments were highly correlated and performing negatively; 4) was being told daily by his staff that there were daily downward moves in SSgA's bond funds; and 5) knew that subprime investments were a "core holding" of LDBF. *Id.*

Flannery knew about GAA's decision shortly after it was made. Flannery was at the Investment Committee meeting when Lowe announced his departure to avoid learning inside information that would affect his ability to advise his clients about their investments in LDBF, and later the same day, Flannery had a regularly scheduled meeting with Lowe at which Lowe told him GAA was meeting to decide what to do about its clients' investments in the SSgA fixed income funds. FOF 433-34. Flannery received an internal SSgA communication on August 1 stating that GAA had recommended that its clients redeem from LDBF and the Related Funds, and his own handwritten notes from August 6 reflect his awareness of GAA's recommendation. FOF 435-36.

J. SSgA's Three Letters to Investors In July and August Misrepresented and Concealed LDBF's Increased Risks.

At the same time that SSgA was preparing to redeem its internal advisory group clients' and the Related Funds' investments in the Fund, and was selling LDBF's highest-rated assets to fund those redemptions, SSgA began sending a series of letters to all investors in the Fund and the Related Funds. These three letters – dated July 26, August 2 and August 14 – continued to mislead outside investors by omitting material information about the Fund and the Related Funds, including information that was already available to its internal advisory groups and the portfolio managers of the Related Funds. Hopkins and Flannery played an instrumental role in the misrepresentations in these letters, which were material to investors trying to decide whether to continue to purchase or continue to hold their investments in the Fund and the Related Funds. As Flannery observed: "when you hold illiquid positions in an illiquid market, it is generally not advantageous to telegraph that holding, that view. I don't think most investment managers would be specific about that exposure." FOF 409.

1. Others At SSgA Relied On Hopkins And Flannery To Get The Letters' Facts Correct.

Though members of SSgA's investment, client service, and legal groups were involved in drafting and editing each of the letters, Hopkins and Flannery were unique among those involved in the letters in that they personally suggested edits for the letters that they knew, or were reckless in not knowing, were false and/or misleading by omission. Hopkins drafted the document that was the "skeleton" of the July 26 letter, and was the primary person responsible for communications between the investment team and the client service team on subprime issues. FOF 200, 322, 339. He, perhaps alone among the letter's reviewers, knew what clients had not yet been told, knew what they needed to know to make intelligent investment decisions about their holdings in LDBF and the Related Funds, and understood the causes of LDBF's underperformance. He knew that by mid-July there was still confusion among SSgA relationship managers and their clients about the extent of subprime exposure in LDBF. FOF 318-20, 338. He even knew that some believed LDBF's BBB-rated ABX investment was its only subprime investment. FOF 338.

The role that Flannery and others on the investment team played in reviewing or editing the letters was to: gather information and offer their analysis of the market situations and the portfolio and what was going on in the portfolio; provide market expertise; and provide information about the accuracy of the investment issues that were described in the letters. FOF 313. As the senior member of the investment team reviewing the letters, it was ultimately Flannery's job to ensure that they were factually accurate. *Id.* No one else was double-checking the letters' factual accuracy. FOF 314-17. Reviewers from the legal group and the client service group were relying on Flannery and the other members of the investment team to make sure the letters were factually correct. *Id.* They did not second guess the accuracy of the facts in the letters, and they did nothing independently to confirm those facts. *Id.*

Both Hopkins and Flannery were motivated to keep investors in LDBF and the Related Funds. Hopkins' boss charged him with trying to keep investors in the funds despite their poor performance and he viewed his role as defending the funds and trying to preserve investors' business. FOF 272-73. Flannery wanted to keep investors in the funds because he hoped to buy time to allow them to recover. FOF 438, 440, 442. If the funds lost a substantial percentage of their assets, then poor performance would be locked in and it would be difficult for the funds to survive or compete in the future. The scope of the funds' underperformance was so significant that it also threatened Flannery's reputation and job prospects. FOF 438-43. Hopkins' and Flannery's self interest led them to misrepresent the riskiness of the funds, and the outside investors suffered.

2. The July 26 Letter Was Misleading Because It Concealed LDBF's Subprime Concentration And Mischaracterized LDBF's Risks.

On July 2, 2007, Hopkins emailed another CAR Alert to SSgA's relationship managers describing how negative news and developments in the subprime market had caused LDBF to underperform in June. FOF 322-23. The CAR Alert stated that the cause of LDBF's June underperformance was its BBB-rated ABX investment and the LDBF ERISA fund's exposure to some higher-quality subprime CDOs. FOF 323. It did not explain, however, the full extent of LDBF's subprime exposure. FOF 324. Hopkins asked one of SSgA's technical writers, Patricia Hudson, to polish the July 2 CAR Alert into a client-friendly letter while we was on vacation from July 6 to 14. FOF 326. Hopkins did not expect Hudson to add substance, only edit the letter's form to make it suitable for clients. *Id.* While he was on vacation, Hopkins monitored his email and was aware of the negative media attention on the subprime market. FOF 327. While on vacation, he even wrote that he hoped SSgA had reduced its subprime exposure. FOF 328.

While Hopkins was on vacation, Hudson circulated drafts of the letter to members of the investment team, including Flannery, for fact-checking. FOF 329. Flannery provided edits on July 11 and continued to be involved in drafts that were circulated thereafter. FOF 331. Flannery asked that the draft letter be reviewed by the legal group, but did not provide the legal group with any facts to assist in their review. FOF 332-33. Mitchell Shames, SSgA's general counsel, was the lead lawyer coordinating the legal review of this draft letter. *Id.* Though Shames became aware of LDBF's subprime exposure in July 2007, he did not know any of the details concerning LDBF's subprime RMBS investments or its use of leverage. *Id.* Because the draft letter had already been reviewed on the business side before Shames and the other lawyers saw it for the first time, they assumed that the facts contained in the letter were correct. FOF 333 ("since in general[] we were relying on the business people for providing us with the facts, [] absent [] some red flag or something, we relied upon the facts as they presented them to us"). Among the senior people on whom Shames was relying was Flannery, and there was no one more senior than him on the investment team that dealt with these funds. *Id.*

Through July 18, Shames and Flannery had a series of discussions about the letter and Flannery checked to make sure that the legal group's edits were factually correct. FOF 330-35. When Hopkins returned from vacation, he was again copied on correspondence concerning the draft and Hopkins "became a key person in coordinating certain sets of comments" to the July 26 letter. FOF 336, 339, 343.

The next significant set of edits to the letter was made on July 24, when the legal group considered and adopted edits provided by a subset of the relationship management team known as the "SWAT team." FOF 342-43. The SWAT team also provided these edits to Flannery. FOF 342. One of the edits made by the SWAT team was to delete the phrase "As you know," from the sentence "As you know, our active fixed income portfolios contain exposure to the subprime mortgage market, which has been a source of alpha for many of our active strategies." *Id.* Thus, by July 24, Flannery was aware that there was sensitivity by the client-facing team to assumptions about what clients knew.

Following the incorporation of the SWAT team's edits, Shames asked Hopkins to "make sure that [his] comments accurately reflect our intentions." FOF 343. In Shames' view, Hopkins was "a key person in coordinating certain sets of comments" to the draft letter and he had promised to be responsible for updates to the letter. *Id.* Shames also stated that he was trying to arrange a meeting on the letter with his peers, Flannery and Marc Brown, the Chief Marketing Officer and supervisor of the relationship management team. *Id.* The clear implication of Shames' message is that he was seeking final input and approval for the letter from the head of the investment and client-facing teams so that it could be sent to investors. FOF 344.

In response to Shames' request, Hopkins suggested an additional edit:

As it relates to your comments in the final paragraph, we have in fact lessened our exposure to the subprime sector in many of these portfolios and we are continuing our analysis in terms of further risk reduction. I'm not sure that your comments in the final paragraph reflect the fact that we have lowered our risk profile to this sector in many of the portfolios. Can we be more definitive here?

Jim

FOF 345-46. By the time that he suggested the change, Hopkins knew that LDBF's underperformance was mostly being caused by its investments backed by AAA and AA-rated subprime securities. FOF 347. Hopkins did not recall whether LDBF had reduced its exposure to those tranches of securities. *Id.*

Though Shames did not know whether SSgA had lessened its exposure to the subprime sector or what SSgA was doing in terms of continuing to analyze further risk reduction, he suggested some edits as Hopkins requested:

> We believe that what occurred in June was driven by the liquidity and leverage issues such as those faced by Bear Stearns, and not a fundamental subprime mortgage event. Still, we are mindful of the technical signs in the market, that is, the downdraft in ABX valuations and the impact on the risk profile of our various portfolios. As a result, we are actively analyzing strategies which would enable us, if appropriate, to pare back subprime positions, and we have in fact already begun the process of risk reduction. However, any reductions in these positions will be based on an individual assessment of the specific investment objectives and risk parameters inherent in each investment fund and portfolio. We intend to get to positions that will allow us to reenter the trade when market dynamics are more favorable.
>
> Deleted:
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FOF 348-50 (adding the phrase "and we have in fact already begun the process of risk reduction"). Shames was depending on Hopkins to determine whether his characterization of the risk reduction was correct. FOF 349, 351.

Following this exchange between Hopkins and Shames, there was a meeting later on July 24 to discuss the draft letter. FOF 354. Flannery attended that meeting. *Id.* After that meeting, Stacy Reardon (the co-head of U.S. relationship management) sent an email summarizing the meeting and stating that the group understood that the June 2007 commentary included in the draft would be deleted, and that the group had added a sentence (which is highlighted below):

> We believe that what occurred in June was driven by the liquidity and leverage issues such as those faced by Bear Stearns, and not a fundamental subprime mortgage event. Still, we are mindful of the technical signs in the market, that is, the downdraft in ABX valuations and the impact on the risk profile of our various portfolios. We have used this opportunity to reduce risk in the portfolio by taking advantage of liquidity in the market when it exists, and will continue to do so, without putting further pressure on asset valuations.

Id. Reardon also opined that after the Investment Committee meeting the next day, "we should reconvene to agree on the action plan going forward for client communication." *Id.* She felt that they would need to send clients something like the June 2007 commentary that was being deleted from this draft. *Id.*

There is no evidence that the group reconvened, as Reardon suggested, to discuss the draft letter after the Investment Committee meeting on the morning of July 25. FOF 355-56. On the afternoon of July 25, Shames sent a revised draft of the letter to Reardon, Flannery and Brown, with copies to the July 24th meeting's other attendees, that contained edits to the last sentence:

> We believe that what occurred in June was driven by the liquidity and leverage issues such as those faced by Bear Stearns, and not a fundamental subprime mortgage event. Still, we are mindful of the technical signs in the market, that is, the downdraft in ABX valuations and the impact on the risk profile of our various portfolios. We have been seeking to reduce risk in those portfolios where we believe it is appropriate to do so by taking advantage of liquidity in the market when it exists, and will continue to do so, while we seek to avoid putting undue pressure on asset valuations.
>
> Deleted: have used this
> Deleted: opportunity
> Deleted: the
> Deleted: without
> Deleted: further

FOF 356; Div. Ex. 137 at 120177. Though he circulated these edits, Shames relied on the investment team for the content of the information contained in the letter. FOF 352, 357. He did not recall ever learning what transpired at the July 25 Investment Committee meeting or discussing how decisions made at that meeting might affect the draft client letter. FOF 355.

The letter was sent to SSgA's clients on the afternoon of July 26. FOF 357. In its final form, the key sentence in the letter stated, "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." *Id.* The changes from the July 25th draft to the final version were minor word-smithing edits. *Id.* (deleting "to do so" after "appropriate" and changing "we seek" to "seeking"). The edit suggested by Hopkins on July 24: to be "more definitive" about having "lessened our exposure to the subprime sector" and having "lowered our risk profile to the [subprime] sector," was thus included in the final version of the letter. *Id.*

The July 26 letter disclosed to investors little more than the fact that recent events in the subprime market "are impacting performance in some of our active fixed income portfolios in which you are invested directly or indirectly." Hop. Ex. 98. The July 26 letter was misleading because it emphasized risk reduction based on LDBF's past sales of its BBB-rated ABX investment when its greatest risks were then coming from its exposure to higher-rated AA and

AAA subprime bonds and derivatives. FOF 358. The letter was also misleading because it:

- omitted that LDBF was concentrated in subprime RMBS bonds and was leveraged through other subprime investments; and
- omitted that LDBF's highest rated assets were being sold to fund redemptions by other State Street funds and OFA and GAA clients.

FOF 361-63. The purpose of the letter was to update investors on how the subprime market was affecting their investments, and the missing facts were essential to that message. In the summer of 2007, investors needed to know that they were invested in a fund concentrated in subprime investments in order to make an intelligent decision about whether they wanted to purchase more of or sell that investment. FOF 362. Moreover, the statements about risk reduction misled investors into staying in the fund to their detriment. Investors who remained in the fund after the cash from the AAA bond sale was gone held a riskier investment. FOF 284-91, 298-301, 386-405.

When he commented on the July 26 letter, Hopkins knew that:

- the cause of LDBF's underperformance was its AAA and AA-rated subprime investments;
- the draft letter omitted the material information that the Fund was concentrated in subprime bond and derivatives and leveraged by other subprime investments;
- at least some investors and client service personnel believed that LDBF's only subprime exposure was the relatively small BBB-rated ABX investment that he had highlighted earlier in the year in two client letters and various investor presentations.

FOF 318-20, 337-38, 347, 358, 361. Hopkins failed to correct these problems and instead suggested edits to downplay the Fund's risk. FOF 345-46, 351. He suggested focusing on LDBF's sale of its small BBB-rated ABX investment while omitting two key facts he knew – 90% of LDBF's assets were invested in higher-rated subprime investments and those higher-rated assets were causing its July underperformance. FOF 338, 347. Hopkins was in a unique position to understand that many investors were unaware of what was driving LDBF's risks and underperformance, but he failed to provide that information.

The deceptive course of business with which Flannery is charged begins with his role in the

July 26 letter. Flannery played an oversight role in crafting the July 26 letter and was responsible for its omissions and misleading statements as the senior member of the investment team involved in its review. FOF 329-35, 342-56. He was obligated to ensure the letter's accuracy and completeness and he failed in that task. He believed investors would have wanted to know about their subprime exposure through LDBF and he knew that the fund's AA subprime bonds were valued less than securities of other types with comparable credit ratings. FOF 362. He also knew about the ongoing sale of LDBF's highest rated assets. FOF 302-10. Yet these facts are not included in the July 26 letter.

3. The August 2 Letter Misled Investors About LDBF's Risk.

By July 24, Flannery knew that the June 2007 performance information was going to be deleted from the July 26 letter. FOF 354 ("It is our understanding that you do not want us to send with the letter the SSgA Fixed Income June 2007 commentary section."). He also knew that the relationship managers thought clients needed another, more detailed communication to explain how the performance of their investments was affected by the subprime crisis. *Id.* Because performance detail was stripped out of the July 26 letter, it had to be provided to clients in a separate communication. That separate communication was the August 2 letter.

On July 31 at 7:20 p.m., Adele Kohler, who was Hopkins' boss and Flannery's direct report, circulated a draft client letter concerning July's month-end performance. FOF 364. Flannery was the senior investment professional copied on this early draft of the August 2 letter. *Id.* Flannery provided his comments promptly – by 7:39 am the following morning – as befitted a communication of this seriousness. FOF 365. Flannery's edits to the "Actions Taken" paragraph of that letter changed its focus from future events to past events and present conditions as shown by the following highlighted edits:

Kohler's 7/31 Version	Flannery's 8/1 Edits
While we believe that events over the past several months have been largely the result of liquidity and leverage issues versus long-term fundamentals, we are also aware that the downdraft in valuations have had a significant impact on the risk profile of our portfolios and thus we have taken steps to reduce risk across the affected portfolios. Within the Limited Duration Bond Fund we have reduced exposure to a significant portion of triple B securities, we have sold a large amount of our triple A cash positions and will be reducing additional triple A exposure as total return swaps roll off at month end. These actions will simultaneously serve to reduce risk in other SSgA strategies that hold units of the Limited Duration Bond Fund. Div. Ex. 151 at 132950.	While we believe that events over the past several months have indicate some deterioration in longer-term fundamentals, we believe price action has been dominated by the unwinding of leverage in a market segment with sharply reduced liquidity. Additionally, the downdraft in valuations has had a significant impact on the risk profile of our portfolios, prompting us to take steps to reduce risk across the affected portfolios. Within the Limited Duration Bond Fund we have reduced exposure to a significant portion of triple B securities, we have sold a large amount of our triple A cash positions and additional triple A exposure as some total return swaps rolled off at month end. These actions simultaneously serve to reduce risk in other SSgA strategies that hold units of the Limited Duration Bond Fund. Div. Ex. 155 at 119621.

FOF 365. Flannery's edits made it clear that he knew – at the time he was making the edits – that LDBF had sold virtually all of its AAA-rated cash bonds, and no longer was invested in some total return swaps based on AAA-rated bonds. FOF 365-71.

Despite his knowledge that LDBF had sold virtually all of its highest rated cash bonds, and his related knowledge that the cash raised from these AAA bond sales would promptly leave the fund through clients' redemptions (and was in fact gone by August 2), Flannery did not change the letter's misrepresentation that these sales reduced risk in LDBF and in other SSgA strategies that invested in LDBF. FOF 368. His edits display his intent to soothe clients' fears by claiming that the sale reduced investors' risk. Flannery did not correct the letter to acknowledge that SSgA's actions increased the riskiness of LDBF's remaining assets by disposing of the highest quality bonds and then disposing of the cash generated by those assets to fund client redemptions. Instead of using his unique knowledge concerning the Investment Committee's reason for authorizing the AAA bond sale – anticipated redemptions by better-informed investors – and his expertise concerning the illiquidity of LDBF's assets to inform investors about the risks they now faced, Flannery provided false assurances that he hoped would cause investors to wait until the market crisis passed. FOF 280, 282, 284-85. As even Carlson conceded, if the cash generated from the AAA bond sales had already left the fund by August 2, a client receiving the letter may have been given "a false sense of comfort." FOF 405.

As the letter was being finalized the next day, Flannery was again involved. Just as he, Shames, and Brown had been consulted before the July 26 letter was sent to clients (FOF 356), Flannery, Shames and Brown were also consulted before the August 2 letter was finalized. FOF 373. Within the two hours just before the August 2 letter was sent out for distribution to SSgA's clients, the senior relationship manager working on the letter, Larry Carlson, showed the draft letter to three other senior managers – his boss Marc Brown, Shames, and Flannery – to get the final approval to send the letter. *Id.* (12:57 pm email "going up to see Marc [Brown] now"; 11:19 am email "I had shown the letter to Sean [Flannery], Mitch [Shames] et al having deleted that"). All three of those senior managers (Brown, Flannery and Shames) had adjacent offices on the executives' floor. FOF 373, 375.

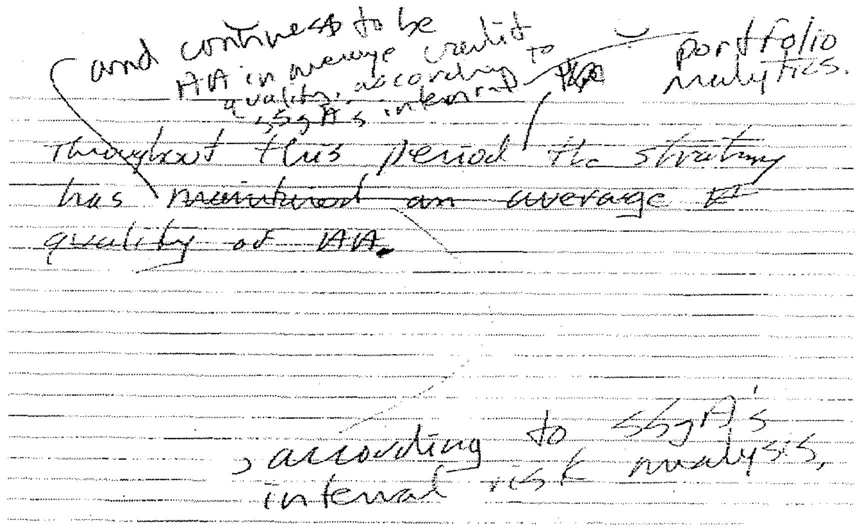
It is also likely that the sentence first added to the letter during that two hour window was drafted by Flannery. FOF 373-77. Specifically, between 12:57 pm and 3:16 pm on August 2, the following misleading sentence was first added to the letter:

> Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics.

FOF 375. The evidence is clear that Carlson, Brown, Shames and Flannery reviewed the letter during the two hour window that this sentence was drafted and added to the letter. FOF 373-77.

Carlson does not recall showing the letter to, or discussing the letter with, anyone else during that time window. FOF 377.

The evidence is also clear that Shames served as the scribe who recorded various drafts of this sentence. His handwritten notes indicate that the sentence first read: "Throughout this period, the strategy has maintained an average quality of AA." FOF 376. It was then changed to read: "Throughout this period, the strategy has maintained, according to SSgA's internal risk analysis, an average quality of AA." *Id.* The sentence then was changed to its final form.


(and continues to be AA in average credit quality, according to SSgA's internal portfolio analytics.
Throughout this period the strategy
has ~~maintained an average~~
~~quality of AA~~
, according to SSgA's internal risk analysis,

Id. Though neither Carlson, Flannery nor Shames recall the drafting of this sentence or the source of the information contained in this sentence, there are a number of reasonable inferences that can be drawn based on the other evidence in this case. First, it would be unreasonable to conclude that Shames concocted this sentence, and edited its three iterations himself. Shames was not aware of any of the facts stated in the "Actions Taken" paragraph independently of being presented with a draft of the letter; he did not know whether as of August 2, 2007, any of the actions taken by SSgA relating to LDBF had reduced risk in LDBF or other SSgA funds; and the information in the Actions Taken paragraph about assets being sold were facts for whose accuracy Shames relied purely on the business people. FOF 381-82. To conclude that he knew about LDBF's average credit quality as reflected in LDBF's internal risk analysis or portfolio analytics systems is unjustifiable. Second, it is similarly unreasonable to think Carlson or Brown was the source of the sentence. Carlson testified that the difference between "internal portfolio analytics" or "internal risk analysis" is not something within his understanding. FOF 378. Carlson also testified that he did not have the investment knowledge to know whether the transactions described in the August 2 letter reduced risk in LDBF. *Id.* Carlson also stated that the edits to the letters made by him, his boss Brown, and the other client facing reviewers were in the nature of form over substance, and he would not know whether any of the investment facts stated in the letter were correct. FOF 314. Of the four senior SSgA officials who reviewed the August 2 letter in the two hours before it was finalized, it is thus most likely Flannery who provided the information about the results of SSgA's internal portfolio analytics. FOF 377-82. Flannery believed at the time that the average quality of LDBF was AA and he knew about both LDBF's internal portfolio analytics and SSgA's internal risk analysis for LDBF. FOF 379.

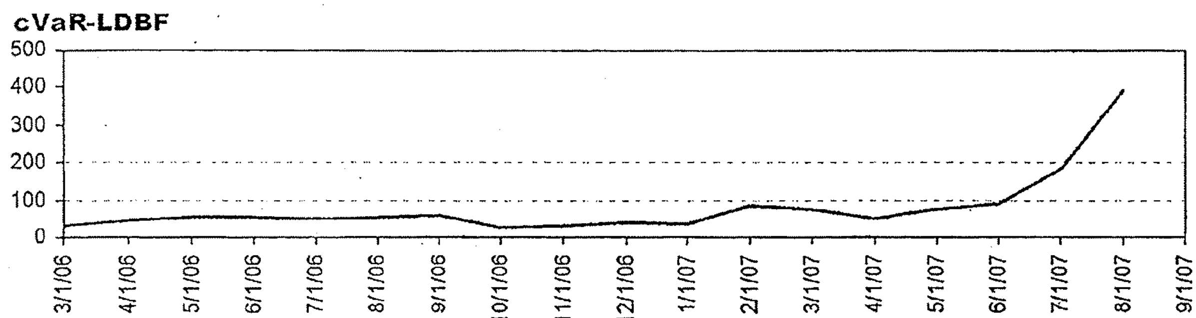
The final version of the August 2 letter was sent to clients by their relationship managers on the afternoon of August 2. In pertinent part, it read:

> **Actions Taken**
> We believe that what has occurred in the subprime mortgage market to date this year has been more driven by liquidity and leverage issues than long term fundamentals. Additionally, the downdraft in valuations has had a significant impact on the risk profile of our portfolios, prompting us to take steps to seek to reduce risk across the affected portfolios. To date, in the Limited Duration Bond Strategy, 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.

FOF 374.

The August 2 letter's statements about LDBF's risk and credit quality are misleading.

While the letter purports to reassure clients about the safety of their investments, it obscures the fact that LDBF's most liquid assets were sold to fund client redemptions and the remaining assets had a higher liquidity risk once the cash generated by that sale was spent, as it had been by August 2. FOF 383. LDBF's "risk" whether described as liquidity risk or the technical cVaR measure employed by SSgA's risk department, increased between the July 26 and August 2 letters:



FOF 391. As Peter Lindner, SSgA's head of North American risk management, explained: once all of the cash from the AAA bond sale left the LDBF portfolio to fund client redemptions, LDBF's risk would increase. FOF 401.

The letter also does not disclose the leverage employed by the remaining LDBF portfolio. By August 2, the LDBF portfolio retained total return swaps on AAA-rated subprime bonds with a notional value of about $1.6 billion. FOF 369. Though the notional value of these AAA-rated derivatives as a percentage of the total notional value of LDBF's assets may have been sufficient to prop up LDBF's "average" credit quality so that it did not move away from its previous AA average, it is misleading to say that LDBF's average credit quality was not impaired by the AAA bond sale on July 26 because the credit quality of LDBF's assets with market value had changed dramatically as a result of the sale. FOF 298, 301, 369. Because LDBF's total return swaps and its other subprime derivates had a **negative** market value by

August 2 (SSgA would have to pay its counterparty to get out of these contracts), the only assets that had any saleable value that could be used to fund investors' redemptions were its cash bonds. Div. Ex. 167; FOF 78, 83, 290, 366. The average credit quality of LDBF's bonds had changed dramatically, from roughly half each of AAA and AA-rated bonds to predominantly AA-rated bonds. *See supra*, pt. H.

Flannery's editing of, and failure to correct, the misstatements about risk and credit quality in the August 2 letter make him uniquely responsible for those misstatements to clients. Flannery, who led the Investment Committee's discussion about the need to sell LDBF's assets to meet client redemptions, knew that selling LDBF's AAA bonds before its AA bonds and then using the cash generated by those AAA sales to fund redemptions would increase LDBF's risk. FOF 302-10. Most other reviewers of the letter either did not understand how LDBF's risk would be affected by the sale, or accepted the letter's language linking the sale to risk reduction once Flannery had blessed it. FOF 354-55, 378, 382. The lawyers and the relationship managers who reviewed the letter relied completely on Flannery and the other members of the investment team for the accuracy of the letter's facts about risk. FOF 317, 357, 381.

4. Flannery's August 14 Letter Attempted To Buy Time For LDBF To Recover By Failing To Disclose Its Increased Risks.

Just before the August 2 letter was finalized, Flannery offered to assist the relationship managers in communicating with clients about the subprime crisis. FOF 407. Flannery believed that, given the seriousness of the problems with LDBF and the Related Funds, clients would want to hear from the CIO. FOF 408. He also understood, through his communications with the relationship managers, that clients were unhappy about the information they were getting from SSgA and thought SSgA was being "cavalier" about the crisis. *Id.* Flannery acknowledged that SSgA was providing confusing information about LDBF and the Related Funds' leveraged exposures, and decided to write a client letter attempting to address these concerns. FOF 408-09.

Flannery wrote the first draft of what became the August 14 letter. FOF 409. He wrote the letter to go out under his signature and bearing his title. FOF 410. There is one sentence in the August 14th letter that is the touchstone of why that letter is misleading. As the letter was edited, that sentence changed. Here are the key versions of that sentence with the edits highlighted:

Flannery's First Draft (Div. Ex. 165)	"While we will continue to liquidate assets for our clients when they demand it, our advice is to hold the positions for now."
Result of edits by multiple members of the relationship management and legal staff (Flan. Ex. 169)	"While we will continue to liquidate assets for our clients when they demand it, our advice is to hold the positions in anticipation of greater liquidity in the months to come."
Edit by attorney Mark Duggan on 8/7 – which stays same through final version sent to clients on 8/14 (Div. Ex. 166)	"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."

FOF 410, 413-14. Flannery approved each of these highlighted edits.

Because Shames was out of the office during the period that the August 14th letter was being reviewed and finalized, another lawyer, Mark Duggan, coordinated the legal review of Flannery's letter. FOF 411-12. As with the earlier letters, there is no evidence that Flannery provided the reviewing lawyers with any factual information to assist in their review. FOF 411. Duggan made edits to Flannery's draft letter on August 7, and explained to Flannery that the reason for his change from "our advice is to hold" to "we believe that many judicious investors will hold" was that SSgA did not normally give out investment advice. FOF 414. Flannery accepted Duggan's edit because it did not change the substance of his draft and he thought it was "not incorrect." *Id.* Though there were changes to other portions of the August 14 letter between August 7 and the date it was sent, Flannery approved each of those changes, and the key sentence did not change. FOF 415-17. Flannery agreed that the final version of the letter expressed to clients a negative view on selling their investments in LDBF in mid-August. FOF 417.

The August 14 letter was misleading for two principal reasons:

- while purporting to convey SSgA's view that "many judicious investors will hold their positions," the letter omitted that all of LDBF's shareholders controlled by SSgA had taken directly contradictory actions and decided **not** to hold their positions in the Fund; and
- the letter omitted 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.

FOF 418-19. With regard to the first point, by August 14, Flannery knew that 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. FOF 424, 433-36. Flannery also knew by August 14 that all of the Related Funds who had held shares in LDBF had redeemed those shares – some for cash and some in kind. FOF 384, 419, 437. Though Flannery may claim that he is insulated from liability because attorney Duggan reviewed the draft letter too, there is no evidence that Flannery ever discussed with Duggan whether the letter's key sentence was appropriate in light of the decisions to redeem made by the Related Funds or SSgA's advisory groups. FOF 411. There is also no evidence that Duggan knew, by August 14, of the decision made by OFA.

With regard to the second point, Flannery also knew by August 14 that LDBF's most liquid investments, its AAA-rated 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. FOF 302-10, 424-46, 432-36. He also knew that almost all of the saleable assets left in LDBF, its AA-rated subprime bonds, were illiquid and were facing extreme pricing pressure as spreads had reached historical wides on AA subprime bonds. FOF 284-87. While judicious investors may have wanted to redeem from LDBF when it still had liquid assets, or cash from the AAA bond sales, they may no longer have wanted to redeem when SSgA would have to sell LDBF's illiquid holdings to meet their redemption requests. FOF 418. Duggan did not share Flannery's knowledge about the increased risk in LDBF. *Id.* Duggan testified that had he been aware that the "overall asset quality of LDBF had gone significantly down by the time the August 14th letter went out," he would have talked more about the "many judicious investors" language "with the product engineers and the investment people to understand why that had happened and whether . . . they viewed it as being material to our clients." *Id.*

Because Flannery alone among the August 14th letter's reviewers knew all of the facts that were misleadingly omitted, he is responsible for the misstatements in that communication.

FLANNERY AND HOPKINS VIOLATED SECTION 17(A) OF THE SECURITIES ACT AND SECTION 10(B) OF THE EXCHANGE ACT AND RULE 10B-5 THEREUNDER.

Together, 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. To demonstrate a violation of these antifraud provisions, the Division must establish that, in the offer or sale of a security (under Section 17(a)), or in connection with the purchase or sale of a security (under Section 10(b) and Rule 10b-5), a party has employed a scheme to defraud, made an untrue statement of material fact or omitted a material fact that is necessary to make a statement not misleading, or has engaged in an act, practice or course of conduct that is misleading and operates as a fraud. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 235 n.13 (1988) (Section 10(b) of the Exchange Act and Rule 10b-5); *United States v. Naftalin*, 441 U.S. 768, 772, 778 (1979) (Section 17(a) of the Securities Act). The Division must establish scienter to prove a violation of Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act, but scienter is not required to prove a violation of Sections 17(a)(2) and (3) of the Securities Act. *See Aaron v. SEC,* 446 U.S. 680, 697 (1980).

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

- 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 failure to correct and update numerous marketing and offering documents for LDBF during 2006 and 2007, his drafting of misleading market updates that were sent to clients, his direct misrepresentations to clients, and his misleading edits to the July 26 client letter.
- Hopkins also made actionable misrepresentations and omitted material facts in documents he and others at SSgA provided to clients, and in his personal meetings with SSgA's clients, in violation of Section 17(a)(2) and Rule 10b-5(b).
- 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 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) through his involvement in the July 26, August 2 and August 14 client letters.
- Flannery also made actionable misrepresentations and omitted material facts in letters sent to SSgA's clients on August 2 and August 14. While Flannery's edits to the August 2 letter violated both Section 17(a)(2) and Rule 10b-5(b), his involvement in the August 14 letter violated only Section 17(a)(2).

Hopkins and Flannery have not been charged with violations of the Investment Advisers Act or the Investment Company Act because LDBF and the Related Funds are not "investment companies" and State Street is not an "investment adviser" under the legislative exemptions contained in those statutes. *See* Advisers Act, §202(a)(11) (exempting banks from definition of "investment adviser"); Investment Company Act, §3(c)(11) (exempting certain unregistered collective trust funds from the definition of "investment company). Because Hopkins and Flannery were associated with a registered investment advisor, SSgA FM, during the relevant 2006 and 2007 time period, the Commission instituted this action pursuant to Section 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act. Respondents' association with SSgA FM also provides an independent basis for ordering penalties and other remedies pursuant to the Advisers Act and the Investment Company Act.

I. The Respondents' Misrepresentations Were Made In Connection With The Purchase or Sale of a Security Under Section 10(b) And in the Offer or Sale of a Security Under Section 17(a).

Hopkins' and Flannery's misrepresentations and omissions were made in connection with securities transactions. The "in connection with" requirement of Section 10(b) and Rule 10b-5 is satisfied if the fraud touches upon a securities transaction. *See SEC v. Zandford*, 535 U.S. 813, 819-20 (2002); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12-13 (1971); *Collins v. Rukin*, 342 F. Supp. 1282, 1290-91 (D. Mass. 1972) (the "in connection with" requirement "must be broadly and flexibly construed so that the broad design of security fraud provisions is not frustrated by the use of novel or atypical transactions") (internal quotation omitted). The documents with which Hopkins is charged included some of the offering documents provided to investors and potential investors in LDBF and the Related Funds (the quarterly fact sheets and standard presentations), and letters updating investors about problems in LDBF and the Related Funds that were sent in an attempt to ease investors' concerns about the funds' performance problems and thus discourage redemptions. Similarly, the letters with which Flannery is charged were sent to investors during a period of market crisis and misrepresented the risks of those funds in an attempt to convince investors to continue to hold their investments so that SSgA could continue to manage the funds during a liquidity crisis. Throughout the period of misconduct by Hopkins and Flannery, shares of LDBF and the Related Funds were still being offered and sold to investors, and some investors made additional purchases during this period. There were many purchases of LDBF and the Related Funds during the first half of 2007, as well as purchases of LDBF made after each of the July 26, August 2 and August 14 letters: 1) the purchase of 20,080 shares on July 31, 2007 for a total of $171,966, 2) the purchase of 7,979 shares on August 3, 2007 for a total of $78,671, and 3) the purchase of 2,828 shares on

August 16, 2007 for a total of $18,158. FOF 384. In addition, there were purchases in LDBF of $5,836,901 on September 28, 2007 as the result of dividend reinvestments. *See id.* Many investors also continued to hold their investments in LDBF and the Related Funds after receiving the July 26, August 2, and August 14 letters. Div. Ex. 174.

Respondents' fraudulent scheme and their misrepresentations were thus in connection with securities transactions because they were made to obtain and retain investments in LDBF and the Related Funds, which are "securities" under both the Securities Act and the Exchange Act. *See* Securities Act, §2(a)(1); Exchange Act, §3(a)(10); *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81, 85 (2006) (recognizing that SEC enforcement actions under Rule 10b-5 are not limited to fraud on purchasers or sellers of securities and that fraud must only "coincide" with a securities transaction). Respondents misrepresented and omitted facts about LDBF that were central to sophisticated investors' understanding of the risks of those funds (*see* FOF 240, 260, 267, 362, 389), and thereby committed fraud in connection with the purchase and sales of investors' interests in those funds. *See SEC v. Terry's Tips, Inc.*, 409 F. Supp. 2d 526, 530, 533 (D. Vt. 2006) ("in connection with" requirement satisfied by misrepresentations and omissions relating to performance of trading subscription service because reasonable investors would have considered such information in deciding whether to purchase or sell securities).

Further, Hopkins' and Flannery's misconduct occurred in the offer or sale of a security as those terms are understood in the context of Section 17(a) of the Securities Act. The Supreme Court defines the terms "in," "offer" and "sale" broadly. *See Naftalin*, 441 U.S. at 773 (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…") (citing *SEC v. National Sec., Inc.*, 393 U.S. 453, 467 n.8 (1969)). The

Supreme Court has also rejected the argument that Section 17(a) should be limited to fraud in registration statements and offering documents. *See Naftalin*, 441 U.S. at 777-78 ("Unlike much of the rest of the [Securities Act], [Section 17(a)] was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading."). Subsequent cases have found violations of Section 17(a) in statements made in various documents that investors might use to make a decision about whether to purchase or sell securities. *See SEC v. Durgarian*, 477 F. Supp. 2d 342, 355-56 (D. Mass. 2007) (complaint stated a claim under Section 17(a) alleging misstatements and a scheme to defraud, in connection with trades and accounting adjustment to conceal customer losses); *SEC v. Chester Holdings, Ltd.*, 41 F. Supp. 2d 505, 518 (D.N.J. 1999) (construing §17(a) broadly "to encompass a wide range of conduct" in light of its purpose to "promote ethical standards of honesty and fair dealing" and finding defendants liable under both 10(b) and 17(a) for misstatements in Forms 10K and Q and press releases) (internal quotations omitted); *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453 (3d Cir. 1997) (affirming summary judgment on 17(a)(2) claim against a corporate executive where two press releases contained false statements).

State Street continued to offer and sell LDBF and the Related Funds to investors after the misrepresentations were made, and some investors made purchases of those funds after receiving the Respondents' misleading statements, including the July 26, August 2 and August 14 letters. FOF 29, 153-54, 257, 384. Thus, the Respondents' misrepresentations were in the offer and sale of a security as these terms are broadly understood by the courts. *See SEC v. Wolfson,* 539 F.3d 1249, 1263 (10th Cir. 2008) (a misrepresentation is "in the offer or sale" of securities under Section 17(a) "because the relevant misstatements were contained in filings available to the public at the time [the entity the defendant worked for] offered and sold [a public company's] stock to overseas investors.").

Moreover, each of the documents with which Hopkins and Flannery were charged are documents that are provided to investors as part of the selling process. Hopkins understood that when he spoke to prospects and clients he was offering securities as part of his job at SSgA. FOF 29. John Peavy, Respondents' own expert witness, also conceded that fact sheets, presentation materials, and periodic communications like the March, July and August letters, were typically provided to investors in unregistered collective trust funds like LDBF, and were part of the information that investors considered when evaluating their investments. FOF 140, 160, 311. These deceptive communications are part of the information that investors would consider when deciding to purchase or sell securities like the unregistered collective funds at issue in this case, and thus subject Respondents to liability under Section 17(a).

II. The Respondents' Misrepresentations Were Material.

The facts misrepresented or omitted by Hopkins and Flannery in their communications with investors and potential investors were material. 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*, No. 09-1156, slip. op. at 15-16 (U.S. Mar. 22, 2011); *Basic*, 485 U.S. at 231-32. 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), *cert. denied*, 394 U.S. 976 (1969). "[S]tatements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors. . . . the disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead." *McMahan & Co. v. Wherehouse Ent., Inc.*, 900 F.2d 576, 579 (2d Cir. 1990).

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 sophisticated 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 clearly demonstrated by the fact that, once SSgA made the truth available to many of these institutional investors, they 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"); FOF 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 the summer of 2007).

A. Hopkins' 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 concealed the fact that, by that period, LDBF was invested almost exclusively in the subprime mortgage market and employed leverage that further exposed it to that market. Similarly, Hopkins' March letter to clients and his continuing presentations about LDBF's ABX exposure in the spring of 2007 led investors to believe that LDBF's subprime exposure was very small, and had been reduced in response to the February performance problems in the lower-rated tranches of the subprime market. 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 2007. It is fundamental that misleading statements about the identity of an investment are material, particularly when the risks of the concealed investments are the subject of a well-publicized 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.*, 80 S.E.C. Docket 1851, 2003 WL 21658248, *11-12 (July 15, 2003) (noting that the securities laws "substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry" and finding that misrepresentations about the nature of a portfolio's investments were material). It is also clear that LDBF's use of leverage was material to its clients. Hopkins even conceded that investors cared about the use of leverage in their portfolios. FOF 121-23. As Hammerstein explained, LDBF's use of leverage mattered to him because it indicated that LDBF was much riskier than he had otherwise believed it to be. FOF 260. When he learned the truth about LDBF's use of leverage, and the extent of its subprime exposure, Hammerstein recommended that his clients terminate their investments in the fund. FOF 265.

B. 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 clients who got information before others. As discussed in section B.1. above, these other misrepresentations were also material.

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 went to investors whose investments were suffering in the middle of a market crisis, it is indisputable that investors paid attention to the letters and considered them as part of the "total mix" of information they used to evaluate their investments. 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. FOF 197. Flannery even conceded that investors would find a letter signed by SSgA's CIO significant, particularly in the midst of a market crisis. FOF 408. That's in part why he decided to write the August 14th letter. *Id.*

The materiality of the information misrepresented and concealed in the three letters is evidenced further by investors' behavior once they finally received accurate and truthful information about their investments in LDBF and the Related Funds – they redeemed. 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. As other independent investors began to learn the truth, they too left. The assets of LDBF and the Related Funds plummeted precipitously throughout the summer of 2007, driven down by investor redemptions. *See Mayhew*, 121 F.3d at 52 (investors' redemptions on learning information at issue indicates information was material).

While Respondents may argue that the letters were not material because investors who received the letters would know enough to ask other questions about LDBF and the Related Funds, Respondents have it wrong. First, the letters must be considered against the context of the Respondents' course of business that operated as a fraud on investors. The July 26 and August 2 letters misrepresented SSgA's efforts to reduce risk in LDBF and the Related Funds without disclosing the fact that LDBF was concentrated in illiquid subprime RMBS. Investors took in these misrepresentations against a backdrop of information provided by Hopkins that the Fund was sector diversified and low risk. Thus, by early August 2007, Respondents were responsible for characterizing the subprime problem to investors as a small problem that SSgA had already dealt with, which is hardly the sort of burning fire that would have caused investors to rush to pick up the telephone and get a more complete story. Second, the combination of sending a letter to every investor and having more detailed "internal use only" FAQs for certain investors belies the argument that Respondents believed investors would know enough to ask the right questions. If the Respondents had really believed that investors would get the complete story about what was happening in LDBF, then why not send the FAQs to all investors or tell investors about the availability of the FAQs? The answer is simple. Respondents hoped that the letters would put investors at ease without the need for further information.

Next, the fact that the letters may have prompted an investor to ask additional questions about LDBF and the Related Funds further demonstrates the materiality of the letters. An investor who contacted SSgA after receiving one of the letters clearly thought the information contained in the letter was important to its investment decision, and that even further details were needed to make an informed investment decision. Moreover, to the extent Respondents argue that no investor actually made a decision based solely on one of the letters, without having a further discussion with their relationship manager or Hopkins or a member of the investment team, Respondents are actually arguing that investors did not ***rely*** on the letters. As this court is well aware, the SEC, unlike private securities law plaintiffs, need not prove reliance. *See SEC v. Pirate Investor LLC*, 580 F.3d 233, 239 n.10 (4th Cir. 2009), *cert. denied*, 130 S. Ct. 3506 (2010); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993); *Schellenbach v. SEC*, 989 F.2d 907, 913 (7th Cir. 1993).

III. Flannery and Hopkins "Made" Misrepresentations Under Section 10(b) and Rule 10b-5(b).

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. Respondents "made" misstatements and "omitted" material facts in other statements in violation of this Rule. Hopkins "made" direct misrepresentations by speaking to Hammerstein during their conference calls and in their face-to-face meetings, or when he made in-person presentations to clients that failed to disclose LDBF's subprime concentration, use of leverage, or misrepresented its exposure to the BBB-rated tranche of the ABX index. With respect to the other communications at issue in this case, Respondents also "made" actionable misstatements and omissions because one or both of them were responsible for drafting, editing, reviewing and approving each of those communications.

Courts across the country have taken differing positions on how much involvement in the preparation of a document was necessary for a person to have "made" a misstatement under Rule 10b-5(b). Most courts have adopted either the "substantial participation" test or the "bright line" test. The Commission has a adopted third test, under which "[a] person can be primarily liable under Section 10(b) and Rule 10b-5 for directly or indirectly making an untrue statement of fact if that person, acting alone or with others, creates a false statement that reaches investors." *Robert W. Armstrong, III*, 85 S.E.C. Docket 2321, 2005 WL 1498425, *7 (June 24, 2005) (Comm'n Op.) (citing with approval cases adopting the "substantial participation" standard).

Under the substantial participation test, an individual may be liable as a primary violator of Rule 10b-5(b) if he "substantially participated" or was "intricately involved" in the preparation of a fraudulent statement. *See Howard v. Everex Sys., Inc.,* 228 F.3d 1057, 1061 n.5 (9th Cir. 2000); *In re Software Toolworks, Inc. Sec. Litig.*, 50 F.3d 615, 628 n.3 (9th Cir. 1994), *cert. denied*, 516 U.S. 907 (1995) (accountants could be held primarily liable when they reviewed and played a significant role in drafting two letters sent by their client to the SEC). The "bright line" test, which developed in private securities litigation, requires that a defendant must actually make a false or misleading statement in order to be held [primarily] liable under Section 10(b)." *Wright v. Ernst & Young, LLP,* 152 F.3d 169, 175 (2d Cir. 1998). To the extent the bright line test requires public attribution of a misstatement, that portion of the test does not apply in an SEC enforcement case because the attribution prong reflects a private litigant's need to prove reliance – an element that the SEC need not prove in a Rule 10b-5 case. *See Wolfson*, 539 F.3d at 1260; *SEC v. KPMG*, 412 F. Supp. 2d 349, 374-75 (S.D.N.Y. 2006); *SEC v. Tambone* 597 F.3d 436, 447 n.9 (1st Cir. 2010).

The evidence in this case demonstrates a violation of Rule 10b-5(b) because Respondents substantially participated in the drafting, editing and review of the misstatements at issue, or were otherwise responsible for their content, even when the misstatements were not personally spoken by, or otherwise attributed to, them. *See Howard*, 228 F.3d at 261 n.5. Even if a more stringent standard were to apply, however, the evidence also shows that Respondents caused the misstatement to occur. *See Wolfson,* 539 F.3d at 1260-61; *McConville v. SEC*, 465 F.3d 780, 786-87 (7th Cir. 2006) (causing a misstatement is sufficient for liability under Rule 10b-5(b)), *cert. denied*, 552 U.S. 811 (2007); *SEC v. May*, 648 F. Supp. 2d 70, 77 (D.D.C. 2009) (same); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 75-76 (2d Cir.) (company's officer could be held primarily liable for misleading statements that were not directly attributed to him where the officer was allegedly involved in drafting, reviewing and/or disseminating the statements), *cert. denied*, 534 U.S. 1071 (2001); *KPMG*, 412 F. Supp. 2d at 374-75 (finding liability "so long as the SEC is able to show that the defendant was sufficiently responsible for the statement - in effect, caused the statement to be made - and knew or had reason to know that the statement would be disseminated to investors"). Allegations, like those here, that Respondents "reviewed, commented on, and approved" drafts of their employer's public statements are sufficient to show that they "made" a misstatement in those publicly-released documents under even the stricter test for evaluating Rule 10b-5(b) liability. *See SEC v. Brown*, 2010 WL 3786563, *16-17 (D.D.C. Sept. 27, 2010) (addressing misstatements in annual reports and proxy statements).

This case is analogous to *Wolfson*, in which the court found that a non-employee consultant "made a misstatement" when he drafted misleading public filings on behalf of a public company. 539 F.3d at 1261. The court reasoned that the consultant had been hired to draft the filings and thus had "caused" the misstatements that were ultimately disclosed to the public. *Id.* The court found that it was unnecessary to demonstrate that the consultant had directly communicated the misrepresentation to the public or that the filings had been publicly attributed to him. *See id.*; *see also KPMG*, 412 F. Supp. 2d at 374 (audit partners "made" alleged misstatement in audit opinions because, as the individuals ultimately responsible for the issuance of the audit opinion, they caused those misstatements to exist); *SEC v. Forman,* 2010 WL 2367372, *4-5 (D. Mass. June 9, 2010) (controller of a public company "made" misstatements in public filings, press releases, and earnings releases when he prepared a first draft of the public filings, and circulated drafts for comments, provided the numbers contained within the earnings press release, and provided the financial numbers discussed in the conference call).

Applying these standards to Hopkins and Flannery, it is clear that the Respondents were sufficiently involved in creating the false statements that reached investors, substantially participated in their drafting, editing and review, and caused the misstatements to exist. Hopkins was responsible for reviewing the relevant representations in the fact sheets each quarter to ensure their accuracy. His failure to conduct this review and to correct the multiple misleading statements in the fact sheets was the direct cause of their misstatements. Similarly, with respect to the misrepresentations in the standard investor presentations, Hopkins was also obligated to review them quarterly and update them as necessary to ensure their accuracy. He had the opportunity to do so on multiple occasions, but again failed in his responsibility, thus directly causing those documents to contain misrepresentations.

As for the March client letter, Hopkins drafted and revised it, and sent it to the relationship management team knowing they would share it with their clients. Hopkins was also designated by his boss as the "point person" on the issues discussed in the March letter. Hopkins was intimately involved in the preparation and revision of the July 26 letter. Hopkins was the person who suggested the edits that made the letter even more misleading than it already was, and he was uniquely situated to understand how clients would be mislead by the letter.

As for the August 2 letter, the evidence supports the finding that Flannery edited the document and added additional deceptive language to it. The evidence also supports a finding that he was one of the final approvers of the letter as the senior reviewing member of the investment team. At all times during Flannery's involvement with that letter, he knew it would be sent to investors. Flannery thus was responsible for the content of the August 2 letter and was the direct cause of the misrepresentations it contained.

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

A. 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); *Scholastic Corp.*, 252 F.3d at 74. "Reckless conduct is, at the least, conduct 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.), *cert. denied*, 439 U.S. 1039 (1978).

As demonstrated above, 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. *See supra*, pt. E.1-4, J.1-2. 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, 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. For example, Hopkins told Hammerstein during a phone call on April 9, 2007 that LDBF was two percent subprime. FOF 237. Hopkins knew, in April 2007, that LDBF was concentrated in subprime RMBS. FOF 119. 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. FOF 150-54, 193-94, 318-25, 358-63. Hopkins' cavalier attitude towards investors is exemplified by his response to a colleague looking to sell LDBF to a new investor: "Isn't there some rule that states that you can't sell an investment to an entity that has recently come out of bankruptcy that might send it back into bankruptcy[?]" FOF 257.

With respect to the July 26 letter, Hopkins was at least extremely reckless when he edited the letter, failed to suggest including the fact that LDBF was concentrated in subprime investments, and made it worse by suggesting that the letter say that LDBF had reduced its risk because it had reduced its position in a small subprime RMBS investment (in the BBB-rated ABX index) that was not the primary cause of its underperformance at the time. *See supra*, pt. J.2. At the time, Hopkins knew that many investors were either unaware of LDBF's concentration in subprime RMBS or incorrectly understood that LDBF was not concentrated in subprime RMBS. FOF 318-20. Hopkins wanted to keep investors in LDBF and the Related Funds, and his goal made him careless with the truth. FOF 272-74.

Flannery was at least extremely reckless in his editing and approval of the August 2 letter. He edited the 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 meet investor redemptions, and that the cash from those redemptions was leaving the fund. FOF 302-07, 309-10, 366-68, 371-72. As Chief Investment Officer, Flannery certainly knew that investors deciding whether to continue 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) ("The Complaint adequately alleges that [the CFO] knew that investors differentiated between revenue obtained from recurring transactions and revenue from non-recurring transactions, and that [the CFO] knew that non-recurring revenue... was being presented to investors as revenue derived from recurring sources. This is sufficient to allege that [the CFO] acted with the intent to deceive investors."). Flannery's conduct was motivated by his desire to buy time for LDBF and the Related Funds to weather the subprime crisis. FOF 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. FOF 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. FOF 36, 439, 443.

B. 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 the Respondents' scienter. Reliance on the advice of counsel is a factor 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, 104-105 (2d Cir. 1994); *United States v. Wenger*, 427 F.3d 840, 854 (10th Cir.

2005) (appellant could not rely on good faith reliance on counsel defense since he did not establish that he disclosed all relevant facts to his attorneys), *cert. denied*, 548 U.S. 913 (2006); *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) (J. Murray) (citing *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1101-02 (2d Cir. 1972) and *United States v. Custer Channel Wing Corp.*, 376 F.2d 675, 683 (4th Cir.), *cert. denied*, 389 U.S. 850 (1967)); *WHX Corp.,* ID-173, 2000 WL 1482921, *20, n.20 (Oct. 6, 2000) (J. Foelak) (citing *C.E. Carlson v. SEC*, 859 F.2d 1429, 1436 (10th Cir. 1988) and *Savoy*); *William H. Gerhauser, Sr.*, Rel. No. 34-40639, 1998 WL 767092, *6 n.25 (Nov. 4, 1998) (citing *John Thomas Gabriel*, 51 S.E.C. 1285, 1292 (1994), *aff'd*, 60 F.3d 812 (2d Cir. 1995)) (Comm'n Op.).

Any claim by Respondents that their reliance on counsel's advice negates their scienter falters on the first prong of the test, and this court need look no further. Neither Hopkins nor Flannery made complete disclosures to counsel about the material facts they knew that were misrepresented in, or omitted from, the July 26 and August 2 letters. Because they did not make complete disclosures to counsel, they thus 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 investments in the BBB-rated ABX index, which were only about 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.

FOF 352.

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

- LDBF's most liquid and highest-rated assets had been sold to fund client redemptions;
- once the funds generated by the sale of LDBF's most liquid and highest-rated assets 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 sales of virtually all of its most liquid and highest-rated assets.

FOF 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) (Comm'n Op.) ("Respondents further contend that, even if they failed to make the necessary disclosure, [the in-house counsel "who assertedly approved the transactions in question"] possessed information from which he could have derived pertinent facts. However, respondents were not entitled to assume that [the in-house counsel's] advice was based on anything except the facts they specifically presented to him.") (citing Hamermesh, *The Reliance on Counsel Defense*, 18 Rev. Sec. & Commod. Reg. 240, 244 (Dec. 18, 1985)).

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

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). To state a claim for a primary violation under a fraudulent scheme theory, a private plaintiff must allege: (1) a manipulative or deceptive act, (2) in furtherance of an alleged scheme to defraud, (3) scienter (except under Section 17(a)(3)), and (4) reliance. *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336 (S.D.N.Y. 2004) (claim that auditor masterminded misleading accounting practices and sham swap transactions used to circumvent GAAP and inflate company's revenues was sufficient to allege fraudulent scheme); *In re Alstom SA Secs. Litig.*, 406 F. Supp. 2d 433, 474 (S.D.N.Y. 2005). Unlike a private plaintiff, however, the SEC need not prove reliance. *See Pirate Investor,* 580 F.3d at 239 n.10. A defendant's participation in a scheme must take "the form of actions or statements that were independently deceptive or fraudulent." *SEC v. Collins & Aikman Corp.*, 524 F. Supp. 2d 477, 486 (S.D.N.Y. 2007). "[I]t is possible for liability to arise under both subsection (b) and subsections (a) and (c) of Rule 10b-5 out of the same set of facts, where the plaintiffs allege both that the defendants made misrepresentations . . . as well as that the defendants undertook a deceptive scheme or course of conduct that went beyond the misrepresentations." *Alstom*, 406 F. Supp. 2d at 475.

The evidence demonstrates that both Hopkins and Flannery engaged in a series of misstatements and other deceptive conduct that were part of a larger scheme to defraud investors in LDBF and the Related Funds. Hopkins' misconduct lasted expansively over a period of approximately one year, in 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 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 in some instances, directly on to clients. Similarly, Flannery engaged in a series of deceptive actions throughout July and August 2007 that were designed to mislead investors about the true risks of the funds in which they were invested. Flannery was involved in the July 26, August 2, and August 14 letters, and with implementing the Investment Committee's decision to loot LDBF of its highest-rated and most liquid assets and allow the cash thus raised to fund the redemptions of better-informed investors. He defrauded investors who remained in LDBF and the Related Funds when he concealed what had happened. Respondents should thus be held responsible for their role in fraudulent schemes and fraudulent courses of business in addition to their discrete misrepresentations.

VI. 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) of the Securities Act, the Division need only establish that the Respondents were negligent in making each of the misrepresentations at issue. *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 Commission can establish a violation of Sections 17(a)(2) or (a)(3) ... by showing merely that the [statement] was materially false and misleading and that defendants negligently caused those misrepresentations or omissions."). Section 17(a)(2) of the Securities Act makes it unlawful for any person in the offer or sale of any securities "to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in the circumstances under which they were made, not misleading." Section 17(a)(3) makes it unlawful for any person in the offer or sale of any securities "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

The Division submits that the evidence discussed above shows that almost all of the Respondents' actions and inactions that form the basis for these Section 17(a)(2) and (3) charges were committed with scienter. The same evidence shows that Respondents' actions and inactions were negligent and it will not be repeated here. The only new allegation, that is brought solely under Sections 17(a)(2) and (3), involves Flannery's drafting, editing and approval of the August 14 letter, which is discussed below.

A. Flannery Was Negligent With Respect to the August 14 Letter Because He Failed to Make an Adequate Disclosure to Counsel Concerning The Misrepresentations in The Letter

Flannery was, at the very least, negligent in signing the August 14 letter and authorizing its transmission to clients when 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.

See supra, pt. J.4. 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. FOF 424, 432-36. Flannery also knew, by August 14, that the Related Funds had redeemed from LDBF. FOF 384, 419, 437. Flannery also knew that LDBF's most liquid investments, its AAA-rated 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. FOF 302-07, 309-10, 371, 424-26, 432-36. 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. FOF 280-310.

Flannery will likely claim that he cannot be found negligent because he acted reasonably in seeking the input of attorney Mark Duggan on the text of his letter. His claim is not supported by the evidence. Nothing in the record suggests that Flannery ever told Duggan all of the facts he knew that made the August 14 letter misleading. FOF 411, 414, 418. Even if Duggan had independent knowledge of one of the omitted facts, that GAA had recommended that its clients redeem, there is no evidence that Flannery ever checked with Duggan to ensure that Duggan was aware of this information, or that Duggan understood the import of this information. There is certainly no evidence that Duggan understood how risk had increased in LDBF as a result of the portfolio's sale of its highest-rated saleable assets. FOF 418. In the absence of such affirmative disclosures by Flannery, Duggan's participation in reviewing and editing the letter cannot absolve Flannery of negligence. Duggan, like the other lawyers reviewing the letter, relied on the investment professionals like Flannery to get the investment facts, and the investment implications of those facts, correct. FOF 357. Flannery fell down on the job, and the responsibility is his.

B. Hopkins and Flannery Obtained Money or Property by Means of Their Misrepresentations.

As Section 17(a)(2) requires, both Hopkins and Flannery "obtain[ed] money or property by means of" SSgA's misstatements to investors in LDBF and the Related Funds. Respondents' misrepresentations were made in the offer or sale of securities to SSgA's investors. *See supra*, pt. I. SSgA thus obtained investors' money as a result of Respondents' conduct. This alone is sufficient to satisfy the statutory requirement where, as here, Respondents made 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 making their misstatements to investors in LDBF and the Related Funds, and those misstatements permitted them to keep earning those salaries and bonuses. *See Wolfson*, 539 F.3d at 1264 (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, at *12 (Dec. 2, 2005) (bond 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).

RELIEF REQUESTED

A. Cease-and-Desist Orders Should Be Issued Against Both Respondents.

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 numerous factors, including 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. *WHX Corp. v. SEC*, 362 F.3d 854, 860 (D.C. Cir. 2004) (appeal of administrative cease and desist order); *KPMG v. SEC*, 289 F.3d 109, 124-25 (D.C. Cir. 2002) (same). "The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction, and, absent evidence to the contrary, a single past violation ordinarily suffices to raise a sufficient risk of future violations." *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." *Fundamental Port.*, 2003

WL 21658248, *18 ("*FPA*").

This case is similar in many ways to *FPA*, in which the Commission imposed cease-and-desist orders and civil monetary penalties on a registered investment adviser and its associated person, and barred the associated person from future association with an investment adviser, broker dealer or registered investment company based on FPA's violations of Section 17(a) and Section 10(b) and the associated person's aiding and abetting of those violations. *See id.* at *1, 17-18. Like the misrepresentations that Respondents made about LDBF, the misrepresentations in *FPA* were misstatements to investors about the riskiness of a collective investment fund that were designed to reassure investors about the fund's safety. *See id.* at *8-11.

The Division has demonstrated that Hopkins and Flannery committed egregious securities violations when they knowingly or recklessly made material misrepresentations to investors in LDBF and the Related Funds. The Respondents have not only failed to provide any assurances against future violations, they have 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 would also serve an important public function in alerting the public that the 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. It must also find that such a penalty 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).

Penalties are statutorily authorized in three tiers. First tier penalties may be imposed in the amount of $6,500 per violation. Where the violative act or omission at issue involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, second tier penalties of $65,000 per violation may be imposed. If the violative act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, and directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission, the Commission may impose a third tier penalty of $130,000. 17 C.F.R. §201.1001-.1003. These penalty amounts apply to each act or omission occurring after February 15, 2005 and on or before March 3, 2009. *Id.*

The Division has established that: (1) the Respondents committed fraud in willful violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by means of their misleading statements concerning LDBF and the Related Funds; (2) their conduct harmed the investors in LDBF and the Related Funds; (3) there is a clear need for deterrence here because the Respondents were in a unique position to understand why their statements were misleading, investors in LDBF and the Related Funds lost hundreds of millions of dollars as a result of the Respondents' misrepresentations, and the Respondents refused to acknowledge any wrongdoing in this matter; and (4) penalties are appropriate to send a message that the Respondents' conduct will not be tolerated. 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, in which they were highly compensated. Substantial civil penalties are appropriate given the 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) (Comm'n Op.) (noting imposition of third tier penalties on president of investment adviser who made misrepresentations and omissions about the safety of investments offered and sold to his clients).

Because the Respondents' violations involved fraud and resulted in substantial losses to investors, third-tier penalties of $130,000 are appropriate for both Hopkins and Flannery.

C. The Court Should Impose Appropriate Bars on Hopkins and Flannery.

In order to protect investors, Section 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act authorize the Commission to bar or suspend a person from association with an investment adviser, or from serving in a variety of positions with a registered investment company, for willful violations of the Securities Act or the Exchange Act. The record shows that at the time they misrepresented facts concerning LDBF and the Related Funds, Hopkins and Flannery were associated with SSgA FM, a registered investment adviser, and were performing advisory services for the registered investment companies advised by SSgA FM. As a result, the Division requests that the court impose appropriate bars on Hopkins and Flannery.

In other administrative proceedings, bars have been issued for violations similar to

Respondents' conduct. *Seghers v. SEC*, 548 F.3d 129 (D.C. Cir. 2008), upheld a Commission order barring an investment adviser from association with any investment adviser based on his violation of the antifraud provisions of the Securities Act, the Exchange Act, and the Advisers Act. A district court had previously enjoined the adviser from violating these antifraud provisions after finding that he had overstated the value of hedge funds that he advised and made statements to hedge fund investors reporting "respectable returns" while he privately told his lawyer that the hedge funds were "in the toilet." *Id.* at 131. After the trial, the Commission instituted proceedings against the adviser and, on the basis of the district court's findings, an ALJ barred the adviser from associating with any investment adviser. *Id.* at 132 (affirming Commission order upholding ALJ's decision).

Similarly, in *Reinhard*, 2011 WL 121451, *1, the respondent had been enjoined following entry of a default judgment from violating the antifraud provisions of the Securities Act, the Exchange Act, and the Advisers Act. In issuing the injunction, the court relied on the Commission's allegations that the respondent made false and misleading statements and omitted material facts to his clients in connection with the offer and sale of collateralized mortgage obligations ("CMOs"), including misrepresentations concerning the safety of the CMOs that he purchased for his clients' accounts and the account of a hedge fund he controlled. *See id.* at *2. The complaint also alleged that the respondent "lulled his hedge fund clients into keeping their investments with the hedge fund by providing them with false quarterly account statements showing materially inflated account valuations." *Id.* In addition to an injunction, the court ordered disgorgement and a penalty of $120,000. *See id.* The Commission later instituted administrative proceedings based on the entry of the default judgment, and an ALJ issued an order barring the respondent from associating with any broker, dealer or investment adviser. *Id.*

at 4. The Commission remanded the order on the basis of the fact that the order was based on a default injunction, but the bar was ultimately upheld based on the respondent's unrelated criminal conviction. *See id.* at *4-7.

CONCLUSION

For the reasons stated above, the Division requests that the court:

(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) or 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) barring Hopkins and Flannery from associating with any investment adviser or serving in a registered investment company, and (iv) imposing such other remedial relief as the court deems appropriate.

Respectfully submitted,

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I hereby certify that, on April 11, 2011, I served copies of the foregoing Division of Enforcement's Post-Hearing Brief on:

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